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MONEY MARKETS

Kenya at a crossroads in quest for stronger ties in global commerce

Workers prepare fruits for export at the Eldoret International Airport. Airstrips in western Kenya will be modernised following an increase in passengers in the region. FILE

President Uhuru Kenyatta's inaugural speech made it patent that enhancing regional integration and promoting Kenya's external trade would be a priority of the new government.

However, with the pressure brought about by the confirmation of the EU-ACP Economic Partnership Agreement negotiating deadline as October 2014, one of the more pressing challenges now facing Kenya's government is how to resolve the cleavage among East African Community (EAC) States on whether to ratify their 2007 Economic Partnership Agreement (EPA) with the European Union.

The five EAC States initialled an EPA in 2007 but further efforts towards ratification have stalled. While Kenya, propelled by its classification as a non-Least Developing Country (LDC), has been individually impelled to ratify the EPA, other EAC States — all of which are classified as LDCs — have been reluctant to sign the EPA.

Kenya has thus been pressed between maintaining solidarity with the region, and a considerable risk of being relegated to a less favourable GSP trading regime by the EU. But now that EU Parliament has endorsed the council's compromise proposal on Regulation 1528, Kenya has to act.

Can these two contesting objectives — the need for EAC solidarity in external trade agreements and maintenance of Kenya's preferential market access to the EU by ratifying its EPA agreement — be reconciled? Perhaps.

Kenya has two options. It can opt out of the EAC solidarity and ratify an individual 2007 'interim' EPA with the EU, or it can prevail upon both the EU and its EAC partner States to sign a minimalist EPA that sticks to the essential legal requirements of World Trade Organisation (WTO) compliancy and discard 2007 agreements on 'WTO plus' issues — export taxes, bilateral safeguards for infant industry, most favoured nation (MFN), trade in services, and development (liberalisation compensation) —which now hold back the EAC-EU EPA agreement. The first option would be outright unpopular with the rest of the EAC.

The second option would be unpopular with both the EAC and the EU. But it would be in line with the EU Council Regulation 1528 article 3 (b) of 2007 and perhaps could be used to contain disruption in regional (political) integration.

The exigencies of a looming negotiating deadline make it almost inevitable that Kenya will go for option one. Both options are unpalatable for Kenya's regional relations and the new government must up its economic diplomacy now in containing the inevitable political fallout expected from its exigency to sign an EPA.

First it would be important to clarify that even though Kenya is expected to lose out on custom revenues if it ratifies an EPA, those fiscal losses are more precise and manageable than the negative multiplier effects of preference erosion.

Kenya would suffer more from preference erosion (over 50 per cent of its exports would face a tax hike of up to more than 20 per cent) while suffering low custom revenue losses of between 0.4 per cent and 4.29 per cent as a percentage of total tax revenues.

The GSP tariff imposition would raise the cost of dutiable Kenyan exports by about 5.8 per cent, potentially wiping out present margins for exporters.

Besides Kenya now faces even stiffer competition in the horticulture industry from countries such as Colombia and Israel which already have Free Trade Agreements with the EU.

Therefore, faced with the choice between fiscal or trade losses, Kenya would be hit less by the fiscal losses than by the trade losses. In any case, the EPA is estimated to generate about Sh10.4 billion annually in increased trade.

If Kenya wanted to use any little negotiating capital it may have left to try and save EAC solidarity, then it would be to persuade both parties, the EU and the rest of the EAC States, to abandon those areas of their 2007 interim agreement that are subsidiary to a basic goods-only FTA.

This would entail discarding agreements reached in WTO-plus areas such as development funding, export taxes and MFN, infant industry safeguards and so on.

In line with the objectives for EPA outlined in Regulation 1528 Article 3(b) of 2007 Kenya could make a good argument for signing a minimalist FTA as a measure to save regional EAC coherence — both political and economic.

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