IMPLICATIONS OF AN EPA FOR KENYA'S AGRICULTURAL MARKET ACCESS IN THE EUROPEAN UNION

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Abstract

Although trade liberalization brings with it considerable welfare gains, the political risks as well as economic costs involved often leads to preferences for trade pacts which tend to balance the import competing interests to those of exporters. Non-tariff barriers and other impediments may however limit the benefits that developing countries can derive from trade pacts such as trade preferences granted by developed countries for products from developing countries. Kenya's agricultural exports to the EU are mainly coffee, horticulture and tea. From the EU she also draws most of her equipment imports. The regional COMESA market is the main destination for her manufactured goods. Therefore EPAs may, although safeguarding market access into the EU, result in loss of competitiveness for Kenya's local manufacturing industries in the domestic as well as regional markets. Further, the envisaged CAP reforms not only threaten Kenya's export earnings from her agricultural exports to the EU but may also result in further decline in exports from other markets as a result of the world price dampening effect of the CAP reforms. Other than this the creeping use of non-tariff barriers to trade in the OECD in general and the EU in particular may further jeopardize the benefits that accrue to Kenya from the EPAs. This is further compounded by the considerable erosion of these preferences by concessions granted by the EU under other trading arrangements such as the WTO. The possibility for moving up the value chain is also blocked by the tariff escalation in the EU.

For Kenya to benefit from the EPAs therefore there must be, inter alia, unfettered access for all Kenyan products into the EU market, long enough tariff phase down period to enable her to consolidate gains from the regional integration, full compensation for expected revenue loss in form of increased budgetary support and trade capacity building to mitigate the costs of complying with the creeping non- tariff barriers such as SPS and TBT measures.

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Abbreviations

ACP	African Caribbean and Pacific Countries
AGOA	Africa Growth and Opportunity Act
AOA	Agreement on Agriculture
CAP	Common Agricultural Policy
COMESA	Common Market for Eastern and Southern Africa
CPA	Cotonou Partnership Agreement
DVS	Department for Veterinary Services
EBA	Everything But Arms initiative
ESA	Eastern and Southern Africa
EU	European Union
EUREGAP	European Retailers Code of Good Agricultural Practices
EPA	Economic Partnership Agreements
FTA	Free Trade Area
FDI	Foreign Direct Investment
GTAP	Global Trade Analysis Project
I.E.A	Institute for Economic Affairs
KEBS	Kenya Bureau of Standards
KEPHIS	Kenya Plant Health Inspection Services
KIPPRA	The Kenya Institute for Public Policy Research and Analysis
KRA	Kenya Revenue Authority
MFA	Multi Fibre Agreement
MFN	Most Favored Nation Status
MRLs	Maximum Residue Levels

NEDSP	National Export Development Strategy Paper
NTA s	New Trading Arrangements
NTBs	Non-Tariff Barriers
OECD	Organization for Economic Cooperation and Development
RTAs	Regional Trade Arrangements
SITC	Standard International Trade Classification
SPS	Sanitary and Phyto Sanitary measures
SRA	Strategy for Revitalizing Agriculture
SSA	Sub-Saharan Africa
TBT	Technical Barriers to Trade
TRAINS	Trade Analysis and Information System
UNECA	United Nations Economic Commission for Africa
VER	Voluntary Export Restraints
WTO	World Trade Organization

Executive Summary

The stated objective of the EPAs, (according to the EU) is to introduce reciprocity into (and therefore achieve WTO compatibility for) the long standing trade relationships between the EU and the ACP. As such it is incumbent on ACP countries like Kenya that are contemplating negotiating an EPA to ensure that, at a minimum, market access gains secured under the Lome conventions are not eroded or that there are net welfare gains for the country in the new trade arrangements.

Theoretical analysis leads us to expect that trade liberalization brings with it significant welfare gains. Nevertheless the sensitivity to the political risks involved in such policy actions often leads to the preference for trade pacts where the interest of export competing and import competing sectors are carefully balanced.

Other than the static welfare effects of RTAs of trade diversion and trade creation, two potential dynamic effects of competition and scale effects as well as trade and location effects are of far greater significance.

Non-tariff barriers and other impediments may limit the benefits that low-income countries derive from the trade preferences granted by developed countries as a substitute for aid. Further the effectiveness of the preferences in targeting the poor may be compromised if productive resources are highly concentrated.

Kenya's trade flows in agriculture and manufactures represents her unique production structure as well as her geographical location. Her agricultural exports are mainly destined for the EU while she exports manufactured goods to the regional markets. As such market access gains arising from the EPAs must adequately compensate the possible loss of jobs, revenue and income that may arise from the increased exposure of the manufacturing sector to competition from the EU. Tea, Coffee and Horticulture are Kenya's dominant agricultural exports to the EU and have benefited from the market access provisions in the Lome and Cotonou trade pacts as evidenced by significant growth in the 1995-2003 period.

The CAP reforms have the potential to affect global agricultural trade and significantly undermine export earnings from Kenya's agricultural exports to the EU. Further they may displace, from global and EU markets, developing countries' agricultural exports. Therefore not only Kenya's present export earnings from the EU but also her potential export earnings may be significantly reduced through the price reductions-in the EU and globally- that will arise from the reforms.

NTBS have proliferated in developed countries even as tariffs have been systematically reduced to embrace globalization. The evidence shows that agricultural exports from all developing countries to the EU, (whether or not they enjoy preferences), faces higher barriers than do manufactured exports from the same.

Agricultural exports from preference receiving developing countries enjoy slight advantage over exports from the middle-income countries and OECD economies. Preference erosion through WTO and other trade negotiations therefore significantly undermine competitiveness of these exports in the EU-where market access is higher than in other

OECD countries. The increasing use of TBT and SPS measures in the OECD markets will undermine whatever tariff liberalization gains made. In addition, Kenyan agricultural exports to the EU face both tariff peaks and tariff escalation-that prevent the country from moving up the value chain- as well as and non-tariff barriers.

NTBs that face Kenyan agricultural exports to the EU are mainly those concerned with SPS and TBT measures. Examples of those particularly causing concern to Kenyan exporters of agricultural products to the EU include: the high costs of conforming to quality standards, new traceability regulations, adherence to MRLs and adoption of EUREGAP. The costs of compliance with these new standards are especially prohibitive for small-scale farmers.

Overall the effect of the EPAs on agricultural market access in the EU will depend on four factors. First, the extent of preference erosion resulting from the CAP reforms and WTO commitments entered into by the EU. Second, extent to which the CAP reforms depress global and EU prices of agricultural goods of export interest to Kenya. Third, the extent and scope of tariff liberalization in the EU on which the overall welfare effects of EPAs depends and fourth, the extent to which the costs of complying with the creeping food and health safety standards presently being used in the EU are mitigated through trade capacity building in Kenya.

Arising from the foregoing we offer the following recommendations which can be used as a negotiating position.

(i) EU Tariff liberalization must allow for the unfettered access for all Kenyan products into the EU market.
(ii) Tariff phase down period for Kenya should be sufficient to enable her to consolidate gains from regional integration.
(iii) There should be full compensation for the expected revenue loss in form of increased budget supported for the expected revenue loss.
(iv) There should be a mitigation of costs of complying with the creeping TBT and SPS requirements through for example, seeking equivalence recognition for the existing verification arrangements in the ACP and EU.
(v) Kenya should seek to undertake a detailed sector-by-sector and product-by-product negotiation of the standards and regulations.
(vi) Kenyan negotiators should demand that standards to protect EU citizens through animal and plant health regulations be designed to minimize trade obstacles to her small-scale farmers.
(vii) EU should facilitate increased access to accurate information on changes in the standards on traceability, MRLs and EUREGAP.
(viii) There should be harmonization of varying individual OECD country standards to an internationally accepted base so as to reduce the compliance costs.
(ix) EU should provide assistance for trade capacity building. For example, EU should give increased assistance to farmers to access suitable equipment for spraying horticultural produce. EU should also equip Pest Control Products Board and key standards bodies like KEPHIS, DVS, Department of Fisheries and KEBS to increase compliance with EU regulations.

1.0 Introduction

In 1975, Kenya was among the seventy countries from the African, Caribbean and Pacific (ACP) countries that signed an agreement with the EU which had both trade and aid provisions. This agreement, called the Lome convention, was based on the colonial links between ACP countries and their, mainly, European colonial masters. The Lome convention however made elaborate provisions for the future trade and aid relations between these two sets of countries. One of the trade provisions was that non-reciprocal trade preferences were granted to ACP products in the European market so that almost 97 per cent of ACP export products to the EU were allowed to enjoy duty free market access, (I.E.A, 2000). These trade agreements were subsequently renewed every ten years with the objective, (between 1975 and 2000), being to: increase the export income of developing countries, promote their industrialization and accelerate their economic growth (Ikiara et al 2003). The Lome IV Convention expired in February 2000 and was succeeded by a new agreement, (the Cotonou Partnership Agreement). The Cotonou Partnership Agreement (CPA) requires ACP countries to reciprocate the duty free access to the EU market from 2008. In this regard, countries are required to sign Economic Partnership Agreements (EPAs), with the EU, preferably in the existing regional groupings in which they are members.

The proposed new trade arrangements (which are projected to come into force in 2008), carry with them some potential sacrifices that the country will have to face as its productive sectors are exposed to increased competition. The benefit of the continued preferential access to the EU market is presumably worth the additional adjustments costs associated with the envisaged liberalization of the trade regime. It is therefore important to seek to understand the nature of the goods that are exported to the EU market and the kind of market access conditions that are presently available for these goods in those markets. Any negotiation position taken by the country must ensure that the market accesses currently enjoyed by the country's exports are either preserved (not eroded) or increased. As such it will be important to examine the nature of the market access conditions for the country's agricultural exports to the EU. The costs and benefits of the EPA arrangements for the country can then be weighed. This will entail comparison between the adjustment costs associated with liberalization of trade after the formation of the EPAs and the benefits from the preferential access to the EU market.

In undertaking this task, this report commissioned by the IEA, evaluates implications of agricultural market access with the EU under the EPAs as well as the possible compensation mechanisms should there be losses from the EPA. In the light of the findings from the study, the report makes appropriate recommendations on the possible negotiating positions that the country should take. The scope and objectives of this report is therefore largely limited by the terms of reference which include *inter alia*: i) to examine the composition of Kenyan agricultural export trade with the EU since Lome (ii) to compare the commodities of export interest to Kenya with the protected products of the EU under the Common Agricultural Policy (CAP) (iii) to examine the Tariff and non-tariff barriers that Kenyan agricultural commodities face in the EU (iv) to examine the implications of an EPA on agricultural market access with the EU and possible compensation mechanisms when losses emerge from an EPA (v) to establish a negotiation position.

In achieving some of these objectives the paper makes use of secondary data sources-mainly published and unpublished literature as well as trade and other statistics. The paper is arranged as follows. Section 2 considers the theoretical issues surrounding the proposed EPA arrangements. In section 3 we examine the Structure of Kenya's trade where we consider the composition of Kenya's agricultural exports to the EU since Lome. Section 4 highlights the effects of the EU reforms on Kenya's agricultural commodity exports while section 5 discusses the tariff and non-tariff barriers facing Kenya's agricultural commodity exports to the European Union. In section 6 we consider the possible implications of an EPA on Kenyan agricultural products' market access in the EU and the possibility of a compensation mechanism to enable Kenya to deal with possible losses arising from the EPA. In section 7 we make conclusions and recommendations of the possible negotiation positions that the country can take at the EPA negotiations.

1.1 The Lome Conventions and the Cotonou Agreement: A Review

In the contractual agreement between the European Union (EU) and the African Caribbean and Pacific (ACP) countries, (famously called the Lome Convention), the EU pledged to provide development aid and preferential export market access to ACP countries. The fourth cycle of the Lome Convention expired on February 29, 2000. Prior to the expiry of the Lome IV Convention, negotiations between ACP countries and the EU took place to explore options available in the Post-Lome arrangement.

