



**AN ASSESSMENT OF THE POSSIBLE IMPLICATIONS OF THE EAC-EU EPA ON KENYAN
AGRICULTURAL SECTOR AND ITS COMPATIBILITY WITH THE WTO RULES**





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Table of Contents

| | | |
|------|---|----|
| 1.0 | INTRODUCTION | 3 |
| 1.1 | Background | 4 |
| 1.2 | Kenya's Trade with the EU | 6 |
| 2.0 | TERMS OF REFERENCE AND OBJECTIVES OF THE STUDY..... | 13 |
| 2.1 | Study objectives..... | 13 |
| 2.2 | Research Questions..... | 13 |
| 3.0 | METHODOLOGY | 14 |
| 3.1 | Overall Approach..... | 14 |
| 3.2 | Review of Related Studies | 14 |
| 3.3 | The Modeling Framework | 20 |
| 4.0: | COMPATIBILITY BETWEEN EPAS AND THE WTO AGREEMENT | 23 |
| 4.1 | Major Issues on Compatibility of the EAC/EU EPA with WTO Obligations..... | 24 |
| 4.2 | Overview of the Interpretation of the WTO Compatibility under EPAs | 29 |
| 4.3 | Implications to Regional Economic Integration Processes..... | 30 |
| 5.0 | IMPLICATIONS OF EAC-EU EPAS ON KEY AGRICULTURAL SECTORS | 33 |
| 5.1 | Overall Revenue, Trade and Welfare Impacts | 33 |
| 5.2 | Likely implications of EPAs on local agricultural production | 36 |
| 5.3 | Implications of EPAs for Small Scale Farmers | 38 |
| 6.0 | THE RATIFICATION PROCESS AND ROLES OF VARIOUS STAKEHOLDERS IN THE IMPLEMENTATION PROCESS | 41 |
| 6.1 | Introduction | 41 |
| 6.2 | The roles of various government institutions | 42 |

| | | |
|-----|--|----|
| 7.0 | SUMMARY CONCLUSION AND POLICY RECOMMENDATIONS..... | 47 |
| 7.1 | Summary and Conclusion | 47 |
| 7.2 | Policy Recommendations..... | 48 |
| | REFERENCES..... | 50 |

LIST OF TABLES

| | | |
|----------|--|----|
| Table 1 | Kenyan Export Commodities to the EU (2012) | 7 |
| Table 2: | Kenyan Import Commodities from the EU (2012)..... | 9 |
| Table 3: | Share of Imports per Product Origin (%) during 2013..... | 37 |

LIST OF FIGURES

| | | |
|-----------|--|----|
| Figure 1: | Kenya’s Exports, Imports and Balance of Trade with the EU 1998-2012 (Kshs Billion) | 7 |
| Figure 2: | Tariff Revenue Effects based on the EPA schedule | 34 |
| Figure 3: | Trade Creation Effects of the EPAS..... | 35 |
| Figure 4: | Trade Diversion Effects of EPAs | 35 |
| Figure 5: | Welfare Effects of the EPAs..... | 36 |

1.0 INTRODUCTION

1.1 Background

Prior to the establishment of the WTO, trade between the EU and ACP Group of countries was governed by the successive Lome Conventions, dating from early 1970s to-date. Under these Conventions, Kenyan products, alongside products from the other ACP countries enjoyed preferential market access in the EU. The formation of WTO and subsequent coming into force of WTO Agreement had the effect of making such preferences under Lome incompatible with the WTO provisions. The incompatibility is due to the fact that continued preferential access to the EU market by the ACP countries discriminated among the ACP countries and other countries with similar levels of development, but do not enjoy similar preferential market access to the EU and consequently contravene the WTOs “Most Favored Nation principle”. The ACP and EU were therefore under an obligation to revise their trade arrangements to make them compatible with the WTO rules.

In relation to agriculture, these developments triggered the reform of the EU's Common Agricultural Policy with the shift from price support mechanism to direct payments for EU farmers thereby adjusting agricultural prices on EU market to world market price level. Subsequently, exports from ACP countries that benefited from these high agricultural commodity prices through preferential market access began to decline. In addition, the erosion of EU preferences granted to ACP countries set in due to increased competition by the EU granting preferences to other developing countries in bilateral trade agreements.

To enable the two parties negotiate a WTO compatible trade arrangement, the ACP and the EU entered into a partnership arrangement known as the Cotonou Partnership Agreement (the CPA) in 2000. The thrust of the CPA was to extend the application of trade preferences under the Lome Conventions until a new agreement, which was to be concluded by December 31st 2007 came into force. Under article 36 (1) of the CPA, the parties agreed to a new WTO compatible trading arrangements, by progressively removing barriers to trade between them and enhancing cooperation in all areas relevant to trade.

The parties under various configurations started negotiations for the new trade arrangements called ‘Economic Partnership Agreements’ (EPAs) in 2002 and were supposed to conclude the same by close of 2007. However, due to the complex nature of the trade

negotiations, it was not possible to fulfill the timelines. All these were against the WTO requirement that the EU and the EAC, alongside other ACP countries align their trade regimes with existing WTO rules by January 2008. In order to meet the WTO deadline, the EAC and the EU on the 27th of November 2007 initialed the Agreement establishing the Framework for an Economic Partnership Agreement (FEPA). The EU-EAC EPA agreement was eventually completed and initialed by both parties on October 14, 2014. This however marks the beginning of yet another long, technical and possible contentious process of both ratification and implementation of the agreement.

Although the impacts of the WTO compatible arrangement are not easy to measure and predict, sector specific assessments can be valuable in exposing the possible impacts. Fontagne *et al.*, (2003), identify three main concerns by ACP countries regarding EPAs. First, there are fears that producers in ACP countries will be hurt due to increased competition by EU producers. Second, there is a likelihood of revenue loss due to tariff cuts, with possible adverse effects on public budgets. Third, are potential welfare losses or adjustment costs, in case where domestic production is undermined by cheap EU imports or where more efficient producers from the rest of the world are displaced by the EU.

In order to determine the likely effect of the EPA agreement, this study examines the impacts of the EAC-EU EPA agreement on Kenya's agriculture sector. This is informed by the importance of Agriculture sector in many African economies. Agriculture contributes, on average 35%, of the GDP 35%, share of total exports and 70% of employment opportunities in many Africa economies. However, agricultural sector in most countries absorbs only a small market size, with the population spread over large rural areas. Further, in African ACP countries, smallholder farmers represent a large part of the rural population, and often rely on simple technologies and cultivation practices. The degree of irrigation, for instance, is very low in African ACP countries. Small-scale farmers mainly produce for own domestic consumption, with limited access to input and output markets or even non-existent. Therefore the role especially the smallholder production, for food security, should not be underestimated since African ACP countries suffer poor development indicators.

In the EAC region, member states have ambitious plans to expand domestic food production. However, it is unlikely that food production will meet the growing demand due to limited financial resources, increased frequency of drought and challenges around land assets.

Thus, these countries depend on cross-border trade to achieve adequate food supplies. Cross-border trade is also necessary to provide diversified range of food products, thus sufficient access to calories and diet diversity necessary to improve on the nutrition content. Food security linkages among the five countries are strong, with Partner States like Uganda and Rwanda making the expansion of food exports to neighboring countries official trade policy (GTZ, 2010). Currently, the EAC countries are highly inter-dependent in terms of food staples, maize and rice. While Tanzania and Uganda are net exporters, Kenya is a net importer of the food staples.

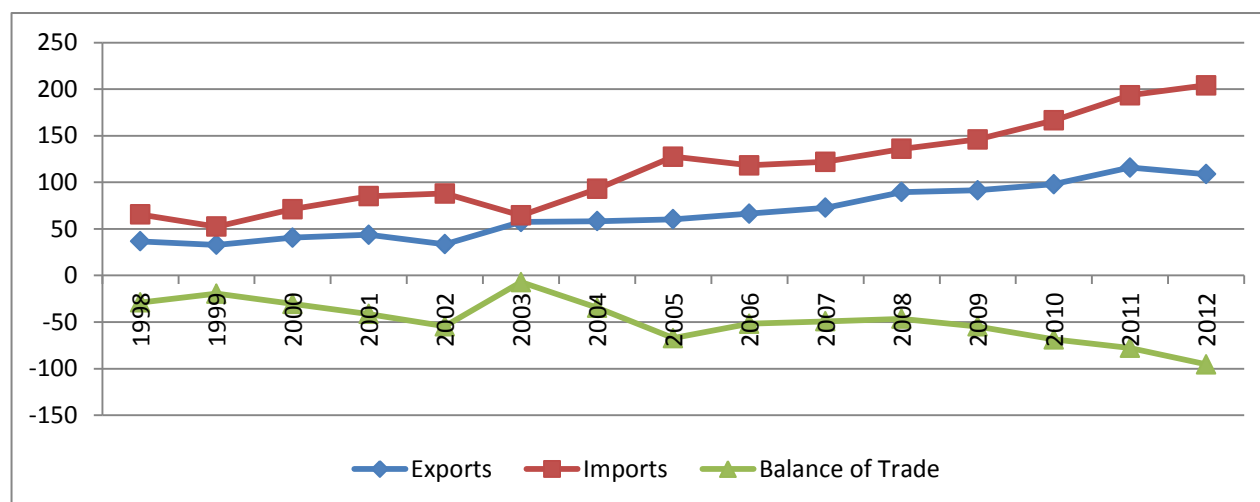
The agriculture sub-sector in Kenya directly contributes 24.5 per cent of the GDP valued at Ksh 741 billion. In addition, through interlink ages with manufacturing, distribution and other service related sectors agricultural sector contributes approximately 27 per cent to GDP. . It also accounts for about 65 per cent of Kenya's total exports, 18 per cent and 60 per cent of the formal and total employment respectively. Agriculture, Rural Development (ARD) sector, hence is identified as one of the six sectors that should contribute to the projected 10 per cent economic growth rate under the Vision 2030.

Therefore to fully understand the likely impacts of the EPAs, this study seeks to assess the possible implications of the agreement with specific focus on the agricultural sector. Since the sectors support a large number of people in the country, and important for rural development. Thus the extent of support EU grants her agriculture pose major affects in the country. This study shall assess the compatibility of the deal to the WTO rules, as well as examine the implications on the future of EAC and EU relations.

