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1. Overview of the East African Community and Region.

The East African Community (EAC) came into force on 7 July 2000 following its ratification by the original founding thee partner states – Kenya, Tanzania and Uganda. Rwanda and Burundi entered the EAC seven years later on 1 July 2007, and on 2 March 2016 South Sudan was admitted as the sixth member of the regional bloc. The EAC objective is to aim at widening and deepening co-operation among the partner states in political, economic and social fields for their mutual benefit.

This paper will focus on the five “established” EAC partner states, in order to assess the overall impact of the EAC on boosting structural transformation, intra-EAC trade, regional value chains and industrial development within the region. Where possible, South Sudan is also considered, and some comparisons are also made with Ethiopia, a country that is not part of the EAC but which trades significantly with the bloc and which has made significant strides over the last decade to transform its economy.

1.1. EAC: history, features and current status.

The EAC Customs Union (CU) became operational in 2005. The CU initially covered Kenya, Tanzania and Uganda with Rwanda and Burundi joining in 2008 and applying its instruments in 2009. The Customs Union intends to liberalise intra-EAC trade and promote efficiency in production through facilitating the free movement of goods within the community. The EAC Common Market (CM) entered into force in 2010 following the ratification of all five partner states. The CM intends to achieve the free movement of services, labour and capital, in addition to the free movement of goods.

The key aspects of the Customs Union are:

1. A Common External Tariff (CET) on imports from third countries;
2. Duty-free trade between the partner states; and
3. Common customs procedures.

Significant progress has been made in the implementation of the CU. Trade between partner states is now free from import duties. In 2010, member states eliminated internal tariffs and set a three-band Common External Tariff (CET) shown in Table X. The maximum tariff under the CET is 25 percent, although the EAC allows higher tariffs for a list of sensitive products, which are analysed in Section 3.3:

Table X: EAC three-band CET rates

<table>
<thead>
<tr>
<th>Good</th>
<th>Common External Tariff</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw materials, capital goods, agricultural inputs, certain medicines and certain medical equipment etc.</td>
<td>0%</td>
</tr>
<tr>
<td>Intermediate goods and other essential industrial inputs</td>
<td>10%</td>
</tr>
<tr>
<td>Finished products</td>
<td>25% (maximum)</td>
</tr>
</tbody>
</table>

Source: EAC website
The CET structure contrasts with former maxima which were 35 percent for Kenya of, 40 percent for Tanzania and 15 percent for Uganda, implying a reduced level of protection with respect to the rest of the world for Kenya and Tanzania but increased protection, and therefore higher import costs, for Uganda.

The EAC Common Market became formally operational in July 2015 following a 5-year transition period, but much is still to be desired in terms of implementation, particularly in the harmonisation of national laws. In 2014, the EAC launched a new scorecard to assess progress towards developing the EAC Common Market, and to foster peer learning and the sharing of best practices across the region. The scorecard identified at least 63 non-conforming measures in the trade of services, 51 non-tariff barriers affecting trade in goods, whilst only 2 out of the 20 capital operations covered by the CM Protocol were free of restrictions in all partner states.¹

The East African Community Monetary Union (EAMU) represents the next stage of integration to maximise the benefits of the single market. The EAMU Protocol was ratified by all five partner states in early 2015. It sets out the process and legal and institutional framework for the establishment of a single currency, including macroeconomic convergence criteria. The EAC Partner States are currently developing Medium Term Convergence Programmes to provide a baseline to track their progress against the convergence criteria. If at least 3 Partner States attain and maintain the criteria by 2021, the single currency will be launched in 2022.

If introduced as planned, the EAMU would eliminate the need for businesses operating in the EAC to work in different currencies, and with no exchange rate risk and transaction costs, intra-EAC trade would be encouraged. Increased price transparency would make it easier for EAC firms to find new suppliers or logistics companies offering better services or lower costs, providing an impetus to the development of regional value chains and cross-border industries. The EAMU Protocol also calls for EAC partner states to integrate banking, payments and financial systems, which would further reduce the costs of regional trade transactions. A positive example in this direction is the West African Monetary Union (UEMOA), which has more intraregional trade than any other region in Africa.²

Based on this linear progress towards full economic union, the EAC is often considered the most advanced and ambitious Regional Economic Community (REC) in Africa. Quantitative exercises by the International Growth Centre³ find significant economic and security gains from the EAC. Historical gravity results indicate an increase in bilateral trade between two partner states of 213 percent compared to a situation without the EAC. This trade promoting impact is much larger than the impact of COMESA (80 percent) or SADC (110 percent) on their respective members. The EAC trade promoting impact is even larger (additional increase of 42 percent) after 2010 when the CU became fully operational. Encouragingly, estimates also indicate

² Currency Unions in Africa Ever Closser (Economist, Dec 7th 2013)
significant economic gains under the scenario of effective implementation of the Common Market, which are expected to reach the same magnitude as the historical gains generated by the implementation of the EAC. On the other hand, the paper finds the potential benefits of adopting a common currency in the EAC to be small as it would take away the flexibility for countries to use exchange rates to absorb shocks.

1.2. East Africa has a more diversified economy than the continent’s average and has promising growth prospects.

All EAC partner states are classified as low income countries, excluding Kenya which recently transitioned into lower middle income status. Four of the EAC partner states (Burundi, Rwanda, South Sudan and Uganda) are landlocked making cross-border ties and initiatives even more important for the region. Table X below provides a snapshot of key economic and social indicators for the region.

**Table X:** Key economic and social indicators for the EAC partner states and Ethiopia*

<table>
<thead>
<tr>
<th></th>
<th>Kenya</th>
<th>South Sudan</th>
<th>Tanzania</th>
<th>Rwanda</th>
<th>Uganda</th>
<th>Ethiopia</th>
<th>Burundi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poverty headcount (%) of population</td>
<td>45.9%</td>
<td>50.6%</td>
<td>28.2%</td>
<td>44.9%</td>
<td>19.7%</td>
<td>29.6%</td>
<td>66.9%</td>
</tr>
<tr>
<td>Life expectancy at birth (years)</td>
<td>61</td>
<td>55</td>
<td>64</td>
<td>63</td>
<td>58</td>
<td>63</td>
<td>56</td>
</tr>
<tr>
<td>GNI p.c. Atlas method (current USD)</td>
<td>1,290</td>
<td>970</td>
<td>920</td>
<td>700</td>
<td>670</td>
<td>550</td>
<td>270</td>
</tr>
<tr>
<td>GDP growth</td>
<td>5.3%</td>
<td>3.4%</td>
<td>7.0%</td>
<td>7.0%</td>
<td>4.5%</td>
<td>9.9%</td>
<td>4.7%</td>
</tr>
</tbody>
</table>

* Poverty headcount data use National poverty lines and were initially sourced from National Household Surveys which refer to 2005 for Kenya, 2009 for South Sudan, 2011 for Tanzania, 2010 for Rwanda, 2012 for Uganda, 2010 for Ethiopia and 2006 for Burundi. Life expectancy data is for 2013. All other data is for 2014.

During the past decade, economic growth in the five established EAC partners was consistently strong, and considerably above that experienced in previous decades. This is clear from Figure X. This improved performance was driven by the maintenance of macroeconomic stability, increased peace and stability, enhanced regional integration and a more conducive environment for private sector growth.

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In 2015, East Africa was the continent’s fastest growing region, growing at 6.5 percent compared to 3.7 percent for Africa as a whole. According to the 2016 African Economic Outlook, this high growth path is expected to continue. The region benefits from large and increasing Foreign Direct Investment (FDI) inflows. Growth in East African countries is largely driven by services and construction (reflecting scaled up public investment programmes), but also by industry and agriculture. East African countries are economically more diverse than the average African country - as of 2014 no EAC country was a net exporter of fossil fuels or food commodities. Although the region is still largely reliant on the production and export of relatively low value primary products such as coffee and tea, its level of economic diversity is increasing. Success stories from the EAC and Ethiopia cover sectors as diverse as cut flowers, financial services, information technology and tourism. Tanzania’s economy, for example, has been propelled, in recent years, by services, telecom, banking and construction.

The region has however faced some difficulties over the last year, largely due to external factors, such as the global strengthening of the US Dollar and the slowdown in China. The depreciation of East African currencies vis-à-vis the US Dollar increased both the costs of debt servicing and imports. Due to the high import content of domestic consumption and production in the region, this fed into higher domestic inflation leading central banks to tighten monetary

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6 D. Pilling, Tanzania’s move to market economy inspires quiet success story. Financial Times, 13 July 2016. [https://next.ft.com/content/e9a6c630-41c7-11e6-9b66-0712b3873ae1](https://next.ft.com/content/e9a6c630-41c7-11e6-9b66-0712b3873ae1)

7 K., Manson, “East Africa set to grow despite endemic problems”, Financial Times, 5 October 2015. [http://www.ft.com/intl/cms/s/0/e79071ce-5e2f-11e5-a28b-50226830d644.html#axzz3qK96KF00](http://www.ft.com/intl/cms/s/0/e79071ce-5e2f-11e5-a28b-50226830d644.html#axzz3qK96KF00)
policy. This has increased borrowing costs for both the private and public sector which has already started to hamper economic activity. Over the past year, Uganda, Tanzania and Burundi also faced heightened uncertainty and increased market speculation surrounding their election cycles.

