Country Economic Report 2002:1

Kenya and the East African Community:

A report for Sida

Arne Bigsten
Beatrice Kalinda-Mkenda

SWEDISH INTERNATIONAL DEVELOPMENT
COOPERATION AGENCY

This country economic report on Kenya is part of a series of annual studies, which are undertaken by the departments of economics of three Swedish universities in collaboration with the regional departments of Sida, under an agreement with the Division for Policy and Socio-Economic Analysis. The purpose of these studies is to improve Sida's economic analysis and knowledge of the programme countries for Swedish development cooperation in order to enhance the effectiveness of programme as well as project support.

This report has been prepared by Arne Bigsten and Beatrice Kalinda-Mkenda, Department of Economics Göteborg University, Sweden.

Per Ronnås
Chief Economist

SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY

Address: S-105 25 Stockholm, Sweden. Office: Sveavägen 20, Stockholm
Telephone: + 46 (0)8-698 50 00. Telefax: + 46 (0)8-20 88 64
Telegram: sida stockholm. Telex: 11450 sida sthlm. Postgiro: 1 56 34-9
ISBN 91-586—8550-2
ISSN 1404-031x

Kenya and the East African Community:
A report for Sida

by

Arne Bigsten and Beatrice Kalinda-Mkenda

Department of Economics
Göteborg University
Box 640
SE 405 30 Göteborg
Sweden

Contact: Arne.Bigsten@economics.gu.se

March 2002

Contents

1. Introduction

Kenya's economy has, in the last few years, had a very poor growth record with falling per capita incomes. In this report we provide a brief discussion of some of the reasons for this. However, the main focus of the study is on the potential effects of the newly formed East African Economic Community (EAC) on Kenya's longer-term growth and poverty reduction prospects. The question is; what are the opportunities and limitations for the EAC initiative. The regional collaboration in East Africa is highly relevant for Sida, for example, with regard to the Lake Victoria initiative, where there is a partnership agreement between the EAC, Sida and several other donors.

The goals for EAC are:

(1) Strengthen and consolidate co-operation in the agreed fields with a view to bringing about equitable development among the member states and thereby uplifting the living standards and quality of life of the people;
(2) Promote sustainable utilization of the region's natural resources and effective protection of the environment;
(3) Enhance the role of women in development;
(4) Promote peace, security and good neighbourliness in the region;
(5) Establish an internationally competitive single market and investment area in the region.

The focus of this study is on the last goal. We will thus primarily analyse the scope for economic integration.

The EAC has identified the following "on-going activities toward regional cooperation": (1) Harmonization and rationalization of macroeconomic and sectoral policies. In particular, this will facilitate movement of people and capital and the flow of good and services for the purpose of promotion of inter-state trade and investment. (2) Promotion of development of regional economic infrastructure projects in order to overcome physical barriers to development and strengthen co-operation linkages. (3) Development of scientific and technological capacity especially in institutions of

higher learning. (4) Promotion of co-operation between EAC and other regional groupings. (5) Strengthening social education and cultural cooperation. (6) Promotion of peace, security, stability and good governance. Of those issues we will focus on goals 1,2 and 4.

The study is structured as follows: In Section 2 we provide a review of the current debate on regional integration agreements. This will then guide us through the discussion of the impacts of the EAC. Section 3 describes the changes in the trade pattern that Africa has undergone in recent decades in an increasingly integrated world. Section 4 then focuses on the current economic situation of Kenya, which will provide the starting point for the discussion of the impact of EAC. Section 5 describes the historical background of the EAC, presents its current development strategy, and analyses what has been achieved so far. Section 6 then attempts to analyse to what extent the East African region is an appropriate grouping and specifically it discusses whether it is an optimal currency area. Section 7 analyses the trade pattern of Kenya and its neighbours and its change over time. We also investigate whether there has been income convergence or divergence between the three countries. Section 8 discusses whether the Kenyan shilling is overvalued or not, and Section 9 concludes the study with a summary of the policy issues.

2. Theory of Economic Integration

2.1. Introduction

In recent years, there has been a surge of regional economic integration initiatives, and in 1999 there existed at least 194 regional integration agreements (World Bank, 2000c, p.1). The World Bank (2000c) review of the experiences identifies some new trends. The first one is an insight that effective integration requires more than just the elimination of tariffs and quotas on trade. Other measures are also needed to facilitate the mobility of goods and services, and investment flows. The second trend is that there is a shift away from closed regionalism aiming essentially at import substitution within a somewhat broader context than one country. Many blocks now actively try to boost international exchange outside the trade bloc. The third observation is that there have emerged trade blocs that consist of countries on very varying levels of development, that is both developed and developing countries.

We will first discuss (Section 2.2) aspects of regional integration, that is issues of its effect on security, bargaining power, and its ability to "lock-in" good domestic policies, then in Section 2.3 we will look at economic aspects. Those are issues such as scale and agglomeration effects as well as trade and location effects. Finally, in Section 2.4 we will consider the policy choices that a country faces with regard to regional integration. This review draws very much on the recent study done by the World Bank (2000c).

2.2. Political Aspects of Regional Integration

A motive for integration may be security, either integration for intra-regional security or for external security. There is some evidence that increased trade between two countries reduces the risk of conflict between them, but it may in some instances increase the risk of conflict with external parties. There are also examples of integration leading to internal conflicts, and the EAC experience from the 1970s may be an example of this. There was a feeling that integration unfairly benefited Kenya at the expense of Tanzania and Uganda. There was a fear that industry would

agglomerate in Nairobi, which had had a head start. The conflict led to the dissolution of the common market and finally in 1978 the confiscation of community assets. In 1979 a war broke out between Uganda and Tanzania.[1] Still, the majority of experiences would point in the other direction. It is difficult to draw a firm conclusion as to whether trade blocs have increased external security.

A second motive for integration may be to increase bargaining power. So far, third world groupings have not generally negotiated in groups, since there often has been a divergence of interests between countries. Africa is the region most fragmented into small states, and particularly this region should therefore be able to benefit from collaborating in international negotiations. However, the negotiating strength of the countries involved may in some instances actually be reduced. If a multinational firm wants to locate in the region, it will be able to get access to the whole regional market, but at the same time it may be able to play the various countries against each other and try to get the best possible tax deal. For the countries involved some tax revenue will be better than none, so unless there is some agreement limiting the tax concessions that are allowed, there may be a race to the bottom.

A third area where collaboration can be highly beneficial is in project cooperation when the countries share some common resource, such as a river, a lake, or a transport link.[2] The difficulty is generally to find a good and equitable way of sharing costs and benefits. Regional integration may in these cases provided a framework that can help the parties to deal with their conflicting interests. SADC was instrumental in setting up a range of multi-country infrastructure projects, and large savings were achieved, thereby having a common power grid. Such international agreements may need the support of the international community, but it will still be easier to achieve solutions if they can be dealt with in the context of regional integration arrangements.

The fourth area identified in the World Bank survey is the use of arrangements to lock in to reform. Domestic economic reforms are crucial for the recovery of African economies, but the success has so far often been limited. One problem is that reforms

[1] Other reasons for the collapse of the EAC are briefly discussed in Section 5.
[2] For example, the EAC partner states share Lake Victoria, and hence issues such as the problem of the water hyacinth, can be better dealt with at a regional level than individually.

may fail just because there is a perceived risk that they will be reversed. A main aim of all reforms is to initiate investments, but if the potential investors are not confident that the reforms will persist, they will be reluctant to invest. They will adopt a wait and see attitude. And the mere fact that they do so may make it more likely that the policy makers find it in their interest to reverse the reform. There is a time inconsistency problems for the policy makers. A commitment to an international agreement that ties them to the reform package may help them to get out of this dilemma. Institutions that help them doing this are referred to as commitment mechanisms. Regional integration agreements work best in the area of trade policy, where procedures for handling breaches of agreements are in place. However, this is also the area where they are least needed, since there are wider agreements such as those with the WTO that puts pressure on governments here. Arrangements may explicitly extend to other areas as well, such as democracy, or other areas of economic policy. So, how efficient are regional agreements as commitment mechanisms? Collier and Gunning (1995) find that they are least likely to be effective in small and poor countries that typically trade little with each other. For them to be effective, the country that breaks the rules must have something substantial to loose from doing so. The partners must be sufficiently concerned to be willing to enforce the rules. In the longer-term, it may be possible that a EU-Africa agreement along the lines of NAFTA may serve as a commitment mechanism for African countries also outside the area of trade policy.

2.3. Economic Aspects of Regional Integration

The main economic mechanisms affecting integration outcomes may be grouped into two groups (following the World Bank, 2000c, review again), that is, competition and scale effects, and trade and agglomeration effects.

Competition and scale

Most countries in Africa are too small to support activities that are subject to large economies of scale. Specialised inputs may not be available or the goods market may be very limited. When an industry is producing a good subject to economies of scale it is likely that only one or a few firms can survive, and we may end up with a domestic

monopoly situation with high prices, low sales and probably high costs as well. A regional integration arrangement may, in such a situation, reduce monopoly power through increased competition from firms in the other countries in the trade bloc. The increase in competitive pressure should lead to lower prices and higher sales to the benefit of consumers. Second, there may also be some structural rationalisation, making it possible for surviving firms to produce on a large scale and thus at lower costs. Third, it is likely that internal firm efficiency, X-efficiency, will be improved under the pressure of more intense competition.

Market segmentation may still exist, however, since there are generally other border frictions than tariffs that hinder the free flow of goods and services. This is the argument for going for a deeper integration that reduces these frictions, such as the reduction of border red tape, and differences in national standards.

A less researched area is what the effect of a regional integration agreement has on terms of trade. There is some evidence that it may reduce import prices via the increased competition from domestic suppliers.

A regional integration agreement may also induce foreign direct investment. If the investment is lumpy, it may only be possible if there is a sufficiently large internal market. Increased domestic competition may also make it more likely that FDI comes in. However, if there are high external tariffs and the FDI only wants to avoid paying them, it may well be that the new supplier is more expensive than the original foreign supplier. Then the trade diversion would have a negative effect on real incomes. This may be counteracted, however, by domestic technology spillovers from FDI.

The conclusion that can be drawn about the effects of the competition and scale arguments is that there are large potential gains to be had, but they depend on whether the policy environment really is able to secure effective competition.

Trade and agglomeration

Regional integration will change relative prices in the countries involved. Prices on imports from the other participating countries will be lowered when tariffs are

reduced or eliminated, and this will have an impact on domestic demand and supply. It is an old result in trade theory that tariffs leads to an expansion of import-competing industries and a reduction in the export industries. A tariff reduction would thus lead to a reversal of this pattern and to a welfare improvement. Is a bilateral tariff reduction between countries in a trade bloc therefore welfare enhancing? This does not necessarily follow, as shown already by Viner (1950) in his classic article on trade creation and trade diversion. If the union leads to a shift in supply from a high-cost domestic supplier to lower cost supplier in the partner country, there is trade creation and welfare improves. However, if the shift is from a competitive external supplier to a less efficient supplier in the partner country, there is trade diversion and welfare is reduced. The risk of trade diversion is obviously higher the higher the external tariff is, so a prudent policy would therefore be to have a low external tariff. One should also note that trade diversion in the cases of capital goods or intermediate inputs may be particularly harmful, since these will increase costs of production and reduce technology transfers that typically comes via imports. This will then be particularly detrimental to productivity improvements and future export expansion. Moreover, the loss from trade diversion for the importing country is not fully compensated by the gain for the country exporting the good? Empirical estimates of the impact of trading blocs can typically be obtained by using gravity models, which makes it possible to control for other relevant effects. We report on some empirical studies along those lines in Section 3.

One problem that is notable in many African countries is that a considerable share of government revenue comes from import tariffs. When this is reduced, the government must seek other income sources. However, in Africa intra-regional trade has tended to be rather small, so the direct loss of tariff revenue from a regional integration agreement may still be limited.

A crucial issue in case of regional integration agreements is whether the income levels in the participating countries will converge or diverge. The EU is, for example, a well-known case of income convergence. But is the same pattern likely to apply for example to African blocs? The EAC experience of the 1960s and 1970s may have been a case where there was divergence rather than convergence. This was anyway the perception in Uganda and Tanzania and led to the collapse of the EAC in 1977.

The pattern of comparative advantage is important for the effect of regional integration agreements. The World Bank (2000c, p.54) study illustrates this with an example using Kenya and Uganda. The analysis draws on Venables (1999). The two countries have very little capital relative to labour compared to the rest of the world, but Kenya has more than Uganda. Both countries have small manufacturing sectors surviving behind tariff walls. If they enter into a tariff union, manufacturing will tend to shift to Kenya from Uganda, which now will supply goods to consumers in both countries. This shifts Kenya's production structure even further away from its true comparative advantage and Uganda closer to its comparative advantage. However, Kenya will gain from being able to supply a larger market, while Uganda will suffer from trade diversion having to buy from a high cost supplier. The general argument that this aims to illustrate is that countries closer to the world average in terms of comparative advantage will tend to do better than countries with a more extreme position. In the case above, the insertion of this intermediate country between Uganda and the world distorts the trade pattern of Uganda leading to a switch in import supply away from the cheapest supplier. The intermediate country Kenya, however, does not experience this switch in supply pattern; its trade with the extreme country, Uganda, and the rest of the world are less close substitutes, and therefore less vulnerable to trade diversion. The implication is thus that the income levels of the two poor countries will tend to diverge. It would be the case that for two countries above average income, the extreme country would again lose relative to the less extreme, but in this case the extreme country would be the richer country, and we would therefore see convergence as in the case of the EU. A union between a rich and a poor country would be less problematic and more beneficial for the poor partner. This suggests that for example, the EAC would be a less problematic venture for Kenya than for Uganda or Tanzania.

Relocation is not driven only by comparative advantage but also by a cumulative causation type of agglomeration process. Regions that have got a head start tend to extend this advantage. There are conflicting centrifugal and centripetal forces that interact and determine the location of economic activity. The centripetal forces have, since Marshall, been classified into three categories. The first is knowledge spillovers or other technological externalities that make it profitable for firms to locate close to

each other. The second are labour market pooling effects. Firms locate where they can easily access labour skills. The third arises from linkages between buyers and sellers. The centrifugal forces include congestion, pollution or other negative externalities. Competition for immobile factors will work against agglomeration, since the price of land and labour in the major agglomerations are bid up. Dispersed consumers will also work to decentralise production, particularly when transport costs or trade barriers are high.

So how does the regional integration agreements affect these counteracting forces? First, reducing trade barriers should make it easier to supply a market from fewer locations, which is it should increase agglomeration. This does not necessarily lead to increasing regional income differences provided that different sectors agglomerate in different countries. It gets more problematic if, for example, all of manufacturing would tend to cluster in one place. This is more likely to happen if the manufacturing sector as a whole is small, since agglomeration would then be less likely to push against factor supply constraints or lead to much higher prices of fixed factors such as land. It will also be more likely to happen when linkages are broad across many sectors. This is likely to be the case in poor countries where the industrial infrastructure is poorly developed.

The agglomerative forces may well interact with comparative advantage forces and reinforce each other in South-South arrangements. The head start of Nairobi may make it hard for industry in the neighbouring countries to compete. Foreign investors may prefer to locate in only a few locations and they may chose those where there is agglomeration economies. In other instances, the forces may be pulling in different directions. The comparative advantage or cost pull may be in one direction, when the agglomeration forces pull in the opposite direction.

Another important factor to consider in this context is the issue of knowledge spillovers. Coe, Helpman and Hoffmaister (1997), among others, show that access to foreign knowledge has a significantly positive effect on growth, and furthermore, that much of the knowledge spillovers comes via trade, primarily imports. South-South trade agreements may therefore have a negative external effect on growth if it reduces

trade with the North, from which the knowledge spills over, to trade with the Southern partners, from which less of technological spillovers are possible.

The conclusion of this review of conflicting forces is that there is a considerable risk that South-South agreements will lead to divergence of incomes rather than convergence.

2.4. Policy Aspects

Following the review of the theoretical and empirical literature, the World Bank (2000c) study identifies four major policy questions that need to be addressed.

Q1: With Whom?

If we focus on small and poor countries, which are what is considered in this study, the conclusion as far as "political" factors are concerned is that there are real possibilities of cooperation on projects such as infrastructure. An agreement can also make it possible for the countries to be noticed in negotiations. Lock-in effects are likely to be limited, though.

Among the "economic" factors we note that some sectors may benefit from scale and competition effects. FDI may come after the market enlargement. If the external tariffs remain high, there is risk of trade diversion. Tariff-jumping foreign investments may not necessarily be a good thing either in that case. Both effects reduce tariff revenues, which is a problem for the government that needs to seek other income sources.

It is also the case that it is in the South-South regional integration agreements that the risk of uneven development is the largest. If one country has a head start, it is likely that it will benefit from the agglomeration effects. The benefits of the agreement may therefore be very unevenly distributed and this may in the longer term, undermine the arrangement.

There are many instances of complex multiple membership arrangements. Sometimes, these different organisations have contradictory rules. For example, Kenya and Uganda are members of COMESA, CBI, and EAC, while Tanzania is a member of SADC, CBI, and COMESA. There is a risk that the multitude of arrangements confusing investors and thus constitute a growth constraint. Multiple memberships may also overstretch the capacity of governments, and thereby reduce efficiency (see Section 5).

Generally there is a trade-off between the depth of integration and the extent of the membership. The EAC can probably go deeper than COMESA.

Q2: How Much Preference?

The first issue here is how open the grouping should be to the rest of the world. As has been argued above, there are strong arguments for letting the bloc be open to the rest of the world. This reduces the risk of and the negative effect of trade diversion. The gains from competition with low cost suppliers such as lower prices to consumers, a more efficient industrial structure, and efficiency gains at the firm level, may be foregone if the external tariff is high. These are arguments for low and uniform tariffs. Another argument is that the more inward-looking the bloc is, the more important are internal supply and demand linkages and the more likely it is that there will be an agglomeration to the most developed country.

Should there be a customs union or a free trade area? The great advantage with a customs union is that it is possible to have simpler internal border procedures when there is a common external tariff. In free trade areas, one is faced with the problem of trade deflection, that is, imports tend to enter the area through the country with the lowest external tariff for resale to the other members. This then requires a system of rules of origin, but generally the cost of implementing those are high. There are also possibilities for the country with the lowest tariff to exploit the system by importing its own needs of a certain goods and then selling its own produced but similar goods to its partners without breaking the rules of origin codes. This is called indirect trade deflection. There are thus strong arguments for a customs union. However, there are

also problems with a customs union, such as the loss of sovereignty, quarrels about the external tariff level, and decisions about how to distribute tariff revenues.

Q3: How Deep?

First, in a many of choices are various forms of contingent protection such as antidumping, countervailing duties in response to foreign subsidies, and emergency protection to protect the external balance or protect certain industries against a surge in exports. These measures are obstacles to trade whether they are actually applied or only kept in the background as a threat. Dumping may be predatory, but the experience suggests that in most cases where the rules are applied, one cannot actually talk about dumping. In theory, countervailing measures would be appropriate when the other country is subsidising an industry, but in practice this is hard to institute in an effective way. It is also sometimes argued that the availability of those measures is necessary to make various lobbies accept the general liberalisation measures.

A second important area where much can be done concerns border formalities, goods classification, product standards, and other forms of red tape. A rationalisation in this area is important to assure the smooth flow of goods at low cost. In areas such as product standards, one could either pursue a route of harmonisation of standards or alternatively, mutual recognition of what authorities in other member countries do. Finally, there is also the area of public procurement, which traditionally has been very much slanted towards domestic firms. Here much could be done, but the road forward in Africa may well be rocky.

Q4: How Wide?

An important choice concerns the range of areas over which one wants to integrate. The focus normally has been on goods market integration, but trade in factors and services may also be important. A crucial issue here is the extent to which foreign investment is allowed. This is an important area through which developing countries can benefit from regional integration. To allow foreign investors the same treatment as domestic ones sends a signal to the market that the government is not going to distort markets.

Since this is an area where there are a lot of regulations and quantitative restrictions on entry, it seems that this is an area where the gains from international competition will be particularly large. This is also an area where there is no international trade, which means that liberalisation will not be trade diverting, so those negative effects will not be there. Nor is there any loss in tariff revenues. So for these reasons, it would seem easy to liberalise these markets. However, there are strong vested interests in these sectors, which will fight the opening up to competition. The lack of liberalisation in the trade of services will act as a tariff on services, which is a major input into other sectors. These services will thus be loosing out via higher prices and lower quality for those services and thereby they will be less productive and less prone to be successful in the export market.

Apart from investment and trade in services one can, of course, broaden the scope for integration to, for example, labour mobility, fiscal harmonisation and even monetary union. These areas are more complicated, though, and one cannot take all steps at once.

2.5. Concluding Remarks

In conclusion to this review of theory we may note that the South-South trade blocs are the most problematic areas, and that is specifically what we are dealing with here. At the same time, it seems as if the political forces pushing towards blocs are hard to stop, so the issue is really how to deal with the design of these blocs.