1.2 Kenya's Trade with the EU

Kenya's trade with the EU between the period 2007 and 2013 is illustrated in Figure 1. The general trend indicates that exports and imports have been growing over time. Between 2003 and 2011, imports grew faster than exports. Kenya's imports from the EU are growing faster than the exports to the EU, thus widening the trade deficit in favour of the EU. The relative significant increase in imports and exports started in 2010 when the two countries had started implementing the interim EPA agreement.

Figure 1: Kenya's Exports, Imports and Balance of Trade with the EU 1998-2012 (Kshs Billion)



Source: Exports Promotion Council (EPC) and KRA

Table 1 gives Kenya's top 10 exports to the EU in 2012. Using Standard International Trade Classification (SITC), vegetables, tea and coffee constitute the bulk of Kenyan exports to the EU accounting for about 80 percent of exports.

Table 1 Kenyan Export Commodities to the EU (2012)

| | Article (SITC) | Product Description | Value (Kshs) | Share of Total (%) | Cumulative Share (%) |
|---|----------------|---|----------------|--------------------|----------------------|
| 1 | 292 | Crude vegetable materials, n.e.s. | 34,145,882,487 | 31.41 | 31.41 |
| 2 | 054 | Vegetables, fresh, chilled, frozen or simply preserved (including dried leguminous vegetables); roots, tubers and other edible vegetable products, n.e.s., fresh or dried | 18,382,113,500 | 16.91 | 48.32 |
| 3 | 074 | Tea and mate | 16,792,634,907 | 15.45 | 63.76 |
| 4 | 071 | Coffee and coffee substitutes | 14,397,044,882 | 13.24 | 77.00 |
| 5 | 292 | Crude vegetable materials, n.e.s. | 3,679,298,259 | 3.38 | 80.39 |

| | | | | | |
|----|-----|---|---------------|------|-------|
| 6 | 058 | Fruit, preserved, and fruit preparations (excluding fruit juices) | 3,434,566,046 | 3.16 | 83.55 |
| 7 | 278 | Other crude minerals | 2,982,063,595 | 2.74 | 86.29 |
| 8 | 056 | Vegetables, roots and tubers, prepared or preserved, n.e.s. | 2,389,736,947 | 2.20 | 88.49 |
| 9 | 057 | Fruit and nuts (not including oil nuts), fresh or dried | 2,336,818,193 | 2.15 | 90.64 |
| 10 | 034 | Fish, fresh (live or dead), chilled or frozen | 1,379,185,252 | 1.27 | 91.91 |
| 11 | 611 | Leather | 1,297,645,079 | 1.19 | 93.10 |
| 12 | 037 | Fish, crustaceans, molluscs and other aquatic invertebrates, prepared or preserved, n.e.s | 1,268,767,833 | 1.17 | 94.27 |
| 13 | 059 | Fruit juices (including grape must) and vegetable juices, unfermented and not containing added spirit, whether or not containing added sugar or other sweetening matter | 1,192,981,764 | 1.10 | 95.36 |
| 14 | 121 | Tobacco, unmanufactured; tobacco refuse | 844,461,993 | 0.78 | 96.14 |
| 15 | 894 | Baby carriages, toys, games and sporting goods | 582,828,948 | 0.54 | 96.68 |
| 16 | 075 | Spices | 491,663,626 | 0.45 | 97.13 |
| 17 | 098 | Edible products and preparations, n.e.s. | 255,669,567 | 0.24 | 97.36 |
| 18 | 036 | Crustaceans, molluscs and aquatic invertebrates, whether in shell or not, fresh (live or dead), chilled, frozen, dried, salted or in brine; crustaceans, in shell, cooked by steaming | 224,592,695 | 0.21 | 97.57 |

| | | | | | |
|----|-----|---|-----------------|------|--------|
| 19 | 288 | Non-ferrous base metal waste and scrap, n.e.s. | 220,953,595 | 0.20 | 97.77 |
| 20 | 265 | Vegetable textile fibers (other than cotton and jute, raw or processed but not spun; waste of these fibers) | 162,094,047 | 0.15 | 97.92 |
| 21 | | All Others | 2,257,784,198 | 2.08 | 100.00 |
| | | Total | 108,718,787,413 | | |

Source: KRA and Authors' Computation

Table 2 indicates that Kenya's imports from the EU comprises mainly of motor vehicles, medicaments, paper and paperboard, telecommunication equipments, aircrafts and machinery; worn clothing and worn articles, chemical fertilizers among others.

Table 2: Kenyan Import Commodities from the EU (2012)

| | Article (SITC) | Product Description | Value (Kshs) | Share of Total (%) | Cumulative Share (%) |
|---|-----------------------|--|---------------------|---------------------------|-----------------------------|
| 1 | 783 | Road motor vehicles, n.e.s. | 12,026,583,475 | 5.89 | 5.89 |
| 2 | 542 | Medicaments (including veterinary medicaments) | 7,925,664,579 | 3.88 | 9.77 |
| 3 | 641 | Paper and paperboard | 7,548,411,951 | 3.70 | 13.47 |
| 4 | 764 | Telecommunications equipment, n.e.s., and parts, n.e.s., and accessories of apparatus falling within division 76 | 6,729,520,218 | 3.30 | 16.77 |
| 5 | 792 | Aircraft and associated equipment; spacecraft (including satellites) and | 6,364,111,383 | 3.12 | 19.89 |

| | | | | | |
|----|-----|---|---------------|------|-------|
| | | spacecraft launch; and parts thereof | | | |
| 6 | 781 | Motor cars and other motor vehicles principally designed for the transport of persons (other than public-transport type vehicles) including station wagons and racing cars | 6,012,542,912 | 2.95 | 22.83 |
| 7 | 713 | Internal combustion piston engines, and parts thereof, n.e.s. | 5,346,288,497 | 2.62 | 25.45 |
| 8 | 098 | Edible products and preparations, n.e.s. | 5,175,373,719 | 2.54 | 27.99 |
| 9 | 716 | Rotating electric plant and parts thereof, n.e.s. | 5090391658 | 2.49 | 30.48 |
| 10 | 334 | Petroleum oils and oils obtained from bituminous minerals (other than crude); preparations, n.e.s. containing by weight 70% or more of petroleum oils or of oils obtained from bituminous m | 4831322773 | 2.37 | 32.85 |
| 11 | 562 | Fertilizers (other than those of group 272) | 4,820,127,895 | 2.36 | 35.21 |
| 12 | 728 | Other machinery and equipment specialized for particular industries, and parts thereof, n.e.s. | 4,164,305,601 | 2.04 | 37.25 |
| 13 | 745 | Other non-electrical machinery, tools and mechanical apparatus, and parts thereof, n.e.s. | 3,829,414,056 | 1.88 | 39.12 |

| | | | | | |
|----|-----|--|---------------|------|-------|
| 14 | 269 | Worn clothing and other worn textile articles; rags | 3,739,617,203 | 1.83 | 40.96 |
| 15 | 541 | Medicinal and pharmaceutical products, other than medicaments of group 542 | 3,736,245,076 | 1.83 | 42.79 |
| 16 | 591 | Insecticides, rodenticides, fungicides, herbicides, anti-sprouting products and plant-growth regulators, disinfectants and similar products, put up in forms or packings for retail sale or | 3,540,990,674 | 1.73 | 44.52 |
| 17 | 752 | Automatic data processing machines and units thereof; magnetic or optical readers, machines for transcribing data onto data media in coded form and machines for processing such data, n.e | 3,207,544,833 | 1.57 | 46.09 |
| 18 | 598 | Miscellaneous chemical products, n.e.s. | 3,055,733,968 | 1.50 | 47.59 |
| 19 | 772 | Electrical apparatus for switching or protecting electrical circuits or for making connections to or in electrical circuits; electrical resistors, other than heating resistors; printed board | 2,969,980,529 | 1.45 | 49.04 |
| 20 | 782 | Motor vehicles for the transport of goods and special purpose motor vehicles | 2,875,744,775 | 1.41 | 50.45 |

| | | | | | |
|----|--|--------------|------------------------|-------|--------|
| 21 | | All Others | 101,143,055,026 | 49.55 | 100.00 |
| | | Total | 204,132,970,801 | | |

Source: KRA and Authors' Computation

Kenya therefore exports primary commodity exports to the EU and imports high valued technology commodities. This offers some explanation on the widening trade balance between Kenya and the EU.

2.0 TERMS OF REFERENCE AND OBJECTIVES OF THE STUDY

2.1 Study objectives

The objective of the consultancy is to carry out an assessment of the impact of the EAC-EU EPA on the agricultural sector in Kenya with specific focus on products widely grown by small-scale farmers for purposes of export to the EU market. The assignment specifically looks at the likely impacts the deal might have on the trade between the EU and EAC and aims at recommending the necessary steps required by both parties in ensuring that small-scale farmers and producers of certain agricultural products are cushioned from any negative impacts emanating from the EPA agreement. The specific objectives include:

- 1) To evaluate the compatibility between the EAC-EU EPA text and the WTO rules.
- 2) To establish the likely implications to the EAC regional integration process.
- 3) To establish the likely impacts of the agreed EAC-EU EPA deal on key agricultural sectors e.g. horticulture (flowers and beans), coffee, tea, sugarcane.
- 4) To ascertain the legal ratification process and roles of institutions/stakeholders in Kenya and EAC in implementing the agreed EAC-EU EPA agreement.
- 5) To recommend appropriate way forward to the economic relationship between the EAC and the EU.

2.2 Research Questions

In order to address the above objectives, the research seeks to address the following questions:

- i. How compatible is the agreed EAC-EU EPA texts to the WTO rules and what are the likely implications to the EAC regional integration process?
- ii. What are the likely impacts of the agreed EAC-EU EPA deal on key agricultural sectors e.g. horticulture (flowers and beans), coffee, tea, sugarcane.
- iii. What is the legal ratification process and roles of institutions/stakeholders in Kenya and EAC in implementing the agreed EAC-EU EPA deal?
- iv. What is the way forward to the economic relationship between the EAC and the EU?

3.0 METHODOLOGY

3.1 Overall Approach

This study uses both qualitative and quantitative methods in examining the effect of EPAs. Qualitative information was obtained through review of literature and other related sources. In addition, the guideline in Article XXIV of the WTO was used in the interpretation and assessment of the agreement. The quantitative approach involved data analysis on the imports into Kenya from the EU. This was to establish possible impacts arising from implementing different aspects of the EPA agreement.