The region’s development prospects have been enhanced by recent natural resource discoveries. Tanzania recently discovered massive gas reserves that are being explored by international companies, and Uganda and Kenya are developing their newfound oil sectors. Exploration is still ongoing so the confirmation of more commercially viable deposits is possible. Uganda’s oil sector is expected to contribute approximately 7 percent of GDP in the mid-2020s and be the country’s main investment magnet in the coming years. The country is planning to build an oil refinery to add value before exporting, and various oil-related infrastructures to facilitate the export of oil within the region – enhanced road networks, the laying of new pipelines and the building of a new airport in Hoima. The inflow of foreign exchange from natural resource exports however runs the risk of appreciating East African currencies and reducing the competitiveness of the region’s other tradeable goods. These risks can be mitigated through sounds macroeconomic management, increased economic diversification and fiscal rules attached to resource revenue management.

2. Objectives

The key objectives of this paper are to assess the impact of the EAC customs union and regional integration efforts more broadly on:

- Volume and type of intra-EAC trade;
- Development of Regional Value Chains (RVCs), in particular in smokestack-free industries; and
- Development of industries that can compete internationally.

After providing an analysis of current trade flows and regional value chains in the region, the paper presents the case study of the dairy industry in Uganda, which has expanded significantly over the last decade, partially thanks to export opportunities within the EAC.

The chapter focuses on the CU as an instrument, since it has been in full operation for over five years, whereas implementation of the CM has been slow and the EAMU is yet to be established.

3. EAC performance: pre and post the Customs Union

3.1 Exports and imports

Intra-EAC exports have registered a considerable upward trend since the implementation of the Customs Union in 2005. They increased from USD 912 million in 2004 to USD 2,509 million in 2014 (excluding South Sudan). Kenya exports the most to the EAC, followed by Uganda and Tanzania. Rwanda and Burundi have also seen their exports to EAC partner states increase, but this has been from a much lower base (see Figure X).

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**Figure X:** Exports and imports within the EAC and globally over time, by partner state (USD thousand).

The value of total intra-EAC imports is also on an upward trend, having increased from USD 1,223 million in 2005 to USD 2,875 million in 2014 (see Figure X above). Imports are however less integrated within the EAC than exports. In 2014 intra-EAC exports as a share of total EAC exports was 18 percent, whereas intra-EAC imports as a share of total EAC imports was just 7 percent. This is less than the figure of 10 percent for 2005, reflecting the EAC’s growing reliance on imports from the rest of the world. The region’s growing demand for imports is driven by the EAC countries’ structural transformation agendas which require imported industrial goods, construction materials and equipment. Most of this demand is met by external trading partners due to the relatively low technological base of EAC partner states. Uganda, Rwanda and Tanzania import the most from within the EAC, while Kenya, the group’s most advanced economy, relies more on imports from the rest of the world.

*Source: UNCTAD STAT accessed on 18 June 2016.*
As shown in Figure X, Kenya, the strongest economy in the group, decreased its exports to the EAC as a share of total exports after joining the CU. This reflects the significant expansion of Kenya’s trade with other African countries outside of the EAC. On the other hand, Uganda is the country which has expanded its exports to the EAC as a share of its total exports the most after joining the CU. On average, intra-EAC exports as a share of total EAC exports remains largely unchanged from its 2004 level, prior to the CU.

Figure X: Exports shares before and after accession to the Custom Union, by partner state (%)
suggesting that EAC countries have competitive import opportunities for manufactured goods within the area, although they still import the majority of manufactures from outside.

**Figure X:** Trade within the EAC and with the rest of the world, 2014, by product

<table>
<thead>
<tr>
<th>EAC exports to rest of world</th>
<th>EAC internal exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chemical products, 3%</td>
<td>Other manufactured goods, 48%</td>
</tr>
<tr>
<td>Machinery and transport equipment, 4%</td>
<td>All food items, 11%</td>
</tr>
<tr>
<td>Fuels, 4%</td>
<td>Ores and metals, 10%</td>
</tr>
<tr>
<td>Pearls, precious stones and non-monetary gold, 9%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EAC imports from rest of world</th>
<th>EAC internal imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery and transport equipment, 28%</td>
<td>Other manufactured goods, 24%</td>
</tr>
<tr>
<td>Chemical products, 13%</td>
<td>All food items, 1%</td>
</tr>
<tr>
<td>Fuels, 23%</td>
<td>Ores and metals, 1%</td>
</tr>
<tr>
<td>Pearls, precious stones and non-monetary gold, 0%</td>
<td></td>
</tr>
</tbody>
</table>

Source: authors’ analysis of UNCTAD data extracted on 14 July 2016.

As shown in **Figure X**, the EAC has diversified its trade partners over time and is importing increasingly from Asia, particularly China and India. China and India represented 21 percent and 20 percent respectively of EAC’s imports in 2014, compared to only 7 percent for both countries in 2005. The role of traditional trade partners such as the EU and the US has conversely reduced. The EAC imported 21 percent and 7 percent of her total imports from the EU and the US respectively in 2005, compared to only 11 percent and 5 percent in 2014. The
The majority of the EAC’s imports originate from industrialised countries with developed infrastructure, reflecting the nature of the goods imported which are largely industrial goods. Manufactured goods represent the largest share of the EAC’s imports (see Figure X).

**Figure X:** EAC imports by origin (% of total EAC imports)

Source: Authors’ calculations based on UNCTAD STAT

### 3.2 Sensitive items in the EAC: tariffs and internal value chains

The EAC has a list of sensitive items that have higher tariff lines than the maximum CET rate of 25 percent. While these are maximum rates, actual applied tariffs have been lower and varied considerably\(^{10}\). Higher protection for these items was justified on the grounds of food security, poverty reduction and the protection of vulnerable domestic producers. 59 tariff lines are designated as EAC sensitive products, of which 31 are agricultural lines (at HS8 level). Table X shows the main categories of goods categorised as sensitive. The names of the product categories have been simplified for ease of reading. Fully detailed product names can be found in the link provided below the table.

Sugar has the highest protection, with a tariff rate of 100 percent for some types of sugar products. Rice is also heavily protected, with a 75 percent tariff rate, followed by wheat, meslin flour and dairy products at 60 percent.

**Table X:** list of EAC tariffs for sensitive items.

<table>
<thead>
<tr>
<th>Items</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cane or beet sugar and chemically pure sucrose, in solid form.</td>
<td>35% for juggery. 100% or USD 200/MT for other, whichever is higher for industrial sugar and other types</td>
</tr>
</tbody>
</table>

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Table X below shows the corresponding exports of sensitive products for each of the EAC countries, where data allows. Shaded cells are those for which the relevant country exports over USD 5 million of the sensitive product in question. As can be seen, in 2014, Uganda and Tanzania exported the highest number and value of sensitive products. Tobacco, maize and sugar were the most widely exported sensitive products in the region, with total EAC exports recording USD 499,331, USD 141,080 and USD 129,439 respectively. The value of exports of sensitive products by EAC partner states is not small, implying that the sensitive tariff list is having the desired effect of protecting EAC firms from possibly harmful competition. The sensitive product share in the value of exports is 12 percent for Tanzania, 11 percent for Uganda, 6 percent for Rwanda and Burundi, although only 2 percent for Kenya. The Ugandan dairy industry, on which the chapter’s case study focuses, has benefited significantly from this protection.
<table>
<thead>
<tr>
<th>Sensitive product</th>
<th>Rwanda</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanzania</th>
<th>Burundi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Articles of cement, concrete or artificial stone</td>
<td>309</td>
<td>735</td>
<td>252</td>
<td>372</td>
<td>-</td>
</tr>
<tr>
<td>Matches, other than pyrotechnic articles of heading 36.04</td>
<td>544</td>
<td>368</td>
<td>1,906</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Various types of woven fabrics of cotton or synthetics</td>
<td>7,176</td>
<td>1,175</td>
<td>711</td>
<td>862</td>
<td>7</td>
</tr>
<tr>
<td>Bed linen, table linen, toilet linen and kitchen linen</td>
<td>121</td>
<td>728</td>
<td>366</td>
<td>15</td>
<td>-</td>
</tr>
<tr>
<td>Track suits, ski suits and swimwear; other garments</td>
<td>4</td>
<td>5</td>
<td>2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Sacks and bags, of a kind used for the packing of goods</td>
<td>22,532</td>
<td>3,386</td>
<td>2,931</td>
<td>537</td>
<td>10</td>
</tr>
<tr>
<td>Primary cells and primary batteries</td>
<td>34</td>
<td>963</td>
<td>1,481</td>
<td>709</td>
<td>1</td>
</tr>
<tr>
<td>Tobacco and manufactured tobacco substitutes</td>
<td>322,943</td>
<td>106,531</td>
<td>66,018</td>
<td>584</td>
<td>3,255</td>
</tr>
</tbody>
</table>

Source: ECA analysis of ITC data.