Among the conclusions drawn in the analysis, the following stand out. It is acceptable to be in several blocs provided that they do not conflict. High preference leads to agglomeration, so preferably the external tariff should be low. A common external tariff has both pros and cons. By deepening liberalisation countries can be more certain to get the potential benefits of integration. How wide the integration process should be is to some extent a matter of capacity to manage change. To extend the agreements beyond goods trade into services and investments is generally a good idea.

The World Bank (2000c, p. 133) actually concluded its review on the following sombre note: "South-South blocs cannot do for the South what North-North blocs did for the North. This is not because of a lack of political will; it is because the same economic forces will produce radically different outcomes. South-South blocs offer little to the poorest countries and may even harm them."

Thus, the poor countries need to secure access to the Northern markets, and this can either be via the WTO route of multilateral agreements or some association agreement with the EU, Japan, or the US. The poor countries should both support the WTO against Northern protectionist lobbies at the same time as it tries to get access to the Northern clubs. They should also demand the same rules for their own trade blocs as the North have been given for theirs. What the government is really saying is that to help our import-competing industry, we must tax our exporters. This is what a tariff does. It seems quite unlikely that such a strategy is the shortest route to export success.

Appendix 2A. The equivalence Between an Import Tariff and an Export Tax

"We must nurture the domestic industry by protecting them from foreign competition" (Government official).

It seems quite reasonable to argue that one should nurture upcoming industries. This is the old infant industry argument, which says that new industries need to have protection early on while learning the business and then later on, when their productivity has improved, the protection can be removed. This was the argument underlying the industrialisation strategy of import-substitution that was pursued in Africa from the 1960s. The failure of that strategy in Africa is well documented, but the notion that this is an appropriate strategy still lingers on. So, let us again review some basic theoretical notions.

First, assume that we have a small economy, like Kenya, that has to take the world market prices as given. We assume that it produces two goods, exportables and importables. In a free trade situation, it would produce according to its comparative advantage. Its production structure would have a slant towards the exportables sector where it has its comparative advantage. Now, assume that the importables sector is industry and you want to protect this to let it expand. By introducing a tariff you shift the domestic relative price in favour of importables and against exportables. This leads to a reallocation of resources away from the exportables sector to the importables sector. The former shrinks and the latter expands. The tariff generates some revenue, which we assume is given back to consumers. Still, domestic consumption of both goods will decrease, and the welfare of consumers will thus be reduced in the tariff-situation. The tariff introduced to nurture industry does do that, but it hurts exportables production even more so that welfare declines.

To illustrate this point further, we would like to show that an import tariff is having the same effect as an export tax, the so-called symmetry argument. The point is that the outcome is driven by the domestic relative price change. To show this, first consider the case of a tariff. The domestic nominal price of imports becomes $p_{md}=(1+t)p_{mw}$, where p_{md} is the price of the importable in the domestic market, p_{mw} is the corresponding world market price, and t is the tariff rate. The domestic price of

the exportable will simply be equal to the world market price, $p_{xd}=p_{xw}$. The domestic relative price of importables will thus be $p_{md}/p_{xd}=(1+t)p_{mw}/p_{xw}$. Now assume instead that the country imposes an ad valorem tax on its exportables. The domestic price of exportables will still have to be equal to the world market price, that is $p_{md}=p_{mw}$. The domestic price of exportables in the domestic market net of the tax will have to be below the world market price, since $p_{xd}(1+t)=P_{xw}$, or $p_{xd}=P_{xw}/(1+t)$. Now t is the export tax. The domestic relative price of importables in this case is thus $p_{md}/p_{xd}=(1+t)p_{mw}/p_{xw}$, which is the same relative price that we derived for the case of a tax. We have thus shown that an import tariff will be equivalent to an export tariff. Since both have the same effect on domestic relative prices, they will have the same effect on domestic production. The attempt to help the import-competing sector can thus only be achieved by punishing the export-competing sector.

But so far, we have looked at the static reallocation effects. These obviously are negative, but there are dynamic effects that more than compensates for the short-term misallocation of resources. The infant industry argument implied that productivity would improve in the protected sector, since new firms that would be started would be learning-by-doing in the early stages of their life. The idea is thus that the firms will be allowed to charge higher prices than the world market would allow them to do as long as they are in the learning phase. The crucial question is thus whether the new firms will increase their productivity behind tariff protection. This is not a theoretical issue but an empirical question. The experiences in Africa have so far been poor, possibly due to the lack of commercial pressure to be efficient. The Asian experiences are better, but there the firms have not been allowed indefinite high protection, and have been forced to show results on the export front to get access to subsidies and protection. Thus, since experiences in Africa with tariff protection are poor, one should seek other routes to nurture new and upcoming firms. It is clear that if Kenya is to take off, it must break into the export markets. So what support could be given? First, of course, the general economic environment and governance have to be improved, and this will help all firms in whatever sector they are to be found. The issue here is whether there should be special measures to help firms to export. Here, a whole range of measures can be introduced instead of tariffs.

What the government is really saying is that to help our import-competing industry, we must tax our exporters. This is what a tariff does. It seems quite unlikely that such a strategy is the shortest route to export success.

3. Africa's International Trade Pattern

In this era of globalisation or international economic integration most parts of the third world have seen considerable economic improvements, while Africa stands out as having been left behind. Global inequality as measured by the Gini coefficient in purchasing power terms has decreased since 1968, but the bottom ten percent of the distribution has seen its share of the global GDP decline. This category largely comprises Africa. So why has Africa not benefited in this era of globalisation?

There are basically two schools on this. The first one argues that Africa has not benefited because it has not globalised. The declining share of Africa in world trade is taken as an indication of this. This view suggests that it is crucial to Africa's economic recovery that it pursues export promotion policies (World Bank, 2000b, Sachs, 2000). There are many studies that suggest that international economic integration is beneficial for growth (see the survey by Collier and Gunning, 1999).

The second school suggests that Africa actually did take advantage of trading opportunities in accordance with its income and development. This view is supported by studies that suggest that Africa is not trading too little given its underlying characteristics and trade determinants such as size, income, and geography (Foroutan, 1993; Coe and Hoffmaister, 1999; Rodrik, 1999). This view thus suggests that the causality runs from growth and productivity to trade, and that the policy focus needs to be on a broader range of issues determining productivity.

First, it is noteworthy that Africa's share in world export has fallen from 3.5% in 1970 to 1.5% in 1997, and it share in world imports has fallen from 4.5% to 1.5% during the same period. That Africa's share in world trade has declined is thus abundantly clear. The next question that one may pose is whether its current share is atypical relative to some benchmark. Studies that have approached this issue have done some in somewhat different ways, but generally have used gravity models. Foroutan and Pritchett (1993) compared Africa with other Third World Countries and concluded that the intra-Africa trade pattern is not atypical and that distances impose similar restrictions as in other similar regions. Coe and Hoffmaister (1999) investigated

North-South trade and found that in 1970, Africa overtraded with the North, while in the 1990s, its trade flows were not different from those of comparable non-African countries. Rodrik (1999) just looked at aggregate trade and found that Africa's total trade is not atypical after controlling for income, size, and distance to the world.

A recent study by Subramanian and Tamirisa (2001) investigates in greater detail whether Africa undertrades or overtrades and how the trading pattern has changed over time. The authors test all three dimensions mentioned above, that is total trade, within Africa trade, and trade with developed and other developing countries. In Africa they also distinguish between Francophone and Anglophone Africa. Africa here means sub-Saharan Africa and includes 16 countries comprising about 90% of total African trade. The paper uses a global benchmark for its assessments. It uses non-linear least squares and bootstrapping to allow for the non-normality of residuals. This is a methodological improvement compared to the previous studies.

Earlier the gravity model was viewed with scepticism as an atheoretical statistical device, but recent work by, for example, Deardorff (1995), shows that it is consistent with a Heckscher-Ohlin model, which includes transport costs. The gravity model that they employ is of the following form:

$$TRADE_{ijt} = (Y_{it}Y_{jt})^{\alpha}(P_{it}P_{jt})^{\theta}D_{ij}^{\beta}e^{\mu_{ijt}}$$

where TRADE is bilateral trade between country i and country j, Y_i is GDP of country i and Y_j is GDP of country j, P_i and Pj are the population sizes of the two countries, D_{ij} is the distance between countries i and j, and t is the time subscript. The error term is

$$\mu_{\iota\varphi\tau}=\gamma_{\kappa} + \varphi_{\lambda t} + \varepsilon_{ijt}$$

where γ_{κ} are fixed effects for trade between African and other countries, $\varphi_{\lambda\tau}$ are fixed effects for other potential determinants of bilateral trade (for example, membership in trade blocs or for countries that share a common border or a common language), and ε_{ijt} is a well-behaved error term. With this approach, one can test whether, after

controlling for economic size, distance and other factors, bilateral trade between or within regions in Africa is different from the trade of other regions. The test is whether the estimated fixed effects γ_κ are significant. The model is estimated for 1980, 1990, and 1997.

The data used showed that over the period 1980-1997, Anglophone African trade grew by 2.1% per year, while Francophone trade only grew by 1.6% per year. For the Anglophone countries, trade within the region grew by 9.4% per year and trade with the South by 8.9% per year. Trade with the North, however, only grew by 0.9% per year. Francophone trade with the South grew rapidly, but from a very low base.

Francophone Africa undertrades in total, with the North and with the South. It is only within the group itself that it does not undertrade. The trend is also negative, that is, Francophone Africa disintegrates quite rapidly from the rest of the world. While its global trade was about normal in 1980, it was 52% below average in 1997. In its trade with the North it went from normal to 75% below average. This is an amazing and alarming decline, since much of technology transfer comes via trade (Coe, Helpman, Hoffmaister, 1997). This may have very serious implications for the ability of the Francophone countries to catch up with the faster growing regions.

The situation for the Anglophone countries is definitely better. In 1997, it is still not significantly different from average, although also here the (not significant) trend on the coefficient is in the negative direction. There is thus a weak indication that also Anglophone Africa is disintegrating. Anglophone countries traded more than average within the group itself, while trade with the South and non-Lomé industrial countries were typical. Trade within the group of Anglophone African countries had a negative sign in 1980, but by 1997 it had turned positive and were clearly significant. Here, the question is what the various trading agreements might have meant for this pattern.

Furthermore, the results of Subramanian and Tamirisa (2001) show that the process of globalisation has been quite rapid in the period 1980 to 1997. The elasticity of trade flows with respect to distance has fallen by 30%. This means that goods flow more easily across the globe than they used to do. This could be due to technological

progress and lowered transport costs or to improvements in trade-related service sectors or trade liberalisation measures that certainly have been quite extensive in the 1990s. It is also notable that the common language dummy went from significantly positive to insignificant, which may suggest that inter-country contacts are less hindered by language barriers than they used to be. English is possibly taking over as the universal language. The dummy for a common border, however, has actually become even more significant.

Subramanian and Tamirisa (2001) then raise the question of what explains the differences in performance between Anglophone and Francophone Africa. One could consider, for example, differences in the commodity composition of trade or in transport and communications costs. They test this in a regression analysis and they do not find that concentration in the export of primary commodities explains the difference. On the trade cost variable, they find that there is an increasing disadvantage for Francophone Africa relative to Anglophone Africa between 1980 and 1997, and they identify an increasing cost disadvantage for Francophone Africa of close to 20% relative to Asia. This is very significant. One may also assume that the negative development of francophone Africa was due to the increasing overvaluation of the CFA Franc up to its devaluation in 1994. The evidence in the paper is consistent with this interpretation.

The benchmark so far has been all international trade, but it may be argued that it would be more reasonable to compare with other developing countries. This is also done, and the analysis shows that also relative to other developing countries, Africa under-performs. And even more distressing, Africa has gradually disintegrated from the rest of the world, while the rest of the developing world has been rapidly integrating.

In the final part of the paper, the authors address the question that is of great interest in this context. Is there a bloc effect in intra-African trade? The authors set out to test whether there is a bloc effect by introducing a dummy for each pair of countries that are members of the same trade bloc. The test is done on the countries before the preferences have been implemented. The results from this analysis shows that COMESA has a negative bloc effect, that is, these countries trade less with each other

than what would be expected given the other variables included in the analysis. They therefore conclude that COMESA is a disparate group of countries that may not be natural partners. If they were natural trading partners, they would tend to overtrade with each other before there were preferences. Eastern and Southern Africa as a whole, however, has a significantly positive bloc effect. This suggests that it would make sense to rationalise the system of trading blocs within Eastern and Southern Africa into one big bloc for the whole region.

The conclusion from the study by Subarmanian and Tamirisa (2001) is that there is a marginalisation from trade in Africa. That is, Africa has not benefited from globalisation because it has globalised in the first place. Both Francophone and Anglophone Africa have seen a negative trend, but the level for Anglophone Africa is still average while it is much below average for Francophone Africa.

Moreover, it is particularly the trade with the North that Africa has been lagging behind, and this is particularly serious since it is via this trade that many of the expected benefits of globalisation would come. The results do not depend on the concentration on commodity exports, and the situation looks even more acute when one notices that the rest of the developing world has integrated at a rapid pace with the rest of the world including the North.

It thus seems as if Africa really needs to worry about its lack of participation in international trade. This could of course both be in the form of developing the trading system and introducing measures that facilitate export diversification and measures that increase productivity and competitiveness. With regard to the trade blocs in Eastern and Southern Africa, the analysis finds that there are positive bloc effects for CBI and SADC but not for COMESA. This would suggest that there is a need for rationalisation. The EAC specifically was not investigated.

4. Kenya's Economic Situation

4.1. Background

In the second half of the 1980s Kenya changed its economic policy to a more liberal direction, and this paid off with improved growth rates. However, in the early 1990s, the economy went into a period of decline partly due to the international slump, but also due to slippage in domestic macroeconomic policy making in the run up to the elections of 1992.[3] Both national accounts estimates of the CBS and WDI data in constant 1995 PPP adjusted US$ show that per capita incomes fell dramatically in the early 1990s, followed by some recovery in 1995-1996. Then there was another turbulent period in the run-up to the election in 1997, which meant that per capita incomes started to fall again. According to the WDI estimates, per capita incomes fell by 10 percent between 1989 and 1998, while the CBS data shows a decline by 6 per cent over the same period. The economy then continued to decline in the late 1990s, so by 2000 the CBS series did show a decline by 10 percent.

The causes of the poor recent development has been analysed in earlier studies in this series (Levin and Ndung'u, 2001). We will here update their analysis and try to identify new elements in the current economic crisis. We will do this to provide a background for our analysis of the potential role of the EAC for Kenya's future economic development, which is the focus of the main part of this study.

4.2. Growth, Investment, and Employment

In 2000, Kenya's gross domestic product shrank by 0.3 (Table 4.1), which means that per capita incomes fell by about 2.4 percent. This is a serious decline considering that the country has had a negative per capita income development all the time since 1997. A key factor behind the dramatic decline in 2000 was the drought that had a strong effect on agriculture, which shrank by 2.4 percent. The impact of the drought was aggravated by inefficiencies in coffee marketing. Since agriculture constitutes about a third of GDP, its decline had a great direct impact. Then there are important linkages

between agriculture and the rest of the economy, which meant that the agricultural slump spread to the non-agricultural sectors. Moreover, the drought led to a serious energy shortage with extensive rationing of electricity, which hurt industrial production severely. We thus note significant declines in output in the secondary sectors as well.

Table 4.1: Sectoral and overall growth rates, 1995-2000

	1995	1996	1997	1998	1999	2000
Agriculture (monetary)*	4.8	4.5	1.0	1.5	1.2	-2.4
Manufacturing	3.9	3.6	1.9	1.4	1.0	-1.5
Building & Construction	2.7	2.8	1.9	1.3	0.9	-1.5
Utilities		3.1	4.0	2.5	1.5	-4.1
Trade, Restaurants & Hotels	8.6	8.0	4.0	2.3	2.0	1.0
Transport, Storage & Comm.	4.2	4.0	2.0	1.2	1.4	2.0
Finance, Real Estate & Bus Serv	6.9	7.1	5.3	3.2	2.0	0.4
Government Services	1.8	1.6	1.1	0.8	0.7	0.7
GDP	4.8	4.6	2.4	1.8	1.4	-0.3

* Subsistence production, mainly subsistence agriculture, is about 13% of monetary agriculture. This is not included in monetary agriculture, but it is included in total GDP.
Sources: Economic Survey 2001, p. 20, and earlier issues.

The fact that the year 2000 was exceptionally bad thus has a natural explanation, but the underlying growth was miserable already before the drought, so there are also more fundamental problems. The problems that Kenyan firms face in terms of a poor economic environment are well documented (Bigsten and Kimuyu, 2001), and the process of economic liberalisation has not been undertaken with vigour. Policies have been poorly implemented and many economic services are still government controlled and poorly functioning. The rehabilitation of infrastructure has been patchy, which means that transport and communication costs are high. In spite of this, the economy has seen some successes such as the export of cut flowers, where Kenya now is the world's major exporter. There is also a new optimism in the textile sector. Due to the agreement that Kenya got with the USA within the framework of the AGOA, it now has unlimited and tariff-free access to the American market. This is taken advantage of by both old domestic producers as well as a trickle of foreign investors who set up shop in Kenya. Still, these are exceptions to the generally gloomy picture.

[3] "Between 1980-96, total Bank commitments to Kenya were nearly $3 billion. Kenya complied only weakly with Bank conditionality, frequently backtracking in reforms" (World Bank, 2000a, p. I).

Investment levels continued to fall in 2000 in spite of a recovery in the construction sector. The economy has continued to be depressed in 2001 and there are no signs as yet of a recovery of investment activity (see Table 4.2). We also note that domestic savings finances a smaller and smaller share of investment. This is a potentially serious restriction on future growth.

Table 4.2: Savings and investment (% of GDP)

	1996	1997	1998	1999	2000
Gross domestic savings (% of GDP)	20.1	10.5	9.8	10.8	7.9
Gross domestic investment (% of GDP)	20.3	18.5	17.4	16.2	15.7

Source: CBS, Monthly Economic Review, September 2001, p. 4.

Levin and Ndung'u (2001) argued that the depressed state of private investment was due to the domestic and external debt overhang, policy uncertainties and political risk, and lack of complementary infrastructure. On top of this, the generally depressed economic activity means that there is bound to be little demand for new capital. We note that, for example, manufacturing investment is in steep decline (Table 4.3).

Table 4.3: Annual growth rates of capital formation, 1995-2000

	1995	1996	1997	1998	1999	2000
Agriculture	19.3	-17.1	-8.6	12.8	-8.0	2.8
Manufacturing	43.2	21.3	-3.7	0.1	-8.8	-5.7
Building & Construction	43.3	24.2	6.5	20.1	-5.9	29.4
Utilities			3.7	-5.0	-2.0	0.9
Transport, Storage & Comm.	-20.9	-1.5	2.8	-3.0	-2.1	-8.7
Government Services	57.3	-15.1	7.5	-5.8	-5.5	-5.0
Trade, Restaurants & Hotels	34.7	-9.6	7.1	-7.6	-1.3	-12.0
Finance, Real Estate & Bus..serv.	12.9	11.7	6.7	3.7	-2.8	-3.1
Total	15.8	1.3	1.9	-0.2	-4.7	-2.4

Sources: Economic Survey 2001, p.31 and earlier issues.

So how is the economic development reflected in the structure of employment? The most dramatic shift in the pattern of labour use in the last decades has been the virtual explosion of employment in the informal sector outside agriculture. The statistical picture is not quite clear, but a recent survey provides a reasonable picture of the current employment structure in Kenya. We see that agriculture still dominates with about 60 percent of total employment, followed by services at close to 25 percent. The industrial sector only employs 6.6 percent of the labour force according to this estimate (Table 4.4).

Table 4.4: The structure of employment 1999 ('000)

	Women		Men		Both	
	Number	%	Number	%	Number	%
Agriculture	4173	60.9	3504	58.5	7677	59.8
Industries	143	2.0	703	11.7	846	6.6
Trade	540	7.9	614	10.3	1153	9.0
Services	2000	29.2	1165	19.5	3165	24.6
Total	6859	100.0	5986	100.0	12842	100.0

Source: CBS, 1999, p. 33.

We may compare this table with the regular statistics from the CBS (Tabled 4.5), where employment in modern establishments and the informal non-agricultural sector. Here employment on smallholdings is excluded. The two sets of data are not completely compatible, but it is abundantly clear that modern sector employment, which sometimes has been referred to as the "Kenyan labour market", is only a small part of employment. This type of employment has hardly grown at all in recent years, which means that its share is also rapidly shrinking. According to the official statistics it constitutes only some 13.6 percent of total employment, and even if we disregard smallholder agriculture, it is only 29.6 percent of employment. Data on the very limited employment growth by sector is shown in appendix 4A.