3.2 Review of Related Studies

In this sub-section, we review some related literature on this subject. Trade liberalization can result into different outcomes, like changes in tastes and demand (due to cultural homogenization) or movements in labour and financial capital. Thus it is not easy to examine the cause of the adjustment process. Bhagwati (1978, 1983) argued as well, that it is difficult to predict the impact of trade liberalization, since trade liberalization affect different sectors, and widely reduce trade barriers. Even so, it would seem desirable to the extent possible to try to examine the effects arising from trade integration, in this case EPAs.

Economic Partnership Agreements (EPAs) has been considered a challenge for most countries in African. According to Bond (2002), EPA negotiation process adopted a narrow and difficult conceptualisation of regional integration. He argued that regional integration was perceived an export platform where markets are liberalised, whereas the fundamental objective should have been to achieve socio-economic and environmental needs of the continent's people.

Bacchetta and Jansen (2003) underline the importance of separating adjustment costs due to trade agreements (e.g. EPAs) from other costs of adjustment. On the contrary Rama (2003), disagrees, that it is neither desirable nor feasible to separate adjustment costs, arguing that globalization plays an important role and not just trade agreements by themselves which cause adjustment.

According to Karingi, et al. (2005), liberalisation under the EPA would decline in the production of natural resources, energy and cotton as well as an increase in production of fish, animal products, livestock, crops, sugar oilseeds, vegetables and cereals. Under the scenario of full reciprocity, there is a decline in production of fish, livestock and vegetables. Milner et al. (2006) provided an analysis of the impact of liberalisation under the EPA for Kenya, Uganda and Tanzania. The study concludes that the liberalisation will result to consumer gains, and production losses especially for Kenya which has a net loss due to the erosion of its manufacturing export base by competition from the EU.

IEA (2006) examined the possible effects of EPAs on Kenya's agriculture. First they noted that the country's exports into the EU comprise mainly agricultural exports of coffee, horticulture and tea. Kenya's imports from the EU include mostly manufacturing equipment. While the COMESA region is identified as the main destination for Kenya's manufactured goods. The study determines that even though EPAs could, safeguard market access into the EU, there are possible loss of competitiveness for Kenya's local manufacturing industries in the domestic as well as regional markets. Furthermore, CAP reforms pose some threat Kenya's agricultural foreign exchange earnings from her exports to the EU. Furthermore, EU CAP may also result into decline in exports from other markets because of the world price dampening effect of the CAP reforms. IEA (2006) established that there is increasing application of non-tariff measures in trade with the EU. Thus despite benefits from market access guarantee under EPAs, NTBs may inhibit the benefits accruing to Kenya agricultural producers.

Fontagné, Laborde and Mitoritonne (2008) also investigated the impact of EPAs for all six ACP regions. According to their study, liberalization under EPAs would result to increased exports of vegetables, agricultural products, livestock and textiles to the EU while increasing imports from the EU textiles, metallurgy, primary products and other industries. However, these studies use a partial equilibrium approach conceding

that in the face of lack of reliable and detailed data on the structure of ACP economies, this is the best method to estimate the impact of EPAs.

Bond (2008) argues that EPAs may lead to regional disintegration, unfair trading relations, internal economic sectoral dis-articulations, social polarization and export-oriented biases in profit streams in the continent.

Odari and Njehu (2013) observe that the liberalisation of agriculture under the EAC EPA, pose challenges for the agricultural sector. Specifically, they observe that the framing of provisions relating to export subsidies and domestic support clauses exposes the agricultural sector to competition from products that enjoy support from the EU. This view is reinforced by the EU's reforms on the Common Agricultural Policy (EC, 2013) which notes a marginal shift in EU policy on domestic support and export subsidies for the period 2014-2020.

Broadly to assess the effect of trade policy measures, two approaches are used in literature. The first method use sector analysis which uses partial equilibrium econometric models. Second approach employ computable general equilibrium (CGE) analysis assuming that the effects of trade agreements are universal to the economy. The context of EPAs, thus gives room to exploit either a partial model or CGE framework to determine any effects quantitatively and qualitatively by checking the compatibility with WTO provisions for example.

Brenton et al., (2007) adopted a partial equilibrium approach to determine the revenue impacts of EPAs in COMESA countries. The authors undertake revenue simulations using detailed tariff lines. A key factor influencing the revenue impact of an EPA is the share of the tariff revenue currently derived from EU imports. Their data suggest considerable variation across countries in the importance of imports from EU. For example, in Ethiopia, imports from the EU contribute 16 per cent of tariff revenues. For Madagascar the contribution is much higher at 29 per cent, while it is 17 per cent for Zambia and only 6 per cent for Malawi. The results show that tariff exemptions are important in all four countries. In Ethiopia, 72 per cent of the revenue that would be

collected if all statutory rates were applied is actually collected. In Madagascar this collection rate is 77 per cent and in Zambia and Malawi it is 66 per cent and 73 per cent respectively.

Lwanda (2011) use a qualitative method to examine whether EPAs in the southern African region is trade promoting to regional integration amongst southern African countries. The author argues that EPAs may hinder rather than promote regional integration. The reason advanced is that EPAs fail to meet certain provisions and/or obligations of the World Trade Organization (WTO).

Mathews (2010) studied ban on export restrictions and export taxes, limits on the size of the remedies available under the bilateral safeguard clause, and the failure to prohibit the use of export subsidies by the EU partner. The analysis use tariff liberalization schedules and determine that ACP states made use of their flexibility to exempt a number of food staples from EPAs liberalization. The authors' recommends that EPA areas which potentially might limit the policy space of ACP governments to improve food security, and which move beyond WTO-compatible provisions, should be removed either through renegotiating then interim agreements or the when full EPAs are established.

Magai and Mbagha (2009) used qualitative method to examine the conformity of Interim EPAs on WTO rules in Tanzania. They developed a checklist based on available literature as a tool to test the consistency of interim EAC-EU EPAs. The results show that EAC-EU EPA has certain clauses conforming to the WTO. However, other areas within the interim EPAs fail to conform to the WTO. The qualitative analysis reveals that removal of tariffs and non-tariff barrier by Tanzania and other EAC Partner States during the implementation of the agreement have implications on local industries, production, investment, competition, welfare, employment, and trade and government revenues.

The development of Computable General Equilibrium (CGE) models like GTAP has expanded the available tools for researchers to predict the effects of trade policies

and obtain robust findings. CGE models make certain assumptions on labour and goods markets. They assume that households are rational and seek to maximize their welfare. Importantly, CGE allows for the introduction of shocks thus ability to quantify the changes in welfare produced by trade liberalization (like EPAs). The models also allow for comparison of the welfare in the economy before and after the change. Melo and Tarr (1990) used a CGE model to study the effect of the removal of quantitative restrictions in the US, they find an adjustment cost of 1.5 per cent of overall gains. Another work using CGE model as done by Melo and Roland Holst (1994) examine the effects of trade reforms in Uruguay.

Kone (2008) used the standard Global Trade Analysis Project (GTAP) model to assess the prospective economic and social effects of the proposed EU-ECOWAS EPAs in Cote d'Ivoire. The impacts of EPAS along with proposed average tariff reductions are used to forecast the possible revenue gain or loss when EAPs are established. The simulation results show that full reciprocity will be costly for Cote d'Ivoire due to revenue losses, and adjustments costs associated with de-industrialization. However, unrestricted market access for Cote d'Ivoire into the EU-25, taking into account the issue of fiscal compensations have positive gains including welfare benefits.

Hammouda et al., (2007) simulated the effect of Sudan's trade liberalization because of EPAS using the WITS/SMART model. The authors define three scenarios to assess the effect of the EPAs on the economy: the full liberalization, sectoral liberalization and strategic liberalization. Using the liberalization of all the imports as an illustration, Sudan experience an increase in its net import value of about USD 310 million. The increase in net imports introduces certain unfavourable outcomes to the local economy. Indeed, foreign competitors which produce value-added goods reinforce their position on the domestic market to the disadvantage of less competitive Sudanese producers. This may undermine the growth of the industrial sector in the country. Further, EPA's strengthen the position of EU exports on Sudan market to the detriment of the other trading partners including the COMESA member states. The EU

gain about \$US 401.4 million in export value, while the rest of the trading partners lose about \$US 91.5 million in export value to Sudan. Thus EU gains are more than 4.3 times the total trade diversion from the other partners.

Andriamananjara et al., (2009) discussed potential economic implications of EPAs in Nigeria. The study uses the World Bank's Tariff Reform Impact Simulation Tool (TRIST) to assess the effects of preferential tariff liberalization with respect to the European Union. The results suggest that the impact on total imports into Nigeria is not major. The reason is that the Agreement allows the most protected sectors to be excluded from trade liberalization. Equally where substantial tariffs are involved, much of the increase in imports from the European Union occurs at the expense of other suppliers of these imports. It is this trade diversion, arising from the discriminatory nature of the EPA, which generates negative welfare effect in the tariff reforms. The authors suggested that Nigeria could limit the losses through non-preferential trade liberalization before implementing an EPA.

Ragolo and de Melao (2014) simulated the welfare and revenue effects of EPAs on Rwanda's economy. They determine that under the EPA, revenues on imports from the EU will decrease. The estimation (assuming that import patterns will not change after the entry into force of the EPA) forecasts total revenue loss of about 37 per cent of initial revenues from the EU for Rwanda during Phase 2 and 3 of tariff elimination, totaling USD 7,358,000. Rwanda's imports increase by 0.1 per cent due to the small reduction (3.3 per cent) in the average applied tariffs on all imports.

Morrisy and Zgovu (2009), paper estimates the impact on a sample of 36 ACP countries of eliminating tariffs on agricultural imports from the EU under EPAs, considering trade, welfare and revenue effects. Even assuming 'immediate' complete elimination of all tariffs on agriculture imports from the EU, and when excluding up to 20 per cent of imports as sensitive products, over half of ACP countries are likely to experience welfare gains. However, although most LDCs gain (10 out of 13), most non-LDCs (about 60 per cent) lose. The overall welfare effect relative to GDP tends to be

small (whether positive or negative). While potential tariff revenue losses are non-negligible, given that countries have at least ten years in which to implement the tariff reductions, there is scope for tax substitution. Another important issue is identifying the sensitive products (SPs) to be excluded. By excluding SPs the welfare gain are reduced (or increased the welfare loss), compared to the estimates with no products are excluded.