The Cotonou Partnership Agreement, (CPA), signed on June 23, 2000 in Cotonou, Benin, is the successor of the Lome IV Convention. This will operate for 20 years and will expire on 29 February 2020. In effect, the trade arrangements under Cotonou roll over the Lome IV trade provisions until 2007, during which time a new regime with ACP is to be negotiated. Thus, as a first step, the non-reciprocal preferential market access foreseen under Lome was extended by 8 years starting March 1st 2000.

The Non-reciprocal trade preferences that were at the heart of the EU's two–pronged approach towards the ACP countries are to be withdrawn gradually in the new trade arrangement which is expected to have full reciprocity to conform with the provisions of the WTO trade disciplines. The genesis of the proposed new trade arrangement was the 1996 EU "Green Paper" on "the relations between the European Union and the ACP countries on the eve of the 21st Century." This paper gave voice to the dissatisfaction, within both the EU and the ACP, with the failure of the Lome conventions to effectively redress poverty in the ACP countries in addition to the arrangement being contestable at the World Trade Organization's (WTO) for violating the key principle of non-discriminatory trade among members.

Despite the trade preferences that were offered under the Lome conventions, many ACP countries were still unable to compete due to the erosion of these preferences through the gradual reduction in EU tariffs for competing non-ACP exporters. This, coupled with the failure of ACP countries to boost their productivity and diversify their exports, had resulted in a steady decline in the ACP country share of EU imports. Studies by the ACP secretariat reveal that despite the Lome conventions, ACP countries have become increasingly marginalized in world trade. Over the period of the successive Lome conventions ACP share in world exports fell from 3.4% to 1.1% whereas the share of ACP in total EU imports declined consistently from 6.7% in 1976 to 2.8% in 1999 at the same time as the ACP share of EU Foreign Direct Investment (FDI), fell even lower from 2.8 per cent in 1996 to 1.7 per cent in 1999 (Nyangito and Ronge, 2003). There was therefore a need for fundamental changes to make the trade arrangements both more effective for ACP development as well as more WTO compatible. The Green Paper highlighted the nature of the required changes.

With regard to the trade arrangements with the ACP the "Green Paper" envisaged four options that a new trade arrangement between the ACP and the EU would take. Of the four available options the EU settled on the option that proposed the need for differentiated reciprocity in the trade arrangements between the EU and the ACP countries. This meant that although trade preferences were to continue being extended to the ACP countries some of them, depending on their level of development, would now be compelled to reciprocate these preferences by, in turn, opening up their markets to EU goods.

The Cotonou Agreement represented a fundamental alteration in the focus of the trade and economic cooperation between the ACP and the EU. Thus whereas article 167(1) of the Lome IV Agreement sought to "promote trade between the ACP states and the community," Article 34(1) of the new Cotonou Agreement had a broader objective-"to foster the smooth and gradual integration of the ACP states into the world economy thereby promoting their sustainable development and contributing to poverty eradication in the ACP states" (Nyangito and Ronge, 2003). Thus the aim and focus of the new trade agreement represented a shift from the previous (Lome IV) Agreement, which explicitly sought to "improve the conditions of access for their products to the market." As outlined in the Cotonou Agreement under Article 34(2) and Article 34(3), the broader objective is to "enhance the production, supply and trading capacity of the ACP countries as well as their capacity to attract investment by creating new trade dynamics between the parties with a view to facilitate their transition to the liberalised global economy."

Articles 34 to 38 of the Cotonou Agreement explicitly recognize the proposed new trading arrangements. For example Article 36 of the Agreement commits the ACP and EU states to negotiate new WTO-compatible Economic Partnership Agreements (EPAs)[1] including new trading arrangements (NTAs) that will gradually[2] replace the current non-reciprocal trade regime. Article 37(5) of the agreement gives flexibility to ACP countries to negotiate with the EU at a level appropriate to them but in accordance with procedures agreed with the ACP group taking into account the regional integration processes within the ACP.

The focus of the proposed new arrangements is therefore to reorient the nature of the trading relationships between the EU and the ACP. It changes the non-reciprocal trading arrangement between the ACP and the EU into an arrangement where the preferential access to EU market by ACP goods would have to be reciprocated.

[1] Economic Partnership Agreements (EPAs) seek to increase integration between the EU and the ACP states by progressively removing all barriers to trade between the two sets of countries so as to achieve the broad objectives of the new agreements – increase integration with the world economy. The larger integrated areas between the EU and the ACP that the EPAs permit, offers participating ACP states several advantages including: enlarging markets for the ACP states, allowing for economies of scale, improving the level of specialisation, increasing the competitiveness of the ACP and attracting investment.

[2] It is envisaged that these agreements should be concluded by 2008 latest, although implementation will take a while longer.

With the onset of the WTO in 1995 the preferential trading arrangements that had been granted to the ACP countries under the auspices of the EU-ACP Lome agreements were formally challenged in the WTO dispute settlement body and exemption granted until 2007 for the EU to continue this practice. The preferential market access granted to the ACP countries by the EU could only be continued within the context of a formal trade arrangement through which reciprocal trade preferences would need to be granted to the EU in the ACP markets – thus the Economic Partnership Agreements (EPAs). These latter arrangements, essentially free trade agreements, are expected to maintain the *acquis* enjoyed by the ACP countries under Lome and Cotonou while at the same time requiring the ACP countries to grant access to the EU countries' goods. It is therefore essential for ACP countries to get the maximum market access possible for their export goods to the EU without unduly compromising their import competing industries as well as overall welfare by granting preferences to EU goods over goods from the rest of the world. Welfare losses would result if the new trade arrangement resulted in trade diversion whereby goods from less efficient EU producers displaced goods from more efficient producers from the rest of the world in the ACP markets. The proposed trade arrangement could also be welfare enhancing, (or trade creating), if the imports from more efficient EU producers displaced less efficient domestic producers of the same. The net welfare effect would then help us judge the overall impact of the new trade arrangement and hence come to a decision on its viability.

2.0 Theoretical Frameworks for Considering the Implications of the New EPA arrangements

The Lome conventions and the present Cotonou Partnership Agreement sought to grant non-reciprocal trade preferences, (essentially duty free market access into the EU), to the ACP region. The proposed EPAs are, on the other hand, based on the principle of reciprocity, as permitted by WTO provisions, which covers "substantially all trade" between the EU and the ACP. Any evaluation of the costs and benefits of the proposed EPAs must therefore not only take account of the costs and benefits of the proposed free trade areas but also of the costs and benefits of the existing trade preferences – the preservation of which has in fact forced on the ACP countries the need to negotiate the EPAs. In this section we look at this analytically.

Support for free trade is pegged on the premise that it permits a more rational allocation of resources as countries specialize in the production and export of goods for which they have a comparative advantage. Opponents of free trade, (especially as regards developing countries), base their case on the limited sources of comparative advantage that such countries have compared to their more developed counterparts. Further, free trade policies limit the scope to which developing country governments can intervene to direct the economic development of their countries. In addition because developing countries only have comparative advantage in production of goods that are labour and resource intensive, (which have been facing relative declining terms of trade with respect to the high technology and skill intensive products which they import from developed countries), free trade would confine developing countries like Kenya to poverty regardless of their best efforts. However, the strength of this argument is undermined by the fact that vehement opposition to free trade is also found in developed countries. Developed country lobbyists against free trade base their case on the fact that trade liberalization brings in its wake considerable redistribution of incomes as well as adjustment costs. As such developed country policy makers are like their developing country counter parts constrained to engage in some manner of trade intervention in order to pacify politically and economically influential constituencies that may otherwise be adversely affected by reform of the existing trade regime.

In the realm of international trade, trade barriers are the norm- most governments erecting them for the purpose of achieving certain economic objectives or for appeasing certain political constituencies. There are two kinds of barriers to trade that are commonly used by governments. These are first, tariff barriers- which are essentially commodity taxes levied on imports and second, non-tariff barriers which can be quantitative or administrative restrictions on imports or other policies pursued by governments which have the effect of restricting the quantity of imports. The overall effect of tariff and non-tariff barriers to trade is that they restrict trade, raise import prices and redistribute income. However it is apparent that Non-Tariff Barriers (NTBs) have a more adverse effect on national welfare than tariff barriers. It is interesting that despite the foregoing most governments are increasingly making use of Non-Tariff Barriers to trade as an instrument of trade policy.

The significant influence that main stream economic thinking has had on policy makers the world over has led many economic managers to embrace trade liberalization as a necessary condition for economic growth. However, countries that are also sensitive to politically influential interests are only able to liberalize their trade regimes within the context of trade pacts that enable them to take cognisance of the countries competing interest groups. As such, trade agreements serve to galvanise export interests in a country –who benefit from increased market access- to act as a strong counter lobby to the import competing interests that support protectionist measures. Trade pacts therefore serve to balance the interests of import competing sectors against those of export competing sectors within the course of negotiations. A typical developing country entering into a trade pact with a developed economy-for example as in the proposed EPAs- would have to carefully balance the interests of exporters- in this case mainly agricultural producers -against the manufacturing sector interests. The market access gains that are made as a result of the trade pacts must compensate for the increased competition, (and possible losses of markets, jobs and revenues), that would result for the import competing sectors – in this case the manufacturing sector.

Multilateral trade agreements and Regional Trade Agreements (RTAs) are the most important trade pacts. Multilateral trade agreements are characterised by the principles of most favoured nation and national treatment. The MFN principle seeks to eliminate discriminatory trade between members of the trade agreement and as such requires that concessions extended to one member be extended to all members of the trade pact. National treatment requires that once imports have entered a country's borders (i.e once they have been charged the stipulated border taxes) they be granted the same treatment as that granted to similar import competing domestic goods. These provisions are found within the present WTO agreement whose main objectives are to achieve a gradual negotiated liberalization of the global trade regime. In recognition that due to historical, economic and geographical ties countries sometimes prefer to form trading blocs, WTO provisions – particularly Article XXIV -permits regional trade arrangements that discriminate in the trade liberalization concessions made to different member states of the WTO.

It is however arguable whether, in fact, Regional Trade Agreements are a building bloc or a hindrance to further multilateral trade liberalization. For example, regionalism may be seen as a facilitator of global trade negotiations because it increases the bargaining power of the trading bloc and reduces the number of independent participants in the global trade talks hence increasing the probability of trade negotiations being successfully completed. Further, RTAs may give incentives to excluded countries to accelerate multilateral trade negotiations as included countries accelerate multilateral trade liberalization. It is also possible to undertake deeper trade liberalization in a regional trade agreement than in a multilateral trade pact. Regionalism can be considered a hindrance if it causes trade diversion or if it increases the proclivity for trade wars among countries. Further regionalism may also result in protection of certain sectors, (for example agriculture in the EU) that make it much more difficult to conclude multilateral trade negotiations. Increased bargaining power for certain trading blocs may also increase their ability to coerce other trading partners to agree on their preferred positions. Trade blocs may also complicate trade negotiations for participating partners, as they have to develop a common position supported by all members of the trade bloc.

2.1 Costs and Benefits of Regional Trade Arrangements

Regional Trade Agreements have both costs as well as benefits. RTAs may lead to an expansion of some sectors even as others contract. The mechanisms by which this takes place can be grouped into two main types viz: (i) Competition and Scale effects and (ii) Trade and location effects.

- **Competition and Scale Effects**

Competition and scale effects occur when separate national markets become more integrated –as a result of the trade pacts-into a single unified market. As a result of the larger market, economies of scale are achieved even as producers of member countries come into closer contact and increase their competition with one another. Efficiency within firms is increased as entrenched monopoly positions are challenged. Further foreign suppliers will change their pricing strategies as well as their attitude towards FDI, (preferring the latter to exporting), as a result of the change in market size as well as competition.

- **Trade and Location Effects**

Trade and location effects occur when the RTA results in a change in the patterns of trade and the location of production. Direction of trade will change as the imports from the neighbouring countries become cheaper and hence consumers substitute these for the locally produced substitutes. The location of economic activity may also change for integrating countries. Some activities will expand while others will contract. When these changes are not evenly balanced some countries will do better than others. These changes may lead to convergence or divergence of countries' incomes- raising the incomes of poorer countries to the levels of richer countries. Alternatively when some partner countries in the RTA benefit at the expense of others the integration may cause divergence.