Table 4.5: The formal-informal structure of employment 1995-2000

	1995	1996	1997	1998	1999	2000
Modern establishments*			1711.5	1729.7	1738.7	1742.1
Informal sector			2986.9	3353.5	3738.8	4150.9
Total			4698.4	5083.2	5477.5	5893.0
Modern employment growth (%)				1.1	0.5	0.2
Informal employment growth (%)				12.3	11.5	11.0

* Wage employment including self-employed and unpaid family members.
Sources: Economic Survey 2001, p. 46

The evidence in the survey of micro and small enterprises (CBS, 1999), which was also done with the collaboration of the CBS, gives a somewhat different picture. According to the estimates presented, there were 5,165,000 workers outside agriculture in 1999, and of those 1,881,000 were engaged in micro and small enterprises. If these survey estimates are correct, the regular official statistics are undercounting formal employees and overestimating the extent of informal employment. However, even if we use the survey estimate of employment outside agriculture that is not in micro and small enterprises, its share is only 25.6 percent of the workforce. Thus, in any case it seems obvious that policy makers should take a

broader view of the Kenyan labour market than they usually do, but that is not always easy since the formal sector employees are a very powerful lobby group.

The slow growth of formal relative to informal sector employment either reflects wage rigidities that keep wages above market clearing levels in the formal sector, or economic advantages of conducting activities in the informal sector. The important question here from a poverty reduction perspective concerns relative earnings levels in the formal and informal sectors as well as those relative to the income levels in smallholder agriculture. We can see in Table 4.5 that real wages in the formal sector have been increasing rapidly, which indicates that the market is not reacting to the supply pressure. People in the informal sector cannot underbid those in the formal sector. During the last three years, 1998-2000, real earnings in the formal sector that is covered in the official statistics increased by 22.2%, 14.2% and 5.5% respectively (Economic Survey 2001, p. 56).

The average income in the micro and small enterprise sector in 1999 was KShs 6,008 per month, which should be compared with that of the total formal sector, which was KShs 12,179 per month. This shows that average income is about twice as high in the formal sector. However, here we have not controlled for education or other characteristics. Since the formal sector includes the majority of the well-educated labour force, the income gap for comparable skills is bound to be much less. It should also be noted that the average in the SMEs is about 2.5 times the minimum wage. So the situation within the sector is thus not as desperate as is sometimes assumed.

Finally, we must note that Kenya, like many countries in Africa, has an extremely severe AIDS problem to grapple with. The figures on HIV prevalence in Table 4.6 are certainly frightening. The human suffering implied is enormous, and it also has economic implications. Those are hard to quantify, but the loss of human capital is large. People tend to die at an age where their education is complete but where they are only in the earlier stages of their working life. The loss to the society of AIDS must be considerable, and this is a negative growth effect that is often not considered.

Table 4.6: Estimated HIV Prevalence 1996-2000

	1996	1997	1998	1999	2000
Urban	16.3	16.9	18.1	17.8	17.5
Rural	11.0	11.9	13.0	13.0	13.0
Total	11,9	12.8	13.9	13.5	13.5

Source: Economic Survey 2001, p. 42.

4.3. Balance of Payments and the Exchange Rate

The trade balance has been in persistent deficit, but in 2000, the deficit increased to over 10 percent of GDP (Table 4.7). This was mainly due to a surprising increase in imports, in spite of the severe recession in the economy. However, the increase in the import bill was mainly due to an increase in the oil bill by more than 50 percent. Net transfers, particularly private transfers, from abroad increased and kept the current account deficit down to 2.3 percent of GDP. The increase in transfers largely reflects the relief efforts in the wake of the severe drought. Otherwise, it seems to be the case that there is a regular remittance of incomes from Kenyans abroad to maintain families at home or to invest money. Out-migration thus leads to a reverse money flow. There are also some labour incomes to resident Kenyans that end up on this account, but that should really be recorded as export of factor services.

Table 4.7: Balance of payments and the exchange rate, 1995-2000 (% of GDP)

	1995	1996	1997	1998	1999	2000
Exports	32.8	32.6	28.0	25.0	25.5	27.2
Imports	38.7	36.9	35.4	32.6	31.4	37.3
Trade balance	-5.9	-4.3	-7.4	-7.6	-5.9	-10.1
Net factor incomes from abroad	-4.0	-2.4	-2.2	-1.5	-1.5	-1.3
Net transfers from abroad	5.5	6.3	5.4	5.0	6.5	9.1
Current account	-4.4	-0.4	-4.2	-4.1	-0.9	-2.3
Capital account (incl. errors & omissions)	2.7	6.4	4.1	4.1	1.0	3.3
Overall balance	-1.6	6.0	0.0	0.0	0.1	1.0
Exchange rate (KShs/US$ end of year)	55.9	55.0	62.7	61.9	72.9	78.0

Sources: Economic Survey 2001 p.111, and earlier issues, Central Bank of Kenya, Statistical Bulletin June 2001, p.46.

The capital account (including errors and omissions) improved, however, in spite of net portfolio investment outflows and reduced short–term inflows. There is very little interest among investors to invest in the Kenyan economy. It is noteworthy that Kenya also has repaid some of its foreign debt (Table 4.8). These outflows were more than compensated by increases in long-term capital inflows reflecting disbursements

to support the Poverty Reduction and Growth Programme. The agreement achieved in Paris in late 2000 has also reduced the debt service pressure, so the overall balance was therefore still positive. There was therefore overall, surprisingly enough, still a reasonable balance between supply and demand for foreign exchange, and the exchange rate has maintained its parity against the dollar since mid-2000 until late 2001. During 2001 the current account deficit as a share of GDP has been lower than during 2000 (CBK, Monthly Economic Review, September 2001, p. 5) and the capital account has continued to be positive. Therefore the overall balance has been persistently positive in 2001 and foreign exchange reserves have accumulated. It is estimated that the rate of growth of the economy has only gone up to 0.4 percent for the year ending June 2001, which means that the economy still is in a very depressed state. This means that demand for imports is held back, and the exchange rate remains strong. It is probably too strong for Kenyan exporters.

Table 4.8: Public debt (US$ bn)

	1996	1997	1998	1999	2000
External	6.1	5.8	5.7	5.4	5.2
As % of GDP	77.6	64.0	57.7	50.6	45.0
Government domestic	2.3	2.7	3.0	2.6	2.5
As % of GDP	29.6	28.2	30.2	24.5	22.4

Source: CBS, Monthly Economic Review September 2001, p. 5.

If we look in some greater detail on Kenyan trade, we note that there has not been any major change between 1996 and 2000. The export volume was actually 4.5 percent lower in 2000 than in 1996, while the imports volume had gone up by 12 percent. Kenyan exports have thus not made any general breakthrough, although there are isolated successes, such as horticulture and tea. We will discuss the direction of Kenyan trade in greater detail below, but it is noteworthy that the EAC partners Tanzania and Uganda already are important export markets for Kenya. Tanzania received 8.2 percent and Uganda 18.0 percent. If one looks at the time pattern, it is clear that Uganda is becoming increasingly more important, while Tanzania is not. Of total exports, as much as 46 percent goes to African countries, which may seem surprisingly high for an African economy. But this dependence on the African market also means that Kenya suffers from the poor growth in the region. On the import side, Africa is marginal with 9.2 percent, with Tanzania having 0.4 percent and Uganda a mere 0.2 percent (Economic Survey 2001, p. 106-107). In this pattern of trade, we

probably have one of the most difficult issues to deal with in the process of creating an integrated market and lasting collaboration among the three countries. Kenya has a head start and as indicated in the theoretical review, this may lead to agglomeration advantages for Kenya at the expense of its partners.

4.4. Fiscal and Monetary Policies

So far we have noted that the year 2000 was a dismal year economically, and that 2001 will only be marginally better. One reason for the poor performance was the severe drought that hit the country and which possibly was the worst in half a century. This led to a drop in the growth rate. However, we have also not that there are persistent structural problems, such as poor infrastructure, that hinder a rapid expansion of the economy. But what about the macroeconomic policies that have been pursued? The country here faces two problems. There is a need to deepen the longer-term structural adjustment measures, but there is also a need to pursue a sensible short-term stabilisation policy to avoid unnecessary economic setbacks. Here, we will discuss the fiscal and monetary policies that have been pursued recently to see how well they have been adjusted to the economic situation.

We may immediately note that the government has been pursuing a fairly tight fiscal and monetary policy in recent years. The government budget was essentially balanced between 1995 and 1999. The 2000/2001 budget was the first one that was done within the Medium Term Expenditure Framework. The long-term aim of the budget policy is to reduce the share of government expenditures in GDP, while at the same time pursuing a poverty focused development strategy and to reduce domestic indebtedness. In 2000/01, however, the economy was hit by a severe recession due to the drought, and the deficit shot up to 3.4 percent of GDP (Table 4.9). Given the situation, this actually does not seem extraordinary, and is mainly explained by a rapid increase in government expenditures and net lending. The outturn was thus considerably worse than budgeted. Still, total government expenditures for this budget year is estimated to be 41.4 percent of GDP, which is extremely high for an African economy.

It should be noted also that the budget for 2001/2002 is based on a very optimistic estimate of aid inflows. However, there has been no progress *vis-a-vis* the IMF, and it is clear that the budget outturn be much weaker than predicted. Preliminary budget figures for the first months of the new budget year confirms this. This may be acceptable in the short term, but it will put high demands on the government to handle the budget balance in the future unless the donors can be convinced to come back. Some tough choices will then have to be made.

Table 4.9: Central government expenditure and revenue 1995/96-2000/01 (K£ Million)

	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01*
Current Revenue	7142.2	7275.2	8305.2	8985.8	8889.3	9964.4
Current Expenditure	6747.7	6926.7	8334.6	8249.8	7679.7	10909.1
Current Surplus	394.5	348.4	-29.4	736.1	1209.6	-944.7
Capital Revenue	29.0	79.0	52.1	24.5	137.8	52.5
Development Expenditure	896.5	782.4	677.9	615.4	905.0	1382.7
Net Lending	16.2	154.4	57.3	151.4	80.0	97.7
External Grants	290.7	289.2	263.6	246.0	212.4	1056.7
Overall Deficit/Surplus	-198.5	-220.2	-449.0	239.8	574.8	-1315.8
Overall Deficit (% of GDP)	-0.9	-0.7	-1.4	0.7	1.6	-3.4
Financing of deficit						
External Loans	-3.3	-331.7	-356.7	-826.2	-442.9	-1438.1
Domestic Borrowing	-108.2	955.1	561.1	559.7	1202.9	-122.4
Long Term (Net)	-352.5	-206.1	57.25	1375.0	-456.8	-340.6
Short Term (Net)	244.3	1161.2	503.8	-815.4	1689.6	218.4
Change in Cash Balance	309.6	-403.2	-590.9	26.7	-1364.7	2876.3
Public Debt Redemption	1464.0	1265.8	6682.0	3104.0	2496.6	3342.3
External	960.3	918.0	1068.7	1151.4	1323.6	1599.9
Internal	503.6	347.8	5613.3	1952.6	1174.0	2342.3

* Provisional.
Source: Economic Survey 2001, p. 79 and earlier issues.

On the revenue side, the country has done fairly well with current revenues at 25.3 percent of GDP, although still way below expenditures. VAT has increased in importance and indirect taxes generally contribute close to 60 percent of revenue. An item that we are particularly interested in here is tariff revenue, which generates 16.9 percent of revenue. This corresponds to 4.3 percent of GDP, which is a considerable sum.

In the previous report, Levin and Ndung'u (2001) raised some concerns with regard to the fiscal stance. They noted that, "although revenue has been increasing as a result of

improvements in tax administration, the tax-base is relatively small and the marginal tax rate is quite high, which is a serious impediment to faster growth and hence future revenue mobilisation." They also emphasised that "efficiency and delivery of public services have been extremely low despite increased allocations over the years."[4] Thus a major issue for Kenya is to use the resource more efficiently then at present. Kenya is the country in the region with the biggest share of GDP under government control, and if this big share is used inefficiently, the growth rate will be slow and poverty reduction efforts will be thwarted. A combination of a very large public sector and poor governance in the public sector will combine to a severe drag on growth.[5]

A major concern right now is how the government is handling liquidity in the economy. It is certainly worrisome that as the economy is in depression the monetary authorities reduce liquidity as the decline in M3 illustrates in Table 4.10. There was inflationary pressure in 2000 from higher oil prices and the food shortage, but it is worrisome that the Central Bank writes in its annual report that "the need for tighter monetary policy became more urgent during the March 2001 quarter when prospects for economic recovery became elusive" CBK, Annual Report June 2000- June 2001, p.8). By mid-2001 the rate of inflation was actually negative. This is certainly a recessionary deflation indicating low levels of activity in the economy, although the falling food prices in the aftermath of the drought also play a large role. Still, there is certainly no large risk of inflation taking off to motivate the very restrictive monetary policy pursued by the Central Bank. The inflation month on month in August 2001 was -0.3 percent and the 12-month inflation were down to 4.1 percent. However, if the food component is taken out the underlying inflation is still relatively high at 7.3 percent.

---

[4] See Levin and Ndugn'u (2001) for an extensive discussion of these issues.

[5] The World Bank notes in its Country Assistance Evaluation for Kenya, that "the Public Expenditure Review has emphasized the very large number (1,169) of projects and the poor quality of investments in the PIP for Kenya. The Public Investment Programme was completed at a rate of 3 per cent, compared to a target in Kenya's budget of 25 per cent. GOK capacity to undertake new investments was limited in the medium-term. It highlighted (as did the past PER) the need to address expenditure anomalies within a Medium-Term Expenditure Framework (MTEF)." It further notes that "Slippages, as in the past, occurred in critical areas of parastatal reform" (World Bank, 2000a, p 10)

Table 4.10: Monetary and Financial Indicators

	1995	1996	1997	1998	1999	2000
Rate of inflation		8.8	12.0	5.8	2.6	5.9
Money Supply (M3) KShs mn.		267,828	294.052	303.750	312,116	314,686
Domestic private credit		205,474	244,747	260,562	264,710	297,536
Domestic government credit		73,761	82,665	90.067	86,656	83,789
Interest rate 91 days T-bills			26.36	11.07	20.47	13.47
Interest rate savings deposits			9,73	7.96	6.15	4.51

Sources: Inflation – Economic Survey 2001, p.60. M3, domestic credit – ES 2001, p. 65. Interest rates – ES 2001, p. 70.

Furthermore, the whole banking system has stalled due to the introduction of the so-called Donde-bill. This was passed by Parliament and was to come into effect in the middle of 2001. According to this law, banks are only allowed to charge the T-bill rate plus 4 percent on loans and are obliged to pay at least 7 percent on deposits. This has meant that the credit margin has been compressed below the level that the banks believe is commercially viable. There have been complaints to the courts about the bill, so it is still unclear as to what will emerge. Still, the banks are not lending to commercial enterprises because they are uncertain as to what the rule will be and they do not think that the new system if actually realised pays them for the risk taking. Thus, they put the money into T-bills, which are secure, and this has meant that the rates on those have now come down 11-12 percent. The parliament is actually debating about whether to continue reintroducing regulation of for example gasoline prices. If the Parliament goes along this route the reforms that have been put in place could unravel and the country could move back towards a control regime. This again undermines the confidence among investors in the sustainability of government policies.

The government has so far been borrowing in the domestic market on the basis of 91-days T-bills. There is now an attempt to shift the debt stock towards T-bonds instead, which reduces the risks. The official policy is also to reduce the level of indebtedness generally. If these strategies fail, there is a considerable risk that interest rates will remain high and credit to business will be too expensive. In the current situation the bills are also very attractive to the banks, that then do not provide enough credit for business.

The lower interest rates have not as yet reduced the inflow of capital and as long as the domestic import demand is subdued, the exchange rate remains stable. It may in the longer term, however, be difficult to achieve both a stable exchange rate and low interest rates, and it would probably make sense to try to keep interest rates low and accept a depreciation of the Kenya Shilling.

There are some people who argue that the domestic debt should be externalised, that is, domestic loans should be replaced by foreign loans, the idea being to get lower interest rates. However, such loans would be exposed to a considerable currency risk, and in a situation where the Kenyan shilling looks overvalued, the likelihood of an explosion of foreign indebtedness in such a scenario is considerable.

4.5. Concluding Remarks

Several macroeconomic policy indicators in Kenya appear to be good with inflation below 5 percent, nominal interest rates around 11 percent, money supply growth zero, and the exchange rate stable. An exception is the budget deficit, which is now accelerating and will be sizeable during this budget year. Faced with a recession this is not wholly unreasonable in the short term, but it will be hard to get back to a balanced situation unless there are considerable improvements in the handling of government money or if the donors come back.

But in spite of this seemingly good macroeconomic environment the economy did shrink last year, and this year not even the predicted growth of 1.3 percent will be achieved. With a population growth rate of 2.1 percent, per capita income will continue to decline. Investment levels are low, and Kenya even seems to be a net exporter of investment capital. So the question that we are faced with is why the economy is doing so poorly.

First, it could be argued that all macroeconomic policies have not been sound. Monetary policy seems to have been too restrictive for a severe recession without any immediate risk of inflation. Still, the macroeconomic policies have not been dramatically off the mark. Among other factors that one may point to is the lack of government credibility and confidence in the sustainability of its policies (particularly

now in the run up to the election). IMF is on the sideline, not being willing to turn on the money tap again on the basis of its dissatisfaction with government progress on the anti-corruption front.[6] Investors are not willing to invest. The coming year is election year, and given the experiences during the two previous elections years, investors may not unexpectedly fear that macroeconomic management will deteriorate again.

The issue of governance is as always a major concern in the case of Kenya. For example, the World Bank writes in its recent very critical Country Assistance Evaluation: "Since President Kenyatta's death in 1978, the integrity of the public sector institutions has been systematically undermined. Political priorities have taken precedence over the public interest. Public institutions have become part of a patronage system that is geared toward ensuring the political survival of the ruling party" (World Bank, 2000a, p. 3).[7]

On top of earlier identified problems there is now also a serious problem of governance relating to courts. For example, the number of cases in the high court has increased by a factor of six in a decade, and the system has virtually came to a standstill. This also means that corruption cases have got stuck. There was an attempt by the government to institute an anticorruption organisation, KACA, as agreed with the IMF, but this proposal did not get the required majority in parliament. It was also argued that it was unconstitutional and that it was a duplication of the role already held by the Attorney General. Still, some cases, which were to be handled by KACA, have been taken over by the regular system and an Anti-corruption Unit has been set up within the police. An economic crimes bill is being drafted, as well as a code of

[6] "On July 31, 1997 the IMF decided to let the second tranche of the first annual ESAF arrangement lapse, following the failure of the GOK to satisfactorily address specific governance issues (corruption in energy sector projects, failure to ensure accountability for the "Goldenberg" fraud, political interference in the operations of the customs department. (The Commissioner for Customs and Excise was interested in improving the operation of the customs collection, but was removed by influential persons involved in a large-scale sugar import racket, evading customs duties.) Two power contracts in 1996-97 were awarded in a manner that was deficient, non-transparent and out of line with competitive bidding procedures. While 21 "nonstrategic" enterprises were divested by June 1996, the IMF was concerned that the Government may not have received a realistic price for the public enterprises sold and that the process lacked the desired transparency Etc." (World Bank, 2000a, p.9-10).
"The pre-shipment loan-scheme created to provide financing for exporters defrauded the Treasury of some $400 million in 1992 (6.5 percent of GDP)" (see World Bank 2000a, p. 1 on the Goldenberg scam). It is also noted that "some commercial banks also had unwarranted access to Central Bank of Kenya's overdraft and rediscount facilities" (p. 4).

conduct for public officials. The attempt to introduce a Dream Team from the outside in operative positions was not unproblematic, since it lacked some understanding of how the system works and lacked the basis of support from the ministries involved.

[7] For an analysis of these issues, see Bigsten and Moene (1996).

Appendix 4A: Changes in formal and informal employment by sector 1995-2000

Table 4A.1: Public sector employment (annual % changes)

	1995	1996	1997	1998	1999	2000
Agriculture	-1.0	-1.2	-2.1	-2.2	-3.0	-3.4
Manufacturing	0.0	-2.8	-2.1	-3.5	-1.4	-1.7
Building and construction	1.0	0.6	-1.8	-3.2	-3.3	-3.0
Trade, restaurants and hotels	1.4	0.0	-7.1	-1.5	-1.6	-1.5
Transport and communications	-0.5	9.3	-4.7	-1.9	-4.3	-3.0
Finance, Insurance and real estate	2.2	0.5	-3.3	-3.4	-4.7	-3.7
Community, social and personal services	0.3	1.8	1.3	0.5	-1.6	-0.8
Total	0.2	1.6	0.0	-0.4	-2.1	-1.4

Source: Economic Survey 2001, p. 49 and earlier issues

Table 4A.2: Private sector employment (annual % changes)

	1995	1996	1997	1998	1999	2000
Agriculture	6.4	4.3	1.7	1.9	1.8	0.1
Manufacturing	4.6	4.1	2.8	2.1	1.8	-0.6
Building and construction	6.6	5.2	4.1	0.6	0.6	0.2
Trade, restaurants and hotels	6.9	6.5	4.0	1.8	2.1	1.2
Transport and communications	2.4	8.7	4.1	0.0	1.4	1.8
Finance, Insurance and real estate	4.6	4.9	4.5	2.1	1.9	1.0
Community, social and personal services	7.7	8.7	3.6	3.5	4.4	3.5
Total	6.1	5.9	3.1	2.1	2.4	1.3

Source: Economic Survey 2001, p. 49 and earlier issues

Table 4A.3: Informal sector employment (annual % increase)

	1995	1996	1997	1998	1999	2000
Manufacturing	25.3	15.2	13.2	11.8	10.5	9.3
Construction	21.3	14.1	17.5	25.8	15.0	5.8
Wholesale and retail trade, hotels and restaurants	24.8	19.2	12.9	12.0	11.6	12.1
Transport and communications	21.5	18.3	13.0	12.8	11.4	12.9
Community , social and personal services	27.5	18.7	11.9	13.5	13.7	12.3
Urban	26.2	15.1	14.6	12.1	10.3	11.5
Rural	22.8	23.6	10.0	12.7	13.7	10.2
Total	25.0	18.0	13.0	12.3	11.5	11.0

Source: Economic Survey 2001, p. 58 and earlier issues.