3.3 The Modeling Framework

We apply the partial equilibrium analytical framework used by McKay *et al* (2005) and outline the core features as applied by Panagariya (1998) to consider when small countries (Kenya in this case) integrate with large countries (the EU) . Two effects are of particular importance in analyzing the welfare effect of regional integration agreement (RIA). First is trade creation that occurs where inefficient production by domestic firms in an RTA member country (Kenya) is displaced by tariff-free imports by more efficient producers in another member country (the EU).

This increases welfare in total through efficient allocation of production within the RIA. On the other hand, trade diversion imposes a welfare loss when trade from more efficient extra-regional suppliers (Kenya imports from the Rest of the World, ROW) is diverted to less efficient intra-regional suppliers (the EU). For the RIA as a whole, welfare increases if trade creation is greater than trade diversion. We assume that the EU benefits, although we make no attempt to estimate this, and focus on the effects on an ACP country (and further, here, on agriculture only).

The following key assumptions are made in the estimation model,:

1. PEM is a static model.
2. There is perfect substitutability between domestic and imported products. The Armington elasticities (substitutability between domestic and imported products) were assumed to be 1.15, before EPAs, 1.5 during the 1st phase of liberalization, 2 during the 2nd phase of liberalization and 2.15 during the final phase of liberation. These elasticities lie within the general assumption that import demand elasticities for developing and

poor countries lie between 1 and 3 (Taylor *et al.*, 2004). In addition, the increase in the elasticities is meant to reflect the possible increase in domestic demand for imports from the EU when tariffs are lowered.

3. It is assumed that the 2013 data is representative of the likely trade patterns in future between Kenya and the rest of the world.

The simulations are carried out in three scenarios:

- a) The first scenario being liberalization during the first year into the EPAs. During this phase, tariffs for products under Annex IIB of the consolidated EPA text are reduced by 20 per cent i.e. from 10 per cent to 8 per cent, while those under Annex IIC are reduced by 5 per cent i.e. from 25 per cent to 23.8 per cent.
- b) In the second scenario, which shall occur after 8 years into the EPAs, tariffs for products under Annex IIB are reduced by 100 per cent to zero, while those under Annex IIC are reduced by 20 per cent.
- c) The final scenario is where the products under annex IIC of the schedule are reduced to zero and which liberalization cover 82.6 per cent of the tariff lines.

This PEM analysis has the following advantages:

1. It has minimal data requirements unlike the general equilibrium models.
2. The data required is not inbuilt and it thus allows the use of Kenyan trade dataset.
3. It allows for analysis at a disaggregated level and therefore overcomes aggregation bias associated with general equilibrium models. Commodity details of especially sensitive products are of particular interest to ACP countries (Milner *et al.*, 2010).
4. Thus PEM analysis presents more accurate results because the EPA negotiations occur at a much disaggregated level.
5. The PEM results are transparent and easy to implement owing to its simplicity.

3.4 Data Type and Sources

The study used import data for Kenya during 2013. This data was disaggregated at HS eight digit levels and at source levels that is the EAC, EU and Rest of the World. In addition, we used data on import duties as well as domestic taxes including VAT and

excise duties to simulate different scenarios. The trade data used in the study was obtained from Kenya Revenue Authority (KRA), International Trade Centre (ITC) and Export Promotion Council (EPC).

4.0 COMPATIBILITY BETWEEN EPAS AND THE WTO AGREEMENT

The compatibility between the members of the ACP group of states and the EU to the WTO rules has been debated widely. The Cotonou agreement signed on 23rd June 2000, formulated EPAs as a means to make the existing trade arrangement between EU and ACP conforms to the WTO rules (CUTS, 2012). Thereafter ACP countries were put into different regional configurations to negotiate the EPAs. Kenya is part of the EAC regional configuration.

Thus, ultimately EPAS should allow for reciprocity from the current non-reciprocity between EU and ACP countries. EPA hence, represents a form of Free Trade Agreement in which there is more than free trade since it provides for economic cooperation in other areas. The ACP countries under this agreement retained their existing preferential access to European markets, however would reciprocate through progressive opening of their domestic markets to imports from the EU on a preferential basis.

However, Economic Partnership Agreements (EPAs) face two sets of issues; one is the compatibility with existing trade rules, and two, the consistency with the dynamics in multilateral trade negotiations. Compatibility implies that, unlike the Lome Convention, and the current phase of the Cotonou agreement, any new agreement would not require the granting of a waiver by other WTO members.

Second, the negotiation process on EPA's have not occurred in a static environment, but rather when trade rules are subject to new round of negotiations in the context of the Doha Agenda. This is acknowledged in the WTO Ministerial Declaration in Doha, which states that "the negotiations shall take into account the development aspects of regional trade agreements". The implication is that the institutional setups (rules of the game) are likely to change when Doha is finally concluded. For example, the negotiations on Article XXIV of the WTO agreement may modify the conditions imposed on new regional agreements, and hence of performance of EPA's when the COMESA-EAC and SADC tripartite is concluded. This could further

apply to the continental free trade (CFTA) area that encompasses all the regional blocks in Africa. In addition, some of the issues negotiated in EPAs are also subject to negotiations at the WTO. These include competition, investment, government procurement and standards and regulations.

4.1 Major Issues on Compatibility of the EAC/EU EPA with WTO Obligations

One of the requirements under the Cotonou Agreement was that the ACP/EU relationship on trade be consistent with obligations under the WTO. Compatibility under EPA relates to Article XXIV of the General Agreement on Tariffs and Trade (GATT) and Article V of the General Agreement on Trade in Services (GATS). Thus the major issues of compatibility include following:-

4.1.1: Most Favored Nation Treatment

The Most Favoured Nation (MFN) is a WTO rule which requires that any preferential treatment extended to one member country should be extended to all the other WTO members. Article XXIV of the GATT allows for the derogation of the MFN provision when developed countries enter into free trade agreements, customs unions and interim arrangements. EPA defined as a Regional Trade Agreement (RTA) is covered in this provision.

Under Article XXIV (8) (b) of GATT, duties and other restrictive regulations of commerce, except where allowed, are supposed to be eliminated on “substantially all trade.” This is a controversial issue that is yet to be settled. The requirement that RTAs should lead to the liberalisation of ‘substantially all the trade’ to be done ‘within a reasonable length of time’ is especially unsettling given that GATT Article XXIV does not make provision for Special and Differential Treatment. This is provision was conceived under the thinking that such agreements would only happen between developed countries.

The liberalisation under the EAC/EU EPA is structured such that the EAC liberalises 82.6 per cent of the value of its imports from the EU, while the EU on the

hand is expected to liberalise 100 per cent of its trade. The liberalisation is to be carried out by the EAC is staggered over a period of 25 years with 65.4 per cent being liberalised during the 1st phase, 14.6 per cent within the 2nd phase and 2.6 per cent in the final phase. However, about 17.4 per cent of trade is excluded from liberalisation as these products are categorized as sensitive to the EAC. The discussion on liberalisation of trade in services, has been put off under the 'rendezvous' clause to be discussed at a later date. Therefore the inclusion of this provision leaves little policy space to negotiate agreements with other countries.

One of the most significant limitations with the MFN clause in the EPA is the requirement that any preferential treatment given to any "*major trading economy*" should be extended to parties under the agreement. While it excludes ACP and African countries, this provision limits the ability of the EAC countries to enter into other trading arrangements in the future as the benefits would automatically be extended to the EU.

4.1.2 *Agricultural and Non-Agricultural Market Access*

a) Agricultural Market Access

Article 24 stipulates that trade barriers must be removed on "substantially all trade" and "within a reasonable period of time" which can only be exceeded in exceptional circumstances. Hence, pursuant to the WTO, the EC market access offer should consist of 'duty free' and 'quota free' access to imports from the EAC Partner States. On the other hand, the EAC/EU EPA requires the elimination of applied tariffs for 82.6 per cent of some agricultural products as well as non-agricultural products. However, under the WTO regime especially under the flexibilities allowed in the Doha Ministerial, Least Developed Countries (LDCs) do not need to liberalise their agricultural sector at all. The presence of four LDCs in the EAC therefore would require that they do not liberalise. Further, a non-LDC country (where Kenya is classified) has the flexibility to reduce tariffs from its WTO-bound levels and not the applied rates as has been put in the EPA. The flexibility for LDC countries under the WTO also extends

to the “Everything But Arms” mechanism is also threatened by the need to accommodate their non-LDC counterparts. In this case, the four EAC countries may sacrifice their EBA status.

b) Non-Agricultural Market Access

The comprehensive EPA agreement envisages the elimination of applied tariffs for 82.6 per cent of all goods. However, the WTO regime gives flexibility for LDCs (including Burundi, Rwanda, Uganda and Tanzania). Kenya has the flexibility for a more lenient liberalisation framework since it has low tariff binding coverage. The extent of liberalisation under the EAC/EU EPA therefore denies these countries flexibilities that they would enjoy under the WTO system. This means, therefore, that obligations in the EPA are beyond the WTO regime and are therefore “WTO Plus”.

4.1.3 The Extent of Liberalisation

Under the WTO disciplines, LDCs have special treatment through flexibilities that are allowed in their mode of liberalisation. Further, the WTO has an in-built development benchmarking process where countries (especially LDCs) are allowed to liberalise according to their level of development. However, the EPAs in line with Article XXIV of GATT has no SDT mechanism thus excludes these flexibilities for the EAC countries.

4.1.4 Quantitative Restrictions

The EAC/EU EPA in Article 17 of the comprehensive text largely incorporates the spirit of GATT Article XI with addition of exceptions relating to food security and standards or regulation. However, this limits EAC countries the WTO flexibilities relating to balance of payment problems, infant industry protection, the safeguard agreement and import licensing.

4.1.5 The Standstill Clause:

Article 13 of the comprehensive EPA text provides for a standstill clause except for trade defense mechanisms under Articles 19 and 21. This is WTO incompatible as the WTO regime allows for raising the applied tariffs to the bound tariff rates., If

implemented, this could pose a challenge to the agricultural sector as EAC countries used lower tariff rates to address food security concerns.. The countries therefore lose the policy space to protect crucial sectors. According to Bilal and Ramdoo, (2010), the clause also contradicts the development provision of the EPA as this could potentially harm the development benefits accruing from this.