**Table X** looks at which of the products deemed as sensitive and protected by higher tariff lines appear within the top five exports of EAC partner states to one another. It appears that substantial value chains have developed within the EAC in many of the sectors protected by higher external tariffs, notably in cement, maize, unmanufactured tobacco, textiles, rice, sugar and dairy. For example, in 2014 rice made up 13% of Tanzania’s exports to Uganda and construction materials including cement made up 12% of Kenya’s exports to Uganda. Apart from tobacco, all products that are subject to sensitive tariffs represent a larger share of intra-EAC exports than of exports to the rest of the world.

Table X: Trade in sensitive products within the EAC considering only the top five exports for each trading partner (share of a partner states exports to the trading partner, 2014).

<table>
<thead>
<tr>
<th>Sensitive product</th>
<th>Rwanda</th>
<th>Kenya</th>
<th>Uganda</th>
<th>Tanzania</th>
<th>Burundi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rice</td>
<td>Tanzania (2%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction materials including cement</td>
<td>Burundi (7%)</td>
<td>Uganda (12%)</td>
<td>Rwanda (29%)</td>
<td>Rwanda (11%)</td>
<td>Burundi (12%)</td>
</tr>
<tr>
<td>Sugar</td>
<td></td>
<td></td>
<td></td>
<td>Rwanda (3%)</td>
<td></td>
</tr>
<tr>
<td>Maize</td>
<td></td>
<td></td>
<td></td>
<td>Tanzania (8%)</td>
<td>Kenya (21%)</td>
</tr>
<tr>
<td>Tobacco (manufactured)</td>
<td>Rwanda (2%)</td>
<td>Uganda (2%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Milk, cream and milk products</td>
<td></td>
<td></td>
<td></td>
<td>Kenya (7%)</td>
<td></td>
</tr>
<tr>
<td>Textiles</td>
<td></td>
<td></td>
<td></td>
<td>Kenya (21%)</td>
<td>Uganda (14%)</td>
</tr>
</tbody>
</table>


Although it is clear that the existence of sensitive tariff lines under the CU has helped to boost intra-EAC trade in sensitive products - due to the high cost of importing such products from
outside the region - partner states are not equally seizing this opportunity (see Figure X). 30 percent and 23 percent of intra-EAC exports from Tanzania and Uganda respectively are of sensitive products. The other three partner states export a much lower share of sensitive products within the region.

*Source: ECA calculations based on UNCTAD STAT*

### 3.3 Trade in intermediates

Intermediate goods are non-finished goods traded to be further processed before final use, and are therefore often referred to as production inputs. Intermediate inputs account for the bulk of international trade. In 2014 (using 2013 data for Kenya), the EAC imported only 6 percent of its intermediates from within the EAC, compared to 14 percent for consumption goods. The EAC imported USD 26,813 million worth of intermediates from outside the region and only USD 1,594 million from within. Imports of intermediates within the EAC are particularly weak in fuels and lubricants (despite Rwanda importing 100 percent of its primary fuels and lubricants from the EAC) and in parts and accessories of capital goods and transport equipment.

This seems to show that industries in the region source their intermediates from outside. In 2014 57 percent of the EAC’s imported intermediates from outside the region were industrial-related intermediates (industrial supplies, parts and accessories of capital goods, transport equipment and other industrial). Although value chains of basic products such as dairy and textiles are well developed within the region, the EAC does not seem to have fostered value chains of industrial inputs.

There are however some sectors in which intra-EAC imports of intermediates are high (see Figure X). For example, 34 percent of primary industrial supply products such as cement are

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1 Economic Report on Africa 2015: Industrializing Through Trade, ECA
sourced within the EAC. As expected, the less developed EAC partner states, Burundi and Rwanda, import larger shares of intermediate inputs from within the region and export less intermediates to the EAC. Kenya is the leading exporter of intermediates within the EAC (44 percent) followed by Uganda (22 percent) and Tanzania (21 percent).

**Figure X: Intra-EAC imports of intermediate goods as a share of total imports of intermediate goods, by partner state**

![Graph showing intra-EAC imports of intermediate goods as a share of total imports of intermediate goods, by partner state.]

*Source: Authors’ calculations based on UNComtrade data*

### 3.4 Non-Tariff Barriers within the EAC

Like in the rest of Africa, Non-Tariff Barriers (NTBs) are huge obstacles to trade across East Africa. Prominent NTBs include:

- **Transport costs.** These make up, for example, 50-75 percent of retail prices in Rwanda and Uganda. The Economist estimates that shipping a car from China to Tanzania on the
Indian Ocean costs USD 4,000, whereas transporting it from Tanzania to Uganda can cost USD 5,000.\(^\text{12}\)

- **Bureaucracy.** The average time taken to prepare documents for exporting and importing is 25 percent higher in African countries than in the rest of the world. Custom procedures are also 30 percent more expensive.\(^\text{13}\) The International Trade Centres’s (ITC) recent NTM surveys find administrative burdens in Tanzania to be a particular challenge for firms. 88.8 percent of firms covered report time delays and 63.4 percent report complex clearance mechanisms.\(^\text{14}\)

- **Corruption.** International Transparency’s 2011 survey of East Africa’s transport corridors uncovered significant levels of bribery, usually as a result of unnecessary delays (e.g. numerous documentation, slow pace of services, poor understanding of clearing procedures and high tax levels). Tanzania took the highest amount of bribes (USD 12,640) in 2011 and these bribery costs constituted about 18.6 percent of the total value of goods transported.\(^\text{15}\)

- **Expensive settlement of payments.** In 2012, 42 percent of settlements within Africa involved banks outside of Africa. This figure was only 2 percent in West and Central Africa, where countries share common currencies, clearing and settlement infrastructures\(^\text{16}\). The EAC however recently introduced a regional payments platform (discussed below in more detail).

The average costs in ad-valorem equivalent for EAC countries to trade within the region dropped from 136.5 percent in 2004 to 118.8 percent in 2013, but remain high (see Figure X). Costs associated with border crossings in the EAC are one of the main NTBs. All of the five EAC countries rank among the worst 35 percent of the 189 economies covered by the 2016 World Bank Doing Business indicator on the ease of trading across borders.\(^\text{17}\) According to ITC’s recent survey on NTMs, over 70 percent of the firms’ surveyed in Kenya, Rwanda and Tanzania reported to be affected by burdensome NTMs. These figures indicate the need to simplify and reduce the costs of customs procedures.

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\(^\text{13}\) ECA calculations based on ESCAP World Bank International Trade Costs Statistics


\(^\text{17}\) This indicator reflects the time and monetary costs of documentary and border compliance. Burundi, Kenya, Rwanda, Tanzania and Uganda rank 154\(^\text{th}\), 131\(^\text{st}\), 156\(^\text{th}\), 180\(^\text{th}\) and 128\(^\text{th}\) respectively, out of the 189 economies covered.
The elimination of NTBs is crucial for the EAC to increase its trade competitiveness and maximize the benefits from its free trade area. EAC partner states have therefore taken steps to reduce the non-tariff costs and other impediments to regional trade, including the implementation of:

- **One Stop Border Posts (OSBPs)** and the strengthening of Integrated Border Management under the East African Trade and Transport Facilitation Project (EATTFP) should significantly reduce time costs. Traders will be able to clear all formalities at just one stop on either side of the EAC borders.

- **The Single East African Tourist Visa**, launched in 2014, enhances the movement of people within the EAC for tourism. Other EAC members plan to join the single tourist visa. Kenya, Rwanda and Uganda have also agreed to allow nationals of these three countries to enter their territories with only their national ID card. This allows businesses to effortlessly send someone from Nairobi to Kigali for a meeting to agree a deal and get back the same day.
Joint regional transportation infrastructure projects can reduce transport costs and encourage intra-regional trade and business within the EAC. Kenya has made progress on the first phase of the standard-gauge railway project that will connect Kenya, Uganda, Rwanda and South Sudan.\(^\text{18}\) Construction of the 609 km line began in 2012 and is expected to be completed in 2018.

Joint energy infrastructure projects can ensure modern energy sources for business and industries and encourage regional value chains. For example, the construction of a heated oil pipeline from Uganda to the Indian Ocean, serving Kenya, South Sudan and Uganda is expected to be completed in 2020.\(^\text{19}\)

The East African Payment System (EAPS), launched in 2013, has helped to integrate money and capital markets in the EAC economies. The system allows traders to make or receive cross-border payments seamlessly in real time in their respective local currency, reducing the costs and time spent on cross-border transactions in the region.

The EAC has an ambitious agenda for the elimination of remaining NTBs to trade and publishes a quarterly report of NTBs in the region \(^\text{20}\). In December 2014, the report classified 18 NTBs as “unresolved”, 4 as “new”, and 78 as “resolved”. As shown in Figure X below, the vast majority of resolved as well as of unresolved NTBs in December 2014 were “procedural problems”.