RTAs may result in the relocation of economic activities as a result of expansion in some countries and contraction in others. The changes in the demand for labour that result from this also leads to changes in real income. In the EU, for example, there has been convergence in income levels since its formation in 1948 (Word Bank 2000). However convergence is only possible if complementary reforms are undertaken. Non-reforming low-income countries would not therefore be able to reap significant benefits from the union with higher income countries. RTAs can also be able to lead to relocation of economic activity between member states. In the case of two LDCs forming an RTA-where one has a higher relative comparative disadvantage in producing manufacturing compared to another LDC, then manufacturing production activities will shift to the latter. In an RTA between a high income and a low-income country industry relocates in response to the differences in factor endowments and associated differences in factor prices. So for example Kenya, (a lower wage economy) may benefit disproportionately from forming an RTA with the EU- a higher wage economy because it may benefit considerably from the relocation of activities from the EU to the lower cost destination. The possibility of this has increased with time as technological advances make it possible to fragment production processes so that labour intensive activities in the process can move to lower wage countries.

RTAs can lead to clustering of economic activities in locations where economic centres of activity have historically existed. This can result from the lowering of trade barriers where simultaneously transport costs are low. In the process consumers will be supplied from fewer locations. This is because of the lowering of trade barriers in an RTA, if we assume that transport costs are low, will result in fewer locations from which consumers will be supplied. RTA membership may therefore lead to agglomeration and growing divergence between member countries. Agglomeration may in turn accentuate the forces of divergence. Agglomeration forces may also sometimes pull against comparative advantage so that although there are benefits from agglomeration in locating in a particular place, firms seeking to exploit factor price differences between locations may relocate elsewhere. In this regard therefore one of the expected benefits for Kenya from the RTA with the EU-that is FDI inflows-may not actually materialise. However, such an arrangement will still increase trade flows between the EU and Kenya which is bound to result in technology transfers. Theoretically an increase in North-South trade flows is bound to result in increased technology transfer as the extent to which a country benefits from foreign knowledge is dependent on how open it is to countries with the largest stock of knowledge.

Theoretical and empirical research therefore leads us to make the following generalizations about the North–South RTAs: (i) they are more likely to generate useful transfers of technology; (ii) they are more likely to provide lock-in mechanisms in the area of politics (democracy) and economics (Policy credibility); (iii) they are bound to result in higher benefits from deep integration than South-South Integration; (iv) they are bound to realise benefits from comparative advantage for developing countries than in a south-South RTA; (v) and developing countries may be able to, on account of Deep integration, find it more beneficial than a South-South integration.

In summary what can we say about the implications of the Kenya–EU RTA? First, one of the key benefits is that there is bound to be policy lock-in as the RTA will act as a commitment mechanism. Second, the RTA is unlikely to result in significant trade diversion on account of production costs in the EU being near those of the world level as a result of its low trade barriers in manufactured goods. Third, significant losses in government revenues are bound to be sustained. Fourth, Trade and location effects are bound to be favourable to Kenya to the extent that the RTA with the EU permits her to develop effective export activities to supply the EU and that Kenya is drawn into a production network that enables her to undertake labour intensive stages of production activity due to her lower wage costs. However, this is all dependent on the transport costs, quality of infrastructure and the security of market access. Lastly, the RTA with the EU will have significant commitments of new aid and funding which should be useful in the development of supply side capacity of the country.

Regional integration may alleviate the disadvantages caused by small markets such as the difficulty faced by countries in producing profitably goods that are subject to increasing returns or to engage in industries where economies of scale exist. By combining markets RTAs make it possible for monopoly power that arises from such situations to be reduced. The increased competition may lead firms to cut costs and therefore prices and to increase sales- benefiting consumers as a result. Market enlargement as a result of he RTA also allows firms to exploit economies of scale more fully. Firms also respond to the increased competition brought about by regional integration by reducing internal inefficiencies (X-Inefficiency) and raising productivity levels. Increased competition also raises the incentives among workers to improve productivity as way of avoiding bankruptcy of their firms. Deep integration as permitted by the RTAs has the effect of reducing market segmentation. Further, firms from excluded countries are forced to cut the process of their imports into the new integrating area as a result of the higher prospects of competition from the first of the partner countries. This has the effect of increasing the welfare of consumers in the integrating region. By creating larger markets RTAs may also become a more attractive destination for FDI. In the case of lumpy investments, the scale effects of the RTA evidently make it cheaper to supply the domestic market from within the RTA than to face the costs of tariffs and other trade barriers.

2.2 Cost and Benefits of Trade preferences

Trade preferences have over time been used by Industrialised countries as a trade and foreign policy instrument. Through trade preferences imports of selected products from recipient countries enter at lower import duties than those from elsewhere with the following expected benefits to recipient countries (i) Increased returns to exporters who receive them and (ii) Promotion of the industrialisation of these countries (iii) Acceleration of the economic development of the same.

These are however only expected benefits as the trade preferences can impede the development of industries that do not receive them so that the economies in general lose their dynamic capacity to channel their energies and resources to seizing the changing market opportunities. Below we discuss the mechanism by which this takes place.

In examining the effect of trade preferences we should note that import duties have two effects on the economy of the countries that impose them. First, by increasing the domestic price of imported goods they protect domestic producers of the imported good and second, they also increase the government revenues from tariffs. Domestic producers are therefore able to sell their products in the domestic markets at a premium-the higher tariff induced price. When tariffs are applied preferentially they offer the favoured foreign suppliers higher returns than they would otherwise be entitled. This is because the favoured foreign suppliers can now sell their export goods at a higher price than that obtained by the other foreign suppliers. Industrialised countries grant trade preferences to developing country suppliers as a substitute for aid. These trade preferences are offered under a number of schemes such as: the Generalised System of preferences, the US African Growth Act (AGOA) initiative, the Everything But Arms (EBA) initiative, the Lome conventions and Cotonou Partnership Agreement.

There is compelling evidence in support of the argument that such trade preferences are beneficial to the ACP countries when we examine the considerable divergence between the domestic price in developed countries and the world market price for products of export interest to developing countries. Table 1 below indicates the divergence between the EU price and the world price of certain commodities.

Table 1: European Union Producer/ Product Prices and World Market Prices

Produts	EU price $/ Per Tonne	World price $/Per Tonne	Difference (%)
Sugar	650	250	160
Sheep	3,333	1,476	126
Butter	2,954	1,307	126
Rice	600	300	100
Whole Milk Powder	2,605	1,384	88
Bananas	660	360	83
Cheese	3,500	2,154	62
Beef	2,780	1,776	57
Maize	140	92	52

Source: European Commission, 2000. ***"Everything But Arms Proposal: First Remarks on the Possible Impacts on the agricultural sector, European Commission, Brussels"***

As such the preference receiving countries are able to benefit significantly from selling their goods in the EU than they would from selling them in the world markets. However the extent to which the exporters from the recipient countries benefit from the trade preferences is determined by a number of factors including: (i) Range of goods eligible for preference (ii) The extent of preferential treatment provided to the products (iii) Costs incurred in complying with preferential access arrangements (iv) Quantitative limits imposed on goods imported with preferences (v) Extent to which the available preferences are utilized.

The foregoing notwithstanding the LDCs find significant impediments to their capacity to take up preferences offered by the industrialised countries. These factors include the following (i) The costs incurred in meeting the conditions set by the preference giving countries, which may undercut the potential benefits to exporters; (ii) The complexity of such schemes (iii) Exporters limited knowledge of these schemes (iv) Exporters inability to fulfil the regulatory barriers that are imposed by the industrialised countries.

Finally in analysing the significance of the trade preference to low income countries the following can be noted. First, the net financial impact of preferences on LDCs has been inadequate. The financial benefits of the preferences often accrue to owners of the factors of production used to produce the preference receiving exports. Where such owners are Foreign Direct Investment then it is arguable whether the product specific transfers that occur due to the trade preferences are as effective in advancing economic development of poor countries as similar amounts of aggregate revenues provided as direct development assistance. Second, the limited coverage of products by trade preferences often results in limited access to markets of developed countries. Third, trade preferences are often under-utilised hence limiting the extent to which the trade preferences can affect general living standards in poor countries. Fourth, trade preferences increase the dependency of industries that rely on it as well as that of entire countries hence increasing their vulnerability to external shocks. Preferences are also given to provide some sort of justification for continued protection of certain industries in preference giving countries. Developing country producers will as a result lobby strongly for the continuation of the preferences in developed countries. Fifth, preferences result in the preference receiving countries becoming high cost producers on a world scale. This may result in a misallocation of resources in these countries as they have higher average costs of production overall. This tends to compromise the competitiveness of these industries and makes them incapable of taking advantage of opportunities outside the preference giving countries. Sixth, preferences can also affect consumers of these products in preference receiving countries by imposing a heavy burden on them.

Below we examine the nature of Kenya's trade with the EU and the rest of the World in order to come to some informed deduction of this possibility in the subsequent text.

3.0 Structure of Kenya's Trade with the EU

From Table 2 below it is evident that the structure of Kenyan trade is representative of that of a typical developing country with a dominant agricultural sector and a nascent manufacturing sector. Exports of primary and processed commodities dominate exports of all other commodities. However, because of the country's geographical location and the historical circumstances that have made her industrial structure relatively more developed than her regional partners, the country is also a significant exporter of consumer goods. This latter category of exports has seen significant growth, since the 1990s, largely on account of the regional trade liberalization efforts that have allowed the country to competitively export manufactures, (industrial supplies and consumer goods), to the region. The trend growth, as shown in Table 2, in exports of industrial supplies as well as consumer goods, evidently supports this.

Table 2. Commodity Composition of Kenya's Trade, 1990-2004

Type of Commodity		1990	1995	1999	2000	2001	2002	2003	2004
Food and Beverages	Exports [a]	60.4	51.1	55.9	56.3	49.2	51.9	51.3	47.2
	Imports[b]	7.1	4.5	7.8	7.7	10.5	6.0	5.3	3.96
Industrial supplies	Exports	19.9	26.9	17.9	19.1	22.7	24.8	25.4	24.8
	Imports	31.9	39.2	34.5	27.4	29.5	32.4	30.8	30.0
Fuel and Lubricants	Exports	12.2	5.3	8.2	8.6	10.2	3.1	0.3	0.7
	Imports	19.2	13.0	15.5	25.6	20.1	18.4	23.52	25.1
Machinery and Capital Equipment	Exports	0.6	1.4	1.3	0.5	0.6	0.7	0.7	1.2
	Imports	24.9	19.3	17.3	15.8	12.9	13.5	13.7	14.2
Transport Equipment	Exports	0.2	0.5	0.9	0.5	0.4	0.8	0.8	1.1
	Imports	12.4	17.0	15.1	16.7	19.6	19.6	13.1	11.1
Consumer Goods	Exports	6.7	14.8	15.9	15.1	16.8	17.6	19.3	21.2
	Imports	4.3	6.9	9.2	6.4	6.3	7.1	8.18	7.19

[a] as a share of total exports [b]as a share of total imports
Source: Republic of Kenya, ***Economic Surveys (Various)***

These exports permit her to finance the needed imports to support her unique production structure. In this regard the country relies on mainly three categories of imports namely, in declining order: Industrial supplies, machinery and equipment and transport equipment. The dominance of transport equipment is explained by the fact that Kenya's transport sector serves a very useful role for a trading country that has an extensive land locked hinterland. These imports are mainly from developed countries.

By focusing on the direction of trade, Table 3 below shows the significance of the EU as both a market for Kenyan exports as well as a source of imports and serves to give us a reasonable appreciation of the magnitude of trade between Kenya and the EU as well as the significance of the implications of the EPA that we shall be showing later.