4.1.6 Imposition of Export Duties and Taxes

Article 15 of the comprehensive EPA text prohibits the levying of export taxes on goods for export in excess of those levied on goods intended for internal sale. The exception to this rule shall be subject to the approval by the EPA Council with objectives to foster the development of domestic industry or maintain currency value stability. This is when increase in the world price of an export commodity creates the risk of a currency value surge. Further, the enforcement of such taxes is on a limited number of products within a specified period of time. This must be reviewed by the EPA Council after 24 months. However, export taxes are allowed under the WTO regime and give governments' the policy space to develop particular industries. This clause is intended to the EU Raw Materials Initiative which is meant to secure supply of raw materials for industrial sustainability in the EU.

4.1.7 Multilateral Safeguards:

The EACEU EPA makes provision for the use of the WTO Agreement on Safeguards. In addition, they are allowed to use Special Safeguard Provision (SSG) under the Agreement on Agriculture (AoA). The application of these instruments could have benefit from the inclusion of the Special Safeguard Mechanism (SSM) for developing countries. However, stalling of negotiations under the Doha Round limits this possibility. EAC countries are not eligible to use the SSG mechanism under the AoA. The content of the text limits the possibility of using new multilateral safeguards from the WTO.

4.1.8 *Bilateral Safeguards:*

Article 21 of the EAC-EU EPA provides for bilateral safeguards as a trade defense mechanism. However, additional requirements have been placed on the mechanisms that exceed the WTO's SSG, and the proposed SSM mechanism. For example, the flexibility given at the WTO level grants automatic triggers without bureaucratic restrictions. Under the EPA, a prior notification to the EPA Council is a requirement.

4.1.9 *Infant Industry Protection:*

The EACEU EPA provides for infant industry protection under Article 21 of the comprehensive text which relates to bilateral safeguards. The remedy available in this respect is the same like in cases of using of bilateral safeguards. It also has a 15 year limit. However, the WTO regime under GATT Article XVIII provides for a range of governmental action to protect infant industries. This will limit EAC governments in designing effective policies for the protection of infant industries.

4.1.10 *Domestic Support Measures:*

The EACEU EPA precludes the disciplining of domestic support measures. This implies that parties are allowed to provide domestic support without limitations. EU uses Market Price Support (MPS)² as well as direct payments to farmers based on output and variable input use without input constraints. These however, are production and trade-distorting in nature. During the period 2014-2020, for example, the EU allocated EUR 362.787 billion. The amount covers EUR 277.851 billion meant for direct payments to farmers and market-related expenditure, and EUR 84.936 billion for rural development. The EU also shifted some trade distorting measures into the green box thus cannot be held to account.

² Market Price Support is given for a range of agricultural products including wheat, maize, barley, oats, rape seed, sunflower, soya beans, sugar, milk, beef and veal, sheep meat, pig meat, poultry, eggs, potatoes, tomatoes, plants as well as flowers and wine. MPS payments account for about six per cent of total payments under the CAP.

4.1.11 Singapore Issues:

These include transparency in government procurement, trade facilitation (customs issues), trade and investment and trade and competition and were set during the World Trade Organization Ministerial Conference of 1996 in Singapore. However, disagreements between developed and developing economies prevented a resolution in these issues. Despite repeated attempts to revisit them, notably during the 2003 Ministerial Conference in Cancún, Mexico, whereby no progress was made. However, some progress has been realized in the area of trade facilitation, where negotiations are continuing while other three issues (government procurement, trade and investment and trade and competition), have not been put forth for negotiations. The EAC/EU EPA puts a number of issues as part of the 'rendezvous' clause meaning they are part of the disciplines to be negotiated under the EPA within five years. These issues include intellectual property rights, trade in services and competition. However, EPA compatibility with WTO rules do not demand that such issues be negotiated to achieve compatibility with the WTO disciplines.

4.2 Overview of the Interpretation of the WTO Compatibility under EPAs

There are competing narratives on the compatibility of EPAs to the WTO mainly based on the formulation, interpretation and how to balance the interests between unequal partners. The EU's perception on compatibility has been to demand a minimum of at least 80% liberalisation of trade through opening up of tariff lines and the volume of trade. As such, the structure proposed under the EAC/EU EPA in reaching the threshold under Article XXIV of GATT fits with the EU's interpretation.

However, the interpretation of Article XXIV by the EU has been inconsistent in some respects. Most notably, the EU concluded the EU-Syria Cooperation Agreement and duly notified under Article XXIV. This agreement is still in force and entails obligations where the EU committed to liberalise almost all products, while Syria was not committal on the same. The argument is that Syria was initially allowed, due to its

development needs. Therefore the corresponding undertakings entered into by the Community, was in accordance with the spirit and letter of Part IV of GATT rules.

The EU emphasised that this does not called into question the validity or applicability of Article XXIV as regards the Community. If one is to re-examine the original intention of the EPA as envisaged under the Cotonou Partnership Agreement, then the development component is not well reflected in the EACEU EPA. This is for a number of reasons. First, the opening up of 82.6% of trade (given that four of these countries are LDCs) imposes obligations that are beyond commitments that major economies such as China and Brazil have made at the WTO level. These commitments that have been made are thus “WTO Plus” as they go beyond the obligations that are required at the WTO level.

It should further be noted that the definition of “substantially all trade” as envisaged under GATT Article XXIV relating to criteria for RTAs has not been settled at the WTO level. Members see this as a red line in terms of interpretation and application. In *Turkey Textiles*, the Appellate Body stated thus:

‘.....neither the GAT Contracting Parties nor the WTO Members have ever reached an agreement on the interpretation of the term ‘substantially’ in this provision. It is clear, though, that ‘substantially all the trade’ is not the same as all the trade, and also that ‘substantially all the trade’ is something considerably more than merely some of the trade...’

4.3 Implications to Regional Economic Integration Processes

The natures of disciplines contained in the EAC/EU EPA have implications for regional integration initiatives due to its efforts to promote growth and development through trade. The implications include challenges to the smooth implementation of regional integration, loss of policy leverage when negotiating outstanding issues at the multilateral level, as well as the loss of key flexibilities that are available to countries at the WTO level. The following part provides a summary of the possible implications to the region within the scope of the comprehensive EPA as agreed.

4.3.1 The East African Community

The EAC established a customs union in 2005 and a union with zero internal tariffs in 2010. It is currently implementing a common market protocol and making advancement towards implementation of the protocol of the EAC monetary union, which was slated for in November, 2013. The EAC negotiated EPAs as an economic block and thus made it easy to develop common positions during negotiations. Importantly, the EAC negotiated a harmonized list of products to be excluded from liberalization, unlike other economic blocs. Therefore, this allows for efficient management of bilateral trade between the two parties.

There are provisions in the EPA agreement which may positively and/or negatively affect EAC Partner States. For example, some new Rules of Origin have introduced flexibilities for EU market access by the EAC Partner States. For instance, textiles and clothing, fisheries and some agricultural products have seen some fundamental changes.

Nonetheless, some aspects of the rules of origin, introduces stringent requirements with respect to the concept of value addition, and their expectation from importers and exporters are included in the agreement. This has the potential of locking out manufactures and value added products from EAC region out of European markets. EAC Partner States require for the growth of their export markets simple Rules of Origin (RoO) that are easy to implement.

4.3.2 The COMESA-EAC-SADC Tripartite FTA

The COMESA-EAC-SADC Tripartite FTA was signed on 22nd August, 2008 in Kampala, Uganda. The regional economic bloc encompasses the 26 countries of the three RECs with a combined population of 527 million people, with total Gross Domestic Product (GDP) of USD624 billion and GDP per capita of USD1, 184. The three RECs make up nearly half the African Union (AU) membership of 53 countries, contribute over 58 per cent of the continent's GDP, and account for 57 per cent of the total population of the African Union. The single FTA is to be established on a tariff-

free, quota-free, exemption-free basis and should adopt the principle of variable geometry by simply combining the existing FTAs of the three COMESA, EAC and SADC into a single FTA.

Unlike the EAC-EU EPAs, the three regional blocs have signed with the EU different agreements with different-content, schedules of implementation and exclusion list (sensitive list of products). This creates three trade regimes within the TFTA hence fragmenting rather than integrating the RECs, this consequently hamper deeper regional integration. South Africa already has an FTA-TDCA with the EU which puts another layer of complexity in harmonizing the three RECs. It has been argued that the COMESA-EAC-SADC blocs should develop regional frameworks and put in place mechanisms that promote intra-regional trade and attract foreign direct investments.

Within COMESA, there are countries (for example Djibouti, Ethiopia, Eritrea and Sudan) that might not have incentives to join the EPAs because they can gain DFQF market access under everything but arms (EBAs) (EU, 2014). Thus there is a likelihood of increasing heterogeneity in the trading blocs and in effect complicate smooth harmonization. In future TFTA member states might negotiating a TFTA EPA with the EU where the complexities of the current arrangement may play out hampering trade negotiations.

The EPA Rules of Origin do not allow for cumulation within the region especially with regard to cumulation with South Africa on account that it is not a member of the ACP group of countries. This applies equally to other SADC members such as Seychelles where the issue of cumulation is already affecting Kenya's exports of tuna to the European market. Tuna processed locally in the country is thus, attracting higher tariffs on account of rules of origin. The situation is also undermining market access of other products of export interest to the region on account that they incorporate raw materials imported from South Africa. However, great impediment to these modified Rules of Origin is that they cannot be addressed without the EAC Partner States negotiating the Rules of Origin with the EC. Hence, there is need to examine and

negotiate the EAC-EU EPA Rules of Origin as the basis of determining the originating criteria of the goods traded between the two parties. Additional impact of the various aspects of the EPAs agreement may have a negative impact on Africa's regional integration process. This is because regional markets in Africa will be opened up to the EU before they are consolidated internally. EPAs could potentially undermine the harmonization of CET, customs clearance procedures and documentations among others in the three RECs.

5.0 IMPLICATIONS OF EAC-EU EPAS ON KEY AGRICULTURAL SECTORS

In this sub-section we determine the likely effects of the EAC-EU EPAs on the agricultural sector. These effects are categorized into revenue effects, trade and welfare impacts and production by small-scale farmers.