**Figure X**: resolved and unresolved NTBs by category, December 2014.

![Resolved NTBs and Unresolved NTBs](image)

Source: EAC, NTBs Volume 8, December 2014.

Table X provides the definitions applied by the EAC to each type of NTB. Notably, in December 2014, there were no remaining NTBs under “government participation in trade and restrictive


\(^\text{20}\) The EAC defines NTBs as “quantitative restrictions and specific limitations that act as obstacles to trade”. 
practices tolerated by government” or “Sanitary and Phytosanitary Measures”, and all NTBs falling under the category “charges on imports” had been resolved.

Table X: EAC definitions of NTB categories.

<table>
<thead>
<tr>
<th>NTB category</th>
<th>EAC definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other (procedural problems)</td>
<td>Arbitrariness, discriminations, costly procedures, lack of information on procedures or on changes, requirement for complex or a wide variety of charges and documentation.</td>
</tr>
<tr>
<td>Customs and administrative entry procedures</td>
<td>Governments imposing antidumping, arbitrary customs classification, misinterpretation of Rules of Origin, import licensing, decree customs surcharges and other charges, international taxes and charges levied on imports and other tariff measures.</td>
</tr>
<tr>
<td>Technical barriers to trade</td>
<td>Restrictive technical regulations and standards not based on international standards, inadequate or unreasonable testing and certification arrangements, disparities in standards, intergovernmental acceptance of testing methods and standards, packaging, labelling and marking.</td>
</tr>
<tr>
<td>Specific limitations</td>
<td>Quantitative restrictions, exchange control, export taxes, quotas, import licensing requirements, proportion restrictions of foreign to domestic goods (local content requirement), minimum import price limits, embargos - non automatic licensing, quotas, prohibitions, quantitative safeguard measures, export-restraint arrangements, other quality control measures.</td>
</tr>
<tr>
<td>Charges on imports</td>
<td>Prior import deposits and subsidies, administrative fees, special supplementary duties, import credit discriminations, variable levies, border taxes.</td>
</tr>
<tr>
<td>Government participation in trade and restrictive practices tolerated by government</td>
<td>Export subsidies, government monopoly in export and import, state trading and preference given to domestic bidders or suppliers, requirements for counter trade, domestic assistance programmes for companies, discriminatory or flawed Government procurement policies.</td>
</tr>
<tr>
<td>Sanitary and Phytosanitary Measures</td>
<td>Sanitary and Phytosanitary Measures, conformity assessment relates to SPS/TBT, special customs formalities not related to SPS/TBT, other technical measures.</td>
</tr>
</tbody>
</table>

Source: EAC, NTBs Volume 8, December 2014.

3.5 Foreign Direct Investment

The EAC Customs Union presents opportunities for firms to locate within the large EAC market and benefit from the single market, particularly through fully liberalised tariffs. This can help to build domestic capacities and stimulate knowledge sharing and the integration of EAC firms into global value chains. Annual FDI inflows into the region increased from USD 680 million in 2004, prior to the CU, to USD 4577 million in 2014. EAC’s FDI inflows as a share of Africa’s total
FDI inflows increased from 3.8 percent to 8.5 percent over the same period. FDI investments have been largely concentrated in Tanzania and Uganda, which received 47 percent and 25 percent of the EAC’s FDI inflows respectively in 2014.

Although FDI in the EAC has significantly increased, foreign investment is still held back by remaining restrictions on the free movement of capital, services, and goods through slow implementation of the EAC Common Market Protocol. Obstacles which particularly impede FDI are legal restrictions on FDI; existence of non-tariff barriers in all member states; discriminatory measures towards foreign investors (taxes, limitations on acquiring or disposing of shares); and non-harmonized FDI and trade laws and regulations among the EAC partner states.21

4. Structural transformation in the EAC

4.1. Building competitive advantages: the EAC Industrialisation Strategy

The EAC countries aim to modernise and industrialise their countries. The mission of the EAC Industrialisation Strategy (2012-2032) is “to create a market-driven, regionally and internationally competitive and balanced industrial sector based on the comparative and competitive advantages of the EAC region”. The strategy aims to achieve the following five targets over the twenty-years to 2032:

- Diversifying the manufacturing base and raising local value-added content of resource-based exports to at least 40 percent;
- Strengthening institutional frameworks and capabilities for industrial policy design and implementation, and effective delivery of support services;

21 Attractiveness of East African Community for Foreign Direct Investment, Penev Slavica and Belgrade Marušić Andreja (2014)
Strengthening Research & Development, Technology and Innovation capabilities to foster structural transformation of the manufacturing sector and industrial upgrading;

Expanding trade in manufacturing by increasing:
- intra-regional manufacturing exports relative to total manufactured imports into the region to at least 25 percent and
- increasing the share of manufactured exports relative to total merchandise exports to at least 60 percent; and

Transforming Micro, Small and Medium Enterprises into viable and sustainable business entities capable of contributing to at least 50 percent of manufacturing GDP up from the 20 percent base rate.

The EAC Industrialisation Strategy identifies six strategic sectors in which the region has potential comparative advantage. These are:

- Iron-ore and other mineral processing
- Fertilisers and agrochemicals
- Pharmaceuticals
- Petro-chemicals and gas processing
- Agro-processing
- Energy and Bio-fuels

This list focusses on industries without smokestacks and looks beyond traditional manufacturing as a means to achieving structural transformation. Inadequate infrastructures, geography and the “late-starter” syndrome currently put EAC countries at a competitive disadvantage in heavy manufacturing relative to other more advanced trading partners. Exploring industries without smokestacks therefore makes sense. The sectors identified are all important for driving productivity improvements, employment creation, value addition and structural change. Although the services sector is not identified explicitly in the EAC Industrialisation Strategy, wide efforts are also being made to grow services such as banking and telecommunications that are important for boosting productivity, trade and development.

The region has already established competitive advantage in mineral and fuels extraction, which made up respectively 10 percent and 4 percent of the region’s exports to the rest of the world in 2014. Within this context, it makes sense for the region to capitalise on these advantages and add value to these products, which are currently exported raw, locally. This is consistent with the ambitions set out in the EAC Industrialisation Strategy to develop iron-ore and mineral processing, petrochemicals and gas processing and energy and bio-fuels. Agro-processing also provides a key growth opportunity given the region’s large exports of food items, which contributed 49 percent of the EAC’s exports to the rest of the world in 2014. For example, Uganda already processes agricultural products such as tea, tobacco, sugar, coffee, cotton, grains, dairy products, and edible oils.

Fertilisers and agrochemicals and pharmaceuticals are starting from lower bases. The pharmaceutical industry in the EAC is currently fragmented with limited local production of generic active ingredients and international pharmaceutical companies exporting pharmaceutical products in the region. Kenya’s pharmaceutical industry has however grown
significantly in recent years and the country plans to tap into the continent’s growing pharmaceutical market in the coming years. The country exported USD 80 million worth of pharmaceutical products in 2014, mainly to Tanzania and Uganda. This compares quite well to USD 325 million of pharmaceutical exports in 2014 from a much more developed country like Egypt. According to a recent McKinsey study “Africa may be the only pharmaceutical market where genuinely high growth is still achievable”, due to increased urbanization and improvements in healthcare capacity and the business environment.\(^\text{22}\)

Fertiliser usage, which would greatly increase agricultural productivity, is currently very low in the EAC region. Agricultural production relies on basic means. In Tanzania, for example, 70 per cent of the land is cultivated by hoe. As in much of Africa, most of the land is dependent on rainfall, not irrigation\(^\text{23}\). Farmers in East Africa are not adequately sensitised about the benefits of using fertilisers and costs for those who do wish to use them remain high. Tanzania however has abundant deposits of natural gas and rock phosphates, which can scale up fertiliser and agro-chemical production in the country.\(^\text{24}\) Yara Tanzania Ltd., a subsidiary of Yara International ASA, established a USD 20 million fertilizer terminal in the port of Dar es Salaam in September 2015. The port will significantly increase Tanzania’s fertilizer production and has the potential to become a regional fertilizer hub, reducing fertilizer costs for EAC countries.\(^\text{25}\)

### 4.2 Sectoral analysis of structural change

Positive structural change requires shifts in the sectoral share of GDP and employment towards more productive and dynamic activities. The composition of output in the EAC and Ethiopia changed markedly over the last two decades (see Figure X). The EAC registered a significant decline in the GDP share of agriculture, hunting, forestry and fishing from an unweighted average of 38.9 percent in 1995 to 32.7 percent in 2014. A decline in the share of agriculture implies gains in productivity, other things equal, given that agriculture tends to have lower value-added than secondary and tertiary sectors. The average manufacturing–agriculture labour productivity ratio for low-income Africa is 2.5.\(^\text{26}\) Given the large difference in output per worker between agriculture and industry and the potential of manufacturing to create more sustainable and high-quality jobs, industrialisation presents a significant opportunity for productivity-enhancing structural change for the continent.\(^\text{27}\)

The majority of the EAC’s decline in the agriculture GDP share however took place in the ten-years prior to the introduction of the EAC Customs Union in 2005. Rwanda was the only

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\(^\text{22}\) Africa: A continent of opportunity for pharma and patients, Tania Holt, Mehdi Lahrichi, and Jorge Santos da Silva, McKinsey & Company (June 2015)

\(^\text{23}\) D., Pilling, Tanzania’s farming blighted by lack of modern infrastructure. Financial Times, 13 July 2016. [https://next.ft.com/content/0280eb8e-41ca-11e6-9b66-0712b3873ae1](https://next.ft.com/content/0280eb8e-41ca-11e6-9b66-0712b3873ae1)

\(^\text{24}\) East African Community Industrialisation Strategy 2012–2032

\(^\text{25}\) [http://yara.com/about/where_we_operate/tanzania.aspx](http://yara.com/about/where_we_operate/tanzania.aspx)

\(^\text{26}\) This means that labour productivity in manufacturing is 2.5 times larger than in agriculture. see Page, 2012 and McMillan and Rodrik, 2013.

country that saw a significant reduction in the share of agriculture, hunting, forestry and fishing post the customs union, declining from 41.3 percent in 2005 to 35.0 percent in 2014. As shown in Figure X below, manufacturing shares remained fairly constant across the EAC following 2005. At the same time, all countries saw growing shares for construction driven by large public investment programmes. The contribution of services to GDP has increased marginally since the introduction of the CU.