5. The East African Community

Regional integration is not a new concept to East Africa. Indeed, the three countries' economies were once integrated in both a monetary and customs union. However, in 1977, the union collapsed. There are a number of reasons that contributed to that break-up. In this section, we will give a brief historical background to the EAC, and touch on the reasons for the break-up of the Community in 1977.

When the EAC was revived, it launched its first Development Strategy, as a vehicle for achieving its objectives. We will review the elements of the EAC's first Development Strategy (1997-2000), and examine the extent to which they are realistic. The first Development Strategy has now been succeeded by the second Development Strategy, which covers the period 2001 to 2005. We will also examine the elements of the second strategy. Furthermore, we will look at how compatible the EAC is with to other regional groupings namely SADC and COMESA.

5.1. A Historical Background of the EAC

The first EAC, which collapsed in 1977, was formed in 1967. However, although the Treaty that formalised the establishment of the EAC was signed in that year, a customs union was already in operation between Kenya and Uganda as early as 1917, with Tanganyika joining ten years later in 1927. In the customs union, the three member states jointly administered a number of services such as, customs, excise and income tax, medical and industrial research, education, communication and agriculture. The union also enjoyed a high level of integration in fiscal terms, and also a monetary union existed. Factors of production were also mobile across the member states.

Before the Community was formalised a significant development occurred in the grouping. This was the formation of the East African High Commission in 1948. The Commission was a legislative and administrative organ for East Africa, whose policy decisions were effected through its Secretariat in Nairobi. Another organ, the Central

Legislative Assembly (CLA), considered and enacted legislation relating to aspects of the commons services.

In 1961, the East African Common Services Organisation (EACSO) replaced Commission, being around the time that the East African countries attained their independence. Some changes were also effected in the way the CLA was to operate. In 1967, the Treaty that established the EAC was signed, with the main aim of forming a common market.

After being in existence for only ten years, the EAC collapsed in 1977. A number of reasons have been cited for the collapse of the EAC, but we shall point out a few important ones. The first reason accounting for the demise of the EAC relates to differences over the distribution of the benefits. Kenya, being more industrialised than Tanzania and Uganda, was always selling more goods than it was buying from the two partner states. This resulted in a trade imbalance, with Uganda and Tanzania being in persistent deficit to Kenya.

The other factor accounting for the collapse of the EAC was ideological. Tanzania, under Nyerere, and Uganda, under Obote, both pursued socialist-oriented strategies, while Kenya was more capitalistic. These differences in a way exacerbated the tensions that already existed among the partner states. In 1971, when Idi Amin took the reigns of power from Obote through a military coup, the EAC faced an uncertain future, as Amin's government was not recognised by Tanzania. Since summit meetings could then not be held, the EAC inevitably collapsed.

Following the collapse of the EAC, the partner states signed an agreement to divide its assets, and to explore ways to co-operate in future. This led to the establishment of the Permanent Tripartite Commission for the co-operation in 1993. Thereafter, the EAC Secretariat was launched in 1996, with its headquarters set up in Arusha, Tanzania. The Secretariat heralded the commencement of operations of the EAC. The Treaty was signed in 1999, after much parliamentary and public debate and scrutiny, with the official launching of the EAC taking place in January 2001.

The long-term objective of the EAC is to establish a customs union, then a common market, a monetary union, and finally a political federation. Thus, its goal is to deepen its economic integration, which will then culminate into a political federation. In order to set out some guidelines for co-operation, the EAC launched its first Development Strategy (1997-2001) in 1997. In the next sub-section, we consider the elements of the development strategy.

5.2. The Elements of the first EAC's Development Strategy (1997-2000)

The EAC's Development Strategy is basically a document that spells out the main objectives of the Community. These are given in Section 1.
The first Development Strategy's overall aims are stated as follows;

- To promote the spirit of regional co-operation, which was deeply rooted in the history of the region;
- To support the existing forces which have major interest in the strengthening of regional institutions and in the free movement of people, capital, goods, as well as services and information within the region;
- To place immediate emphasis on economic co-operation with a view to promoting enhanced political co-operation, and integration in the long run; and
- To reinforce institutional capacities for regional co-operation (EAC, 2001).

In order to realise the above aims, the Strategy earmarked some programme areas of action for implementation. These are;

- Easing of border crossing;
- Free movement of capital;
- Harmonisation of fiscal and monetary policies;
- Facilitation of Inter-state transport and improvement of communication links between Partner States;
- Development of adequate, reliable and affordable energy supply in the region;
- Development of areas of common economic interest (e.g. Environment);

- Sectoral policies to facilitate trade and investment;
- Preparation of EAC region for technological challenge of 21st century;
- Strengthening institutions of co-operation;
- Legal and judicial framework to support economic integration;
- Attainment of satisfactory co-operation;
- Facilitation and strengthening of regional joint programmes to sustain agricultural and livestock development (EAC, 2001).

Under each of the programme actions listed above, some specific measures are identified, which need to be implemented. In the next sub-section, we evaluate the extent to which the actions in the first Development Strategy have been implemented. Our evaluation draws on work done by the EPRC, ESRF, and CODA Consulting Group (2000).

5.3. How Realistic was the First EAC Development Strategy?

A study by the EPRC, ESRF, and CODA Consulting Group (2000) evaluated the extent to which the EAC Development Strategy had been implemented thus far. The study was commissioned as a basis for making recommendations for the agenda for the next stage; the Development Strategy for the year 2001 to 2005. In this section, we shall highlight some of the main findings of that study.

The study tabulated some actions that were achieved and not achieved, and some that are ongoing and would be carried over in the second Development Strategy.[8] The finding of the study was that the implementation process of the strategy was successful, with all partner states indicating their commitment to integration. It was also observed that consensus on policy and programme actions was reached in accordance with the provision of the EAC Treaty. One important achievement was the signing and ratification of the EAC Treaty, which afforded the Community a legal framework to guide the integration process. The study also noted that the speed of implementation of many actions was encouraging, and it expressed optimism for the

[8] Refer to Annex 2 of the report for a detailed summary of the implementation of the EAC Development Strategy actions.

future of the EAC given its small size, which enables conclusions to be reached faster during negotiation, and given that trade protocols were proceeding on course. The future of the EAC was also said to be bright due to the good performance of the EAC Secretariat (EPRC, ESRF, and CODA Consulting Group, 2000).

However, the study also noted some constraints and limitations in the implementation of the first EAC Development Strategy. The first weakness relates to the setting of time frames. It was found that the estimation of the time taken for various actions was unrealistic. This resulted in some policy actions that needed negotiation falling behind schedule. More importantly, the Development Strategy did not take into account the bureaucratic process at national level, and hence the time estimated for some actions was too short. The other constraint lay in the lack of public education and campaigns, resulting in "a time lag between changes made and change of attitudes and modalities" (EPRC, ESRF, and CODA Consulting Group, 2000, p.48). It was also found that the sequencing of activities was sometimes wrong. An example cited is that of the national master plans that were planned for January 1998, a year after the inter-grid connection that was planned for January 1997. The order should have been reversed. This point is related to the issue of institutions being unable to cope with some actions that needed to be done, as some institutions were undergoing some restructuring and/or privatisation. The Strategy did not take into account the privatisation process in its formulation of the actions for those sectors involved.

The other constraint that the study noted relates to funding of programmes. A sad reality of being poor is that some of the programmes in the EAC Development Strategy depend on donor funds. Thus, if donor funds are not forthcoming, the programmes are not implemented. This will continue plaguing the EAC as long as alternative sources of funding are not sought, and as long as the partner states in the EAC remain poor. The other constraint affecting the implementation of the Development Strategy is the long process of negotiation for a common external tariff (CET). The process is still going on, and it is felt that the drawn out process is due to the "perception of unequal development and unequal sharing of benefits and costs of integration" (EPRC, ESRF, and CODA Consulting Group, 2000, p.49).

In our view, the first Development Strategy of the EAC clearly set out some actions that needed to be achieved in enhancing co-operation among the partner states. However, given that the Treaty was only ratified in 2001, it is not surprising that some of the actions were not implemented. The point is that the EAC needed a structure and organ before it could be expected to implement and thoroughly see through its actions. Without a legal body with defined roles, it is not surprising that some of the actions were not achieved. In that sense therefore, the first Development Strategy was too ambitious.

The other important shortfall in the Development Strategy is its reliance on donor funds for some of its programmes. While it is a fact that the member states cannot possibly raise all the funds they require for their programmes, it is at the same time important that realistic goals are set.

5.4. How Different is the Second EAC Development Strategy?

The second EAC Development Strategy takes into account the aims of the Treaty and thus sets up actions consistent with those aims. At the outset, it notes that the Treaty aims at establishing a customs union, then a common market, a monetary union, and eventually a political federation. Besides consistency with the Treaty, the development strategy draws from lessons learnt from the first development strategy. It also incorporates views from stakeholders, and it continues with the activities not completed or undertaken in the first Development Strategy.

Since the immediate important activity is establishing a customs union, the development strategy targets concluding the customs union protocol. On the whole, it itemises, once again, twelve categories of co-operation, while noting that "fast track" activities would be given priority. These are activities that are not controversial, have little financial implications and have few obstacles in implementation (EAC, 2001).

5.5. Is the EAC Compatible with COMESA and SADC?

One of the issues that the second Development Strategy recognises is the fact that the partner states belong to other regional groups. As such, it is noted that the EAC will

complement the other regional groups with a view to realising faster economic growth. The strategy also puts down as one of it its intentions to undertake a study to examine the implications of belonging to more that one regional grouping.

Table 5.1 gives the membership structure of the East African countries to regional groups. It shows that Tanzania is the only EAC member country belongs to SADC, and moreover, Tanzania is the only EAC country that does not belong to COMESA.[9] Thus, any disagreements that may arise from belonging to multiple regional groups are likely to be from Tanzania's membership to SADC and its non-membership to COMESA. In this section, we examine whether the EAC is compatible with SADC and COMESA, and some of the likely trade issues that may arise. In order to do that, we need to look at the main objectives of each of the regional groupings.

Table 5.1: Membership to Regional Integration Groups

	EAC	**COMESA**	**SADC**
Kenya	✓	✓	
Tanzania	✓		✓
Uganda	✓	✓	

COMESA

The Common Market for Eastern and Southern Africa (COMESA) started in 1994, replacing the Preferential Trade Area, PTA (Murinde, 2001). Currently, COMESA extends from Egypt to Namibia, with a membership of 20 countries (COMESA Official Website).[10] The main aim of COMESA was to reduce tariffs between member countries, and on October 31, 2000 it launched its free trade area. This means that tariffs are supposed to have been eliminated in intra-COMESA trade, although some countries have not fully implemented the agreement as yet. Nine of the member countries have implemented the agreement fully. COMESA aims to have a Customs Union by the end of 2004, with a common external tariff structure.

[9] Tanzania officially withdrew from COMESA in September 2000. The government defended the move, citing concerns about harming Tanzania's industrial development as a result of the zero internal tariff that was to be implemented from October 2000 (BBC News, September 2, 2000).

[10] The COMESA member countries are; Angola, Burundi, Comoros, D.R.Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, Zimbabwe

SADC

The Southern African Development Community (SADC) was formed in 1992, after replacing the Southern African Development Coordination Conference (SADCC), which was originally established to achieve four principal objectives, namely;

- To reduce member States dependence, particularly, but not only, on apartheid South Africa
- To implement programmers and projects with national and regional impact;
- To mobilise Member States' resources, in the quest for collective self-reliance; and
- To secure international understanding and support (SADC Official Website).

Following the collapse of the *apartheid* system in South Africa, the focus changed into normal economic cooperation, with South Africa joining the group in 1994. Other members of SADC are Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, Swaziland, Tanzania, Zambia and Zimbabwe. Thus, from a narrow focus of objectives stated above, SADC broadened its aims to alleviating poverty, mobilising resources for development projects, and regional integration. It states its ultimate objective as

> ...to build a Region in which there will be a high degree of harmonisation and rationalisation to enable the pooling of resources to achieve collective self-reliance in order to improve the living standards of the people of the region (SADC Official Website).

Having looked at the objectives of SADC and COMESA, it is clear that they have more or less similar aims as EAC, although COMESA focuses more on trade and commercial issues, while SADC focuses more on development projects. All three regional groupings want to have a customs union, but given that their trade and commercial objectives are similar, one wonders why all the countries belong to multiple groupings. Membership to multiple groupings creates a duplication of effort, and since all bodies require payment of membership fees, such membership entails financial commitments that are most certainly burdensome for the countries (GCA,

1991). Such commitments are hardly needed given the other developmental issues that need resources in Africa.

The other trouble with belonging to multiple regional groupings is that policy formulation and implementation might be inconsistent among the groupings involved, resulting in unnecessary delays in clarifying issues with the business community. As the GCA (1999, p.4) put it, "the business community [would] face more than one set of rules of origin, customs regulations, and potentially conflicting trade regimes" (see also Tsikata, 1999). Muuka *et al* (1998, p.9) also contend that multiple grouping often fragment markets and restrict the growth potential of the sub-region.

The other trouble with overlapping regional groups is that it brings conflicts resulting from differing concessions and rules, which may not otherwise arise if members belonged to one group (World Bank, 2000, Goldstein and Ndung'u, 2001). Goldstein and Ndung'u (2001) note that although COMESA and SADC may have similar objectives, they may choose conflicting routes to achieve them. Citing the case of COMESA and EAC, they observe the following: "COMESA [may have] a timetable for tariff reduction, which may not be similar to that which EAC members will have to fix" (p.30). This is a serious source of concern. As of now, COMESA ratified a treaty to form a free trade area as from October 2000, although a number of countries have not yet achieved the zero tariff levels. SADC also signed a trade protocol aimed at achieving a free trade area by the year 2004. This begs the question as to how Tanzania, a member of SADC, would relate to its COMESA members who are on a different path towards a free trade area. At the same time, all the three countries must in the meantime devise another timetable for a customs union under the EAC!

If the East African countries still feel that they should belong to multiple groups, they should appoint a formal body that should look into the way to coordinate the various relationships in the groupings (GCA, 1999). For the future, if at all they want to join other groupings, they should first and foremost carefully weigh the costs and benefits of belonging to several regional groups, given the costly implications of too many institutions co-existing that basically are meant to achieve the same goals.

6. Is the EAC an Optimum Currency Area?

One of the long-term objectives of the EAC is to establish a monetary union, in which a common currency will be used. The question that needs to be answered is whether the EAC is an optimum currency area.

There are a number of economic conditions that needs to be fulfilled for countries intending to form a currency area. These conditions are discussed in the literature on currency areas,[11] and we will examine whether the EAC fulfils these conditions. This discussion is in section 6.2. But first, in section 6.1, we start by applying a time series econometrics technique to evaluate whether a group of countries constitutes an optimum currency area or not.

6.1. The Generalised Purchasing Power Approach (G-PPP)

Enders and Hurn (1994) developed a method for evaluating the optimality of a currency area, called the Generalised Purchasing Power Parity. The idea behind the method is as follows; if the real exchange rates of a group of countries intending to form a currency area are cointegrated, then it implies that they face similar shocks. The reason is that since the movement in the real exchange rates is determined by underlying economic fundamentals, and if the fundamentals move together, then the real exchange rates would also move together. Thus, if the countries experience a shock, that shock would impact on the economies in a similar way. Thus, they will need a similar exchange rate and the same monetary policies in dealing with the chock. Such countries can thus afford to adopt a common currency. Hence, cointegration of the real exchange rates indicates that the countries are affected in a similar way by shocks, and hence they can form a currency area.

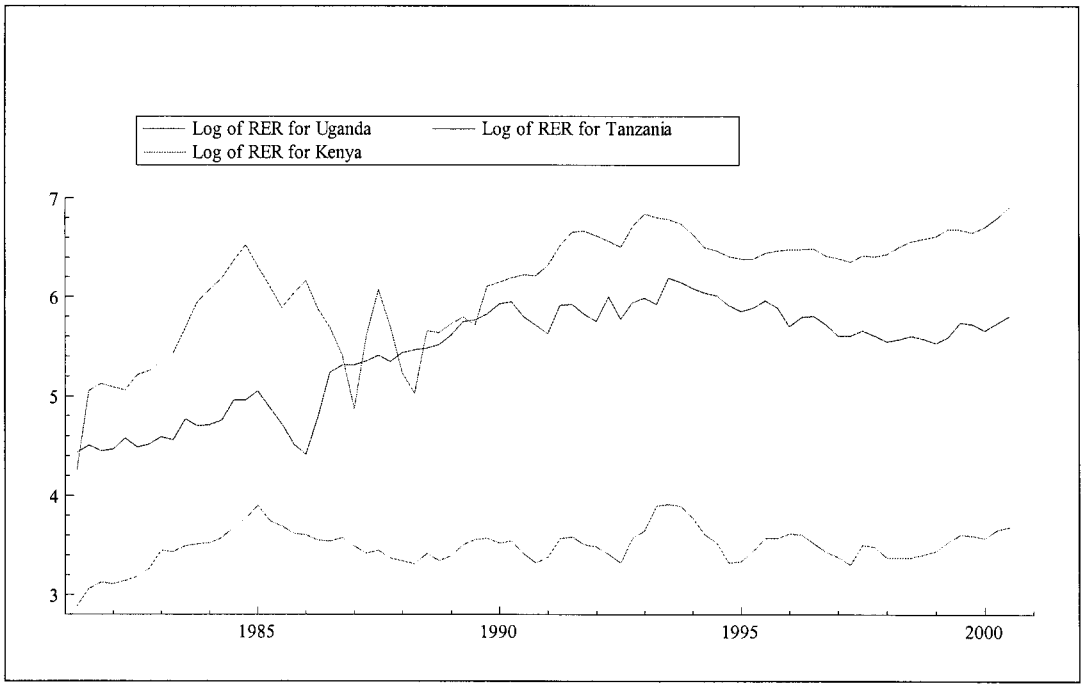
Mkenda (2001) used annual data to investigate the optimality of the currency area in East Africa. However, in this study, we will use quarterly data to examine the same issue. Thus, we have increased the sample size to ensure more robust results. Furthermore, unlike Mkenda (2001), we will use United Kingdom, rather than Kenya,

as the base country. This is because the United Kingdom is the leading source for the three countries' imports within the European Union, and it is also an important market for Kenya's exports; an average of about a third of Kenya's exports to the European Union between 1996 and 2000 went to the UK (CBS, 2001). We constructed the real exchange rate indices as follows, covering the period between 1981(q2) and 2000(q3):

$$\langle 1 \rangle \quad r_{1_{it}} = s_{1_{it}} \frac{p_{it}^{*}}{p_{it}}$$

where, r_{1it} is the bilateral real exchange rate index between country 1 (the base country) and country i at time t. As mentioned above, we used the United Kingdom as the base country. S_{1it} is the nominal exchange rate between the base country and country i at time t, and P_{it}* is the base country's wholesale price index, and P_{it} is the domestic price index for country i, proxied by the consumer price index for each of the three countries. The resulting real exchange rate indices are graphed below.

Figure 6a: RER Indices for Kenya, Tanzania and Uganda



[11] Mundell's (1961) pioneering work set the framework for the theoretical discussion. Other contributions are by McKinnon (1963), Kenen (1969).

A visual inspection of the graphs of the real exchange rate indices shows that there were a lot of fluctuations in Uganda's real exchange rate from the beginning of the sample period up to the late 1980s. There were also some fluctuations in Tanzania's real exchange area and Kenya's real exchange rate, although not as much as Uganda's. In the 1990s, there is a notable stability in all the real exchange rate indices, especially after the mid 1990s.

Our analysis was done with two samples; the full sample, from 1981(q2) to 2000(q3), and a sub-sample, from 1990(q1) to 2000(q3). The latter sample constitutes the period when all countries undertook significant market reforms. We first tested for unit roots using the Augmented Dickey Fuller (*ADF*) test, and the test results are reported in Table 6.1. The real exchange rate for Tanzania is integrated to order 1, while the real exchange rates for Kenya and Uganda are barely stationary for the full sample. For the sub-sample, the only real exchange that was barely stationary was for Kenya, while the rest were integrated to order 1.