5.1 Overall Revenue, Trade and Welfare Impacts

To evaluate the effects on revenue, trade and welfare, we estimate the effects of tariffs on revenue, trade and welfare in three phases using the EPA liberalization phases³:

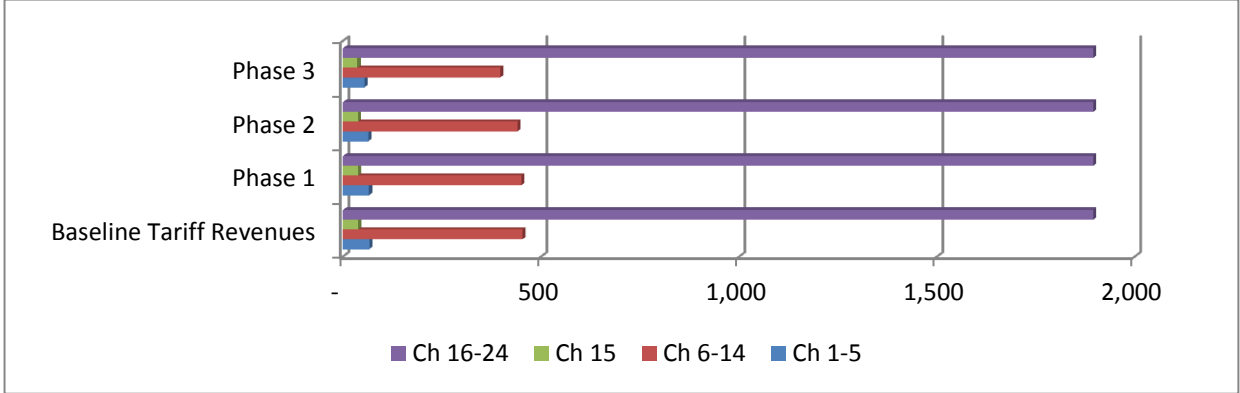
1. The first phase is the liberalization during the first year into the EPAs. During this phase, the tariffs for products under annex IIB are reduced by 20 per cent i.e. from 10 per cent to 8 per cent, while those under annex IIC are reduced by 5 per cent i.e. from 25 per cent to 23.8 per cent.
2. The second phase will take place after 8 years into the EPAs where tariffs for products under annex IIB are reduced by 100 per cent to zero, while those under annex IIC are reduced 20 per cent.
3. The final phase is where the products under annex IIC of the schedule are reduced to zero and upon which liberalization will cover 82.6 per cent of the tariff lines.

5.1.1 Tariff Revenue Effects

³ See Products under annexes IIB and IIC in the appendix

This is estimated effects for agricultural products where the EU is the globally efficient and dominant supplier to the EAC region. The results indicate that there will be minimal or no tariff revenue changes from the agricultural sector due to the EAC-EU EPA tariff liberalization schedule as indicated in the Figure 2. The reason is that agricultural commodities have been listed under the sensitive products list and are exempt from tariff reductions during implementation of the agreement. There is, however, minimal reduction in revenues from products under chapter 6-14 for example. vegetable products, where tariff revenues are reduced from ksh 453 million in the baseline scenario to ksh 397 million during the last phase of liberalization. This could be attributed due to reduction in imports on these products from the EU or increased domestic production.

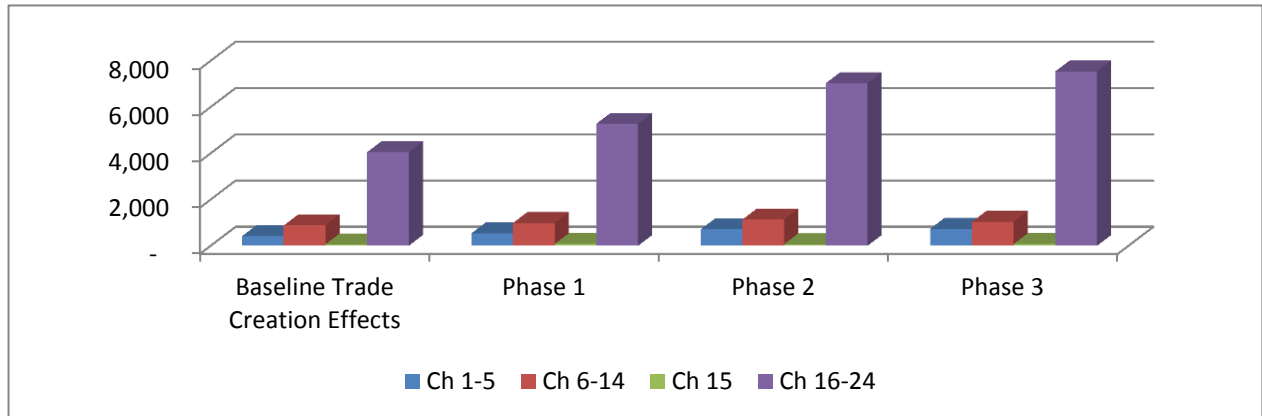
Figure 2: Tariff Revenue Effects based on the EPA schedule



5.1.2 Trade Creation Effects

Assuming the EU is a more efficient supplier than the ROW, and then all current imports from the EAC region would be replaced by more efficient production from the EU. As a result of tariff reductions, there would be increased imports from the EU for all agricultural products as indicated in Figure 3. However, the biggest trade creation effects is realized for products under chapter 16-24 which include prepared foodstuffs, beverages, spirits and vinegar, tobacco. Besides, there is steady increase in trade in terms of liberalization schedules with the largest effects being Ksh 7.5 billion during the third phase of liberalization.

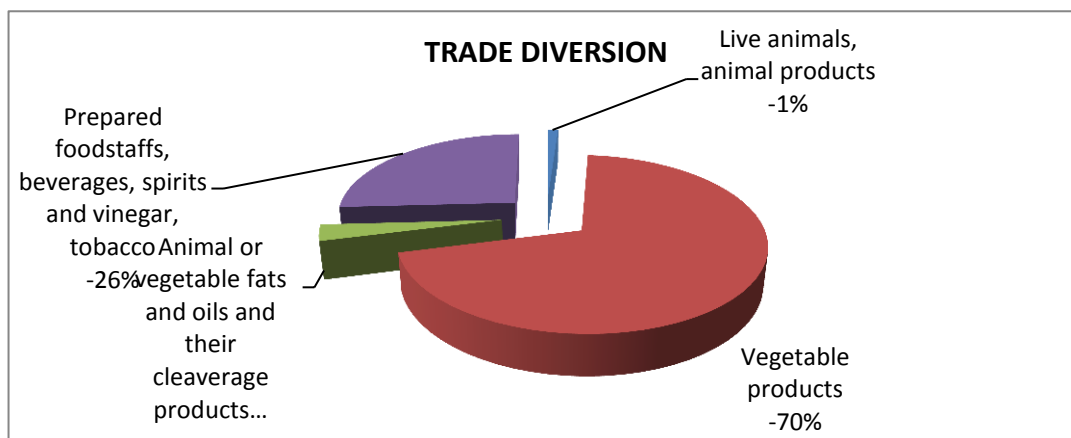
Figure 3: Trade Creation Effects of the EPAS



5.1.3 Trade Diversion Effects

Trade diversion effects occur when there is a shift of imports from the more efficient ROW producers to the EU region as a result of tariff phase-down in favour of EU producers. Since the tariff on products remains unchanged from the baseline line levels. The estimates are indicative of the largest trade diversion effects possible from the baseline estimates. Trades in vegetable products are diverted the most from the EU due to the expansion of domestic production or importation from the regional EAC market (see Figure 4).

Figure 4: Trade Diversion Effects of EPAs

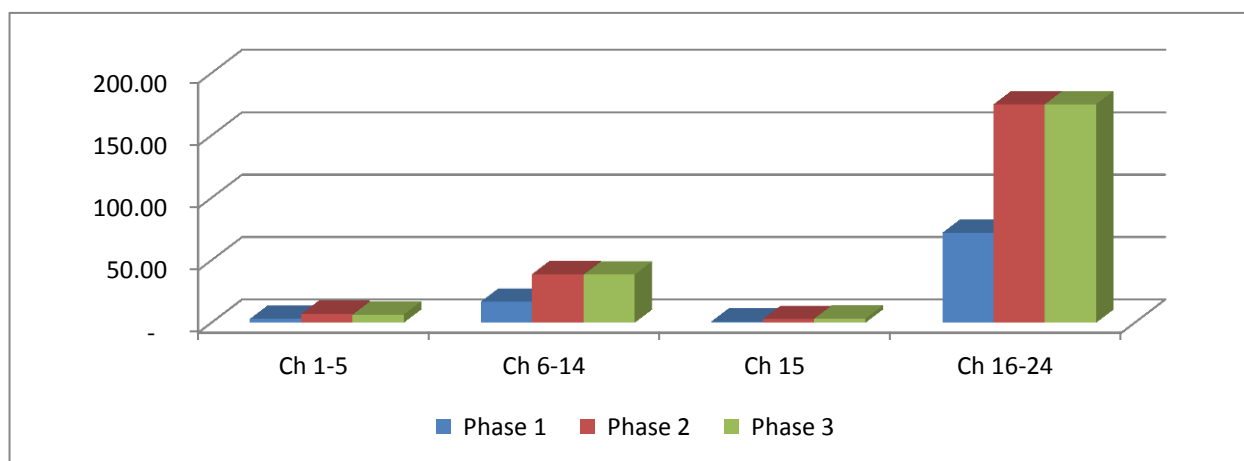


Source: Author's compilation

5.1.4: Welfare Effects

Welfare effects occur from the overall consumption effects due to trade creation and trade diversion. Figure 5 shows that the biggest net welfare effect takes place for products under chapters 16-24 and during the phase 3 of liberalization worth about Ksh 175 billion.

Figure 5: Welfare Effects of the EPAs



Source: Author's compilation

5.2 Likely implications of EPAs on local agricultural production

The threat of EPAs on local agricultural production is due to the potential flooding of the domestic market by imports from the EU following the liberalization schedule. However, most of the agricultural products are listed as sensitive products and therefore are protected from tariff liberalization. The analysis of the likely impacts on agricultural domestic production, considering the import origins from the EU, the ACP countries and the Rest of World is presented in the table 3 below.

It is noticeable that the EU is the largest source of non-agricultural products imports under chapter 71, while the ACP group remains the biggest exporter of agricultural products to Kenya under chapters 1-5, 6 - 14, 15 and 16-24. The ROW is the biggest sources of products under chapter 41-43. Thus, tariff reductions under EPAs do not pose a big threat to agricultural production in the country, especially if Kenya and the EAC maintain and enforce tariffs within the framework of sensitive products.