Table 3. Direction of Kenya's Exports and Origin of its Imports, 1990-2004

Geographical Area and Country	1990	1995	1999	2000	2001	2002	2003	2004
European								
Exports	46.8	33.7	31.3	29.8	27.1	27.1	28.5	26.5
Imports[b]	48.8	40.4	32.8	30.5	24.8	32.2	23.7	23.8
Rest Of western Europe								
Exports	1.0	1.3	0.8	0.9	1.1	1.4	1.5	0.84
Imports	1.6	1.4	1.8	1.4	1.9	1.6	1.9	1.6
Eastern Europe								
Exports	1.6	0.1	0.5	0.5	0.6	0.8	0.9	0.6
Imports	0.6	0.5	0.9	2.1	0.7	0.7	2.0	1.6
America								
Exports	4.4	3.6	2.7	2.7	2.9	2.4	2.1	0.5
Imports	7.1	6.9	9.7	6.0	15.7	7.4	6.5	6.7
Tanzania								
Exports	2.4	11.8	11.2	8.2	9.2	8.38	7.96	8.26
Imports	0.5	0.4	0.2	0.4	0.2	0.3	0.5	0.6
Uganda								
Exports	5.0	15.1	17.3	18.0	20.4	18.5	16.7	17.3
Imports	0.1	0.1	0.2	0.2	0.2	0.3	0.4	0.3
Rest Of COMESA								
Exports	11.6	13.9	15.3	15.9	16.8	16.4	16.9	17.6
Imports	2.2	0.7	1.4	1.5	3.5	3.5	3.8	3.7
Rest Of Africa								
Exports	2.2	6.1	2.9	3.9	2.8	5.8	4.5	4.3
Imports	0.2	7.5	9.0	7.1	7.0	7.1	8.55	9.8

Source: Republic of Kenya, ***Economic Surveys (Various)***

[a] as a share of total exports

[b] as a share of total imports

Although as a share of total exports, exports to the EU have been declining steadily since the 1990s, the EU still remains a significant destination for Kenyan, (mainly agricultural), exports. The Common Market for Eastern and Southern Africa, (COMESA), regional market is the key destination for Kenyan manufactured exports and has displaced the EU as the number one destination for Kenya's exports. It would appear that a market with such growth prospects needs to be safeguarded-yet the proposed EPAs may likely compromise that. This point is best illustrated by comparing the relative growth of Kenyan exports in COMESA and the EU. During the 1990s exports to the EU have declined even as exports to COMESA have increased. However, if the decline in Kenyan imports from the EU is an indication of future trends of imports from the EU to the region, then competing Kenyan exports to the region may not face significant adverse competition. However this is unlikely given that Kenya's trade structure – exports of both primary agricultural and final manufactured goods and imports of capital and intermediate goods-is unique in the region and that many of her neighboring countries are likely to have similar imports from the EU and Kenya. By eliminating trade barriers EPAs are likely to increase the competitiveness of imports from EU to the region.

In sum the strong growth in exports to the region in the 1990s is likely to be reversed due to the increased competition to the manufacturing sector, resulting from the EPAs. But it is arguable whether the EPA will result in increased market access for Kenyan exports to the EU and whether this increase would be sufficient to compensate the country for the possible losses that the manufacturing (and agricultural) sectors are likely to face from increased adverse competition from EU imports into the country and region. The next section addresses this question.

3.1 Composition of Kenya's agricultural exports to the EU since Lome

- **Structure of Kenya's Agricultural Production**

The agricultural sector dominates the Kenyan economy, albeit on a declining basis. The bulk of the crops grown in Kenya are also tradable although only a few of them are actually exported. As a share of Gross Domestic Product over the last five years the sector (Agriculture and Forestry) constituted about 25.7 per cent of the economy (Economic Survey 2004)[3]-explaining why the bulk of her exports are agricultural in nature. In 2004 agriculture contributed 24 per cent of Kenya's real GDP although the sector's growth rate declined from 2.7 per cent to 1.4 per cent in 2003 and 2004 respectively[4]. Whatever the reason for the decline this could only portend a related decline in agricultural exports. The sector employs almost 70 per cent of the country's total labour force while earning about 60 per cent of the country's foreign exchange as well as making significant contributions to the country's agro processing industries that constitute the bulk of the country's industrial sector.

Kenya's agricultural production structure comprises both large and small-scale farmers. The Government's 2004 policy document "The Strategy for Revitalizing Agriculture" (SRA), notes that the bulk of small holder farms, (of which there are about three million in number), are less than 2 hectares in size and account for over 75 per cent of total agricultural production. The increase in the small farm sector's share of marketed production since 1980 is reflected by the fact that they produce about 70 per cent of maize, 65 per cent of coffee, 50 per cent of tea, 80 per cent of milk and 70 per cent of beef and related products SRA (2004). Table 4 below, (abstracted from a recent KIPPRA (2005) report), classifies the key agricultural commodities according to their importance (land area utilization over time) and their tradability Table 4 enables us to make the following observations: the major tradable food crops in Kenya are: maize, wheat and rice while the key non-tradable food crops comprise sorghum, millet and pulses (beans and peas). The key industrial crops, which constitute major raw material inputs into the country, are: Sugar Cane, Cotton, Sisal and Pyrethrum.

[3] Growing of crops and Horticulture averaged 18 per cent over the same period while the farming of animals constituted about 6.2 per cent.
[4] It is not clear what caused the decline in growth of the sector although a number of factors could be possible including: decreasing farm size, inadequate budgetary allocation by the government, poor research and extension facilities and collapsed infrastructure.

Table 4: Classification of Agricultural Commodities in Kenya and Area Coverage.

Commodity	Commodity category	Tradable	Non tradable	Area 000 ha 1980-1989	Area 000 ha 2000
Maize	Food	Y		1300	1,500
Wheat	Food	Y		140	150
Rice	Food	Y		8	9
Sorghum/ millet	Food		Y	110	142
Pulses	Food		Y	525	750
Roots and tubers	Food		Y	120	231
Tea	Export	Y		84	120
Coffee	Export	Y		140	167
Horticulture	Export & domestic	Y	Y		
Fruits				95	136
Vegetables				81	88
Herbs and spices				2	1
Cut flowers				1	2
Sugar	Industrial	Y		100	120
Cotton	Industrial	Y		70	38
Pyrethrum	Industrial	Y		15	27
Sisal	Industrial	Y		50	26
Tobacco	Industrial/export	Y		5	13
Other	Industrial	Y		15	32
Dairy cattle ('000' heads)	Livestock	Y		1300	500
Beef cattle ('000' heads)	Livestock	Y		9900	11800
Poultry ('000' heads)	Livestock	Y		6000	15000
Other ('000')	Livestock	Y	Y	5000	9000

Source: Kenya, ***Statistical Abstracts (various) and National Development Plan 2002-2008***

Similarly, the key export crops in terms of their contribution to foreign exchange earnings in Kenya are: Coffee, Tea and Horticultural products. These three crops together contribute about: 60 per cent of the country's foreign exchange earnings, 34 per cent of the agricultural Gross Domestic Product in addition to employing over 40 per cent of the agricultural labour force. From the foregoing analysis- which includes a detailed examination of the structure of agricultural production and its importance in the economy-it is possible to conclude that safeguarding market access into the EU for these products is important. Although the proportion of Kenya's agriculture export trade with the EU has been on the decline, Table 5 below shows that total exports over the period 1995 to 2004 has been increasing.

Table 5: Kenya's Total Exports (Ksh'000) 1995-2003

Year	Value	Growth Rate (%)
1995	93,123,680	
1996	113,925,980	22.34
1997	114,459,454	0.47
1998	114,445,317	-0.01
1999	114,841,680	0.35
2000	119,763,714	4.29
2001	121,433,882	1.39
2002	131,394,055	8.20
2003	136,708,767	4.04

Source: ***Statistical Abstracts (Various)***

It is clear from the foregoing that total exports have been growing, albeit at different rates, since 1995. The average rate of growth of exports over the nine-year period between 1995 and 2003 has been about 4.6 per cent. Table 6 and 7 below decompose these growth rates in total exports into different export categories at Standard International Trade Classification

(SITC) digit 1-showing a slightly different picture. In Table 5 we see that the exports are categorized into the nine broad SITC digit 1 categories.

Table 6: Kenya Exports by 1 digit SITC and their growth rates

SITC Category Number	SITC Category Description	Value of exports (1995-2003) in ksh	Average Growth rates of exports 1995-2003(%)
0	Food & live animals	59, 124,980,658	15.3
1	Beverages and Tobacco	2,805,183,958	7.98
2	Crude materials, inedible expect fuels	13,907,094,763	16.89
3	Minerals fuels, lubricants & related materials	19,087,545,944	29.27
4	Animals & regular oil, fats and waxes	2,012,320,639	8.94
5	Chemicals and related products	7,162,407,892	13.03
6	Manufactured goods	15,244,556,861	7.14
7	Machinery & Transport equipments	3,794,915,372	12.03
8	Miscellaneous manufactured articles	6,883,643,026	14.31
9	Commodities and sectors n.e.s	532,013,832	66.36

Source: ***KRA Database***

At a more disaggregated level we notice a more varied export performance. Table 6 shows that Category 9 of SITC level 1 goods–i.e. Commodities and sectors n.e.s-has been the fastest growing over this period even though it has the lowest product value. Category 3 of SITC level 1 goods–Minerals, fuels and lubricants & related materials- has had the second fastest growth over this period. Categories 0, 1, 2 that constitute the bulk of agricultural products have experienced the fourth, third and ninth fastest growth rates in exports over this period.

In Table 7 below, we replicate the analysis for Kenyan export goods to the EU to see how these exports have performed over this period.

Table 7: Kenya Exports to the EU by 1 digit SITC and their growth rates

SITC Category Number	SITC Category Description	Average Value of exports (1995-2003) in Ksh	Average Growth rates of exports (1995-2003)
0	Food & live animals	26,740,811,039	13.63
1	Beverages and Tobacco	424,514,733	46.86
2	Crude materials, inedible except fuels	7,976,493,994	31.25
3	Minerals fuels, lubricants & related materials	9,227,467	120.84
4	Animals & regular oil, fats and waxes	6,183,873,	51.35
5	Chemicals and related products	152,996,056	42.47
6	Manufactured goods	630,367,989	7.11
7	Machinery & Transport equipments	196,828,159	61.77
8	Miscellaneous manufactured articles	1,174,344,586	275.13
9	Commodities and sectors n.e.s	27,004,473	668.04

Source: ***KRA Database***

Table 7 above more or less repeats the same story told in Table 6. Growth in exports to the EU is similar to that of overall export growth for similar goods at the SITC digit 1. Trend growths are replicated so that the fastest growing exports goods are those of category 9 - namely Commodities and sectors n.e.s with an overall growth of 668 per cent. Exports of miscellaneous manufactured articles-Category 8 of SITC digit 1-grows at the rate of 275 per cent. This is followed by category 3 goods at SITC revision 1–Mineral fuels, lubricants and related materials-growing at an average rate of 121 per cent over this period. Exports of

Beverages, Tobacco and Crude materials, inedible except fuels-category 1 and 2 of SITC revision 1 have grown at the rates of 47 per cent and 31 per cent respectively -coming fourth and fifth.
In absolute values the three top exports to the EU are respectively: (i) Food and live animals, (ii) Minerals fuels, lubricants & related materials and (iii) Miscellaneous manufactured articles. This shows that even miniscule growth in exports in the first two categories may represent a bigger value added than high growth in exports of say, Commodities and sectors n.e.s. Just to illustrate the above point it is important to note that Kenyan exports to the EU with the highest value is 990 times larger than the value of the lowest value exports to the EU. Goods of export interest can therefore be identified by both growth in exports as well as the export value over the relevant period.

The composition of the top twenty agricultural exports to the EU in 2003 helps us draw conclusions on the nature and structure of agriculture exports to the region.