**Figure X:** Output by sector for EAC countries and Ethiopia, 1995-2014 (% of GDP)

This minimal change in the compositions of GDP post 2005 indicate limited structural change over the last decade. Structural change is however a long term process which requires fundamental changes to the supply side of the economy. The significant growth of the construction sector in the EAC, from an unweighted average of 5.4 percent in 2005 to 7.9 percent in 2014, reflects the expansion of public investment and infrastructure programmes to enhance connectivity and the productive capacity of economies. This should provide an impetus to positive structural change in the medium term. Moreover, implementation of the Customs Union has been gradual, with supportive interventions such as the implementation of the Common Market and trade facilitation measures moving at a slower pace. Fast tracking such as complementary regional integration efforts would maximize the positive impact of the free trade area on production structures in the EAC. It is also clear from Figure X that significant

Source: Authors’ calculations based on World Bank data, downloaded 14 July 2016.
Structural change had already taken place across East African economies prior to 2005, therefore providing less scope for immediate additional restructuring following the establishment of the CU. **Table X** provides a more detailed breakdown of GDP by sector across countries.

**Table X: Sector contribution to GDP across countries, latest year available (%)**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining and quarrying</td>
<td>0.9</td>
<td>1.9</td>
<td>0.9</td>
<td>4.6</td>
<td>0.7</td>
<td>1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>11.7</td>
<td>5.1</td>
<td>10.6</td>
<td>7.4</td>
<td>10.9</td>
<td>4.2</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
<td>2.2</td>
<td>0.7</td>
<td>2.6</td>
<td>1.3</td>
<td>0.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Construction</td>
<td>5.0</td>
<td>7.5</td>
<td>8.1</td>
<td>9.9</td>
<td>5.0</td>
<td>9.4</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of vehicles, household goods; restaurant and hotels</td>
<td>10.2</td>
<td>15.5</td>
<td>18.1</td>
<td>12.7</td>
<td>7.1</td>
<td>18.7</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>9.9</td>
<td>5.8</td>
<td>6.5</td>
<td>6.8</td>
<td>4.0</td>
<td>4.7</td>
</tr>
<tr>
<td>Finance, real estate and business services</td>
<td>15.8</td>
<td>14.8</td>
<td>11.7</td>
<td>10.2</td>
<td>13.8</td>
<td>9.0</td>
</tr>
<tr>
<td>Public administration and defence</td>
<td>5.4</td>
<td>3.6</td>
<td>3.1</td>
<td>7.6</td>
<td>5.1</td>
<td>4.1</td>
</tr>
<tr>
<td>Other services</td>
<td>9.3</td>
<td>10.1</td>
<td>11.4</td>
<td>5.8</td>
<td>10.6</td>
<td>5.7</td>
</tr>
</tbody>
</table>

*Source: ECA analysis of AEO data 2015.*

The share of the labour force engaged in low productivity agricultural activities in EAC countries remains high, also indicating limited structural change of labour markets. Above 60 percent of the labour force in all EAC countries remains employed in agriculture, with less than 7 percent of the labour force in all EAC countries employed in manufacturing (see **Table X**). In Tanzania, for example, agriculture employs three-quarters of the workforce, yet produces only one-quarter of economic output. It contributes to exports, but much of it in unprocessed form.\(^{28}\) However, despite the majority of the EAC population still working in agriculture, households are beginning to diversify their income streams. For example, in rural areas in Uganda agriculture remains the most important source of income, on average accounting for slightly over half of household income, but non-agricultural household enterprises and wage employment have emerged as important supplementary income sources, accounting for 15 percent and 14 percent of average household income respectively.\(^{29}\)

**Table 1: Employment by sector for EAC countries and Ethiopia (% of total employment)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
<td>1998</td>
<td>92.2</td>
<td>2.2</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>2013</td>
<td>72.7</td>
<td>7.4</td>
</tr>
</tbody>
</table>

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\(^{28}\) D., Pilling, Tanzania’s farming blighted by lack of modern infrastructure. Financial Times, 13 July 2016.

The industrial sector has the potential to contribute significantly to the growth of the East African Community, through creating productive jobs and stimulating other smokestack-free sectors including agro-processing and services such as transport and storage. Regional cooperation should be strengthened to ensure effective policy coordination towards eliminating the binding constraints to firm upgrading and the creation of new productive industries. Manufacturing in the region still faces massive obstacles such as large overheads, expensive borrowing, high costs for imported inputs, skill deficiencies and infrastructure gaps such as energy and transport. These challenges can be reduced through investing in the promotion of FDI; skills creation through enhanced education and vocational training; cross-border infrastructure projects; and improved access to finance. As shown in section 3.1, lower trade costs from enhanced EAC integration will also help to boost the region’s exports of more complex products such as construction material agro-processed goods.

5. Implications of other trade agreements the EAC is engaged in

5.1 EAC trade agreements with the rest of Africa.

Uganda, Burundi, Rwanda and Kenya are members of COMESA. Burundi is also a member of the Economic Community of Central African States, which aims at establishing a Central African Common Market.30 In 2015, the EAC joined the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC) in the Tripartite Free Trade Agreement (TFTA), which brings together 26 African countries, or 58 per cent of the continent’s GDP. Upon entry into force of the agreement the target for trade liberalisation in goods was of 60-85 percent. Negotiations will continue for the remaining tariff lines with an expectation that liberalisation will take place over the next five to eight years. This means that it will take at least this amount of time for the TFTA to match the existing levels of liberalisation in some of the RECs including the EAC.

Also in 2015, the African Union launched the Agenda 2063, reaffirming the continent’s commitment to rebalancing the policy agenda towards the achievement of structural transformation for shared growth, decent jobs and economic opportunities for all. In recognition of the role that intra-African trade can play in accelerating Africa’s structural transformation, in January 2012 the Assembly of the Heads of State and Government of the African Union during its 18th Ordinary Session endorsed an Action Plan for Boosting Intra-African Trade (BIAT) and agreed on a roadmap for the establishment of a Continental Free Trade Area (CFTA) to be operationalized by an indicative date of 2017.

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30 [http://www.eac.int/sectors/trade](http://www.eac.int/sectors/trade)
The BIAT Action Plan contains seven major clusters aimed at addressing the key constraints and challenges of intra-Africa trade, namely: trade policy, trade facilitation, productive capacity, trade-related infrastructure, trade finance, trade information and factor market integration.

The CFTA negotiations were launched by the AU Assembly at the 25th Ordinary Summit of Heads of State and Government on 15 June 2015 in Johannesburg South Africa. Negotiations are scheduled to last until the end of 2017 and shall be conducted in two phases, the first covering trade in goods and trade in services, and the second covering investment, intellectual property rights and competition policy. A continental free trade area shall help to realise the potential to expand and accelerate the dynamism of intra-African trade - including the aim to increase trade among African countries by 50 percent by 2022 - and to resolve the challenges of multiple and overlapping memberships of trade regimes.

Boosting intra-African trade provides an opportunity to enhance product diversification and industrialisation in Africa, including the EAC. The ECA calculate strong positive and real income gains from the elimination of the high tariff barriers on goods across Africa. Estimates indicate that the establishment of the CFTA would boost intra-African trade by USD 34.6 billion (52.3 percent) from 10.2 percent in 2010 to 15.5 percent in 2022, translating into real income gains of 0.2 percent (USD 296.7 billion). Sectoral disaggregation indicates that the CFTA would support Africa’s industrialisation process, with Africa’s exports of agricultural and food products benefiting most. Africa’s export volumes of agricultural and food products would increase by 9.4 per cent (USD 5.0 billion) over the same period. Africa’s exports of industrial products, in particular textiles, wearing apparel and leather products; petroleum coal products; mineral and metal products; and other manufactured products would also increase at the same horizon; with industrial exports increasing by 4.7 percent (US$ 21.1 billion) over the twelve years to 2022.