Table 3: Share of Imports per Product Origin (%) during 2013

| Chapters | Product Descriptions | Imports from the EU | Imports from ACP | Imports from ROW |
|----------|--|---------------------|------------------|------------------|
| 1-5 | Live animals, animal products | 7.92 | 65.48 | 26.60 |
| 6-14 | Vegetable products | 4.11 | 14.38 | 81.51 |
| 15 | Animal or vegetable fats and oils and their cleavage products | 0.61 | 1.71 | 97.68 |
| 16-24 | Prepared foodstuffs, beverages, spirits and vinegar, tobacco | 20.76 | 51.88 | 27.35 |
| 25-27 | Mineral products | 3.70 | 4.26 | 92.04 |
| 28-38 | Products of chemical or allied industries | 26.54 | 13.46 | 60.00 |
| 39-40 | Plastics and articles thereof, rubber and articles thereof | 11.09 | 7.97 | 80.94 |
| 41-43 | Raw hides and skins, leather, furskins and articles thereof | 35.04 | 50.23 | 14.72 |
| 44-46 | Wood and articles of wood, wood charcoal, cork and articles of charcoal | 3.65 | 40.63 | 55.72 |
| 47-49 | Pulp of wood or other fibrous cellulosic material, paper or paper boards | 33.70 | 21.16 | 45.13 |
| 50-63 | Textiles and textile articles | 16.52 | 13.46 | 70.02 |
| 64-67 | Footwear, headgear, umbrellas, walking sticks | 3.01 | 2.91 | 94.08 |
| 68-70 | Articles of stone, plaster, cement, asbestos, mica or similar materials | 14.15 | 10.25 | 75.60 |
| 71 | Natural or cultured pearls, precious or semiporous stones | 85.70 | 1.95 | 12.34 |
| 72-97 | Base metals, machinery, vehicles & transport equipment, arms, opticals etc | 8.49 | 19.47 | 72.04 |

| | | | | |
|--|--------------|--------------|--------------|--------------|
| | Total | 10.93 | 12.32 | 76.76 |
|--|--------------|--------------|--------------|--------------|

Source: Authors' Calculations based on KRA 2013 data

With regard to Kenyas exports, the EU under EPAs grants the country duty free access preference under the EU Market Access Regulation 1387-2014. This is deeper than the GSP preferences which are the next best alternative. However the advantage of market access through tariff reduction is small as long as non-tariff barriers, including high agricultural subsidies and high sanitary and phytosanitary standards are in place in the EU.

5.3 Implications of EPAs for Small Scale Farmers

International trade and investment liberalization agreements as being negotiated under the EAC-EC EPA have both direct and indirect implications for the broader development goals of the EAC Partner States involved. The first concern for Kenya is agricultural production and food security in the context of trade-related aspects of agricultural production. Agriculture is a vital in the national economy since it accounts for over 70 per cent of total employment in the country. The human rights definition of the right to food, the governments thus have an obligation to protect the livelihoods of farmers, more so the small-scale farmers, majority of whom are women. This is to enable them to produce food for the local community and ensuring that they gain a fair share in the commodity chain if they are engaged in production for the export market, in this case, the European Union under the envisaged EPA framework.

Besides, Kenya is classified as a Net Food-Importing Developing Country under the WTO-GATT (1994) and thus agriculture plays a critical role in livelihoods support. However EPAs potential may stifle Kenya governments' ability to support and protect farmers from the surge of cheap products into Kenyan market. The use of proposed trade remedy instruments⁴ in the EPA offer limited guarantee for effective protection of the livelihoods sources across different sectors of the economy and regions in the

⁴ Anti-dumping duties, Subsidies and Countervailing Measures and Safeguard Measures

country. This is despite EC's stance not to open up discussions on agricultural subsidies during the EPA negotiations. Even though the EC made duty free quota free (unlimited) market access offer on all products originating from EAC except sugar, bananas and rice.

Kenya has no comparative advantage in production and export of the commodities like sugar, bananas and rice. However, a quick glance at horticultural exports (with about 49 per cent being cut-flowers) where Kenya has certain comparative advantage demonstrate that the major barrier to export growth of Kenya's horticultural industry in the EC are non-tariff barriers. These NTBs include rules of origin, environmental measures, food safety standards, EUREP GAP and other stringent standards that can be applied arbitrarily to bar exports into the EU market.

EPA provides for reciprocity in trade between the Parties and this inevitably means that Kenya and the EAC region will be faced with increased competition from highly subsidized EU agricultural commodities. Such commodities for examples of include maize, wheat, cereal, milk and milk products, rice, sugar, tomato paste, poultry, flour, even meat and meat products and cotton.

Some , There is evidence in some literature that competition will be concentrated in agricultural commodities like maize, wheat, cereal, milk and milk products, rice, sugar, tomato paste, poultry, flour, and meat and meat products. These are products in which Kenya has substantial production and trade interest. Cotton, which is not Kenya's major traded product but one that is currently being revived in key growing areas to address rural incomes and food security, is also likely to suffer owing to EU's cotton subsidies. Another area of concern is that under EPA, Kenyan farmers may still be prevented from moving up the value chain through value addition and processing of raw products. This is because Government loses policy space and ability to apply duties on EU imports into the country and export taxes on Kenya's raw materials destined for European markets. For example the Government of Kenya may not continue imposing export tax (of 5per cent) on hides and skin to protect, nurture and stimulate the leather

industry in the country to grow. Furthermore, value added products from Kenya may continue to face tariff escalation, tariff peaks and technical barriers. Kenya currently has a narrow export base and limited number of value-added agricultural exports into the EU market.

The sanitary and phytosanitary (SPS) measures aimed at securing human and plant health, are set high standards for the export of agricultural products into the EU. However information asymmetry on new rules and high costs of inspection and compliance prevent smallholders from the application of any higher standards and from participating in international trade. Often, the consequence is a shift from the smallholder model to large-scale farming which is capable to guarantee the expected high standards. In addition trade-distorting measures in the EU agricultural market and the potential misuse of SPS measures to protect the domestic market against ACP exports hinder market access for small-holder farmers. Besides, there has been an increase in the number of private voluntary standards in the EU market that are likely to pose challenges for smallholder producers in the Kenya who would wish to export. However, there is a reprieve since the private standards are likely to be challenged at the WTO.

The subsidized EU exports could have two effects on smallholders in Kenya. The lower world market prices reduce their export income, while low-cost imports drive farmers out of the local markets. The EU imports lower the producers' income when the households are net sellers of a commodity that becomes cheaper after liberalization, even though it provides cheap food to local consumers. These imports are vulnerable to external fluctuations in commodity food prices and therefore may have a strong impact on food security.

6.0 THE RATIFICATION PROCESS AND ROLES OF VARIOUS STAKEHOLDERS IN THE IMPLEMENTATION PROCESS

6.1 Introduction

Recognition of international treaties, including the EU-EAC EPAs, is provided for under Articles 2(5) and 2(6) of the Kenya Constitution 2010. The former allows that “the general rules of international law shall form part of the law of Kenya.” The implication is that it is possible for a Court to recognize the so-called “general rules” without having to resort to some written law. Article 2(6) in turn provides that “...*any treaty or convention ratified by Kenya shall form part of the law of Kenya under this Constitution.*” Hence, once Kenya formally agrees to be bound by the terms of a treaty qua state, that agreement simultaneously have consequences at the domestic level.

The process and procedures for the ratification of the EPA agreement is grounded on the *Treaty making and Ratification Act No. 45 of 2012*. Ratification hence is a one-off process that has a dual effect; it not only binds Kenya in her relations with other states, but more importantly, has an effect in the domestic law framework. Parliament passed the Treaty Making and Ratification Act with the sole intention of “[giving] effect to article 2(6) of the Constitution and to provide the procedure for the making and ratification of treaties and connected purposes.”

The Act provides for the procedure of initiating and ratifying multilateral treaties and certain bilateral treaties. Section 3(2) of the Act stipulates that the Act applies to multilateral treaties; bilateral treaties which deal with the security of Kenya, its sovereignty, independence, unity or territorial integrity; the rights and duties of citizens of Kenya; the status of Kenya under international law and the maintenance or support of such status; the relationship between Kenya and any international organisation or similar body; as well as those relating to the environment and natural resources. Further the Act, under Section, 3(4) provides that, notwithstanding the provisions in Section 2(b) which relates to bilateral treaties, the government may enter into bilateral agreements necessary for matters relating to government business or relating to

technical, administrative or executive matters. The provision uses the term “*notwithstanding*” to insulate certain types of bilateral agreements from ratification. In its totality, Section 3(4) of the Act provides for an exception to the operation of Section 2(b) by way of the use of the word “*notwithstanding*.” In addition, a distinction is made between “*bilateral treaties*” and “*bilateral agreements*” which the drafters of the law intended to demarcate the boundary that distinguishes them. The interpretation of this Article can effectively be used to ratify some agreements without subjecting them to parliamentary ratification.

In fact, the office of the Attorney General, in a legal opinion relating to the treatment of Double Taxation Agreement between Kenya and Mauritius argued that the dichotomy between treaties and agreements under the Act is a clear indication of the intention of the framers. The AG argues that the bilateral treaties referred to in the Act have serious implications on domestic laws as well as an impact on the Constitution which is a sovereign law. They must thus be ratified under Article 2(6) of the Constitution. In this position, the government may enter into bilateral agreements relating to specific issues that are not covered by the preceding provisions. This is an interesting analogy that may serve to include the EPA in the category of “*agreements*” that require no ratification. The following part examines the respective roles various government institutions, the private sector as well as civil society in the implementation process.

6.2 The roles of various government institutions

The Constitution of Kenya allocates various roles to different entities of the government relating to the implementation and ratification of the EPA. The institutions of the National Executive, Parliament as well as the Judiciary all have different roles, and relationships with regards to the issue of ratification of treaties. The procedure of ratification is laid out in the Treaty Making and Ratification Act. The following part sets out the respective roles and procedure of ratification of treaties.

6.2.1 The National Executive

The national executive, according to Article 130(1) of the Constitution, consists of the President, the Deputy President and Cabinet Secretaries. The fourth schedule of the Constitution lists foreign affairs, foreign policy and international trade as functions of the national government. This means that EPAs is within the role of the National Executive in making policy decisions and negotiations on trade agreements.