Table 8: The Top Twenty Agricultural exports to the EU in 2003

Hs Code	Description	Value of Exports	Share of Total Exports (%)	Average Growth of Exports (%) 1995-2003
060310	cut flowers and flower buds, fresh	12,388,446,705	23.35	27.4
090240	black tea fermented or partly	7,269,438,976	13.7	20.1
070990	vegetables, chilled or fresh	4,675,808,052	8.81	103.4
070820	beans fresh, chilled	4,495,258,319	8.47	30.2
090111	coffee, not roasted nor decaffeinated	4,469,969,920	8.43	6.1
200820	pineapples, fresh	3,731,277,504	7.03	7.1
060210	live plant cutttings and slips, unrooted	2,537,329,828	4.78	101.3
200559	other beans	893,286,592	1.68	10.4
030410	fish fillets fresh or chilled	752,961,600	1.42	116.8
080440	avocados fresh or dried	635,982,528	1.20	30.4
240120	tobacco stemmed /stripped	577,276,352	1.09	22.3
070810	peas fresh or chilled	569,809,363	1.07	52.4
130214	vegetable saps and extracts of pyrethrum	532,343,318	1.00	31.4
030420	fish fillets frozen	427,219,136	0.81	1.8
200940	pineapple juice, sweetened or not	403,641,536	0.76	31.1
081090	fruits, fresh	221,832,523	0.42	93.3
210120	tea and mates extracts/essences prepared	183,266,320	0.35	20.1
060491	foliage branches, fresh	163,533,664	0.31	74.0
200551	beans, shelled, prep	156,587,392	0.30	3.8
030751	octopus, live, fresh chilled	131,520,760	0.25	6.8
070410	cauliflower, headed broccoli, fresh, chilled	112,597,256	0.21	

Source*: KRA Database*

Tables 8 above shows that agricultural exports to the EU are highly concentrated. For example the top three exports constitute about 45.9 per cent of the total agricultural exports to the EU. In declining order of importance these exports are: Cut Flowers, Fermented Tea and Vegetables. As such we can conclude that Horticultural products dominate the bulk of agricultural products to the EU. Examining the top ten agricultural exports to the EU further reinforces the foregoing. These top ten products comprise about 79 per cent of total agricultural exports to the EU. Of these ten products only two–Tea and Coffee-are traditional export crops, while eight are horticultural products and can be referred to as non-traditional exports. The importance of horticultural products in the share of agricultural exports to the EU leads to the conclusion that the bulk of the market access to the EU is beneficial to this sub sector. Similarly Table 8 shows that the top ten exports have also experienced significant growth in exports as compared to the other top twenty products. However without examining the sector specific barriers to horticultural products in the EU presently we can hardly make such conclusions. Looking at the top twenty agricultural products to the EU we can see that they constitute about 85 per cent of total exports of agricultural products to the EU.

From the top twenty agricultural exports to the EU we have three key exports namely: Tea, Coffee and horticultural exports. Below we discuss some of the characteristics of the three major export crops to the EU.

- **Coffee**

Coffee has been grown in Kenya since colonial times. Smallholder farmers produce presently almost 50 per cent of the country's coffee. Production levels have nevertheless declined steadily (since 1987), when it peaked at 130,000 tonnes. In 2003 only 55,000 tonnes were produced. Presently coffee output is also characterized by declining quality. Some of the reasons that can explain these trends include: collapsing World market prices, high input costs, erratic weather, pests and diseases, and poor governance. Although still a key producer of high quality Arabica coffee, Kenya has over time become a high cost producer of coffee producing significantly above the production costs of lower cost producers.

- **Tea**

Kenya is the world's third largest producer of tea, which is a leading Kenyan export commodity that accounts for about 20 per cent of total exports earnings. Smallholder farmers dominate the production of tea and by 2003 they accounted for 60 per cent of the 290 million kilograms of tea produced in the country. Nevertheless Kenya needs to diversify the export markets for tea to incorporate rapidly growing markets like the USA and Russia given that presently only three countries account for 60 per cent of Kenya's tea exports. Tea, (unlike coffee), production and marketing is mainly done by the private sector, which has strived to increase smallholder productivity.

- **Horticulture**

Almost 70 per cent of horticultural production is sold domestically although the export horticulture sub-sector-comprising Fruits, Vegetables, Flowers, Spices and Herbs-has grown considerably since the 1970s. Small holders account for about 70 per cent of total horticultural production-which increased by over 60 per cent between 1997 and 2003-although much of what they produce is for domestic consumption. The dominant products of the sector are vegetables and fruits, which together accounted for 99 per cent of the total volume of production in 2003.

In 2003, Kenya exported a total production of 133,000 tonnes - a significant increase from the 58,000 tonnes exported in 1992. The bulk of export horticulture is produced in the exporters own farms, leased land or large commercial farms. In terms of value, cut flowers accounted for 55 per cent of the value of exports in 2003 followed by vegetables (45%) and Fruits (5%). The bulk of fruits are produced by small holders who face many difficulties, among which are, high level of technical and management skills required, poor road networks, high prices of farm inputs, high incidence of pests and diseases and increasingly strict and complex Sanitary and Phyto sanitary measures in the EU market which absorbs about 85-90 per cent of Kenya's horticultural exports.

4.0 The Effect of the EU Common Agricultural Policy (CAP) on Kenya's Agricultural Commodity Exports

In the immediate wake of the Second World War, the European Union was faced with concerns about food security as well as stability of supplies of agricultural products including raw materials. Although, Article II in the treaty of Rome, which dealt with agriculture, had already addressed some of these concerns the key objectives of the Common Agricultural Policy provided a framework to comprehensively tackle these problems by developing the European Union's agricultural sector.

This framework was provided for in Articles 38 to 47 of Title II of the Treaty of Rome. Article 38 extended the areas of cooperation in the common market to agriculture and trade in agricultural products while providing for a common European policy to guide the development and operation of the common market for agricultural products. Article 39 outlined the objectives of the CAP to include the following: increasing agricultural productivity, improve the standard of living for the agricultural community, stabilization of markets, ensuring the availability of supplies, and ensuring that supplies reached consumers at reasonable prices. Although the CAP framework is largely WTO consistent, Article 42 sought to protect the agricultural sector by derogating from the requirements of the multilateral liberalization.

To meet the CAP objectives the EU employs trade policy tools such as tariff and non- tariff barriers (among which are quotas and guaranteed prices for the main agricultural crops and products) that serve to shield the domestic EU producers from foreign competition. The system of guaranteed prices on which the CAP is based consists of three types of prices:

a) Target prices, which are the minimum price the EU farmers receive in the EU market.
b) Entry prices which is the minimum price at which the products may be imported into the EU.
c) Export subsidies, which pay EU exporters of agricultural products the difference between the EU price and the world market price.

Reforms to the EU's Common Agricultural Policy which began in 1992 have persisted through the 1990s and are expected to end in the year 2006. The CAP reforms have been undertaken to ensure consistency with the provisions of the WTO Agreement on Agriculture, (AOA), which seeks to liberalize both production and trade in agricultural sector. Some of the proposed reforms under the WTO AOA include: binding of tariffs on imports of agricultural products, reduction in domestic support measures in favor of agricultural producers, removal of export subsidies of various types for agricultural exports and export competition commitments. Apart from liberalizing agriculture to achieve WTO compatibility, some of the other objectives of the CAP reforms include:

(i) Guaranteeing the competitiveness of the European agriculture in world markets
(ii) Preparing for the enlargement of the EU to include the Central and Eastern European states
(iii) Preparing the EU for the subsequent rounds of the WTO negotiations
(iv) Countering the negative effects of agriculture on the natural environment and landscape
(v) Providing a better balance between the joint management of CAP and the greater decentralization.

The present CAP reforms place less emphasis on production support to farmers, (in favour of support for environment protection and the maintenance of traditional landscape), and seek to make farmers more responsive to market signals and hence to eliminate agricultural surplus production. CAP reforms have therefore shifted support for agricultural production from price support to direct payments, which are less trade distorting because they are decoupled from current production. For example when CAP reforms started 91 per cent of the CAP budget was spent on export refunds and intervention an amount that is expected to drop to 21 per cent by 2006 when the CAP reforms are completed. CAP funds (presently about 10% of total CAP expenditures), are also increasingly earmarked for the support of the less trade distorting rural development initiatives.

4.1 Potential Effects of the CAP Reforms

The CAP reforms will have consequences at the global level as well as at the ACP economy level as discussed below.

- **Potential Effects of the CAP reforms at the Global level**

There are three major implications of the CAP reforms at the global level. First, the CAP reforms will increase the amount of direct payments to farmers even as they reduce trade-distorting measures and as a result will increase the price competitiveness of EU products in the global market. This is expected to undermine production of farmers from other countries. Second, as the CAP reforms lowers prices in the EU market, domestic EU consumption of the relevant products is likely to pick up while the cost of disposing of the EU surplus in the foreign markets will drop. Third, the EU intervention prices are envisaged to fall below the word market prices and this will probably result in an increase in EU exports far above the pre-reform levels.

- **Potential Effects of the CAP reforms on ACP Economies**

At the level of the ACP economies there are three main implications of the CAP reforms. First, the CAP reforms are likely to create either a trade diversion or trade deflection effect in the light of the EPAs between the EU and regional ACP groupings. Efficient producers from the rest of the World are likely to be replaced in the local ACP markets by the less efficient producers from the EU. Trade deflection is also likely from more efficient local suppliers to less efficient EU suppliers. Second, EU products will also offer adverse competition to ACP products more so if the EU intervention prices fall lower than the world market prices and EU exports consequently rise above their pre-reform levels. Third, the CAP reforms will, because of their effect on prices in the EU market, lead to a fall in the export revenues accruing to ACP economies from their exports to the EU. Fourth, CAP reforms may also stifle the development of non-traditional exports to the EU from the ACP countries. This will adversely affect the efforts by ACP economies to diversify their export base. A close examination, in the next section, of Kenya's existing and potential agricultural exports to the EU that are also affected by CAP may give some indication of the likely effects of the CAP reforms on the Kenyan economy.

- **Potential Effects of CAP reforms on Kenya**

As stated above the CAP reforms will have implications at global as well as at the level of ACP economies. For Kenya the effects on the economy will depend on the extent to which these reforms will either undermine price competitiveness in global markets of existing or potential agricultural exports (products of export interest) or whether they will erode preferences presently enjoyed by Kenyan products in the EU market.

Determining the agricultural goods of export importance for a country such as Kenya is fairly simple because of the fairly concentrated export structure as established in section 3 above. For example the top three agricultural exports to the EU make up about 50 per cent of Kenyan agricultural exports to the EU. The top ten agricultural exports to the EU constitute about 80 per cent of all exports. Eight of these top ten products are horticultural products while the remaining two are the more traditional products of tea and coffee.

The recently published National Export Development Strategy Paper, (NEDSP), sheds further light on this issue. The NEDSP, which was developed through a fairly wide-ranging process of stakeholder consultation, has the overall objective of deepening and diversifying the existing export markets. Out of the fourteen sectors chosen for export development ten were prioritized and five of these are agricultural sectors consisting of the following: Horticulture, Tea, Livestock and livestock products. The only agricultural exports that do not appear in our analysis in Table 8 above is the livestock and livestock products. In Table 9 below we also present the result of our analysis of the CAP products that are also of export interest to the country. This was done at the two digit HS level and therefore may be fairly aggregative in nature. The values in Table 9 indicate the value of these export products to the EU. Many of the products in Table 9 are horticultural products (HS code: 06, 07 and 08) and arable agricultural products (HS 12, 15 and 17). Most significant in terms of loss of export earnings as a result of the CAP reforms is Sugar (HS 17) which is protected by the sugar protocol between ACP and EU.