The potential impact of the CFTA on EAC member countries is large. Although exports are being increasingly integrated into the EAC, this is less the case for imports, which are instead being more integrated into world markets (see Figure X). Most of the region’s imports originate from industrialised countries in Asia and the EU with more developed infrastructure and technologies. Moreover, the levels of trade between the EAC and other African countries remains limited. Figure X shows that the level of trade between the EAC and other African countries is roughly the same as intra-EAC trade, however the internal African market offers about 1,185 million people, whereas the EAC market is only about 163 million people. This of course reflects the achievement of the EAC’s regional integration process and the close proximity of EAC partner states to one another, but it also points to the need for greater

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31 In particular, wheat, cereals, raw sugar (sugar cane and sugar beet), raw milk and dairy products, and other processed food (meat, sugar and other food products). These are products in which African economies have comparative advantage in but sometimes face high protection.


33 Data for 2015 from UNCTAD STAT.
integration within Africa. Tariff protection within Africa averages about 8.7 percent but only 2.5 percent to the rest of the world.

Figure X: EAC exports and imports by destination, 1995-2014

Source: Authors’ calculations based on UNCTAD STAT data

The ECOWAS sub-region has an internal market of about 349 million people, presenting significant export market opportunities for the EAC. West Africa presently relies on extra-African imports of coffee and tea, and the EAC would be well-placed to tap into this market if high tariffs were eliminated through the CFTA and trade facilitation improved. Kenya and Nigeria – which officially became the largest African economy in 2014 – signed trade pacts in

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34 Data for 2015 from UNCTAD STAT.
2014 aimed at deepening trade ties between the two countries. The large size of the continental market – over 1 billion – would provide a supportive environment for enhanced product diversification, industrialization and regional complementarities.

In order to harness these benefits, it is important that the CFTA is fast tracked. The recent shift towards mega-regional trade agreements (MRTAs) is expected to greatly modify trading relationships worldwide. Currently three major MRTAs are envisaged: the 12 nation Trans-Pacific Partnership (TPP), the Trans-Atlantic Trade and Investment Partnership (TTIP) between the United States and the European Union, and the Regional Comprehensive Economic Partnership (RCEP) encompassing 16 Asian economies. According to ongoing research at the ECA, the three MRTAs will result in a loss of market share by African countries in these markets through preference erosion and competitive pressures. The projected decline in Africa’s trade in these regions can only be mitigated if Africa implements the CFTA through its impact on boosting intra-African trade.

The shifting of negotiating international trade agreements to a continental level need not dilute the role of RECs such as the EAC. The EAC will play an important role in facilitating the negotiations and building capacities among its partner states to benefit from the CFTA, and can also assist through supporting regional value chains, promoting regional standards and policies, and developing industrial capacities.

5.2 EAC trade agreements with the rest of the world

Products from EAC countries can access various markets in the developed world through the Generalised System of Preferences (GSP) under the WTO, which offers preferential treatment to a wide range of products originating from developing countries. Burundi, Rwanda, Tanzania and Uganda are covered by the EU’s Everything But Arms initiative, under which all products from Least Developed Countries except arms and ammunitions have preferential access to the EU market. Together with other African countries (excluding North Africa), the EAC Partner States also qualify for duty-free access to the US market under the African Growth and Opportunity Act (AGOA), with the exception of Burundi whose eligibility has been revoked with effect from 01 January 2016 due to political factors.

On 16 October 2014, the EAC finalized the negotiations for a new comprehensive Economic Partnership Agreement (EPA) with the EU, which is expected to be ratified by October 2016. The agreement calls for continued duty-free quota-free (DFQF) access to the EU market for all EAC exports and the partial and gradual asymmetric opening of the EAC market to imports from the EU. The EAC has committed to liberalise the equivalent of 82.6 percent of imports from the EU by value, of which half are already imported duty free under the EAC Customs Union. The remainder will be progressively liberalised within 15 years from the date the EPA

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35 The Continental Free Trade Area: What’s going on? Bridges Africa Vol. 3 No. 9, Ilmari Soininen (October 2014).
36 It should be noted that Kenya, the only non-LDC in the EAC, briefly saw its preferential margins in Europe eroded after negotiators initially failed to meet a deadline for conclusion of the EPA. During this short period Kenya’s exports to the EU were categorised under the Generalised System of Preferences (GSP), which implies tariffs reductions on only about 66 percent of tariff lines.
comes into effect, with 2.9 percent being liberalised within 25 years. Various products are excluded from liberalization: agricultural products, wines and spirits, chemicals, plastics, wood-based paper, textiles and clothing, footwear, ceramic products, glassware, articles of base metal and vehicles.\(^{37}\)

The EAC EPA and other recently agreed EPAs between African countries and the EU have important implications for the EAC’s regional integration and structural transformation prospects. The new EAC EPA provides no improvements in market access for the EAC member states but significantly improves EU access to the African market, at least at the end of the transition period, given the high levels of protection it currently faces. Without further continental liberalization, in some sectors EU-originating goods will be granted more favourable treatment than African products on the EAC market, which instead qualify for CET treatment. This would likely constrain the development of regional value chains and intra-African trade in intermediates.

Modelling exercises at the ECA suggest that new EPAs implementation in both Western Africa and the Eastern and Southern Africa region would see a significant influx of EU exports to African counterparts in almost all sectors, and especially in industry. This would result in a reduction in tariff revenues and intra-African trade. The findings are expected to generally hold for other African countries signing an EPA with the EU, including the EAC, given the relatively similar asymmetry in tariff structures and trade relations.\(^{38}\)

Sequencing trade reforms in such a way that the establishment of the CFTA predates the implementation of the EAC EPA is therefore recommended to ensure that EAC partner states can harness the trade gains from the EPA, whilst avoiding any adverse effects it may have on the region’s integration and industrialization processes. When implemented, EAC countries should also take advantage of the transitional period granted for certain products under the EPA, and build productive capacities and competitive industries, before they fully open to the pressure of more developed EU competitors. The same arguments apply to AGOA’s successor in 2025 which is expected to take a more reciprocal approach to the granting of market access.

### 6 Case studies: smokestack-free industries in the EAC

6.1 The dairy sector: an example of the development of value chains in the EAC

Countries tend to successfully diversify by moving from the products they already produce to other more sophisticated ones that require more productive knowledge.\(^{39}\) Given the EAC’s

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\(^{39}\) The Structure of the Product Space and the Evolution of Comparative Advantage – Hausmann and Klinger (2007).
productive structure and capabilities are currently dominated in agriculture, and to a large extent livestock, the dairy processing sector provides a natural progression and appropriate diversification strategy. Dairy cows are one of the most valuable and profitable assets for East African farming families, and adding value to these assets can help to boost farming incomes and transform livelihoods. Locally produced and consumed dairy products also provide benefits in the form of lower prices compared to expensive imported products. Regional markets for dairy products constitute an important dimension of regional economic integration for EAC partner states, due the importance of the agricultural sector to their economies and its potential to contribute to poverty reduction.

6.1.1 Trends in the EAC dairy sector

As shown in Table X, dairy is indeed an important economic activity across East Africa, which is now the leading milk-producing region in Africa, representing 68 percent of the continent’s milk output.40

### Table X: Dairy sector indicators in the EAC.

<table>
<thead>
<tr>
<th>Country</th>
<th>Milk (million tonnes) 2011</th>
<th>Milk (% change 2000-11)</th>
<th>Butter (thousand tonnes)</th>
<th>Cheese (thousand tonnes)</th>
<th>Smallholders dairy farmers (million)</th>
<th>% share of agricultural GDP</th>
<th>% share of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethiopia</td>
<td>4.4</td>
<td>14.2</td>
<td>17.6</td>
<td>5.8</td>
<td>n/a</td>
<td>40%</td>
<td>14%</td>
</tr>
<tr>
<td>Kenya</td>
<td>4.3</td>
<td>5.5</td>
<td>14.7</td>
<td>0.3</td>
<td>2</td>
<td>50%</td>
<td>3%</td>
</tr>
<tr>
<td>Rwanda</td>
<td>0.2</td>
<td>5.3</td>
<td>0.7</td>
<td>n/a</td>
<td>0.1</td>
<td>15%</td>
<td>6%</td>
</tr>
<tr>
<td>Tanzania</td>
<td>1.8</td>
<td>7.8</td>
<td>31.5</td>
<td>13.0</td>
<td>n/a</td>
<td>n/a</td>
<td>1.8%</td>
</tr>
<tr>
<td>Uganda</td>
<td>1.2</td>
<td>8.0</td>
<td>n/a</td>
<td>n/a</td>
<td>0.7</td>
<td>50%</td>
<td>8%</td>
</tr>
</tbody>
</table>


EAC exports of dairy products (milk, cream and milk products) to both the region and the world increased significantly following the establishment of the customs union in 2005 (see Figure 1). In the decade before the establishment of the customs union, the average share of intra-EAC exports of dairy products in total EAC exports of dairy products was only 7 percent. The value of intra-EAC exports of dairy products however jumped from USD 281,445 in 2005 to USD 18.3 million in 2014, indicating a 6.4 percent increase.