Table 6.1: Unit Root Tests for G-PPP Model

Sample	Variable	Trend	Lags	ADF	LM	Order of Integration
Full sample	LrerU	Yes	7	-3.782*	F(5,55) = 0.827 [0.536]	0
	LrerT	No	0	-1.844	F(5,70) = 0.882 [0.498]	1
	ΔlrerT	No	0	-7.906**	F(5,69) = 0.713 [0.616]	0
	lrerK	No	1	-3.443*	F(5,68) = 1.314 [0.268]	0
1990-2000	LrerU	No	2	-2.224	F(5,30) = 0.966 [0.455]	1
	ΔlrerU	No	4	-3.139**	F(5,26) = 0.428 [0.825]	0
	LrerT	No	0	-2.222	F(5,34) = 0.909 [0.487]	1
	ΔlrerT	No	0	-7.812**	F(5,34) = 0.932 [0.473]	0
	lrerK	No	1	-3.248*	F(5,32) = 0.726 [0.609]	0

We then conducted cointegration analysis first for the full sample, and then for the period between 1990 and 2000. The results are given in Table 6.2.

Table 6.2: Cointegration Results

Full sample						
Ho:rank=p	λ_{max}	Adj. for df	95%	λ_{trace}	Adj. for df	95%
p == 0	22.79*	20.05	22.0	41.4**	36.43*	34.9
p <= 1	14.74	12.97	15.7	18.62	16.38	20.0
p <= 2	3.87	3.41	9.2	3.88	3.41	9.2
1990-2000						
Ho:rank=p	λ_{max}	Adj. for df	95%	λ_{trace}	Adj. for df	95%
p == 0	25.62*	20.26	22.0	36.42*	28.8	34.9

p <= 1	8.09	6.4	15.7	10.8	8.54	20.0
p <= 2	2.70	2.14	9.2	2.70	2.14	9.2

For the entire sample, the results show that one cointegration vector exists between the real exchange rates. This suggests that in the long run, the real exchange rates are cointegrated, and hence the region constitutes an optimum currency area. The results for the sub-sample also show that one cointegrating vector exists between the real exchange rates. The results of the cointegration analysis are not surprising. Even though the three countries pursued fairly divergent macroeconomic policies in the 1980s, towards the late 1980s, they became more similar, although the pace of reforms was different. In the 1990s, they are even more similar, and the convergence in macroeconomic policies is enhanced by the similar structural adjustment policies that they are pursuing. Figure 6a, showing the real exchange rate indices, clearly shows this.

6.2. *Standard Optimum Currency Area Criteria*

The literature on optimum currency areas discusses some economic conditions that are relevant for countries to form a currency union. We now discuss some of these conditions, to see whether the East African countries could constitute a currency area. We shall not exhaust all the conditions discussed in the literature due to lack of data for some of the criteria.

Degree of product diversification

The degree of product diversification simply refers to the extent to which an industrial structure of any particular country is varied in terms of the number of goods produced. A country that produces a wide range of goods is also able to export a wider variety. If a shock occurred in one sector, the country could shield itself from that shock, compared to one that only exports a limited variety. Thus, a country with a more diversified product range would be suitable to join a currency union. This is because it does not frequently need monetary and exchange rate instruments to deal with shocks as a less diversified country does.

In order to see how diversified an industrial structure of a country is, a Herfindahl Index can be calculated (see Jonung and Sjöholm, 1998) at different levels of ISIC, with a higher value indicating a smaller degree of product diversification. Mkenda (2001) calculated some Herfindahl indices for the three East African countries, for selected years between 1989 and 1997, for which data was available. These are reproduced in Table 6.3. An important point though to note is that the indices do not seem very stable. This could indicate that the countries are in a period of transition, with some sectors in some countries assuming renewed prominence, such as mining in the case of Tanzania. We can thus say that the indices are not reliable. Furthermore, we could not update the series, as data is not available. As such, the conclusions from the indices in that study stand, that is, it is not possible to make a conclusive remark about the suitability of the three countries to form a currency union based on this criteria, unless more updated data is available.

Table 6.3: Degree of Product Diversification, 1989-1997

	1989	1990	1991	1994	1995	1996	1997
Kenya	na	11.4	11.9	13.9	16.6	na	na
Tanzania	na	11.1	20.1	na	na	na	na
Uganda	22.2	Na	na	13.0	12.4	13.5	13.5

Authors' calculation from UNIDO, International Yearbook of Industrial Statistics.

Openness

In the theory of optimum currency areas, it is argued that the more open an economy is, the more suitable it is to join a currency union. This is because for an open economy, the use of the exchange rate as a unilateral policy tool is redundant, and hence pursuing an independent adjustment in its exchange rate in case of a shock would be irrelevant. Thus, for an open economy, it is easier to join a currency union, as the exchange rate is already redundant. When countries join a currency union, they keep their exchange rates among themselves irrevocably fixed.

Table 6.4 gives the degree of openness as measured by total trade as a percentage of GDP for the three countries. Of the three countries, Kenya is more open, followed by Tanzania. Uganda is the least open of the three. Clearly, the degree of openness is

different for all three countries. Using this criterion therefore, Kenya is more suitable to join the currency union than the other two. Uganda is the less qualified to join.

Table 6.4: Degree of Openness 1990-1999 (Total Trade as % of GDP)

	Kenya	Tanzania	Uganda
1990	57.6	50.1	27.0
1991	56.0	43.9	31.4
1992	52.2	51.8	27.3
1993	76.1	65.7	27.7
1994	70.8	64.2	29.0
1995	71.5	65.6	31.6
1996	69.8	51.9	32.6
1997	63.4	41.9	30.4
1998	57.6	41.5	30.9
1999	54.6	40.2	34.1

Source: Authors' calculation from IFS CD-ROM, and IMF (1999).

Co-variation of economic activity

The extent to which countries' economic activities are correlated can also help to indicate whether or not the countries could form a currency union. If the economic activities are correlated, then it means that if faced with a shock, the countries would be affected in a similar way, and hence their response to the shock would be similar. This implies that the need to conduct independent policy reactions to the shock would not be there, but rather a collective action would suffice.

In order to check whether the economic activities of the East African countries are correlated, we calculated the correlation of real output growth. Table 6.5 shows that Tanzania's output growth is correlated with Uganda's output growth, and the correlation is significant at 5 percent. The correlation of Kenya's output growth with the other two countries is not significant, although the correlation of it's output growth with Tanzania is greater than that with Uganda. From this, it is difficult to make a conclusive remark about their suitability to form a currency union. We need to back our conclusion with other criteria.

Table 6.5: Correlation Matrix

Real Output Growth					
	Kenya	Tanzania	Uganda	Mean	SD
Kenya	1.000			0.175	0.053
Tanzania	0.471	1.000		0.264	0.053
Uganda	0.148	0.695**	1.000	0.155	0.071

*Source: Authors' calculation from IFS CD-ROM. **Significant at 5%.*

Similarity in economic structure

The theory of optimum currency areas also recommends that countries with similar economic structures are suitable to join a currency area. This is because they tend to be affected by shocks in a similar way, and hence necessitating similar policies. In other words, since their economic structures are similar, there would be no need to undertake unilateral adjustments in the exchange rate if they are faced with a terms of trade shock.

Table 6.6 gives the macro structure of the three countries. It shows that, by and large, the three countries are dominated by the agricultural sector, although Uganda and Tanzania have a higher percentage of value added from agriculture than Kenya. The dominance of the agriculture sector in the three countries could be seen further by the contribution of the sector to export earnings. Table 6.7, which gives the contribution of the principal agricultural crops to the export earnings of the three countries, shows that for most years, the crops account for more than fifty percent of export earnings. Clearly, the agriculture sector contributes a large percentage to the export earnings of the three countries. The reliance of the three countries on agriculture implies a shock to the agricultural sector would affect all the countries in a similar way.

Table 6.6: Macroeconomic Structures

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Agriculture, value added (% of GDP)									
Kenya	29.1	27.0	26.6	31.5	33.3	31.1	29.6	27.5	26.1
Tanzania	48.0	47.2	48.1	48.1	46.3	46.2	47.6	47.3	45.7
Uganda	56.6	52.8	51.1	51.5	49.9	49.4	45.1	42.0	44.6
Manufacturing, value added (% of GDP)									
Kenya	11.8	12.2	11.1	10.0	10.7	9.9	10.2	9.7	10.8
Tanzania	8.9	9.1	8.5	7.8	7.4	7.3	7.3	7.1	7.2
Uganda	5.7	5.8	6.2	6.0	6.5	6.8	7.9	8.6	8.9
Services, etc., value added (% of GDP)									
Kenya	51.7	53.0	54.5	51.6	49.4	52.8	54.3	57.5	57.7
Tanzania	35.5	35.6	35.4	36.1	38.3	39.0	38.0	38.4	39.4
Uganda	32.4	34.8	35.7	35.4	36.2	36.3	38.7	40.5	37.8

Source: World Bank, World Development Indicators.

Table 6.7: Percentage Contribution of Principal Agricultural Crops to Export Earnings

	1996	1997	1998	1999	2000
Kenya					
Coffee, tea, horticultural products					
Percentage Contribution	48.07	49.56	54.81	56.09	58.51
Tanzania					
Coffee, cotton, tea, cashew nuts, tobacco					
Percentage contribution	56.00	48.80	59.10	50.20	39.00
Uganda					
Coffee, tea, cotton					
Percentage contribution	72.86	60.08	68.78	57.49	48.38

Source: Authors' calculations from the following publications: CBS, Economic Survey 2001, IMF (2000), Bank of Uganda, Annual Report, 1999/2000.

Similarity of inflation rates

Countries with similar inflation rates could join and form a currency union because a similarity in inflation implies that their economic policies are similar, and so are their economic structures.

For East Africa, Table 6.8 shows that the average percentage growth in consumer price indices between 1990 and 1999 is converging. Of the three countries, Tanzania has the highest inflation, while Kenya and Uganda's inflation rates are similar. It must be noted that Tanzania's inflation rate is now single digit, and approaching 5%. As alluded to earlier, in the 1990s, the three countries' macroeconomic policies are similar due to the adoption of structural adjustment policies. It is not so surprising thus that the effect is seen in the convergence in their inflation rates.

Table 6.8: Average % Growth of CPI, 1990-2000

	1990-1999	1990-1995	1995-1999
Kenya	13.44	17.92	5.54
Tanzania	18.36	22.29	14.39
Uganda	12.29	17.29	5.42

Authors' Calculation from annual CPI data, IFS CD-ROM, 2001.

Political and other factors

In the formation of a currency union, some political factors are important. That is, a political will and commitment is needed by leaders so as to enable them to persuade the governed of the importance and need of belonging to a union. Without political

will and commitment, it could be difficult to obtain any public support by way of explaining and justifying belonging to the union. Since belonging to a currency union could involve a joint coordination of policies that may not be popular to the people, the leaders should be committed enough to woo enough public support to the union.

In East Africa, the three partner states of the EAC have some cultural and historical ties that bind them together. The important one being that they were members of the defunct EAC. From that experience, they are bringing forth the lessons learnt from its operations and how they could avoid the pitfalls that they encountered. The other cultural factor relates to the languages that they share. All three countries use Kiswahili and English, a factor that makes it easy to communicate with each other. Also, many tribes bestride the three countries' borders, for example, the *Luo and Maasai*. The three countries also share a tribal group, *Luo*, which cuts across all three borders.

The other factor is political will. So far, some pronouncements from all three political leaders and top politicians indicate that they favour closer cooperation in the region. Speaking at the resurrection of the East African Community's Parliament and Court, the three presidents had the following to say;

> "The Community has now come of age and we will now from today build a true East Africa." (President Moi).
>
> "The community now brings us together and unites our voices... When we speak as East Africa, and not as individual countries, people elsewhere will listen to us". (President Museveni).
>
> "A new East Africa is born." (President Mkapa). The Nation, (2001).

And in the spirit of cooperation, the Tanzanian president invited the Ugandan and Kenyan presidents to the celebrations of Tanzania's 40th Independence Day in December 2001. Thus, unlike in the defunct EAC, the political commitment among the leaders in East Africa seems strong. It is hard to predict whether that will change with a change in leadership. Chances are that if strong institutions are set up before a change in leadership occurs, there is likely to be continuity in political commitment and hence brighter prospects for more cooperation.

7. The Trade Pattern of EAC Members and its Change Over Time

An important motivation for the revival of the EAC is to increase the volume of trade in the region. In this section, we examine the trade pattern of the EAC members and its change over time. We will look at the extent to which the members trade amongst themselves versus the rest of the world, and the value of this trade over time.

One of the reasons for the collapse of the "old" EAC is the feeling that the benefits of the common market was accruing more to Kenya due to its higher level of industrialisation compared to Tanzania and Uganda. To what extent has this changed? What challenges lie ahead for the partner states in the EAC?

7.1. The Evolution of Intra-Regional Trade

The extent to which the partner countries in any regional trade arrangement trade with each is an important indicator of the sustainability of the grouping. We thus examine the extent to which Kenya's dominance in the region has evolved. The trade data presented is reported from Kenya's point of view.

Table 7.1 shows the trade figures from Kenya's point of view for the period between 1996 and 2000 (although the figures for the year 2000 are provisional). On average, 12 percent of Kenya's total exports have been going to Tanzania over the sample period, while close to 17 percent have been going to Uganda. This is a considerable improvement from the 1990 figures, where only about 2 percent of Kenya's exports went to Tanzania. On the import side, the picture is not so encouraging. On average, Kenya imported only 0.5 percent and 0.2 percent from Tanzania and Uganda respectively. The very low percentage of imports from the partner countries is a reflection of the still low level of industrialisation that is prevalent in Tanzania and Uganda.

Table 7.1: Intra-Regional Trade in the EAC, 1996-2000

	1996	1997	1998	1999	2000*
Kenya's Exports by Destination in Ksh million and Percentage					
Total exports	118200	120445	121181	122559	1314527
Total Africa	57350	56198	57627	57326	61935
- of which Tanzania	15508	15790	16116	13767	11092
(as % of Total Exports)	(13.12)	(13.36)	(13.63)	(11.65)	(9.38)
- of which Uganda	17730	16571	19466	21189	24186
(as % of Total Exports)	(15)	(14.02)	(16.47)	(7.93)	(20.46)
Kenya's Imports by Origin in Ksh million and percentage					
Total Imports	168486	190674	197789	206401	247804
Total Africa	16181	28917	17339	22298	22746
- of which Tanzania	928	865	610	480	928
(as % of Total Imports)	(0.55)	(0.51)	(0.36)	(0.28)	(0.55)
- of which Uganda	30	467	60	307	515
(as % of Total Imports)	(0.02)	(0.28)	(0.04)	(0.18)	(0.31)

*Source: CBS, Economic Survey 2001, *Figures are Provisional.*

In the next sub-section, we examine the overall evolution of trade in East Africa

7.2. *The Overall Structure of Trade in East Africa*

Table 7.2 shows Kenya's structure of trade (exports and imports) between 1985 and 1999. At the beginning of the period, Kenya's exports to African countries were dominated by sector 6, followed by sector 0. This was the case until the beginning of the 1990s, although throughout the 1990s, sector 6's dominance started declining, being overtaken by sector 5 in 1999, followed by sector 8 and then sector 0. Sector 6 fell to the fourth place. On the import side, at the beginning of the period, sector 6 dominated, followed by sector 3. This remained so throughout most of the sample period. However, towards the end of the 1990s, sector 3 dominated Kenya's imports, followed by sector 5, sector 5 and sector 0.

In Table 7.3, we present Tanzania's trade structure over the same sample period. Tanzania's exports to Africa were dominated by sectors 6,3,7 and 5, although towards the end of the 1980s, sector 3's contribution fell to zero. In the 1990s, sectors 5 and 6 dominated Tanzania's exports. Sector 4's contribution increased throughout the 1990s; from contributing nothing in much of the 1980s, it increased to about 13 percent in 1999.

Table 7.2: Kenya's Trade Structure – Percentage Distributions, 1985-1999

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Exports to Africa:															
0 Food and live animals	30.3	9.7	23.0	54.9	43.8	5.9	2.7	3.9	4.6	49.4	8.4	8.0	43.3	16.1	13.6
1 Beverages and tobacco	0.3	0.0	0.0	0.3	0.2	0.6	0.0	1.7	1.8	1.1	0.7	1.1	1.0	1.7	1.4
2 Crude materials, inedible, except fuels	5.1	2.2	12.1	29.0	36.4	3.0	0.5	2.1	3.2	2.3	2.3	3.3	3.0	3.2	0.0
3 Mineral fuels, lubricants and related materials	0.0	2.0	30.1	0.0	0.0	0.3	0.0	4.3	3.0	1.4	17.4	12.7	1.4	1.1	0.0
4 Animal and vegetable oils and fats	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.3	0.2	0.2	0.0
5 Chemicals	0.5	1.6	2.0	0.0	15.0	4.8	1.9	22.9	20.0	11.2	15.0	20.5	12.6	21.0	50.5
6 Manufactured goods classified chiefly by material	56.0	80.3	21.0	3.8	1.9	79.9	29.4	54.9	44.8	20.9	26.3	22.7	16.9	22.7	7.3
7 Machinery and transport equipment	4.4	2.2	10.8	2.4	0.9	1.7	59.8	6.7	18.7	11.1	21.6	26.5	18.4	27.3	0.2
8 Miscellaneous manufactured articles	0.4	1.0	0.2	3.5	1.5	2.2	0.8	2.8	3.3	2.4	4.0	4.8	3.2	6.6	26.1
9 Commodities & transactions not classified to kind	2.8	0.8	0.7	6.0	0.3	1.6	4.9	0.7	0.5	0.1	4.2	0.2	0.1	0.2	0.8
Imports from Africa:															
0 Food and live animals	9.7	11.0	21.9	38.2	21.4	11.9	5.6	9.7	10.9	9.8	15.4	17.9	10.7	18.2	5.9
1 Beverages and tobacco	0.2	0.2	0.3	0.0	0.0	0.0	0.7	0.2	0.2	0.0	3.6	4.1	4.6	0.0	1.2
2 Crude materials, inedible, except fuels	6.1	1.6	0.8	0.6	0.5	0.5	0.6	2.1	1.9	3.5	2.2	3.5	2.8	5.9	0.3
3 Mineral fuels, lubricants and related materials	28.1	29.1	9.8	0.0	0.2	24.6	10.7	16.1	9.3	2.3	4.1	3.3	3.7	4.8	59.2
4 Animal and vegetable oils and fats	0.1	0.2	0.1	0.0	0.0	1.4	0.2	0.0	0.0	0.0	0.4	0.7	0.8	0.0	0.0
5 Chemicals	7.7	8.5	11.6	8.6	15.4	14.8	23.4	12.7	10.9	11.3	12.2	14.2	16.6	20.5	16.7
6 Manufactured goods classified chiefly by material	41.1	41.3	35.3	45.9	50.1	38.4	46.6	49.8	57.8	68.0	39.9	37.6	36.4	41.3	13.1
7 Machinery and transport equipment	4.7	5.0	13.2	1.7	5.0	3.3	4.7	2.7	2.8	1.3	14.4	14.3	17.3	6.8	0.3
8 Miscellaneous manufactured articles	2.1	2.8	7.0	4.9	7.3	5.0	7.4	6.5	5.9	3.5	7.8	4.2	6.9	1.7	2.9
9 Commodities & transactions not classified to kind	0.4	0.3	0.0	0.2	0.1	0.1	0.2	0.1	0.3	0.3	0.1	0.2	0.1	0.8	0.4

Source: Authors' calculations from UNCTAD Data.