Table 9: Kenyan Exports to the EU that are Affected by the CAP

HS Code	Description	Value of Exports to EU (1995-2003)	Value of Total Exports (1995-2003)	% of total Kenyan exports
02	Meat and edible offal	260452.4	121,696,773	0.21
04	Dairy produce	3,265,212	563,323,422	0.58
06	Live Trees, Plants	7,111,221,405	7,777,665,146	91.43
07	Edible Vegetables, Roots, Tubers	4,929,133,041	8,938,571,889	55.14
08	Edible Fruits and Nuts	526,835,414	1,303,001,278	40.43
10	Cereals	180,711	524,807,039	0.03
11	Milled products	805,195	800,022,165	0.10.
12	Oil seeds and oleaginous fruits	86,137,177	448,875,221	19.9
15	Animals and vegetable fats	10,173,853	2,656,556,771	0.38
16	Edible preparations of Meat, fish etc	165,094	50,195,576	0.33
17	Sugar and sugar confectionary	39,401,944	1,800,138,910	2.19
24	Tobacco and Manufactured tobacco substitutes	413,978,467	2,092,981,214	19.78

Source*: KRA Database*

A number of observations can be made from Table 9. First in terms of average 1995-2003 export values of Kenyan exports that are affected by the CAP we notice that two of the three lowest exports are livestock products- edible preparations of meat, fish etc and meat and edible offal. Using the same criteria the top five Kenyan export goods affected by the CAP include the following goods: (i) live trees, and plants, (ii) Edible vegetables Roots, tubers (iii) edible fruits and nuts (iv) Oil seeds and Oleaginous Fruits (v) sugar and sugar confectionary. As such horticultural products and arable agricultural goods as well as livestock products feature prominently among those Kenyan agricultural goods that are of export interest and are also affected by the CAP. We also notice however that there is a high potential for continue4d supply of the EU market form Kenya as a majority of the products affected by the CAP are not actually exported to the EU.

The widespread tariff liberalization by developed countries as globalization proceeds has not been matched by removal of non-tariff barriers and the latter still remain an important market access agenda for developing countries. In some cases NTBs have even increased although the absence of data as well as transparency in their application limits any evaluation of their importance, scope and effects. As stated earlier governments adopt trade policies in order to appease certain economic constituencies that may be politically influential to them. Trade liberalization therefore upsets these groups and is undertaken at significant political risks. Economic policy reforms as well as WTO obligations limit the extent to which governments can apply price based trade policies such as tariffs. To protect their constituents they use NTBs which are less transparent and therefore difficult to notice. This probably explains why both advanced as well as developing nations have simultaneously been lowering tariffs even as they increase the number of non-tariff barriers (especially of an administrative non-price nature). Because they require superior administrative capacity, which is generally lacking in developing countries, non-tariff barriers to trade are proliferating more in developed than in developing countries.

5.1 Generic Types of Trade Barriers

There are three main groups of barriers to market access for agricultural exports from developing countries in the OECD (including the EU), (World Bank, 2000). These include:

- **Import Tariffs**

These are price based border measures that are used for revenue raising purposes as well as to protect domestic producers. They include: import duties, tariff quotas and other border duties, levies and charges. These have been reducing and are increasingly bound under the auspices of the WTO.

- **Non-Tariff Border Measures**

These include all government policies that may restrict market-access through non-price instruments. Examples are: Quantitative restrictions (import quotas, direct prohibitions, domestic content requirements, licensing), Contingency measures (anti-dumping, countervailing and safeguard measures) and technical barriers to trade (TBT) (Regulations, standards, testing and certification procedures) and Sanitary and Phyto-sanitary measures (SPS) (Food, Animal and Plant Health and Safety*)*. These tend to be proliferating and are increasingly replacing tariffs as the dominant form of trade protection.

- **Domestic Policy Measures**

These are government policies that may restrict market access if not applied uniformly to domestic and imported goods. They include: tax, competition, credit and investment policies; price controls; and Fiscal Incentives like trade distorting export subsidies and domestic support (World Bank, 2000).

The significance of each of these NTBs as restrictions on developing country exports to the OECD is a matter of conjecture and there is considerable disagreement in the literature concerning their significance. For example, Amjadi, Reincke and Yeats (1996)) report that the important Non –Tariff barriers that face African exports into the OECD are quantitative restrictions (which covers about 8% of African exports) and price distorting restrictions (which cover about 4% of African exports). COMESA (2003) on the other hand shows that NTBs such as Rules of Origin, Cumulation, Environmental Regulations and SPS issues are important restrictions on market access into the EU for African countries. In addition to these the literature highlights the existence of invisible barriers to trade, which are not part of core NTBs but are prevalent in blocking African exports to the EU OECD (2005).

Despite the proliferation of the different trade barriers Table 10 below shows the ad-valorem tariff equivalent trade barriers imposed on different exports to the EU from developing countries.

Table 10: Effective Ad-Valorem Tariff Equivalent on Bilateral Trade Flows to the EU (USA) from Different Countries

	Exporters				
Type of Trade flows	Least Developed Countries	Other Low-Income Countries	Middle Income Countries	All Developing Countries	OECD
Total Trade	2.8 (13.6)	7.0 (6.2)	10.3 (3.6)	7.2 (4.5)	N/A
Trade In Agriculture	7.6 (28.1)	13.4 (9.5)	24.8 (13.0)	20.0(12.8)	41.6(14.5)
Trade in Manufactures	0.0 (8.0)	5.7 (5.9)	5.5(7.1)	4.5 (3.6)	2.5 (1.6)

Source: Constructed from 2001 World Bank/ IMF report entitled *"Market Access for Developing Countries Exports-Selected issues"*

From Table 10, trade barriers faced by different groups of countries exporting to the EU market vary depending on whether or not they enjoy preferential access to these markets. Table 10 above illustrates this point. For example the Least Developed Countries and other low-income countries that tend to enjoy preferences into the EU market generally face lower trade barriers than the average faced by all developing countries or even the OECD. The existence of preferences is therefore crucial to the continued competitiveness of their products in the EU markets. What we can also notice is that least developed countries and other low-income countries tend to face lower barriers to their exports in the EU than in the USA (figures in parentheses). As such given these levels of market access the EU market is more important to these countries than the US market. We also confirm that though the least developed and low-income countries have a comparative advantage in agricultural production, agricultural exports from these countries face higher trade barriers than do their manufactured exports. Potential benefits that may accrue from the EPAs (ACP countries fall into these category of countries), may increase to the extent that they (EPAs) result in the rationalization in the use of TBTs that have recently proliferated in the EU and become important barriers to trade. Below we briefly review the nature of NTBs faced by developing country agricultural exports to the EU.

5.2 Existing EU Non-Tariff Barriers to Developing country Agricultural exports

Global trends in NTBs show a decline in the use of quantitative restrictions in the post Uruguay Round (OECD, 2005). Both developed and developing countries are using NTBs to limit market access to agricultural exports from both OECD and non-OECD countries. These types of restrictions include (i) Import Licensing systems (ii) Variable levies and production and export subsidies and (iii) Import and Export quotas. Emerging NTBs that are further restricting access for developing country exports into developed country markets include: (i) Technical barriers to trade (ii) Sanitary and Phyto sanitary measures and other standards.

Despite the legitimate purposes that technical standards and other measures serve, unless carefully monitored they may become important obstacles to developing country exports to developed countries. For example, technical regulations and standards and conformity assessment procedures may serve as border protection instruments while SPS measures (concerned with animal health and plant protection), may also be unnecessarily protectionist. SPS measures are of special importance to developing countries because the bulk of their exports to the EU are agricultural. Other important emerging restrictions that seek to safeguard against the rising threat to environmental degradation, national security, terrorism, labor and social standards are likely to be more restrictive unless carefully monitored. The heavy concentration of NTBs on strategic products of export interest to the African region[5] is a concern to policy makers seeking to engage in trade negotiations with the EU.

The three most important NTBs facing African exports to the OECD (particularly EU) are, in descending order of importance: (i) Technical Barriers to Trade (ii) Customs and Administrative procedures and (iii) Sanitary and Phyto Sanitary Measures (OECD, (2005)).

- **Technical Barriers to Trade**

These barriers to trade include: (i) Technical regulations and Standards, (ii) Testing and Certification Arrangements, and (iii) Marking/Labeling and packaging requirements. Concerning technical regulations and standards, they have been used to restrict African exports to the extent that they impose unnecessary compliance costs and time delays. Some of the technical regulations and standards imposed by the EU are at times even more stringent than those specified by relevant international bodies. In addition, African countries find it difficult to keep pace with and adapt to the changing requirements that are necessitated by the frequent upward revision of standards at regular intervals. This problem is compounded by the need to understand different technical standards adopted by different OECD countries who fail to harmonize their standards with international standards. This tends to raise compliance costs and reduce diversification of export markets.

[5] To the extent that some NTBs applied in the EU like MFAs and VERs shield exports from Africa from competition from other developing country exporters into the EU not all NTBs can be considered detrimental.

Testing and Certification arrangements act as trade barriers to African exports because of the general absence of information and lack of transparency in the procedural norms and regulations especially with regard to specifications and methods of sampling inspection and testing. Testing costs are also high because of the high levels of sensitivity[6] specified in the testing methods. The requirement that laboratories of importing countries also undertake verification tests may act as a significant barrier to trade to the extent that they cause delays and time lags that may lead to loss of customers. Other aspects of TBTs that serve to deter exports from Africa include: (i) Elaborate pre-inspection measures which tend to consume time and money (ii) Short (less than one year) duration quality certificates (iii) Extra costs of hosting EU officials inspecting production facilities located in exporting African countries (iv) Time consuming and arbitrary registration requirements.

Marking, labeling and packaging requirements are often burdensome, complicated to implement and not uniformly applied to similar products of domestic origin. Further, these activities often require highly developed technological systems, which many LDCs cannot afford to acquire and put in place. Labeling requirements increase the costs to LDC producers due to the stringent procedures. The frequent and often abrupt changes in packaging requirements also results in the loss of entire shipments.

- **Negotiating Point**

A key-negotiating objective therefore should seek to ensure that the package from the EPA negotiations includes technical assistance and capacity building to alleviate these NTBs. Further Kenyan negotiators should press their EU counterparts to harmonize their standards with the International standards and common approaches to test methods of conformity assessment.

- **Customs and Administrative Procedures**

Up to thirty per cent of total notifications of non-tariff barriers in the OECD made by developing countries were concerned with customs and administrative procedures. The types of barriers found to be especially restrictive in this category include: (i) rules of origin (ii) import licensing (automatic and non-automatic) (iii) customs valuation (iv) customs formalities and (v) customs classifications.

Rules of origin are often discriminative, or inconsistent. Extra costs and delays are also imposed by the need to verify compliance. In addition the increased administrative procedures also impose time delays, which is a significant barrier to trade. Rules of origin can also be preferential or non-preferential and some countries may fail to get originating status under preferential rules of origin denying their products the preferential treatment.

Import licensing procedures delay or impede imports. Even for licenses issued automatically additional requirements such as supporting documents can be arbitrarily introduced. The issue of import licenses frequently lacks transparency.

Customs valuation rules can also act as trade barriers such as when there is over estimation of the process for customs purposes especially using discriminatory and arbitrary valuation a

[6] For example levels of sensitivity may be raised because better technology or testing equipment become available not because specific evidence exists that a higher sensitivity is required to meet a health objective.

method. Further, developing country exporters are prohibited from exporting small volumes due to the requirement that a minimum amount of imports be presented for customs valuation.

Customs classifications can be inconsistent and varying including the right of customs officers to exercise excessive discretion when classifying goods. Further, the delay of customs clearance can increase the transaction costs and by so doing reduce the competition for similar domestic goods.

- **Sanitary and Phyto -Sanitary (SPS) Measures**

SPS measures are the third most important barrier for non-OECD exports to OECD markets (OECD, (2005)). Standards can become trade barriers instead of serving genuine objectives when onerous requirements are imposed without first conducting comprehensive risk assessment work such as chemical residue limits, disease freedom and specified product treatment. Testing, certification and other conformity assessment related to SPS also attract complaints because of the extra formalities (and therefore costs), that often makes African exports to OECD prohibitively expensive. Further, the tedious and substantial documentation as well as bureaucratic procedures involved in obtaining SPS approvals acts as a barrier. Finally, market segmentation can often arise when different OECD countries maintain separate, albeit legitimate, SPS measures to deal with the same perceived risks which then make them a trade barrier.

- **Contingency Measures**

Non Tariff Barriers to trade also exist in the form of contingency measures such as anti-dumping measures. The number of anti-dumping investigations initiated can gauge the extent of the contingency measures faced by ACP exporters to the EU. The record between the periods 1995-2001 can be gleaned from table 11 below.