**Figure X:** EAC dairy product exports, USD Thousand

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40 ECDPM Briefing Note, Recent developments in the dairy sector in Eastern Africa: Towards a regional policy framework for value chain development., Bingi and Tondel (September 2015)
The EAC applies a common external tariff of 60 percent to dairy products imported from outside the community, which fall under the sensitive product category. Partner states also apply a 15 percent VAT on dairy products. This has helped to promote coherency in the sector across the region, and has helped to make intra-EAC imports of dairy products more attractive compared to imports from elsewhere which face high tariff costs. There is however variation across counties, as well as additional taxes and levies and frequent exemptions. Uganda has reduced the import duty on dairy products to 25 percent.

The share of intra-EAC exports of dairy products in total EAC exports of dairy products increased from only 5 percent in 2005 to 39 percent in 2014 (see Figure X), reflecting closer regional integration within the region. Milk, cream and milk products (excluding butter and cheese) are the most common intra-EAC dairy exports, accounting for about 98 percent of intra-EAC dairy exports in 2014 and 41 percent of total EAC exports of milk, cream and milk products (excluding butter and cheese). Dairy products with greater value addition (butter, other fats and oils derived from milk, cheese and curd) represent only about 7 percent of EAC exports in dairy products and are largely destined to countries outside of the EAC.

Figure 2: Intra-EAC exports of dairy products (% of total EAC exports of dairy products), by product type

ECDPM Briefing Note, Recent developments in the dairy sector in Eastern Africa: Towards a regional policy framework for value chain development., Bingi and Tondel (September 2015)
The dairy sector in the EAC provides an example of intra-industry trade, which is largely lacking in the region. All partner states produce and export dairy products. This highlights the opportunities for intra-EAC trade based on product differentiation and economies of scale, despite the similar production structures and capabilities within the region.

**Figure X: EAC dairy product exports by partner state, 2014**

EAC exports of dairy products are unevenly distributed among partner states. In 2014 Kenya and Uganda contributed 44 percent and 48 percent to total EAC dairy product exports respectively. Uganda’s dominance is even stronger in the regional market where it contributes 60 percent to total intra-EAC exports in dairy products. Uganda’s title as the lead dairy exporter...
in the region is new. In 2005 Kenya contributed 84 percent of all intra-EAC dairy product
exports and 80 percent of total EAC exports of dairy products. Uganda’s exports of dairy
products totalled about USD 22.4 million in 2014, compared to only USD 288,730 in 2005. The
major players in milk processing in Kenya are Brookside, New KCC, Spin Knit, Githuguri Dairy
and Aberdare Creamery, whereas in Uganda they are Brookside (Formerly SALL limited),
Amos Dairies, Pearl Dairy and JESA farm. Burundi, Rwanda and Tanzania contribute very little
to EAC dairy exports.

The demand for dairy products in Africa is expected to increase significantly over the next
decade. For example, the milk deficit in Africa is projected to triple from approximately 40,000
tonnes in 2012 to 120,000 tonnes in 2024, reflecting population growth, changing consumer
preferences and a rise of the middle income group. This provides further opportunities for
EAC countries to tap into this demand and capitalize on their strategic location in the region.

6.1.2 A background to EAC collaboration in the dairy sector

Although the EAC does not have a specific regional policy for the dairy sector, in collaboration
with the dairy regulatory authorities, partner states have made significant headway in
identifying areas and opportunities for enhancing cooperation and growth in the sector. The
East Africa Dairy Regulatory Authorities Council (EADRAC) was established in 2006 under the
framework of the EAC Customs Union protocol as a platform to facilitate the harmonization of
dairy product regulations and standards in the region. The EADRAC comprises all EAC dairy
authorities.

Under the CU protocol, starting in 2005, Uganda and Kenya were exempt of import duties
whereas Kenyan exports to Tanzania and Uganda were subject to 25 percent and 10 percent
taxes, respectively. All import tariffs, including those on dairy products were reduced to zero
following a transition period.

Article 25 of the EAC Common Market Protocol called for greater cooperation among partner
states to ensure increased value addition and food security in agriculture, including livestock.
Multi-stakeholder meetings have helped to achieve this, bringing together experience and
expertise from the Association for Strengthening Agricultural Research in Eastern and Central
Africa (ASARECA), the International Livestock and Research Institute, the EAC Secretariat,
national dairy regulatory authorities, among others.

Areas of collaboration include trade in dairy products; regional dairy industry sanitary
standards; improved milk production; access to markets; the promotion of milk consumption in
the region; and conflict resolution related to trade in dairy products. About 42 different
products standards have been developed and adopted by EAC partner states, of which 3 are
directly concerned with milk and milk products. For example, it is mandatory that all dairy

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42 Tetra Pak Dairy Index – A global balancing act: dairy supply and demand (October 2014)
43 ECDPM Briefing Note, Recent developments in the dairy sector in Eastern Africa: Towards a regional
policy framework for value chain development., Bingi and Tondel (September 2015)
44http://www.eac.int/agriculture/index.php?option=com_content&view=article&id=99%3Adairy-
industry-regulators&catid=1%3Alatest&Itemid=149
imports from member countries should bear an Animal Health Certificate endorsed by a Competent Authority.45 Recent improvements in regional infrastructures and planned cross-border infrastructure projects, such as the standard gauge railway, also play a key role in supporting trade and investment in the dairy sector, particularly for dairy products with a short shelf-life.

This collaboration has helped to transform the region’s dairy sector, to one which was largely subsistence based, to a modern sector with increasing levels of commercialization and intra-regional trade. According to the Executive Director of Eastern and Southern African Dairy Association (ESADA):

“The dairy sector in the EAC is undergoing significant transformation and growth in both production and market access. The five EAC countries have recorded increased interest in the sector by various stakeholders including governments, development partners, as well as local and foreign investors. In Kenya for instance, the last five years have seen not less than ten processors and not less than three foreign investors investing directly in the dairy industry through the acquisition of existing operations (partially) and in some instances development of new outfits. Some of these include Friesland Campina, a Dutch company and Arla foods that is already in Nigeria and Tunisia. Within the same period, Uganda has seen the entry of two big processors – both based in Mbarara (Western Uganda) - Nice Processing Plant and Pearl Dairy. Pearl Dairy is producing milk powder and supplying 50 percent of its products to Kenya. This shows the interest in the dairy industry. To sum it all, the dairy sector in the EAC is experiencing one of its best growth periods. Investment is growing, production is also growing; the entire industry is experiencing good growth.”46

Collaboration in the dairy sector also goes beyond the EAC. Kenya, Uganda, Rwanda and Tanzania are members of the Eastern and Southern Africa Dairy Association, the premier dairy association in Africa with an overall mandate to increase trade in African dairy products. ESADA contributes to the harmonization of dairy standards in the ESA region, particularly the Sanitary and Phyto-Sanitary (SPS) regimes between East Africa and Southern Africa. The harmonized standards are expected to be adopted by all countries and operators by the end of 2016. The association helps its members to meet requirements and standards to trade in dairy through training and exposing operators to new technologies. ESADA also organizes the annual East Africa Dairy Conference and Exhibition where companies can showcase the technologies they are developing and network with potential clients. This has helped to share knowledge and best practice in the region. For example, at the 2011 conference the “Extended Shelf Life” technology was launched in Kigali, which is now adopted by a large share of processors in the region.47

6.1.3 Donor assistance for the EAC dairy sector

The potential for dairy in the EAC has also attracted the attention of the international donor community. The World Bank, in collaboration with the Association for Strengthening Agricultural Research in Eastern and Central Africa, has invested heavily in the sector through the Eastern Africa Agricultural Productivity Programme (EAAPP). The programme is a regional partnership covering Ethiopia, Kenya, Tanzania and Uganda, which have been supported in establishing Regional Centres of Excellence (RCoE) for agricultural research based on the commodities identified by ASARECA as being of sub-regional importance to mitigate food security. Kenya is the RCoE for dairy.

At the more micro-level, TechnoServe established the East Africa Dairy Development (EADD) program in 2008 to boost the milk yields and incomes of small scale-farmers and improve market access to robust dairy value chains. The first phase of the project running from 2008 to 2013 helped 179,000 smallholder farming families in Kenya, Uganda and Rwanda to double their farming incomes. This large positive impact has led to the continuation into phase two of the program, which is funded by the Bill and Melinda Gates Foundation.

6.1.4 Foreign Direct Investment into the EAC dairy sector

The large EAC market and the existing high levels of dairy production in the region has also attracted the attention of private international players to the industry, who are facing weak growth in Europe and China. The sizeable milk production in the EAC, compared to other regional groupings in Africa, is often not matched by processing capabilities to enter into high-end markets. This offers opportunities for foreign companies to work with farmers in the region and play a role in supporting commercialization, enhancing product standards, sharing knowledge and building capacities for value addition in the sector.