Table 7.3: Tanzania's Trade Structure – Percentage Distributions, 1985-1999

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Exports to Africa:															
0 Food and live animals	8.7	19.1	1.3	12.1	4.8	8.5	6.5	4.6	5.5	18.4	8.8	13.1	13.4	14.1	15.8
1 Beverages and tobacco	1.3	3.1	4.5	3.4	3.4	8.8	8.5	22.0	23.3	18.9	8.5	6.2	4.0	4.2	2.5
2 Crude materials, inedible, except fuels	6.4	2.3	6.5	3.5	0.1	1.2	2.0	2.7	1.3	0.9	1.7	1.2	1.2	1.0	1.9
3 Mineral fuels, lubricants and related materials	20.2	29.1	32.6	16.6	0.0	9.6	24.9	8.5	8.2	3.5	20.7	12.2	5.3	7.2	9.7
4 Animal and vegetable oils and fats	0.0	0.1	0.1	0.0	0.0	1.6	0.6	0.3	1.1	3.9	5.1	5.0	7.4	8.1	12.7
5 Chemicals	12.8	14.9	16.3	15.8	53.0	9.8	19.7	16.9	15.2	19.4	15.6	19.6	21.1	20.0	25.8
6 Manufactured goods classified chiefly by material	28.4	20.2	26.3	35.5	13.1	20.2	17.7	27.8	28.4	21.6	24.3	25.5	27.8	22.0	19.6
7 Machinery and transport equipment	14.9	5.7	4.7	6.1	16.5	34.0	8.0	9.4	10.5	7.1	9.1	10.9	11.1	14.9	2.0
8 Miscellaneous manufactured articles	7.0	5.4	7.8	7.0	8.9	5.7	11.9	7.9	6.4	6.4	6.1	6.2	8.7	8.5	10.0
9 Commodities & transactions not classified to kind	0.2	0.2	0.1	0.0	0.2	0.6	0.2	0.1	0.3	0.0	0.0	0.0	0.1	0.1	0.0
Imports from Africa:															
0 Food and live animals	3.0	6.0	29.7	31.1	57.4	26.2	12.7	13.9	23.7	22.3	31.2	40.1	32.3	21.2	3.0
1 Beverages and tobacco	7.3	6.5	0.0	0.0	0.0	0.0	0.0	0.5	0.0	6.4	0.0	0.4	44.0	5.4	7.3
2 Crude materials, inedible, except fuels	39.0	4.3	4.3	6.6	11.4	41.8	24.5	53.7	34.8	25.6	34.9	30.3	7.9	17.3	39.0
3 Mineral fuels, lubricants and related materials	17.4	28.9	3.9	10.1	15.3	4.7	30.1	4.0	16.1	9.9	8.9	9.6	4.5	8.4	17.4
4 Animal and vegetable oils and fats	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.5	0.0	0.0	0.1	0.1
5 Chemicals	0.0	0.4	0.2	0.5	0.0	1.2	0.4	0.3	1.0	1.6	1.9	1.0	0.6	2.5	0.0
6 Manufactured goods classified chiefly by material	27.0	44.4	38.0	37.1	11.1	22.8	29.6	18.4	18.6	11.6	10.8	5.5	2.5	11.6	27.0
7 Machinery and transport equipment	4.0	6.9	22.7	14.0	4.6	3.0	2.0	8.5	5.6	22.1	9.4	11.7	7.6	30.0	4.0
8 Miscellaneous manufactured articles	1.8	0.8	1.1	0.6	0.1	0.1	0.4	0.6	0.2	0.3	1.9	1.1	0.4	3.2	1.8
9 Commodities & transactions not classified to kind	0.4	1.8	0.1	0.0	0.1	0.1	0.3	0.0	0.1	0.2	0.6	0.4	0.1	0.3	0.4

Source: Authors' calculations from UNCTAD Data

Table 7.4: Uganda's Trade Structure – Percentage Distributions, 1985-1999

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Exports to Africa:															
0 Food and live animals	2.3	2.2	3.3	2.3	0.1	3.7	2.6	2.2	4.4	8.0	14.1	14.8	14.7	9.5	9.7
1 Beverages and tobacco	3.6	7.5	5.9	0.3	8.2	0.3	0.4	0.5	0.5	0.7	0.7	0.5	0.3	0.7	0.5
2 Crude materials, inedible, except fuels	0.2	0.9	1.5	4.9	75.4	3.8	3.3	2.3	2.8	3.0	3.5	4.4	3.3	4.1	3.9
3 Mineral fuels, lubricants and related materials	49.0	42.1	37.7	43.8	0.0	16.4	39.3	35.2	20.1	7.8	15.4	19.7	20.6	24.1	31.0
4 Animal and vegetable oils and fats	0.3	0.4	0.3	0.5	0.0	2.9	0.3	0.3	3.3	5.8	3.8	2.9	2.1	1.4	0.5
5 Chemicals	15.6	14.1	14.3	7.6	0.0	7.2	9.9	7.6	8.1	12.7	11.0	12.7	13.3	13.0	11.9
6 Manufactured goods classified chiefly by material	24.7	24.4	26.2	30.9	1.9	21.6	35.2	39.5	47.2	43.7	34.4	29.4	30.2	26.8	28.4
7 Machinery and transport equipment	2.2	4.3	6.4	5.2	11.7	36.9	1.4	5.9	4.0	4.9	6.6	3.9	3.5	9.3	1.6
8 Miscellaneous manufactured articles	2.1	4.1	4.4	4.5	1.4	7.1	7.4	6.5	9.7	13.3	10.5	10.9	11.4	11.1	12.5
9 Commodities & transactions not classified to kind	0.0	0.0	0.0	0.0	1.3	0.0	0.1	0.0	0.0	0.0	0.0	0.9	0.7	0.0	0.0
Imports from Africa:															
0 Food and live animals	60.5	85.8	66.1	84.9	12.4	38.5	8.5	38.2	62.6	59.5	44.4	21.5	28.0	7.0	49.9
1 Beverages and tobacco	0.0	0.0	0.0	0.0	0.0	5.8	0.0	0.4	1.9	0.3	19.6	2.2	2.0	3.9	1.1
2 Crude materials, inedible, except fuels	1.7	6.2	4.4	10.7	0.0	54.8	80.9	55.0	32.1	35.7	8.1	22.5	3.0	46.7	2.4
3 Mineral fuels, lubricants and related materials	32.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	43.7	0.0	0.7
4 Animal and vegetable oils and fats	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0	0.0	0.0
5 Chemicals	0.0	0.8	0.0	0.0	0.0	0.2	0.2	2.6	0.1	0.1	2.5	2.2	6.8	2.0	20.0
6 Manufactured goods classified chiefly by material	0.1	1.3	9.1	0.0	12.4	0.2	4.7	1.6	0.4	0.7	6.3	4.7	2.2	0.9	1.5
7 Machinery and transport equipment	5.6	5.0	20.4	4.2	60.9	0.5	5.5	1.4	2.9	3.3	12.4	26.9	14.1	21.4	23.3
8 Miscellaneous manufactured articles	0.1	0.1	0.1	0.2	1.6	0.0	0.2	0.6	0.0	0.3	5.8	18.3	0.2	17.7	0.9
9 Commodities & transactions not classified to kind	0.0	0.2	0.0	0.1	12.7	0.0	0.0	0.1	0.0	0.1	0.4	1.7	0.1	0.3	0.2

Source: Authors' calculations from UNCTAD Data

On the import side, in the 1980s, the following sectors dominated, albeit not consistently: 0,2,4,5 and 6. In the 1990s, all the sectors showed fluctuations in their percentage contributions, with sector 0's percentage falling to a mere 3 percent in 1999, before contributing 39 percent just in the previous year in 1999, followed by sector 6. Imports of sector 7 fell sharply in 1999 to 4 percent from 40 percent in the previous year. In the 1990s, we also note the high percentage contribution of sector 1 in 1997, to the highest for the whole sample period.

Uganda's trade structure is given in Table 7.4. It shows that Uganda's exports in the 1980s were dominated by sectors 3, 6 and 5. Although sector 3 dominated the beginning of the period, by 1989, it fell to zero. On the other hand, sector 2's contribution shot up to 75 percent in 1989 from contributing less than 5 percent in the previous year. Sector 6's contribution also fell to close to 2 percent in 1989 from contributing about 31 percent in 1988. The same happened to sector 5; its contribution fell to zero in 1989 from averaging 15 percent in three years at the beginning of the period. At the beginning of the 1990s, sector 7's percentage contribution was the highest, but it lost its first position for the rest of the 1990s, ending up in second place after sector 3. Sector 8 increased its percentage contribution in the 1990s, being the third highest.

On the import side, in the second half of the 1990s, Uganda's imports were dominated by sector 0, although it lost its first position to sector 8, which picked itself from third position to first. Although sector 3 was second, its percentage contribution fell to zero in most years, except in 1997 when it shot up to 44 percent.

In the 1990s, sector 0 maintained its dominance in most years, followed by sector 2, although its percentage contribution fell sharply in 1999. The contribution of sector 5 increased in the 1990s, assuming third position after sector 7.

Of particular importance is also South Africa's dominance in East Africa. Before *apartheid* was dismantled, most African countries shunned doing any commercial business with the regime. However, after 1994, some trade relations were restored. Thus, in the later half of the 1990s, South Africa has become an important source of imports for East African countries.

We thus examine some trade data from SACU,[12] which is given in the Appendix 7A (Table 7A.1-7A.6).

Table 7A.1 and Table 7A.2 give Kenya's trade pattern with SACU for the period between 1992 and 1998. The percentage distribution shows that Kenya's trade with SACU is dominated by three sectors, namely, 5,6 and 7. However, in some selected years, sector 0 accounted for quite a large share of exports, including sector 3. On the import side, Kenya is dominant in sectors 0 and 5, and in the later part of the 1990s, in sectors 7 and 2.

In Table 7A.3 and Table 7A.4, we give Tanzania's trade pattern with SACU. Its exports are dominated by sectors 6 and 7, and sector 5 picked up in the later part of the 1990s. Sector 3's contribution also picked for two years in the middle of the 1990s. Sector 1 lost its percentage in the later part of the 1990s when it had the highest percentage contribution in 1992. Sector 0's contribution picked in 1994, before falling and then picking again in the later part of the year. On the import side, the most dominant sectors are 0 and 2, while sector 7 picked up in the middle and later part of the 1990s. Sector 6's percentage contribution also picked in 1998.

Uganda's trade pattern with SACU is given in Table 7.6A..5 and Table 7A.6f, and it shows that exports were dominated by sectors 5, 6 and 7. Sector 0's contribution has been fluctuating, and sector 9 picked in 1996 after contributing nothing in the earlier years. A number of sectors show fluctuations. It is not easy to pick a dominant one, but sectors 7, 8, 2 and 1 show fluctuations. Sector 0 also shows some picks for some years.

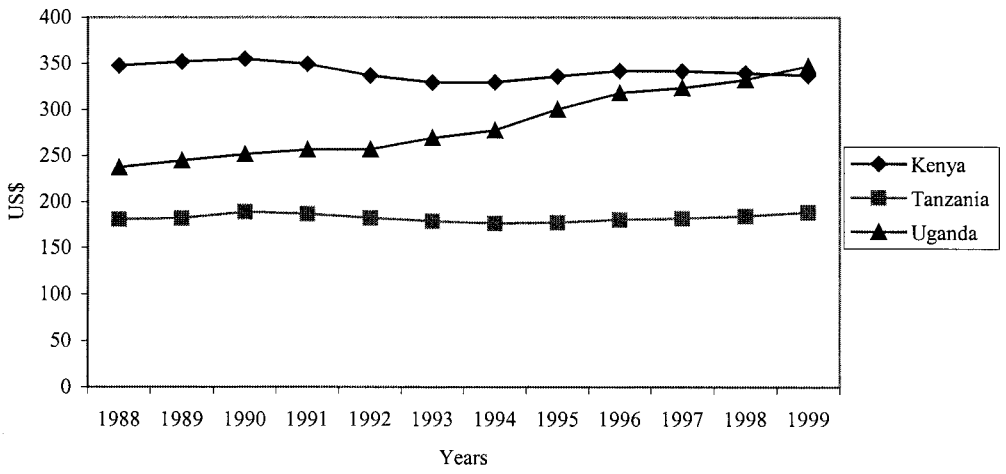
7.3. Is There Income Convergence in East Africa?

One of the major concerns in the debate on the East African Community, now as well as in the past, is whether the various countries will benefit equally. The view that Kenya was benefiting disproportionately in the earlier EAC of the 1960s and 1970s was one of the reasons why it collapsed. We have also noted that there are grounds for fearing that the country with a head-start may have the best chance to benefit from integration. We have also noted that there is a need to be aware of this problem and to introduce some safeguards. So

[12] The SACU member-countries are; Botswana, Lesotho, Namibia and Swaziland and South Africa. Although data is not disaggregated, it is fair to say that South Africa represents the most dominant economy in SACU; South Africa's GDP is about six times the GDP of all the other SACU members combined (IFS CD-ROM).

far, we cannot say anything about the impact of the new community on income differences between the countries. However, it is interesting to note that since 1988, there has been income convergence between Uganda and Kenya (see Figure 7a). These two countries now have the same per capita income levels, while Tanzania is still lagging behind. During the period concerned it is actually only Uganda that can record any significant improvement in incomes. Still, in terms of industrial structure, Kenya is still more advanced. Thus, it is still likely that Kenya will benefit more than the others. It is Tanzania, though, that should be most worried rather than Uganda. We can conclude that Kenya is still the most advanced country in terms of industrial structure, but the dominance is probably less than it was 30 years ago. Still, the issue of benefit sharing will be important for the future of the community.

Figure 7a: Per Capita Incomes in Constant PPP 1995 US$



Appendix 7A: Trade Flows in the Region

Table 7A.1: Kenya's Exports to SACU, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
	Value in '000' US Dollars						
0 Food and live animals	1728.8	1521.6	88985.0	21277.9	16343.5	127949.7	36378.8
1 Beverages and tobacco	1197.0	1438.6	1453.7	1781.3	2621.7	3164.0	1855.6
2 Crude materials, inedible, except fuels	1245.3	2307.4	4207.8	5961.1	7523.7	6356.5	7323.6
3 Mineral fuels, lubricants and related materials	2214.0	2534.4	2813.6	46891.8	29759.4	5124.5	2435.3
4 Animal and vegetable oils and fats	0.0	4.6	323.9	424.6	641.4	714.4	443.3
5 Chemicals	15685.0	13755.0	20315.8	38707.1	46833.5	45188.9	46711.5
6 Manufactured goods classified chiefly by material	24018.0	23403.3	39608.2	67517.9	48070.7	56958.4	51400.2
7 Machinery and transport equipment	4165.4	14913.9	20475.8	56499.0	59535.1	65835.4	62009.9
8 Miscellaneous manufactured articles	1855.6	2432.4	4256.0	9796.8	8779.5	9641.1	13585.8
9 Commodities & transactions not classified to kind	174.09	247.9	134.32	11188.02	500.91	159.86	462.7
Total	52283.09	62559	182574	260045.6	220609.3	321092.7	222606.5
	Percentage Distribution						
0 Food and live animals	3.3	2.4	48.7	8.2	7.4	39.8	16.3
1 Beverages and tobacco	2.3	2.3	0.8	0.7	1.2	1.0	0.8
2 Crude materials, inedible, except fuels	2.4	3.7	2.3	2.3	3.4	2.0	3.3
3 Mineral fuels, lubricants and related materials	4.2	4.1	1.5	18.0	13.5	1.6	1.1
4 Animal and vegetable oils and fats	0.0	0.0	0.2	0.2	0.3	0.2	0.2
5 Chemicals	30.0	22.0	11.1	14.9	21.2	14.1	21.0
6 Manufactured goods classified chiefly by material	45.9	37.4	21.7	26.0	21.8	17.7	23.1
7 Machinery and transport equipment	8.0	23.8	11.2	21.7	27.0	20.5	27.9
8 Miscellaneous manufactured articles	3.5	3.9	2.3	3.8	4.0	3.0	6.1
9 Commodities & transactions not classified to kind	0.3	0.4	0.1	4.3	0.2	0.0	0.2

Source: Authors' calculations from UNCTAD Data

Table 7A.2: Kenya's Imports from SACU, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
	Value in '000' US Dollars						
0 Food and live animals	4810.1	4734.8	3442.0	23429.07	16698.51	6075.27	3718.85
1 Beverages and tobacco	1.2	38.2	8.5	94.42	530.68	0.68	0.2
2 Crude materials, inedible, except fuels	700.6	565.1	904.1	1028.74	1160.96	1384.68	1264.39
3 Mineral fuels, lubricants and related materials	0.0	0.0	0.0	0	0	0	0.04
4 Animal and vegetable oils and fats	16.9	0.0	0.0	0	0	2.16	0.11
5 Chemicals	1775.4	2210.0	2676.7	4846.04	5334.41	2830.5	2356.03
6 Manufactured goods classified chiefly by material	148.3	230.9	241.4	423.9	415.91	942.98	679.1
7 Machinery and transport equipment	314.8	863.0	297.3	430.21	4370.72	1292.58	1375.1
8 Miscellaneous manufactured articles	506.7	616.9	295.0	193.9	230.96	249.71	122.2
9 Commodities & transactions not classified to kind	37.07	164.02	0	94.53	134.06	27.57	16.14
Total	8310.84	9422.83	7864.84	30540.81	28876.21	12806.13	9532.16
	Percentage Distribution						
0 Food and live animals	57.9	50.2	43.8	76.7	57.8	47.4	39.0
1 Beverages and tobacco	0.0	0.4	0.1	0.3	1.8	0.0	0.0
2 Crude materials, inedible, except fuels	8.4	6.0	11.5	3.4	4.0	10.8	13.3
3 Mineral fuels, lubricants and related materials	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4 Animal and vegetable oils and fats	0.2	0.0	0.0	0.0	0.0	0.0	0.0
5 Chemicals	21.4	23.5	34.0	15.9	18.5	22.1	24.7
6 Manufactured goods classified chiefly by material	1.8	2.5	3.1	1.4	1.4	7.4	7.1
7 Machinery and transport equipment	3.8	9.2	3.8	1.4	15.1	10.1	14.4
8 Miscellaneous manufactured articles	6.1	6.5	3.8	0.6	0.8	1.9	1.3
9 Commodities & transactions not classified to kind	0.4	1.7	0.0	0.3	0.5	0.2	0.2

Source: Authors' calculations from UNCTAD Data

Table 7A.3: Tanzania's Exports to SACU, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
	Value in '000' US Dollars						
0 Food and live animals	704.98	174.51	8893.01	11031.42	11866.06	14827.32	16936.09
1 Beverages and tobacco	3068.61	3400.28	4287.09	6140.08	7251.49	1993.33	4599.28
2 Crude materials, inedible, except fuels	746.03	271.55	392.13	795.45	468.52	1535.14	488.86
3 Mineral fuels, lubricants and related materials	33.17	37.71	253.16	80090.31	30044.75	549.24	191.62
4 Animal and vegetable oils and fats	0	0	0	90.29	299.98	51.61	631.15
5 Chemicals	655.09	1564.81	6992.63	16176.58	27084.53	21493.6	22104.69
6 Manufactured goods classified chiefly by material	1418.64	5167.27	7564.37	20710.31	14421.84	25456.07	31423.05
7 Machinery and transport equipment	2596.08	6768.41	10327.87	31014.7	32301.66	36784.3	47517.1
8 Miscellaneous manufactured articles	385.82	291.52	1464.43	6744.34	4001.47	8037.21	8452.17
9 Commodities & transactions not classified to kind	1.07	266.3	0	33.2	84.39	208.55	336.74
Total	9609.49	17942.36	40174.69	172826.7	127824.7	110936.4	132680.8
	Percentage Distribution						
0 Food and live animals	7.3	1.0	22.1	6.4	9.3	13.4	12.8
1 Beverages and tobacco	31.9	19.0	10.7	3.6	5.7	1.8	3.5
2 Crude materials, inedible, except fuels	7.8	1.5	1.0	0.5	0.4	1.4	0.4
3 Mineral fuels, lubricants and related materials	0.3	0.2	0.6	46.3	23.5	0.5	0.1
4 Animal and vegetable oils and fats	0.0	0.0	0.0	0.1	0.2	0.0	0.5
5 Chemicals	6.8	8.7	17.4	9.4	21.2	19.4	16.7
6 Manufactured goods classified chiefly by material	14.8	28.8	18.8	12.0	11.3	22.9	23.7
7 Machinery and transport equipment	27.0	37.7	25.7	17.9	25.3	33.2	35.8
8 Miscellaneous manufactured articles	4.0	1.6	3.6	3.9	3.1	7.2	6.4
9 Commodities & transactions not classified to kind	0.0	1.5	0.0	0.0	0.1	0.2	0.3

Source: Authors' calculations from UNCTAD Data

Table 7A.4: Tanzania's imports from SACU, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
	Value in '000' US Dollars						
0 Food and live animals	278	2170.62	1006.94	1255.92	1121.48	2206.81	1520.8
1 Beverages and tobacco	0	0	0	0	89.95	422.58	0
2 Crude materials, inedible, except fuels	3048.65	4218.8	1640.46	2705.76	3002.84	819.62	550.42
3 Mineral fuels, lubricants and related materials	0	0	0	0	0	0	0
4 Animal and vegetable oils and fats	1.21	0	0	0	0	0	0
5 Chemicals	4.73	0	12.04	0.51	140.28	36.28	68.65
6 Manufactured goods classified chiefly by material	11.98	3.39	75.27	58.63	83	92.13	841.6
7 Machinery and transport equipment	223.07	89.98	1625.91	48.43	631.05	594.82	817.42
8 Miscellaneous manufactured articles	32.83	12.91	38.7	388.56	131.88	61.26	110.14
9 Commodities & transactions not classified to kind	3.5	14.77	52.12	55.43	21.6	38.29	43.26
Total	3603.97	6510.47	4451.44	4513.24	5222.08	4271.79	3952.29
	Percentage Distribution						
0 Food and live animals	7.7	33.3	22.6	27.8	21.5	51.7	38.5
1 Beverages and tobacco	0.0	0.0	0.0	0.0	1.7	9.9	0.0
2 Crude materials, inedible, except fuels	84.6	64.8	36.9	60.0	57.5	19.2	13.9
3 Mineral fuels, lubricants and related materials	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4 Animal and vegetable oils and fats	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5 Chemicals	0.1	0.0	0.3	0.0	2.7	0.8	1.7
6 Manufactured goods classified chiefly by material	0.3	0.1	1.7	1.3	1.6	2.2	21.3
7 Machinery and transport equipment	6.2	1.4	36.5	1.1	12.1	13.9	20.7
8 Miscellaneous manufactured articles	0.9	0.2	0.9	8.6	2.5	1.4	2.8
9 Commodities & transactions not classified to kind	0.1	0.2	1.2	1.2	0.4	0.9	1.1

Source: Authors' calculations from UNCTAD Data.