Table 11: Initiations of Anti-dumping Investigations

	Affected Countries					
Initiating Country	Industrial Country	United states	EU	Developing Countries	Transition countries	Total
Total Number of Investigations:	511	102	313	1,086	248	1,848
Developing countries	379	85	242	718	131	1,228
Per cent of investigations :	28	6	17	59	13	100
Industrial countries	26	3	11	60	19	100
EU	6	2	0	67	27	100
US	31	0	18	57	12	100
Developing countries	31	7	20	58	11	100

Source: Constructed from 2001 World Bank/ IMF report entitled, ***"Market Access for Developing Countries Exports-Selected issues"***

Table 11 clearly shows that the largest share of anti-dumping cases have been lodged by developing countries against other developing countries. Nevertheless the bulk of anti-dumping cases initiated by developing countries against industrial countries have been mainly against the EU. The high number of anti-dumping actions initiated in the EU against developing countries is also indicative of the rising influence of the protectionist forces opposed to exports for developing countries. These instruments reduce the predictability of the EU trade policy facing exporters of agricultural products from countries such as Kenya.

5.3 Specific Trade Barriers facing Kenyan Agricultural exports in the EU

Understanding barriers to trade facing Kenya's agricultural exports to the EU is invaluable for trade negotiators seeking to develop an offensive position for the EPA trade negotiations. Table 12 below shows the 2002 incidence of trade barriers that were in existence for the top thirteen commodities in the EU include the following shown in Table 12 below:

Table 12: Tariff and Non-Tariff Barriers on Top Thirteen Kenyan Agricultural Exports to the EU

HS Code	Description	MFN Mean (%)	MFN Minimum (%)	MFN Maximum (%)	NTM Incidence (%)	No of Tariff Lines
060310	Cut flowers and flower buds, fresh	9.7	8.5	12	0	27
090240	Black tea fermented or partly	0	0	0	0	1
070990	Other vegetables, chilled or fresh	11.2	4.5	12.8	12	69
070820	Beans fresh, chilled	N.A	N.A	N.A	0	9
090111	Coffee, not roasted nor decaffeinated	0	0	0	0	1
200820	Pineapples	20.6	17.6	25.6	0	10
060210	Live plants cuttings and slips, unrooted	2	0	4	25	2
200599	Other beans	19.2	19.2	19.2	0	1
030410	Fish fillet fresh or chilled	13.3	0	18	4	52
080440	Avocadoes	4.6	4	5.1	0	8
240120	Tobacco stemmed/stripped	N.A	N.A	N.A	0	15
070810	Peas fresh or chilled	9.9	8	13.6	0	3
030420	Fish fillet frozen	10.3	0	18	2	52
200551	Beans, shelled	17.6	17.6	17.6	0	1

Source: Kenya Revenue Authority and TRAINS Databases

- **Tariff Barriers**

From Table 12 we note that the multiple MFN rates shown above are representative of the multiplicity of trade arrangements in which the EU is engaged as well as the multiplicity of trade preferences granted to developing countries. Further it is important to note that even for those products, which are under CAP, preferences are only seasonal and are not fixed all year round. We also notice from Table 12 above some significant variation in the duties applied to different products in the top thirteen products. Examining the mean MFN rates for example, we notice that there are tariff peaks on pineapples and beans, which attract (the highest) rates -above 15% on average. Plants, tea and coffee generally attract rates lower than 3%.

- **Tariff Escalation in the EU**

Tariff escalation in the EU has also been a hindrance to the development of significant processing and value addition activities in Kenya and remains one of the key problems faced by developing countries' exports to OECD markets. Tariff escalation occurs when import tariffs in the OECD countries are far higher for processed than for unprocessed primary products so that the former are relatively uncompetitive therefore limiting the extent of value adding activities that developing countries can undertake. The EU tariff structure denies the developing countries the possibility of moving up the value chain and hence confines them to exporting raw materials to the EU. Tariff escalation in the EU has therefore enabled her to add value to low priced primary imports (such as coffee and rice) from developing countries and then to re-export the same to other countries including developing countries themselves. For example, green coffee beans, (one of Kenya's key exports), attracts no tariffs in the EU while tariffs of 7.5% and 9% respectively apply to the roasted coffee and decaffeinated coffee respectively. This tariff structure is obviously responsible for the fact that out of the $2.84 billion worth of developing country exports to the EU in 2003 ninety seven per cent was green coffee beans.

- **Negotiating Point**

For Kenya to succeed in increasing value addition to her primary exports to the EU one of the negotiation points for her in the EPA negotiations is to demand that tariffs on the processed products in which she has a comparative advantage, (such as coffee, vegetables, tea and fruits), be lowered. Further, Kenya should seek assistance to move up the value chain in these products.

- **Non-Tariff Barriers**

Given that most of Kenya's agricultural exports to the EU are primary unprocessed products, clearly not all the NTBs discussed in previous sections apply to them. Kenya – specific studies have been conducted to evaluate the effects of these barriers. We review them below. Because of the shortage of data on NTBs, and the fact that it is difficult to translate these into tariff equivalents it is important to show, as we do below, the effect of some of the NTBs that are faced by Kenyan exports to the EU market. In Table 12 we note that the incidence of NTBs on live plants and vegetables is generally much higher than that on Fish and fish products. This does not only show that NTBs are not equally applied across all products but also that this data may ignore the fact that some products have been totally banned.

There are four major challenges associated with the SPS provisions and market led requirements that face Kenyan agricultural exports to the EU: Conformity to quality standards, traceability directives; adherence to maximum residue levels and the EUREGAP requirements (KIPPRA (2005)).

(i) Conformity to Quality Standards (Directive No EC 1148/2001)

This directive requires that in addition to a Phyto-sanitary certificate, a certificate of conformity be issued after a conformity check has been undertaken for each exported consignment by official inspection bodies. Even after such conformity checks have been done by the exporting countries individual EU member states are required to undertake the checks on significant proportions (in some cases the entire consignment) of the goods imported which results in wastage and higher costs as well as additional delays from the increased bureaucracy.

- **Negotiating Point**

As it is not practically possible for the EU to undertake conformity checks for entire consignments of exports from the developing countries it is punitive to require developing country producers (to whom such costs are inevitably passed) to meet the costs of a service that is not undertaken. Kenya should negotiate for the local or regional institutions such as KEPHIS to be accredited by the EU to undertake such test with the EU then doing confirmatory tests on smaller samples of these exports. In addition EU should be urged to provide capacity building for such local certification institutions to bring them to EU standards.

(ii) Traceability Regulations (Directive No EC 178/2002)

Since coming into effect in January 2005, purposely to fight bio terrorism, the EC traceability regulation seeks to trace, through the value chain, agricultural products that are either consumed by human beings or enter into the human food chain. Exporters are required, to keep detailed documentation to enhance the transparency of the processes undertaken to trace a product right through to its origin. The burden of proof is placed on the private sector, which faces high penalties in the event that they do not take precautions to prevent the contamination of fresh fruits and vegetables. Suppliers are therefore under significant pressures to provide all guarantees of traceability and food safety. Small-scale Kenyan producers who are insufficiently equipped to supply the amount of information required are likely to be adversely affected.

- **Negotiating Point**

Kenya should urge the EU to grant sufficient lead-time before requiring compliance in the event of new regulations so as to allow small-scale farmers to adjust. Further the EU should provide capacity building for local farmers as well as institutions charged with implementing these regulations.

(iii) Adherence to Maximum Residues Levels (MRLs)

By fixing the MRL level at "analytical" zero value this health and safety regulation requires that there be no trace of pesticide in fruits, flowers and vegetables intended for the EU market. Pesticide use is, as a result, tightly controlled in terms of the types of chemicals used and their rate of application. Exporters must give information on the types of chemicals used. The MRLs prescribe the type and quantity of pesticides to be used by Kenyan and other tropical farmers in total disregard of the fact that the original intention was to reduce pesticide use in the temperate European region and that this may not be feasible in tropical regions. This requirement has had adverse effects to small and medium scale producers to the extent that some have been entirely locked out of the European market.

- **Negotiating Point**

(i) Assistance for trade capacity building from the EU to enable her to remain competitive against her primary competitors in the EU market - South Africa, Israel, Morocco and China.

(ii) The MRL should be based on scientific standards so that for example in the case of tea- where it is based on dry matter- it should be based on what people actually drink.

Adoption of European Retailers Code of Good Agricultural Practices (EUREGAP)

EUREGAP, (the new comprehensive standards on safety, environmental friendliness and social acceptability which require the traceability of produce from retail shelf back to the farm gate), poses a challenge on horticultural and other exports related to food. Kenyan farmers and exporters require certification from companies accredited by European retailers. These standards, though judged to be advantageous by some key stakeholders, have severe cost implications for, especially, small-scale farmers who, (unlike their larger counterparts), are not as well organized and may result in their being locked out of the EU market. The better-organized Fresh Produce Exporters Association of Kenya (FPEAK) and the Kenya Flower Council (KFC) who cater for large-scale farmers have established a code of practice for their member that is strictly enforced so that a penalty for non-compliance is deregistration. To address the challenges being posed by the EUREGAP the Ministry of Agriculture has established a steering committee comprising public and private sector participants. Further, harmonization of national and international standards is also being pursued. As a result export license will in future only be granted to those who have been accredited to the code of practice.

Kenya's future export prospects into the EU will therefore be determined by the extent of compliance with these standards: traceability, MRLs and EUREGAP measures-which stakeholders believe to be beneficial to the country in the long run. Continued support for them by stakeholders is dependent on adequate capacity being built.

- **Negotiating Point**

(i) Increased access to accurate information on changes in these standards, traceability, MRLs and EUREGAP measures (ii) Increased assistance to farmers to access suitable equipment for spraying horticultural produce (iii) Supply of equipment to the Pest Control Products Board to judge the efficiency of the chemicals used (iv) Equipping key standards bodies like KEPHIS, DVS, Department of Fisheries and KEBS to increase compliance with the EU regulations.

Non-Tariff Barriers Facing Kenyan Horticultural Exports to the European Union

Kenya is one of the dominant exporters of horticultural products as is evident from the 75 or so unique horticultural export products of both raw materials as well as pre-prepared vegetables. Kenyan exports of green beans supply almost 30 per cent of the EU market with the UK being her most important market. There are also significant fruit exports to the EU with Kenya's exports supplying about 25 per cent of the EU market in 2000. Presently the country has moved up the value chain and as a result sells directly to supermarket chains in the UK. New innovations in the Fresh vegetables chain include the transfer of processing activities from UK importers to African exporters.

Although most Kenyan horticultural products enjoy duty free access into the EU market they still face substantial Non-Tariff barriers to trade in the form of standards and regulations as shown by Odek (2003). The key Non tariff barriers in the EU as faced by Kenyan exporters of horticultural products are the Technical Barriers to Trade (TBT) and Sanitary and Phyto-Sanitary (SPS) measures. TBT and SPS issues faced by Kenyan exporters can be divided into the following: (i) standards setting (ii) costs of Technical Compliance (iii) costs of verification and (iv) transitional arrangements.

The drawbacks faced by Kenyan horticultural exporters to the EU include the following: (i) High fixed costs of compliance that make Kenyan products uncompetitive in the EU and also limit the capacity of small-scale farmers to engage in production and export of these products. The EU has recognized the effect of the significant compliance costs on undermining the price competitiveness of EU farmers and offered financial assistance schemes to cushion them from the costs of complying with these standards.

(ii) Excessive costs of setting up the monitoring, testing and certification infrastructure required for compliance with these standards. These infrastructure costs often hinder market-access for Kenyan agricultural exports to the EU.

- **Negotiating Position**

(i) Mitigation of these costs could be done by, for example, seeking equivalence recognition for the existing verification arrangements in the ACP and EU. The reduction of verification costs increases the participation of small-scale farmers in these export markets, and their earnings from the same, therefore enabling them to get out of poverty.

(ii) Kenyan horticultural stakeholders may not be able to change the stringent standards on horticulture and Floriculture due to the lengthy negotiations process involved. However negotiation of the detailed sector-by-sector and product-by-product regulations can still be undertaken.