- Nestlé Equatorial African Region (EAR) Ltd. was established in 2008 and is headquartered in Nairobi, where one of its four processing factories is based. The region covers 21 countries including all EAC countries and Ethiopia, among others. Nestlé EAR aims to take full advantage of the regional integration group and adapt its products to emerging economies using a PPP strategy. The company has combined milk procurement and dairy development to ensure efficiency and quality, and to build relations with suppliers. This has helped to share knowledge and enhance the returns to farmers. The Nairobi plant is not yet processing fresh milk, but is exploring opportunities for possible investment in the near future. In a recent interview, Mr. Manuel Schärer (Technical Expert in Supplies Development, Nestlé EAR Kenya) highlighted the need to enhance access for EAC producers to big international markets such as China and India, to make value addition more viable.48

- On 18th July 2014 Danone Dairy bought 40% of Brookside Dairy Limited, East Africa’s largest dairy player with a portfolio of products ranging from fresh and UHT milk to powdered milk, yogurts, fermented milk, ghee and butter. This reflects a growing trend of international companies opting to acquire existing local processors to ensure that they

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can seamlessly enter into the local industry. Brookside was first established in Kenya in 1993 and recorded revenues of around EUR 130 million (USD 176 million) in 2013. The company’s distribution platform enables daily access to over 200,000 outlets, and manages the largest milk collection network in East Africa, with 140,000 farmers in the region. By uniting Danone’s international expertise in Fresh Dairy Products with Brookside’s regional expertise and robust supply chain, the partnership aims to support Brookside’s growth acceleration by expanding its product portfolio and strengthening its geographical presence in key markets in the East African region, including Uganda and Tanzania.49

More recently, in 2015, Brookside Dairy Limited acquired Ugandan dairy company Sameer Agriculture and Livestock Limited (SALL), a subsidiary of the Kenyan Sameer Group. The deal involved Brookside taking over the management of SALL’s contracted farmers and assets, including production of its fresh dairy products which have a significant market share in Uganda. Brookside plans to upgrade all SALL’s milk cooling and processing facilities.50

This type of consolidation is expected to continue moving forward, with a growing number of large processing companies attracted to the market. This should help to cut operation costs, but it is important that the needs of small holder farmers are prioritized, with commercialization arrangements helping to build productive capacities and incomes of rural farmers.

EAC governments could support this process through helping to strengthen farmer cooperatives in their respective countries. The East African Farmers Federation (EAFF), a regional organization representing farmers in the Eastern Africa and Horn of Africa regions, could provide an important platform to lobby and advocate for the interests of dairy farmers in the context of agricultural trade development. The EAFF has developed a regional livestock strategy that proposes specific interventions to improve the productivity and competitiveness of livestock systems in the region, and was instrumental to the formulation and passing of the 2014 EAC Cooperative Societies Bill.

6.1.5 Developments and opportunities in the Ugandan dairy sector

Although Uganda isn’t the largest dairy producer in the EAC, its dairy sector has registered the highest growth over the previous decade. The country’s livestock sector contributed 4 percent to total GDP in 2014/15. Less than 10 years ago, Uganda was a huge importer of dairy products from UHT milk and fermented products, mainly from Kenya, despite the abundance of milk in the country due to limited infrastructure to collect and process the milk in the country. Uganda is now one of the major dairy producing countries in Africa and one of the few countries in the world that are low-cost producers of milk. The country specializes in milk production with milk, cream and milk products (excluding butter and cheese) accounting for 94 percent of Uganda’s dairy exports.

49 Danone Press Release: Danone partners with Brookside, East Africa’s leading Dairy Products company (Paris and Nairobi, July 18, 2014)
In 2010 Uganda became a net exporter of dairy products. The country recorded a trade surplus in dairy products of USD 15 million in 2014 compared to a deficit of USD 2 million in 2005. Uganda’s exports of dairy products jumped from just USD 288,730 in 2005 to USD 22.4 million in 2014, with about 82 percent of her dairy exports destined to trading partners within the EAC. Figure X shows the significant increase in milk exports over the last five years.

**Figure X**: Exports of milk, cream and milk products (excluding butter and cheese) by destination, USD thousand

![Figure X: Exports of milk, cream and milk products (excluding butter and cheese) by destination, USD thousand](image)

Source: Authors calculations based on UNCTAD STAT

Uganda’s exports to the EAC have become more concentrated towards Kenya since 2005, with 92 percent of Uganda’s EAC exports of dairy products now destined for Kenya (see Figure X). This reflects growing productive capacities of the domestic dairy sectors of Burundi, Rwanda and Tanzania, which were relatively infant compared to Kenya’s dairy sector, but also rapidly growing demand for milk in Kenya, and the export of milk to Kenya for processing before onward export. Kenyan processors previously largely imported powdered milk from European countries. However with the introduction of the customs union, it is now cheaper to source milk locally from Uganda, process it into powder and export it regionally.⁵¹

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In 1998, the Ugandan parliament promulgated the Dairy Industry Act, which created the National Dairy Development Authority (DDA) to regulate the dairy industry. The monopoly National Dairy Company was privatised in 2006 and subsequently acquired by Brookside Dairy Limited of Kenya in 2015. The Ugandan government maintains a minority shareholding in the company. The standards of all products, including dairy, are set and regulated by the Uganda National Bureau of Standards (UNBS). UNBS in conjunction with the DDA are responsible to develop, improve, inspect and implement all standards for milk and milk products.

The liberalisation of the dairy industry in the 1990s broke the monopoly of the Dairy Corporation and opened up opportunities for private investment. Since liberalisation, improved husbandry, breeds and feed systems were developed, adopted and disseminated, with many dairy farmers settling in and around urban areas. This led to an increase in productivity and production. At the same time, the range of products offered in the market expanded. Whilst dairy products were previously limited to raw milk and pasteurised milk, consumers can now access a range of processed products, including UHT milk, fermented milk (or traditional sour milk), butter, cheese, yoghurt and milk powder.

Driven largely by dairy, the livestock sector has maintained positive real growth averaging 2.5 percent per annum between 2010/11 and 2014/15. Strong performance of the dairy sector is largely attributed to the policy and dairy sector reforms, in addition to good financial institutions put in place by government and the private sector towards the promotion of the

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52 Uganda Bureau of Statistics.
sector. Development of the dairy value chain has led to employment creation and income generation not only for about 700,000 dairy farming households, but also for farm input dealers and dairy equipment dealers.\textsuperscript{53} The Government of Uganda has invested heavily in the sector through the National Agricultural Advisory Services (NAADS) and the National Agricultural Research Organisation (NARO) has contributed to the sector’s development through spearheading the commercial production of fodder.

Despite these improvements, the majority of the country’s milk production goes unprocessed, reflecting the still infantry status and structure of the industry\textsuperscript{54}. The country is however investing heavily in processing plants. Processing capacity has increased from 330,000 litres per day in 2004 to 1,454,480 litres per day, with capacity expected to increase by a further 300,500 litres per day by the end of 2015.\textsuperscript{55} Yoghurt, UHT milk, powdered milk, pasteurized whole milk, yoghurt, cheese, butter, ice cream and ghee are major the milk products being processed.\textsuperscript{56}

To support increased processing in the sector, the DDA encourages small holder farmers who don’t have access to pasteurizers to contact dairy processing companies to pasteurize their milk at a cost of USD 25 per tonne before delivering to the coolers. This fee is however considered to be too high to be profitable. The authority therefore plans to enhance the user friendliness of negotiations between traders and processors and make processing options more accessible and cheaper for small holder farmers, before it introduces a ban on selling raw milk.

The hygiene and handling practices at farm level are however generally poor. The collection and transportation of warm milk as well as sale of loose unprocessed milk are still a big challenge to improving quality in the dairy chain.\textsuperscript{57} Uganda needs to improve milk collection cold chains so that more milk can reach the market and enhance processing to extend shelf-life and enter into higher rungs of the value chain. Enhanced public investments in infrastructure, such as roads and electricity, would facilitate farmers’ delivery of milk to cooling centres within two hours of milking when the milk is still considered to be at its best quality.

Planning and improving the sector is however difficult due to seasonality, which makes milk supply and prices fluctuate over time, and therefore forces processing plants to operate below capacity. This could be addressed through dairy development programmes with a focus on dairy belts. Access to finance for small holder dairy farmers also needs to be enhanced. In Asia, Nestle negotiated with banks to extend credit to dairy farmers at favourable rates under the commitment that they open a bank account with the bank, to which they would make direct re-

\textsuperscript{53} http://www.newvision.co.ug/new_vision/news/1324360/-uganda-milk-processed
\textsuperscript{54} http://www.newvision.co.ug/new_vision/news/1324360/-uganda-milk-processed
\textsuperscript{55} ECDPM Briefing Note, Recent developments in the dairy sector in Eastern Africa: Towards a regional policy framework for value chain development., Bingi and Tondel (September 2015)
\textsuperscript{57} http://www.bdsknowledge.org/dyn/bds/docs/770/SNVDairyAnalysisUganda.pdf
payments into from their monthly milk sales. Such a model significantly reduces the risk of default and the ability of banks to identify and track lenders, and could also be adopted in Uganda.