Table 7A.5: Uganda's Exports to SACU, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
	Value in '000' US Dollars						
0 Food and live animals	52.79	100.79	707.82	770.61	3473.77	5618.68	3107.6
1 Beverages and tobacco	2.89	65.74	231.86	387.33	434.59	257.3	516.79
2 Crude materials, inedible, except fuels	1.25	17.8	24.36	38.59	42.46	318.09	342.1
3 Mineral fuels, lubricants and related materials	0	0	1.98	2.63	395.44	248.19	368.51
4 Animal and vegetable oils and fats	0	1.58	0	0.04	26.38	20.91	6.27
5 Chemicals	302.14	351.63	1435.42	3409.36	8342.57	5635.41	6931.81
6 Manufactured goods classified chiefly by material	138.59	1611.64	2745.52	10090.6	2991.73	9169.39	10918.34
7 Machinery and transport equipment	417.02	491.67	725.63	9384.4	6495.76	7663.01	26411.34
8 Miscellaneous manufactured articles	120.55	165.52	249.16	1658.89	1715.36	2337.73	4545.3
9 Commodities & transactions not classified to kind	0	0	7.04	3.88	2978.67	1647.41	110.8
Total	1035.23	2806.37	6128.79	25746.33	26896.73	32916.12	53258.86
	Percentage Distribution						
0 Food and live animals	5.1	3.6	11.5	3.0	12.9	17.1	5.8
1 Beverages and tobacco	0.3	2.3	3.8	1.5	1.6	0.8	1.0
2 Crude materials, inedible, except fuels	0.1	0.6	0.4	0.1	0.2	1.0	0.6
3 Mineral fuels, lubricants and related materials	0.0	0.0	0.0	0.0	1.5	0.8	0.7
4 Animal and vegetable oils and fats	0.0	0.1	0.0	0.0	0.1	0.1	0.0
5 Chemicals	29.2	12.5	23.4	13.2	31.0	17.1	13.0
6 Manufactured goods classified chiefly by material	13.4	57.4	44.8	39.2	11.1	27.9	20.5
7 Machinery and transport equipment	40.3	17.5	11.8	36.4	24.2	23.3	49.6
8 Miscellaneous manufactured articles	11.6	5.9	4.1	6.4	6.4	7.1	8.5
9 Commodities & transactions not classified to kind	0.0	0.0	0.1	0.0	11.1	5.0	0.2

Source: Authors' calculations from UNCTAD Data

Table 7A.6: Uganda's Imports from SACU, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
	Value in '000' US Dollars						
0 Food and live animals	0	0	65.73	503.32	37.33	99.66	34.23
1 Beverages and tobacco	0	0	0	0.03	124.7	110.77	0
2 Crude materials, inedible, except fuels	0	286.35	372.04	0.79	65.49	18.88	1308.61
3 Mineral fuels, lubricants and related materials	0	0	0	0	0	0	0
4 Animal and vegetable oils and fats	0	0	0	0	0	0	0
5 Chemicals	0	0	0	0	23.27	1.66	2.49
6 Manufactured goods classified chiefly by material	0.35	26.55	0.42	2.78	13.55	0.97	6.94
7 Machinery and transport equipment	15.65	23.25	16.71	215.19	142.16	450.58	233.43
8 Miscellaneous manufactured articles	0.33	0	4.26	171.03	31.25	8.74	306.92
9 Commodities & transactions not classified to kind	1.69	1.17	0	19.89	0	0	5.26
Total	18.02	337.32	459.16	913.03	437.75	691.26	1897.88
	Percentage Distribution						
0 Food and live animals	0	0	14.3	55.1	8.5	14.4	1.8
1 Beverages and tobacco	0	0	0	0.0	28.5	16.0	0
2 Crude materials, inedible, except fuels	0	84.9	81.0	0.09	14.9	2.7	68.9
3 Mineral fuels, lubricants and related materials	0	0	0	0	0	0	0
4 Animal and vegetable oils and fats	0	0	0	0	0	0	0
5 Chemicals	0	0	0	0	5.3	0.2	0.1
6 Manufactured goods classified chiefly by material	1.9	7.9	0.1	0.3	3.1	0.1	0.4
7 Machinery and transport equipment	86.9	6.9	3.6	23.6	32.5	65.2	12.3
8 Miscellaneous manufactured articles	1.8	0	0.9	18.7	7.1	1.3	16.2
9 Commodities & transactions not classified to kind	9.4	0.4	0	2.2	0	0	0.3

Source: Authors' calculations from UNCTAD Data.

8. Is the Kenyan Shilling over-valued?

One important factor that will determine Kenya's competitiveness with the EAC is its macroeconomic environment. Specifically, in this section, we analyse an important indicator of international competitiveness – the real exchange rate. We are asking whether the Kenya's real exchange rate is over-valued. It is important to do so because an over-valued exchange rate can harm economic growth.

In section 4, we have seen that the macroeconomic indicators in Kenya seem quite satisfactory, apart from the growth rate of GDP. The rate of inflation is low, and the Central Bank of Kenya is boasting at the fact that they have maintained Kenya's inflation rate at below 5 percent. The monetary variables also seem satisfactory. However, given that the economy is not growing, one wonders why the nominal exchange rate seems to be appreciating, and is more or less stable. Does the real sector need to be encouraged by perhaps a depreciation in the exchange rate? This section seeks answers to this question.

A study by McPherson (2000) examined the role of the exchange rate in Kenya's economic growth. The study established that Kenya's over-valued real exchange rate had impeded its growth, although other factors were also responsible for its poor economic performance. The other factors included aid dependence, a large and inefficient public sector, low rates of saving and investment, persistent and relatively large budget deficits, and inconsistent macroeconomic policy (p.4). In order to provide empirical support for the study, McPherson and Rakovski (2000) conducted some regression analysis involving both single equation and simultaneous equation estimation. Their sample covered the period 1970 to 1996, and they used annual data. In their single equation estimation, they found a negative and significant relationship between the growth of real income and the rate of inflation. Other factors that influenced the growth of real income, though not significant, are money growth and the exchange rate.

They also estimated a model involving a change in the real exchange rate as the dependent variable. They found that real income growth was positively related to the change in the real exchange rate, although not significant. The real interest rate was found to have a positive and significant effect on the real exchange rate. They further included an external factor, the price of coffee. They found that an increase in the price

of coffee was positively and significantly related to the change in the real exchange rate, with the effect being stronger after one period.

McPherson and Rakovski (2000) further estimated a structural model involving six equations. Their model drew on Khan and Knight's (1991) macroeconomic model, but they enhanced it by adding open economic indicators and some details relevant to the Kenyan economy. The structural model they estimated was meant to determine the relationship between growth and the exchange rate, while allowing for other main determinants on both variables (p.8). Their structural model was estimated using three stage least squares (3SLS), and in general, they found that the direct relationship between the real exchange rate and real income growth is negative (p.9). Their policy conclusion was that an improvement in Kenya's exchange rate management could influence the rate of income growth, but only in the context of a broad-based structural adjustment and reform (p.11).

There seems to be an agreement in the literature that the Kenyans Shilling is over-valued. In order to analyse this issue, we need to estimate the main determinants of Kenya's RER. The fundamentals determining the RER will help us to calculate the equilibrium RER, after which we could then see whether or not Kenya's RER is misaligned. The first thing to do is to calculate the RER. This was calculated as follows:

$$\langle 2 \rangle \quad RER = e\frac{P^*}{P}$$

where e is the nominal exchange rate between the Kenyan Shilling and the UK Pound, given that the UK is Kenya's main source of import and destination of its exports (see Central Bureau of Statistics, 2001), P^* is the UK's wholesale price index which proxies an index for tradables, and P is Kenya's consumer price index, which proxies the index for nontradables. We used annual data, covering the period 1969 to 1999. We first tested for unit roots in the variables that are likely to influence the RER. We used the Augmented Dickey Fuller (ADF) test, and we found that all the variables are integrated to order one. After that, we run several VAR models using one lag for each of the variables, of which the following variables were found to be cointegrated; RER, real GDP, terms of trade, interest rate, and domestic credit. The results of the cointegration analysis are given in

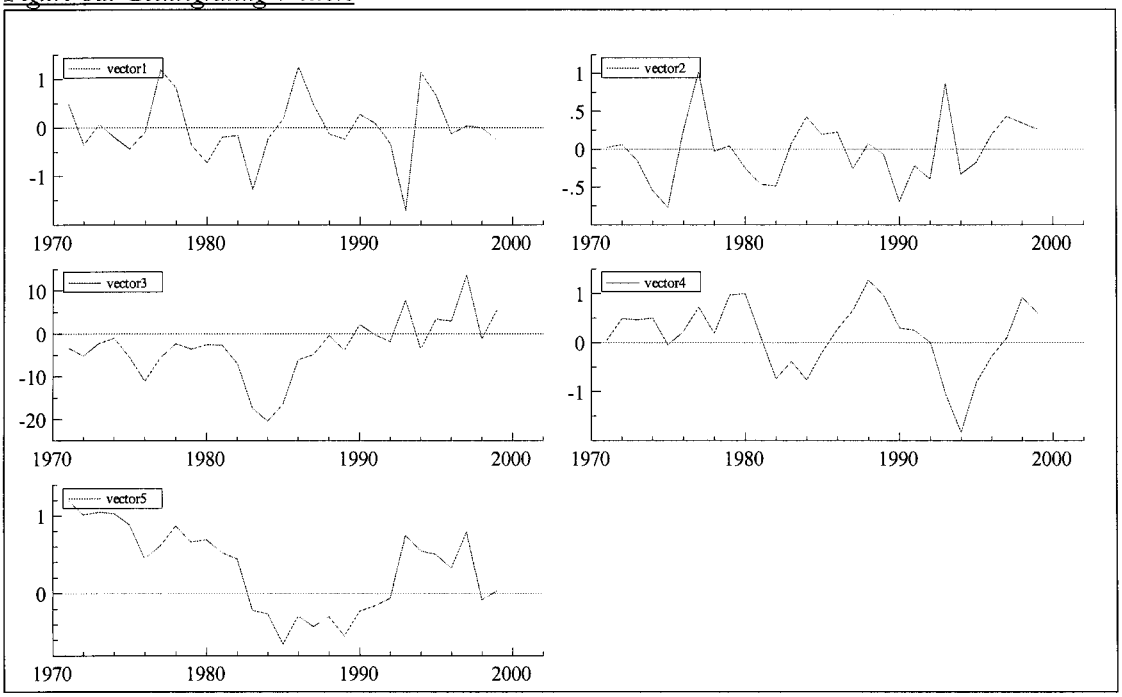
Table 8.1. Clearly, one cointegrating vector was found, as the null hypothesis of no cointegrating vector was rejected. This is supported by the more stationary first vector depicted in the Figure 8a, compared to the rest of the vectors.

Table 8.1: Cointegration Results

Ho: rank=p	λ_{max}	Adjusted to degrees of freedom	95%	λ_{trace}	Adjusted to degrees of freedom	95%
P==0	40.75**	33.72	34.4	93.63**	77.49*	76.1
P==1	22.25	18.41	28.1	52.89	43.77	53.1
P==2	16.11	13.33.	22.0	30.64	25.36	34.9
P==3	8.93	7.39	15.7	14.53	12.03	20.0
P==4	5.60	4.63	9.20	5.60	4.63	9.2

***Significant at 1%; *Significant at 5%.*

Figure 8a: Cointegrating Vectors



We also conducted exclusion tests on all the exogenous variables, and the results in Table 8.2 show that the null hypothesis that each one of the variables could be excluded was rejected.

Table 9.2: Multivariate Test for Exclusion of Variables

Variable	Test Statistic
Log of terms of trade	$\chi^2(5) = 25.604$ [0.0001]**
Log of real GDP	$\chi^2(5) = 22.563$ [0.0004]**
Domestic credit	$\chi^2(5) = 22.16$ [0.0005]**
Interest rate	$\chi^2(5) = 13.267$ [0.0210]*
Constant	$\chi^2(5) = 27.305$ [0.0000]**
All variables	$\chi^2(9) = 39.885$ [0.0000]**

Table 8.3 shows the cointegration results with the restriction of one cointegrating vector imposed. It shows that all the variables are statistically significant, and the Kenya's RER appreciates when real GDP, terms of trade and domestic credit increase. The negative effect of terms of trade on the RER implies that in Kenya, the income effect is stronger than the substitution effect. This means the when terms of trade improve, the increase in income creates excess demand in the local economy, which push the local prices of nontradable goods, leading to an appreciation in the RER. The negative impact of real GDP on the RER can also be explained by the increase in the prices of nontradable goods due to technical progress, while an increase in domestic credit is inflationary, and hence appreciates the RER.

Table 8.3: Cointegration Analysis with Restrictions

β					
Lrer	Lrgdp	Ltot	Int	Dc	Constant
1.0000	2.4029	2.2939	-0.013451	2.7953	-45.590
(0.0000)	(0.55650)	(0.43701)	(0.00847)	(0.5550)	(8.8355)
α					
Lrer					
-0.29035					
(0.03632)					

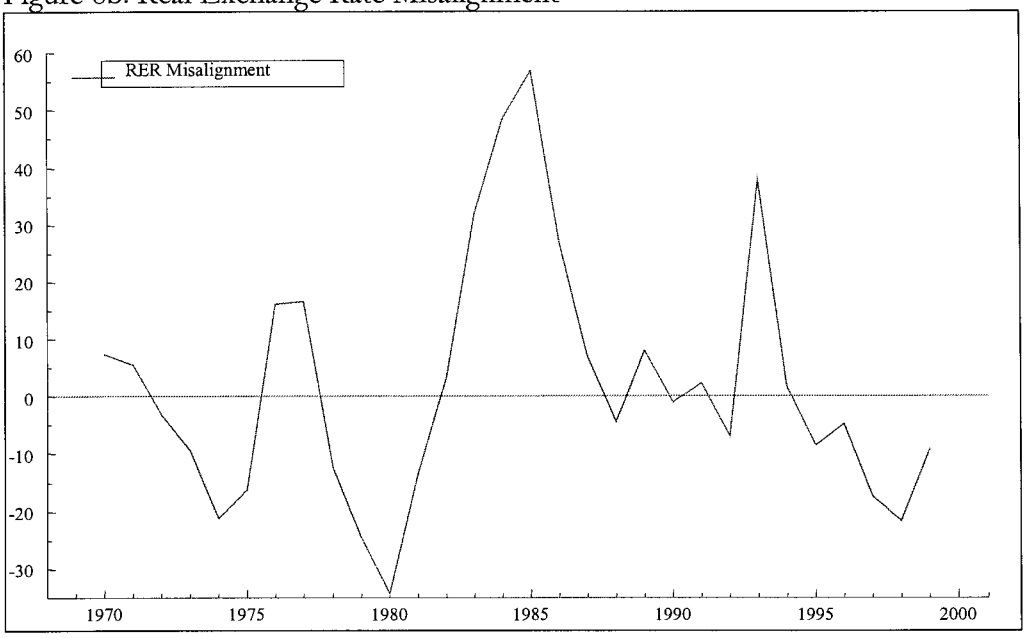
The results show that the RER depreciates when the interest rate increases. The positive effect of the interest rate on the RER is difficult to explain, and is inconsistent with theory. McPherson and Rakovski (2000) also found this result.

We then estimated the degree of misalignment in Kenya's RER. We used the long-run estimates of the fundamentals to obtain the fitted values, which we then filtered using the Hodrick-Prescott filter. We then calculated the misalignment as;

$$\langle 3 \rangle \quad emis = \frac{RER - ERER}{ERER}.$$

where, RER is the actual RER, ERER is the filtered fitted values. The calculated percentage degree of misalignment is reported in Table 8a in the appendix, and Figure 8b graphs the misalignment. In the figure, the negative numbers indicate over-valuation, while the positive numbers indicate under-valuation.

Figure 8b: Real Exchange Rate Misalignment



We can see from the diagram that there are a number of episodes in which Kenya's RER was over-valued. The over-valuation in the RER that occurred from the mid-1990s is by far the longest, and serves to illustrate and confirm assertions by observers that the RER is over-valued, and is responsible for part of the sluggish performance in the economy. Our findings concur with those of Goldstein and Ndung'u (2001) that "the real effective exchange rate shows a certain equilibrium until 1995. Since then, Kenya has maintained a strong and, perhaps over-valued currency,...". Thus, besides overall improvement in macroeconomic management, the RER needs to be realignment, by perhaps a depreciation in the nominal exchange rate.

Appendix 8A: Exchange Rate Misalignment

Table 8a: Calculated Percentage of Misalignment

Year	*Percentage of Misalignment*
1969	-
1970	7.27
1971	5.45
1972	-3.13
1973	-9.45
1974	-21.15
1975	-16.25
1976	16.15
1977	16.58
1978	-12.35
1979	-24.63
1980	-34.31
1981	-13.50
1982	3.40
1983	31.96
1984	48.51
1985	56.82
1986	27.05
1987	6.78
1988	-4.45
1989	7.97
1990	-1.11
1991	2.26
1992	-6.98
1993	37.81
1994	1.65
1995	-8.53
1996	-4.68
1997	-17.38
1998	-21.60
1999	-9.27

9. Policy Issues

In this paper, we have discussed, , a range of policy areas that are important in an EAC perspective. Obviously, there will be demands for coordination among the countries involved in different policy areas. The first question is how much and how fast coordination is required. So far, we have seen that the setting up of the EAC has been much slower than planned, and we know that the three countries have a limited administrative capacity. So the speed of policy change and policy coordination will be constrained by these two factors. So far, there have clearly been problems of lack of prioritisation. All aspects of reform are of some interest, but given the limited capacity to handle change there should be a clear priority order. To be successful a regional integration agreement requires effective leadership, and if possible, simplicity and automacity of policy implementation. The EAC has as yet not gone very far in any of those areas.

We have discussed a range of possible benefits from integration within frameworks such as the EAC, some of which are hard to quantify. The reduced risk of conflicts, the extra clout in international negotiations, and more stable commitment to economic reform are examples of such factors. An area where there clearly seems to be scope for gains is with regard to large joint infrastructure projects. We further noted that the countries involved are economically small, and they should therefore gain from increased competition and scope for economies of scale within a larger economic area.

We have seen through various criteria that are used for assessing the suitability of countries to form a currency union that the East African countries seem to be, on balance, suitable for a currency area and the ongoing macroeconomic reforms in the three countries are moving them closer into an optimal currency area. The prospect for a successful economic integration is made brighter by the strong historical and cultural links between the three countries. Also, as matters stand right now, there seems to be a strong political will for forging closer economic cooperation between Kenya, Uganda and Tanzania. What is paramount though, is the building of strong institutions that will withstand political change. The opening of the Court of Justice

and Legislative Assembly is encouraging, and one hopes that the institutional structures will be in place at a faster pace than is the case now.

We have pointed out that the result of integration in terms of classical welfare gains depends on the mix of trade creation and trade diversion. A low common external tariff reduces the risk of trade diversion and should therefore be pursued if one is concerned about the benefit to the group as a whole. This does not seem to be the Kenyan view. The country is, in EAC negotiations, trying to force Uganda to increase its comparatively low external tariff to a level comparable with that of Kenya and Tanzania. As we noted in our theoretical review, the union is more likely to benefit Kenya than Uganda or Tanzania, and this imbalance is likely to be aggravated by high external tariffs. It thus seems clear that the Ugandan view is consistent with their position in the economic hierarchy, as is Kenya's. The outcome for the region as a whole will be best if Uganda wins the argument.

A major problem for the EAC is that it is probably Kenya (again) that is going to benefit the most from the community, even if a low common external tariff is introduced. It already has an agglomeration of manufacturing firms, and this tends to attract new investment. For integration to work, there has to be compensating mechanisms and/or safeguards for the weaker partners. The Treaty is weak and obscure on the issue of safeguards, and this may open up for violations of the spirit of the agreement. There should be mechanisms in place that can compensate the losers, but so far there are none. On a more positive note though is that if the other two industrially less developed than Kenya could move faster in investing in the improvement of infrastructure, and also reduce the administrative bottlenecks, more investors are likely to be attracted there, and hence placing them in a better position to compete with Kenya. Also, an increase in cross-border investment would help to balance the uneven growth pattern that is currently prevalent. There is hope in this direction; for example, the current macroeconomic climate in Tanzania has attracted a significant flow of investment from Kenya.[13].