(iii) Kenyan negotiators should demand that standards to protect EU citizens through animal and plant health regulations be designed to minimize trade obstacles to small scale less developed and developing countries' farmers.

6.0 Implications of an EPA on Kenya's Agricultural market access with the EU: Is there a need for a Compensation Mechanism?

The World Bank appropriately defines market access as foreign producers' ability to sell in a given country (World Bank, (2002)). The previous section has shown that there exist a significant number of tariff and non-tariff barriers to Kenya's agricultural exports to the EU. By effectively reducing barriers to "substantially all trade" EPAs are expected to preserve (or even increase) market access for Kenya's agricultural exports to the EU.

However, both theoretical and empirical analysis in the foregoing sections have shown that the effect of the EPA on agricultural market access in the EU will depend on whether or not the WTO negotiations as well as the ongoing CAP reforms erode the benefits that are presently being enjoyed by exporters of agricultural products to the EU. If this erosion is significant then the benefits that accrue to Kenya from the increased market access may not be adequate to compensate her for the revenue and employment losses that may result from the reciprocity principle embedded in the EPAs. The increasing use of NTBs as health standards to preserve human and animal health and safety may have protectionist effects that may erode the market access gains that may be made through Tariff liberalization.

For Kenya to benefit from an EPA there must be net welfare benefits. In more concrete terms this means that the benefits to consumers (due to lower priced goods), and producers (due to increased export revenue) must outweigh the losses due to reciprocity incurred by producers (import competing manufacturing sector), lost employment from collapsing sectors and foregone government tariff revenues.

However, the benefits of an EPA from higher or assured market access to the EU may be tempered by the expected CAP reforms which may reduce the margins obtained by exporters of agricultural exports to the EU. Further, the CAP reforms as stated earlier may further depress prices in the global agricultural market in addition to eroding the preferences, (granted under the Lome and Cotonou trade agreements), that have made Kenyan exports to the EU more competitive.

From the foregoing analysis the conjunction of the rising use of NTBs, CAP reforms and the EPAs is likely to decrease the benefits that the Kenyan agricultural sector will obtain. This is in addition to the fact that Kenyan manufacturers will face stiffer and possibly more adverse competition in the domestic and regional markets resulting from the EPAs. Although theoretical and empirical analysis show that trade barriers are more costly to the countries that impose them, the real question that Kenyan policy makers should be seeking to answer is whether the political risks associated with the EPAs such as income , employment, and revenue loss outweigh the expected welfare benefits that result from the envisaged trade creation. Trade creation gains result from the displacement of inefficient domestic producers by more efficient (hopefully not subsidized) EU producers. Trade diversion will result if the EPA makes it possible for EU producers to displace more efficient producers from the rest of the World in the domestic and regional markets. To be conclusive about the net effects, a full-blown modeling exercise is required. Previous work by KIPPRA and the UNECA, though not fully representative of the problem at hand, may offer some indicative results.

Using both general and partial equilibrium frameworks, the UNECA study sought to evaluate the economic and social impacts of trade liberalization in the proposed EU-ACP EPAs. The results from the general equilibrium analysis for the entire African continent shows that should Sub-Saharan Africa (SSA) form a free trade area with the EU as envisaged in the EPA then there would be a welfare increase equivalent to 8 billion US Dollars or a rise in GDP by 3.4 percentage points. In addition, an EPA will result in an improvement in the terms of trade.

Such results are underpinned by two key assumptions. First, the EPAs will not exempt any EU sector, (including the sensitive ones), from full tariff liberalization. Second, the study assumes that adjustment costs associated with the FTA under the EPAs, (which could be politically costly), might be minimized if the liberalization was preceded by the deepening of regional integration in SSA. Increased intra- African trade arising from the latter would raise the capacity of current industries to withstand competition from EU imports when the FTA is formed.

The foregoing notwithstanding the study points out that income distribution may worsen because the FTA increases the real returns paid to some factors of production (like Land, Capital and Skilled Labor), without comparable increase in the returns to unskilled labour- the most abundant factor in the continent. As a consequence there would be worsening of income distribution[7]. Since unskilled labour is found in the agricultural sector in African countries we can conclude that the resulting skewed distribution of income in the wake of the EU-ESA EPA will be detrimental to agricultural workers and may not really improve on the poverty outcomes in the rural areas where they are concentrated.

Arising from the foregoing (and assuming that Kenya is typical of the African economy represented in the GTAP database), we can conclude that EPAs can be beneficial to the Kenyan economy. Nevertheless two crucial conditions must obtain for the foregoing to be a reality: First the tariff liberalization must allow for the unfettered access for all Kenyan products into the EU market. Second, Tariff reduction by Kenya in compliance with the EPA provisions must be phased to permit the deepening of regional integration within SSA.

Partial equilibrium analysis was also used in the UNECA study to show country specific impacts of EPAs on trade revenue and welfare. The results show the net trade gains will be to the tune of $ 271 million which is equivalent to a 35% growth in Kenyan imports from the EU. Of this $211 million will be the result of displacing less efficient domestic producers (Trade Creation), while $60 million will result from displacing more efficient producers from the rest of the world which includes $2.5 million from the ESA region. EPAs may therefore undermine regional integration efforts in the continent.

The revenue effects of the EPA will result in the loss of $107 million. The revenue effects is partly the result of the substantial amount of Kenyan imports emanating from the EU. It is exacerbated by the fact that tariff revenue still constitutes a significant (16 per cent) proportion of total tax revenue. Tariffs also serve as a tool for industrial policy and in the

[7] This result is important because almost 75 per cent of the increase in welfare, (amounting to about eight billion dollars), that results from the formation of the FTA between the SSA and the EU results from the increased demand for unskilled labour.

event that they are withdrawn, the subsequent collapse of industries will tend to undermine other potential sources of revenue viz- the income tax.

The arguments against trade liberalization tend to overlook the gain in consumer surplus that results from dramatic lowering of prices as import tariffs are dismantled. The UNECA study took account of this and estimated that there would be welfare (Consumer surplus) gains of about 30 million dollars in Kenya as a result of the removal of the trade barriers to EU goods. This is of course an underestimate of the total welfare changes resulting from the trade liberalization as it fails to take account of the producer surplus changes. By weighing the estimates of the revenue loss against the consumer surplus gain and the positive trade expansion effects the numbers show that EPAs will be potentially beneficial to Kenya.

The KIPPRA study was more detailed and examined the macro level, issues as did the UNECA study, in addition to a more detailed sectoral study including agriculture. The study was not very definitive about the welfare outcomes of the EPAs as the results seem to depend on the elasticities used in the simulation exercise. However, once the sensitive sectors are isolated the results are less ambiguous in concluding that the EPAs will be welfare improving for Kenya.

- **Negotiating Point**

Two crucial conditions, which can be used as negotiating points by Kenyan team negotiating, must obtain for the foregoing to be a reality:

(i) The Tariff liberalization must allow for the unfettered access for all Kenyan products into the EU market.
(ii) Tariff phase down period for Kenya should be sufficient to enable her to consolidate gains from regional integration
(iii) Full compensation in form of increased budget support for the expected revenue loss.

7.0 Conclusions and Recommendations for Kenya's negotiation Position

From the foregoing analysis we can make several conclusions as we do below. The EPAs will introduce reciprocity into (and therefore achieve WTO compatibility for) the long standing trade relationships between the EU and the ACP, it is incumbent on ACP countries like Kenya negotiating the EPAs to ensure that, at a minimum, market access gains secured under the Lome conventions are not eroded or that there are net welfare gains for the country in the new trade arrangements. Further, although theoretically trade liberalization brings with it significant welfare gains, a preference for trade pacts as tool towards liberalization is preferred because they serve to balance the import competing interests with those of exporters and hence reduce both political pressure on the government. The RTAs under which the EPAs are characterized have both static welfare effects - trade diversion and trade creation- as well as two potential dynamic effects of competition and scale effects as well as trade and location effects are of far greater significance.

Existing realties in the EU market however may limit the benefits that accrue from the EPAs. Included in these are the non-tariff barriers and other impediments which limit the benefits that low-income countries derive from the trade preferences granted by developed countries as a substitute for aid. Further, the effectiveness of the preferences in targeting the poor may be compromised if productive resources are highly concentrated.

The pattern of Kenya's trade flows in agriculture and manufactures represents her unique production structure as well as her geographical location. Her agricultural exports are mainly destined for the EU while she exports manufactured goods to the regional markets. As such market access gains arising from the EPAs must adequately compensate the possible loss of jobs, revenue and income that may arise from the increased exposure of the manufacturing sector to competition from the EU.

Tea, Coffee and Horticulture are Kenya's dominant agricultural exports to the EU and have benefited from the market access provisions in the Lome and Cotonou trade pacts as evidenced by significant growth in the 1995-2003 period.

CAP reforms have the potential to affect global agricultural trade and significantly undermine export earnings from Kenya's agricultural exports to the EU. Further they may displace, from global and EU markets, developing countries' agricultural exports. Therefore not only Kenya's present export earnings from the EU but also her potential export earnings may be significantly reduced through the price reductions-in the EU and globally- that will arise from the reforms.

NTBS have proliferated in developed countries even as tariffs have been systematically reduced to embrace globalization. The evidence shows that agricultural exports from all developing countries to the EU, (whether or not they enjoy preferences), faces higher barriers than do manufactured exports from the same.

Agricultural exports from preference receiving developing countries enjoy slight advantage over exports from the middle-income countries and OECD economies. Preference erosion through WTO and other trade negotiations therefore significantly undermine competitiveness of these exports in the EU-where market access is higher than in other OECD countries.

The increasing use of TBT and SPS measures in the OECD markets will undermine whatever tariff liberalization gains that have been made. In addition, Kenyan agricultural exports to the EU face both tariff peaks and tariff escalation-that prevent the country from moving up the value chain- as well and non-tariff barriers.

NTBs that face Kenyan agricultural exports to the EU are mainly those concerned with SPS and TBT measures. Examples of those particularly causing concern to Kenyan exporters of agricultural products to the EU include: the high costs of conforming to quality standards, new traceability regulations, adherence to MRLs and adoption of EUREGAP. The costs of compliance with these new standards are especially prohibitive for small-scale farmers.

Overall the effect of the EPAs on Agricultural market access in the EU will depend on four factors. First, the extent of preference erosion resulting from the CAP reforms and WTO commitments entered into by the EU. Second, extent to which the CAP reforms depress global and EU prices of agricultural goods of export interest to Kenya. Third, the extent and scope of tariff liberalization in the EU on which the overall welfare effects of EPAs depends and Fourth, the extent to which the costs of complying with the creeping food and health safety standards presently being used in the EU are mitigated through trade capacity building in Kenya.

Arising from the foregoing we offer the following recommendations as possible negotiating positions.

8.0 Recommendations on Kenya's Negotiation Positions

(i) EU Tariff liberalization must allow for the unfettered access for all Kenyan products into the EU market.

(ii) Tariff phase down period for Kenya should be sufficient to enable her to consolidate gains from regional integration.

(iii) There should be full compensation for the expected revenue loss in form of increased budget supported for the expected revenue loss.

(iv) There should be a mitigation of costs of complying with the creeping TBT and SPS requirements through for example, seeking equivalence recognition for the existing verification arrangements in the ACP and EU.

(v) Kenya should seek to undertake a detailed sector-by-sector and product-by-product negotiation of the standards and regulations.

(vi) Kenyan negotiators should demand that standards to protect EU citizens through animal and plant health regulations be designed to minimize trade obstacles to her small-scale farmers.

(vii) EU should facilitate increased access to accurate information on changes in the standards on traceability, MRLs and EUREGAP.

(viii) There should be harmonization of varying individual OECD country standards to an internationally accepted base so as to reduce the compliance costs.

(ix) EU should provide assistance for trade capacity building. For example, EU should give increased assistance to farmers to access suitable equipment for spraying horticultural produce, EU should equip Pest Control Products Board and key standards bodies like KEPHIS, DVS, Department of Fisheries and KEBS to increase compliance with EU regulations.

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