The Treaty Making and Ratification Act require the Cabinet to approve draft treaties as the first process of ratification. It states that where the Government intends to ratify a treaty, the Cabinet Secretary of the relevant state department, in consultation with the Attorney-General, submit to the Cabinet the treaty, together with a memorandum outlining a raft of details including objects and subject matter of the treaty, any constitutional implications including any proposed amendment to the Constitution and details on the treaty being consistent with the Constitution by promoting constitutional values and objectives, national interests which may be affected by the ratification of the treaty, obligations imposed on Kenya by the treaty, requirements for implementation of the treaty as well as policy and legislative consideration. Other details include the financial implications, ministerial responsibility, implications on matters relating to counties, the summary of the process leading to the adoption of the treaty and the date of signature.

More importantly, the cabinet secretary is required to submit to the cabinet the views of the public on the ratification of the treaty and include information on whether the treaty permits reservations as well as any recommendations on reservations and declarations. Further, a proposed text of any reservations that should be entered when ratifying the treaty in order to protect or advance national interests or ensure conformity with the Constitution. These requirements serve to protect national interests in the case where certain provisions of the treaty collide with national priorities and interests. Part IV of the Act provides that the CS shall take measures to inform and create awareness to the public about the effects and benefits of the treaty.

6.1.2 The Legislature

The Constitution of Kenya confers powers to the legislature to, among other things, exercise oversight of state organs. This role establishes an oversight and countervailing relationship where actions of the executive are sanctioned through a mechanism that provides for accountability. In cases where the Cabinet approves the ratification of a treaty, the Cabinet Secretary is required to submit the treaty and a memorandum on the treaty to the Speaker of the National Assembly. A treaty approved for ratification by the Cabinet can, depending on its subject matter, be considered by both the National Assembly and the Senate.

When the treaty is submitted to the legislature, the relevant parliamentary committee is required, during its consideration of the Treaty, to ensure public participation in the ratification process in accordance with laid down parliamentary procedures. Parliament may approve the ratification of a treaty with or without reservations to specific provisions of the treaty. In cases where one house approves the ratification of a treaty and the other House refuses to approve the ratification of a treaty, the treaty is referred to the mediation committee in accordance with Article 112 of the Constitution.

Where the ratification of a treaty is approved by Parliament without any reservations to the treaty, the relevant Cabinet Secretary is required, within thirty days from the date of the approval of the ratification of treaty to prepare the instrument of ratification of the treaty. All instruments of ratification of a treaty must be signed, sealed and deposited by the Cabinet Secretary at the requisite international body and a copy thereof shall be filed with the Registrar.

However, the Act merely provides for the process of ratification and does not purport to give Parliament the power to “domesticate” treaties once ratified. It is also not clear on what should be done in case amendments to part(s) of the Treaty need to be done. Thus, in the Constitution and the statute, Kenya has embraced monism as far as the domestic effect of international law is concerned.

6.1.3 The Judiciary

The formulation of public policy, by its very nature, entails matters that are outside the purview of the courts. As such, courts cannot be called upon to carry out an appraisal of the merits and demerits of the EPA in a manner as to satisfy themselves whether or not they are good for the country. This is because the negotiation process is conducted by the political arm of the government. This argument has been tendered by the Attorney General (AG) in *Kenya Small Scale Farmers Forum & 6 others v Republic of Kenya & 2 others [2013] eKLR* where the AG argued that the doctrine of separation of powers limited the extent of the Court's intervention in governmental functions. It was argued that the EPA was negotiated by the political arm of government and as such the court needed to exercise restraint in view of the doctrine of separation of powers.

The court reasoned that it was not called upon to carry out an appraisal of the impugned agreement or negotiations to satisfy itself whether or not they are good for Kenya. Those, the court averred, are matters of policy of which this court is not best suited to handle. The court invoked the dissenting decision of the Supreme Court in *U.S v Butler*, 297 U.S. 1[1936], where it was observed that; "...courts are concerned only with the power to enact statutes, not with their wisdom....For the removal of unwise laws from the statute books appeal lies, not to the courts, but to the ballot and to the processes of democratic government."

However, Article 165 of the Constitution bestows upon the courts supervisory powers and an enforcement jurisdiction for cases where there is a breach of the Constitution, or where certain actions are challenged on the basis of their unconstitutionality. On this account, the court therefore can make a decision on the agreement in cases where the decisions undertaken by the executive do not protect and promote fidelity to constitutional values.

6.1.4 The roles of the private sector

There is no express provision in the Act for the roles of private sector and non-state actors on the process of ratification. Thus, under the circumstances two

indirect avenues exist through which they can influence the ratification process: first, lobbying parliament and the relevant parliamentary committees when the bill is submitted to parliament, and second, effective participation in the negotiations through the inter-ministerial committees. The private sector and non-state actors can also keep monitor and evaluate the implementation of the treaty reporting any adverse effects, to relevant state organs for possible actions or onward transmission to relevant consultative forums. The EPA agreement within the private sector development cooperation aims at ensuring that the sector benefits in the area of bulding their capacity and provide institutional support to institutions such as investment promotion agencies, apex bodies, chambers of commerce, associations, focal points and trade facilitation institutions. The private sector could also highlight other challenges in the implementation of the agreement like barriers to the entry into the EU of products originating from Kenya.

7.0 SUMMARY CONCLUSION AND POLICY RECOMMENDATIONS

7.1 Summary and Conclusion

This report examined the implications of the EAC-EU EPA on Kenya's agricultural sector, specifically the likely effects on smallholder farmers and agricultural outputs. It also reviewed the compatibility between the EPA and the WTO agreement as well as the ratification and domestication of the agreement in Kenya.

The study established that the potential threat of EPAs on local agricultural production lies in the possible surge into the local market by imports from the EU following the liberalization. Fortunately, most of the agricultural products are listed in the EAC sensitive product list, and therefore protected. In addition, the largest source of agricultural imports into Kenya is the ACP group of countries and not the EU per se. However, the policies of the EU are likely to indirectly affect domestic agricultural production through the impacts in the international market prices. At the same time, market access offers granted to Kenya and EAC by the EU through tariff reduction are likely to have marginal effects as long as non-tariff barriers, including high agricultural subsidies and high sanitary and phytosanitary standards are imposed by EU markets.,

The EPA with regard to farmers is likely to affect initiatives towards more value addition and processing of raw agricultural products, due to loss of policy space to apply duties on EU imports into the country, and impose export taxes on Kenya's raw materials destined for European markets. In addition, the high standards and SPS requirements by Europe may diminish the smallholder productions and results into loss of earnings from farm produce and employment opportunities. Subsidized EU exports could also lower world market prices thus reduce farmers' export income, while low-cost agricultural imports crowd farmers out of the domestic markets.

The assessment of the compatibility of the FEPA with the WTO rules was done within the scope of Article XXIV of the General Agreement on Tariffs and Trade (GATT, 1947). This agreement and the said article sets the disciplines for the creation of free trade areas like the one envisaged in the FEPA. The assessment took into account the

various provisions of paragraphs two to eight of the said article. Upon examining the FEPA as currently constituted against the WTO provisions, FEPA seems to meet most of the basic requirements of article XXIV. Taking into account the truism that there is little consensus on the interpretation of most of the requirements of article XXIV, it is unlikely that the FEPA could be challenged by the rest of the WTO membership. The overall conclusion is therefore that the FEPA as currently initialed is compatible with the WTO Rules on the establishment of free trade areas.

The analysis suggests potential impact of the FEPA on development and poverty reduction, that there would be significant impacts of full reciprocity on imports in Kenya under the EPAs. Substantial changes in composition with switching of sources away from the other regional and world suppliers to the EU would, especially, take place in the industrial goods sector as opposed to agricultural and intermediate products sectors. The full implementation of EPA, may shift consumption away from local products, to EU goods. This may in turn lead to a decline in production and employment in large-scale industries.

The study determined net positive revenue impact of EPAs on Kenya; this dispels the initial fears on the fiscal costs of EPAs. The minimal disruption in fiscal revenue is attributed mainly to the existence of the exclusion list where tariff revenues continue to be collected and the need to safeguard agriculture and industrial sectors. Besides, tariffs continue to be collected from imports from other trading partners other than the EU and the EAC. Kenya has also managed to broaden the revenue sources away from import and export tariff revenues.

7.2 Policy Recommendations

In light of the foregoing conclusion, the following specific recommendations are suggested as follows:

1. There should be continued support to all smallholder farmers in the country in order to cushion them from any possible threats of liberalization in the context of

EPAs. The support should include but not limited to supply of farm inputs, increased extension services both from public and private providers, marketing services, storage facilities and trainings etc.

2. Stakeholders should take cognizance of the concluded agreement and the ratification procedures that could be used upon it. The important thing would be to ensure that ratification is done through Parliament which can place necessary caveats on some aspects of the agreements as necessary. Alternatively, Parliament has the power to demand that certain aspects of the agreement be amended to best reflect the needs of the country in the Agreement. This will also provide for wider consultations and participation in the ratification process.
3. All stakeholders should, in the event of ratification, establish a mechanism to monitor the implementation of the agreement. In so doing, there should be a deliberate mechanism to track the challenges in the implementation of the agreement as well as the negative impacts. Such information could provide an important basis for adjustments to be made during the review process which comes two years after the agreement is signed.
4. The government should actively monitor the trade flows between the EU and Kenya and the rest of the EAC Partner States. This should be done on a continuous basis to determine whether it would be necessary to institute trade defense mechanisms in the event of a surge of imports.

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Prior to the establishment of the WTO, trade between the EU and AC Group of countries was governed by the successive Lome Conventions, dating from early 1970s to-date. Under these Conventions, Kenyan products, alongside products from the other ACP countries enjoyed preferential market access in the EU. The formation of WTO and subsequent coming into force of WTO Agreement had the effect of making such preferences under Lome incompatible with the WTO provisions. The incompatibility is due to the fact that continued preferential access to the EU market by the ACP countries discriminated among the ACP countries and other countries with similar levels of development, but do not enjoy similar preferential market access to the EU and consequently contravene the WTOs “Most Favored Nation principle”. The ACP and EU were therefore under an obligation to revise their trade arrangements to make them compatible with the WTO rules.



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