[13] Athi River Mining, a Kenyan company, was reported to have been in the processs of investing US$2.2 million in Tanzania (The Nation, May 2001). Kibo Breweries, another Kenyan company, has

Another key policy issue that needs addressing is seeing to it that transaction costs are reduced. Reduction of transaction costs is crucial to the smooth working of the bloc, and this is an area where there is scope for collaboration if national prestige does not get in the way. Here, we are talking about physical infrastructure, as well as institutional, such as a well-integrated financial infrastructure. This could, for example, be a common stock market in Nairobi covering the whole region. Transport and communications policies could well be integrated, although the experiences so far have not been too promising. A regional energy grid would probably be one of the most promising and useful endeavours, and this may also be an area that is politically easier to handle than for example, transport infrastructure. Cooperation across the borders in terms of infrastructure development is possibly the most promising arena of collaboration. Here, the benefits will be obvious and the distribution of the gains can also be more easily controlled than with regard to effects that come through the market and via decisions taken by independent private agents.

In order to create a union that is sustainable and functioning, the various parties must be assured that it can survive changes in governments in the various countries. This requires pre-commitment mechanisms that may not be forthcoming as yet. Credible sanctions should also be there against member states that do not follow the rules. . This is also an area where politics may come into play. Therefore, these sanctions should be as automatic and apolitical as possible.

Many of the reforms that have been instituted have been done to satisfy demands from the IFIs and other donors, and the governments have therefore not been wholeheartedly behind them. This means that there is a risk that they may be abandoned when they are no longer necessary to attract donor money. If that is the case, one could use some mechanism to keep good policies in place, and we have discussed whether the bloc could constitute such a lock-in mechanism. The lock-in mechanism may not be very effective in the region. The question then is whether some other outside agent of restraint, such as the EU, could be put in its place. In the short term this hardly seems likely.

---

established a plant in Tanzania's Moshi region. Indeed, in terms of sources of foreign investment to

Macroeconomic policies will also have to be coordinated, but this will become more important further down the road when the economies are better integrated. Once they go for a common currency, of course, this will be absolutely central. This is not likely to happen in the short-term, but also if one aims for stable exchange rates between the countries, one has to make sure that inflation rates converge. The demand here will thus depend on the speed of progress.

Another problem is the one of overlapping memberships. If one agent is dissatisfied with what the EAC does he can opt for one or the other of those alternatives, and to some extent, that already seems to be happening, There needs to be coherence of external policies towards the EAC and those towards COMESA, SADC, as well as those towards the WTO. What is to be done in these various policy areas will also depend on the extent to which the countries can decide on which of the overlapping regional agreements that is to be the dominant one. Since the EAC aims for a closer integration than for example COMESA or SADC, the needs of the EAC should be paramount.

Tanzania, Kenya ranks second by the number of investments and sixth by the total value of investment.

Interviews

Göran Englund, Sida
Augustin Fosu, AERC
Peter Gakunu, Economic Secretary/Director of Planning, Ministry of Finance and Planning
Mr Gatuku, Ministry of Finance and Planning
Moses M. Ikiara, KIPPRA
Peninah Kariuku, Central Bank of Kenya
Mwangi S. Kimenyi, Director, KIPPRA
Peter Kimuyu, IPAR
Mark Lesiit, Central Bank of Kenya
William Lyakurwa, AERC
Peter Magnusson, Sida
Damiano Kulundu Manda, KIPPRA and the University of Nairobi
Mr Mugu, Ministry of Finance and Planning
Mr Mwaura, Ministry of Trade and Industry
Germano Mwabu, KIPPRA and the University of Nairobi
Mwega F.M., AERC and the University of Nairobi
Njuguna Ndung'u, IDRC and the University of Nairobi
Dominique Njinkeu, AERC
Terry Ryan, University of Nairobi.
Mr Tuamwari, Ministry of Finance and Planning
Mr X, Ministry of Finance and Planning

References

ACP Group (2001a), Overview of the Agreement on Trade Development and Co-Operation Between the Republic of South-Africa and the European Community, ACP/61/020/01, Brussels.

ACP Group (2001b), Plan of Action, ACP/61/031/01, Brussels.

AERC (2001), *African Development Aid in the New Millennium. Conference Issues and Papers*, AERC, Nairobi.

Bank of Uganda, (2000), Annual Report 1999/2000.

Bigsten, A., Kimuyu, P. (eds.) (2001), *Structure and Performance of Manufacturing in Kenya*, Palgrave, London.

Bowen, H.P., Hollander, A., Viaene, J-M. 1998), *Applied International Trade Analysis*, Macmillan, London.

Central Bank of Kenya (2001a), *Statistical Bulletin June 2001*, Nairobi.

Central Bank of Kenya (2001b), *Annual Report. June 2000-June 2001,* Nairobi.

Central Bank of Kenya (2001c), *Monthly Economic Review. September 2001*, Nairobi

Central Bureau of Statistics (1999), *National Micro and Small Enterprise Baseline Survey 1999. Survey Results*, Nairobi.

Central Bureau of Statistics, (2001), *Economic Survey 2001.*

Central Bureau of Statistics (2001), *Consumer Price Index*, August 2001, Nairobi.

Coe, D.E., Helpman, E., Hoffmaister, A. (1997), "North-South R&D Spillovers", *Economic Journal* 107:134-149.

Coe, C.D., Hoffmaister, A. (1999), "North-South Trade: Is Africa Unusual?", *Journal of African Economies* 8(2): 228-256.

Collier, P. (2000), "How to Reduce Corruption?", *African Development Review* 12(2): 192-205.

Collier, P., Gunning, J. (1995), "Trade Policy and Regional Integration: Implications for the Relations between Europe and Africa", *World Economy* 18:387-410

Collier, P., Gunning, J.W. (1999), "Africa's Economic Performance", *Journal of Economic Literature* 37: 64-111.

Deardorff, A. (1995), "Determinants of Bilateral Trade: Does Gravity Work in a Neoclassical World?", NBER Working Paper No 5377, Cambridge MA.

Devarajan, S., Easterly, W.R., Pack, H.R. (2001), "Is Investment in Africa Too Low or Too High? Macro and Micro Evidence", Policy Research Working Papers No 2519, World Bank.

EAC Secretariat, (1997), *East African Co-operation Development Strategy (1997-2000),* Arusha, Tanzania.

EAC Secretariat, (2001), "The Second East African Community Development Strategy: 2001-2005", Arusha, Tanzania.

Economic Policy Research Centre, Economic and Social Research Foundation, and CODA Consulting Group (2000), *Final Draft of the Evaluation Report of the Implementation of the East African Community Development Strategy 1997-2000,* Occasional Paper No. 8, EAC, Arusha.

Enders, W., and Hurn, S., (1994), "Theory and Test of Generalised Purchasing Power Parity: Common Trends and Real Exchange Rates in the Pacific Rim" *Review of International Economics,* **2**(2), 179-1990.

EPRC, ESRF, and CODA Consulting Group, (2000), "Final Draft of the Evaluation of the Implementation of the East African Cooperation Development Strategy", Occasional Paper No. 8.

Foroutan, F., Pritchett, L. (1993), "Intra-Sub-Saharan African Trade: Is It Too Little?", *Journal of African Economies* 74-105.

Global Coalition for Africa (GCA), (1999), "Regional Integration in Sun-Saharan Africa, Toward Rationalization and Greater Effectiveness", GCA/EC/02/4/2001.

Goldstein, A., Ndung'u, N. (2001), "Regional Integration Experience in the Eastern African Region", Technical Paper No. 171, OECD Development Centre, Paris.

Ianchovichina, E., Mattoo, A., Olarreage, M. (2001), "Unrestricted Market Access for Sub-Saharan Africa: How Much is it Worth and Who Pays?", CEPR Discussion Paper No. 2820, London.

Ikiara, M.M. (2000), "Report on the Proceedings of the AERC-KIPPRA World Trade Organization (WT O) Workshop", Conference Series No. 1, KIPPRA, Nairobi.

Ikiara, M.M. (2001a), "Policy Framework of Kenya's Tourism Sector since Independence and Emerging Policy Concerns", KIPPRA Working Paper No. 2, Nairobi.

Ikiara, M.M. (2001b), "Vision and Long Term Development Strategy for Kenya's Tourism Industry", KIPPRA Discussion Paper No. 7, Nairobi.

IMF, (1999), "Uganda: Selected Issues and Statistical Appendix", IMF Staff Country Report No. 99/116, October.

IMF, (2000), "Tanzania: Statistical Annex", IMF Staff Country Report No. 00/122, September.

IMF and IDA (2000), Assessment of the Interim Poverty Reduction Strategy Paper, Prepared by the Staffs of the International Development Agency and the International Monetary Fund, Washington DC.

Karingi, S.N., Ndung'u, N.S. (2000), "Macro Models of the Kenyan Economy", KIPPRA Discussion Paper No. 2, Nairobi.

Kenya (2000a), Interim Poverty Reduction Strategy Paper 2000-2003. Prepared by the Government of Kenya, Nairobi.

Kenya (2000b), Letter of Intent and Memorandum of Economic and Financial Policies of the Government of Kenya, to IMF, Nairobi.

Kenya (2000c), *Statistical Abstract 2000*, Government Printers, Nairobi.

Kenya (2001a), *Poverty Reduction Strategy Paper for the Period 2001-2004: Prepared by the People and Government of Kenya*, vols. 1-2, Jun, Nairobi.

Kenya (2001b), *Economic Survey 2001*, Government Printers, Nairobi.

Kimalu, P.K., Nafula, N., Manda, D.K., Mwabu, G., Kimenyi, M.S. (2001), "Education Indicators in Kenya", KIPPRA Working Paper No. 4, Nairobi.

KIPRA (2001), Legal and Other Constraints on Access to Financial Services in Kenya. Survey Results", Special Report, KIPPRA, Nairobi.

Levin, J., Ndung'u, N. (2001), "The Kenyan Interim Poverty Reduction Strategy: A Policy Framework for Growth and Poverty Reduction?", Country Economic Report No. 2001:5, Sida, Stockholm.

Manda, D.K., Kimenyi, M.S., Mwabu, G. (2001), "A Review of Poverty and Antipoverty Initiatives in Kenya", KIPPRA Working Paper No. 3, Nairobi.

McCulloch, N., Winters, A., Cirera, X. (2001), *Trade Liberalisation and Poverty: A Handbook*, DFID, London.

McKay, A., Milner, C., Morrissey, O., Jackson, C. (1998), Study on the Economic Impact of Introducing Reciprocity into the Trade Relations Between the EU and EAC Countries, CREDIT, University of Nottingham.

McKay, A., Milner, C., Morrissey, O. (2000), "The Trade and Welfare Effects of a Regional Economic Partnership Arrangement", CREDIT Research paper No. 00/8, University of Nottingham.

McKay, A., Milner, C., Morrissey, O., Jackson, C., (1998), "Study on the Economic Impact of Introducing Reciprocity into the Trade Relations Between the EU and EAC Countries", CREDIT, Final report for the European Commission.

McPherson, M.F. and Rakovski, T., (2000), "Exchange Rates and Economic Growth in Kenya: An Econometric Analysis", *African Economic Policy Discussion Paper No. 56,* July.

McPherson, M.F., (2000), "Exchange Rates and Economic Growth in Kenya", *African Economic Policy Discussion Paper No. 57,* July.

Mkenda, B.K., (2001), "Is East Africa an Optimum Currency Area?", S-WoPEc Working Papers, No. 41, Göteborg University.

Murinde, V. (ed.) (2001), *The Free Trade Area of the Common Market for Eastern and Southern Africa*, Ashgate, Aldershot.

Muuka, G. N., Harrison, D. E., and McCoy, J. P., (1998), "Impediments to Economic Integration in Africa: The Case of COMESA", *Journal of Business in Developing Nations,* Vol. 2(3).

Mwabu, G. et al (2000), Poverty in Kenya: Profiles and Determinants, mimeo, AERC, Nairobi.

Ndung'u, N.S. (2000), "The Exchange Rate and the Interest Rate Differential. A Monetary and Fiscal Policy dilemma", KIPPRA Discussion Paper No. 1, Nairobi.

Ndung'u, N.S., Ngugi, R.W. (2000), "Banking Sector Interest Rate Spread in Kenya" KIPPRA Discussion Paper No. 5, Nairobi.

Ng'eno, N.K., Nyangito, H.O., Ikiara, M.M., Ronge, E.E., Nyamunga, J., (2001), "Regional Integration Study of East Africa: The Case of Kenya", Draft Interim Report, August.

Nyangito, H.O. (2001a), Policy and Legal Framework for the Tea Subsector and the Impact of Liberalization in Kenya", KIPPRA Policy Paper No. 1, 2001.

Nyangito, H.O. (2001b), "Policy and Legal Framework for the Coffee Subsector and the Impact of Liberalization in Kenya", KIPPOA Policy Paper No. 2, Nairobi.

O'Brien, E.S., Ryan, T.C.I. (2001), Kenya, in *Aid and Reform in Africa*, Eds. Devarajan, S., Dollar, D., Holmgren, T., World Bank, Washington DC.

Oyejide, A., Njinkeu, D. (2001), African Preparation for Trade Negotiations in the Context of the ACP-EU Cotonou Partnership Agreement, Paper prepared for the 4th ordinary session if the Conference of Ministers of Trade of the OAU (AEC, Abuja 19-23 September

Rajaram, A., Yeasts, A., Ng'eno, N., Musonda, F., Mwau, G. (1999), Putting the Horse Before the Cart: On the Appropriate Transition to an East African Customs Union, A report prepared for the EAC Secretariat, Final Report, April.

Republic of Kenya, (2001), *Economic Survey 2001*, Central Bureau of Statistics, Ministry of Finance and Planning.

Rodrik, D. (1999), "Making Openness Work", Overseas Development Institute, London.

Ronge, E. (2001), "Export Boom Regimes and the Debt Accumulation Process: The Kenyan Experience", Paper presented at the debt relief conference at WIDER, Helsinki 17-18 August, KIPPRA, Nairobi.

Ronge, E..E., Nyangito, H.O. (2000), "A Review of Kenya's Current Industrialization Policy", KIPPRA Discussion Paper No. 3, Nairobi.

Sachs, J. (2000), "Tropical Underdevelopment", Paper presented at the Economic History Association's 60th Annual meeting.

Subramanian, A. et al (2000), "Trade and Trade Policies in Eastern and Southern Africa", IMF Occasional Papers no 196, Washington DC.

Subramanian, A., Tamirisa, N. (2001), "Africa's Trade Revisited", IMF Working Paper no 01/33, Washington DC.

Söderbom, M. (2001), Constraints and Opportunities in Kenyan Manufacturing: Report on the Kenyan Manufacturing Enterprise Survey 2000, CSAE, Oxford University, mimeo.

The Nation (2001), December 1, (Nairobi).

Tsikata, Y. M., (1999), "Southern Africa: Trade, Liberalization and Implications for a Free trade Area", TIPS 1999 Annual Forum at Glenburn Lodge, Muldersdrift, 19-22 September.

The Nation, (2001), May 30.

Tostenson, A. (2001), Supporting East African Integration. Assessing the potential for Norwegian support to the East African Community, Chr. Michelsen Institute, Bergen.

UNIDO, International Yearbook of Industrial Statistics, various issues.

Venables, A. (1999), "Integration Agreements: A Force for Convergence or Divergence", Policy Research Working Paper No. 2260, World Bank, Washington DC.

Viner, J. (1950), *The Customs Union Issue*, Carnegie Endowment for International Peace, Washington DC.

Wagacha, M. (2000), "Analysis of Liberalization of the Trade and Exchange Regime in Kenya Since 1980", Discussion Paper No. 023/2000, Institute of Policy Analysis & Research, Nairobi.

Wagacha, M. (2001), "Interest Rates under a Treasury Bill Regime. Macroeconomic and Financial Implications", Discussion Paper No. 029/2001, Institute of Policy Analysis & Research, Nairobi

Wei, Shang-Jin (2000), "Natural Openness and Good Governance", mimeo, World Bank, Washington DC.

World Bank (2000a), Kenya. Country Assistance Evaluation, November 20, Washington DC.

World Bank (2000b), *Can Africa Claim the 21st Century?*, Washington DC.

World Bank (2000c), *Trade Blocs*, Oxford University Press, New York.

Country Economic Reports

Nicaragua 1995: A New Door Might be Opened	1996:1
Tanzania 1995: Ten Years of Economic Reform	1996:2
Laos 1995: Labour Market Adjustment and Human Resource Mobilization	1996:3
Lesotho 1995; Lesothoɔs Strategic Economic Options: Towards Closer Integration	1996:4
Guinea Bissau 1995: Missing the Beat	1996:5
Vietnam 1995: Sustainable Growth and the Issue of Capital	1996:6
Kenya 1995: Hesitant but Back on Track	1996:7
Zimbabwe 1995: Domestic and External Debt in Zimbabwe	1996:8
Vietnam 1996: Approaching The Next Stage of Reforms	1996:9
Tanzania 1996: The Impact of Balance of Payment Support	1996:10
Angola 1996: Hyper-Inflation, Confusion and Political Crisis	1996:11
Eritrea 1996: A Peaceful Struggle for Sustained Independence	1996:12
Laos 1996: One Step Back or One Step to the Side?	1996:13
Kenya 1996: Economic Reforms and Impediments to Growth	1996:14
Uganda 1996: Security, Credibility and Market Development	1997:1
Guinea-Bissau 1996: Looking for New Development Paths	1997:2
The South African Economy in 1996: From Reconstruction and Development to Growth, Employment and Redistribution	1997:3
Vietnam 1997: Managing the Transition to Free Trade: Vietnamese Trade Policy for the 21st Century	1997:4
Ethiopia 1996: Government legitimacy, Aid and Sustainable Development	1997:5
Vietnam 1997:2 Small, Medium, or Large?	1997:6
Tanzania 1997 The Urge to Merge: The Revival of East African Cooperation	1997:7
Laos 1997: The Poor and the Rich	1997:8

Country Economic Reports

Zimbabwe: Structural Adjustment and Productivity: A Study of the Manufacturing and Agricultural Sectors	1998:1
Uganda: Towards Results-Oriented Economic Management?	1998:2
Ethiopia: Regional and Business Sector Challenges	1998:3
Kenya: From Chaos to Prosperity?	1998:4
Angola: More Oil and Financial Problems	1998:5
Guinea-Bissau: Going into High Gear	1998:6
Cape Verde: The Economics of Mudança	1998:7
Vietnam and the Asian Crisis: Causes, consequences and cures	1998:8
Cambodia: The Challenge of Productive Employment Creation	1998:9
Sri Lanka: Institutions, Economic Policies and Economic Growth	1999:1
Tanzania: Cost-Sharing in Development Projects Principles, Practice and Problem	1999:2
Mozambique in a Post-Washington Consensus Perspective	1999:3
Moçambique: Numa Perspectiva do Consenso Pós-Washington	1999:3
Kenya:Economic Reorms with Labour Market Rigidities; The Kenya Experience	1999:4
Uganda: Uganda at the End of the 1990s: A Medium-Term Assessment	1999:5
Zimbabwe:Employment, Labour Market Reform and Trade Liberalisation Zimbabwe 1990-1997	1999:6

Country Economic Reports

Mozambique: Dutch Disease in Mozambique?	2000:1
Rwanda: rwanda Looking Ahead: Reconciliation, reform and Regional Stability	2000:2
Sri Lanka: Dispersed Industrial Pattern for Reducing Poverty and Regional Inequality in Sri Lanka	2000:3
Tanzania: Tanzania 1999: Obstacles to Private Sector Growth	2000:4
Eritrea: Eritrea 1999: A bleeding country that never kneels down	2000:5
Moçambique: Doença Holandesa Moçambique?	2000:6
Laos: Emerging Rice Market in Laos?	2000:7
Cape Verde: Putting New Life Into Reform Policy, And Then...	2000:8
Cabo Verde: Dando Vida Nova à Política de Reformas, e depois.....	2000:9
Zimbabwe: Maize Markets in Zimbabwe	2000:10

Country Economic Reports

Cambodia 1999-2000 Land, Labour and rural Livelihood in Focus	2001:1
Poverty in Mozambique	2001:2
Tanzania 2000 Growth, Multilateral Debt Relief and Program Aid	2001:3
Pobreza em Moçambique	2001:4
The Kenyan Interim Poverty Reduction Stragety: A Policy Framework for Growth and Poverty Reduction?	2001:5
Step by Step: Economic Reform and Renovation in Vietnam before the 9th Party Congress	2001:6
The West Bank and Gaza Strip A case of unfulfilled potential	2001:7
Angola 2000: Coming out of the Woods?	2001:8
The Poverty Reduction Strategy Process in Mozambique	2001:9
O Processo de Estratégia de Redução do Pobreza, PRSP, em Moçssmbique	2001:10
Towards Peac, Growth and Poverty Reduction in Rwanda	2001:11
Burkina Faso, Out of the Poverty Trap?	2001:12
Mali, Coping with Adversity	2001:13

Country Economic Reports

Kenya and the East African Community: A report for Sida

2002:1

SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
S-105 25 Stockholm, Sweden
Tel: +46 (0)8-698 50 00. Fax: +46 (0)8-20 88 64
Homepage: http://www.sida.se

ISBN: 91-586-8550-2
ISSN: 1404-031X