

# PROMOTING EQUITY THROUGH STRUCTURAL TRANSFORMATION: THE IMPACT OF REGIONAL FREE TRADE AGREEMENTS ON EAST AFRICA REGIONAL INTEGRATION

## ABSTRACT

This brief discusses the likely implications of the African Continental Free Trade Agreement (AfCFTA) and Tripartite Free Trade Area (TFTA) on integration initiatives in the East Africa Community (EAC). We argue that the TFTA as well as the AfCFTA will not only help harmonize trade policies among member states within various regional economic blocs, but it will also establish industrial linkages. Despite this, the EAC should strive to address existing challenges and constraints in order to effectively participate in the on-going TFTA and AfCFTA negotiations.

Kenya simulation results indicate that substantial trade creation effects or welfare gains will rise following removal of tariffs and other trade barriers. Addressing these barriers will allow for trade expansion and participation of small-scale producers in value chain thus driving job creation and income generation. The study further suggests that priority sectors, such as agriculture or the textiles sector, be identified and protected in order to support value addition and allow for inclusivity

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## POLICY RECOMMENDATIONS

1. EAC should strive to **fully implement the Customs Union and Common Market Protocols in order to harmonize its position** in the on-going negotiations.
2. EAC countries should **effectively address non-tariff barriers** to allow for expansion of industrial production and trade amongst its members.
3. EAC partner states should strive to **remove all forms of restriction on the movement of persons and professionals** in the spirit of the Common Market protocol.
4. **Removal of restrictive measures in various service sectors** including finance, transport, business, education, tourism, communications and distribution services cannot be overstated as services have become essential tools for supporting production, value addition and industrial development
5. EAC region should strive to **be strategic to minimize losses in the wider economic blocs, while at the same time consolidating integration**. For instance, revival of cotton growing and other value-chain integration initiatives will be essential for greater success in the textile sector.
6. EAC region should **negotiate for simple, transparent and predictable ROO** under the TFTA and AfCFTA.
7. There is **need to advance deeper “trade liberalization”, structural transformation and the opportunities for “regional value chain creation.”** This includes a comprehensive review of the “sensitive and excluded products” and pursuing trade competitive tariff structure for raw materials plus intermediate products at the regional level among others
8. **Identify export potentials** so as to take measures, including **strengthening marketing and promotion of EAC products in those markets**, thereby taking advantage of tariff preferences.

### 1. INTRODUCTION

Essential to discussions of the EAC development agenda, within wider continental integration initiatives, are the pathways that structural transformation offers to tackle the challenges of inequality and poverty reduction. As such, East African governments have set themselves out to chart a path of deliberate and managed structural transformation, which is imperative in tackling social, economic and political inequalities.<sup>1</sup>

Structural transformations are the shifts within or between sectors that yield higher growth and development due to more productivity leading to increased incomes. This can be achieved by

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<sup>1</sup> <https://www.sidint.net/content/pan-african-conference-inequalities-context-structural-transformation>

establishing value chains that will open and connect different regions or sectors with each other to move traditional sectors of the economy into sustainable modern activities.

Regional integration initiatives encompass agreements between a group of countries with the aim of removing various aspects of economic, social, political and cultural divergencies amongst participating member states with a view of achieving common goals including efficiency in production, creating employment opportunities, attaining peace and undertaking regional infrastructure development projects. There are various forms or levels of regional integration arrangements.

Generally, the need for integration is urgent because (positive) responses to economic fluctuations tend to be more synchronized with the deepening of trade interdependence under region arrangements. By looking at the impact of economic integration through bilateral trade, Choe (2001) posits that there's a need for greater cooperative efforts in order to prevent or adjust to future economic crisis that may not favour a region.

So far, considerable progress has been made in implementing various protocols provided for in the EAC Treaty as follows: Customs Union (signed in 2005), Common Market Protocol (signed in 2010) and Monetary Union protocol (signed in 2013). To date, the EAC Partner States are yet to fully implement all provisions of the various protocols. The East African Council of Ministers has kicked off the process towards the implementation of a Political Federation and have approved a committee of 12 experts to draft the East African constitution, which is expected to be ready by 2021.

## 2. EAC AND AFRICAN REGIONAL INTEGRATION INITIATIVES

The multiplicity in membership to various integration arrangements within and outside the African region has increased difficulty in integration of the EAC partner states. The main challenges facing the region relate to technical and financial requirements for effective participation in trade negotiations, the likely implications of the various agreements on the EAC integration itself and the need to develop common positions as EAC bloc. A key challenge for the EAC bloc is to determine the appropriate levels of liberalization commitments within the regional economic blocs without undermining its goals and aspirations. The diverse trade pacts with various trading partners require a coherent and uniform approach by the partner states.

According to Abrego, et al, (2019), the trade regimes in the African continent are characterized by three broad elements;

1. ***Preferential trade agreements between individual African countries and countries outside the continent*** such as the general system of preferences (GSP) and AGOA with USA.
2. ***Regional trade agreements between African countries and collective countries outside Africa.*** This grouping includes the various economic partnership agreements (EPAs) that the EU has negotiated with different countries and regional groupings on the continent
3. ***Intra-African trade agreements***, including eight RECs, and four sub-regional groupings within the continent.

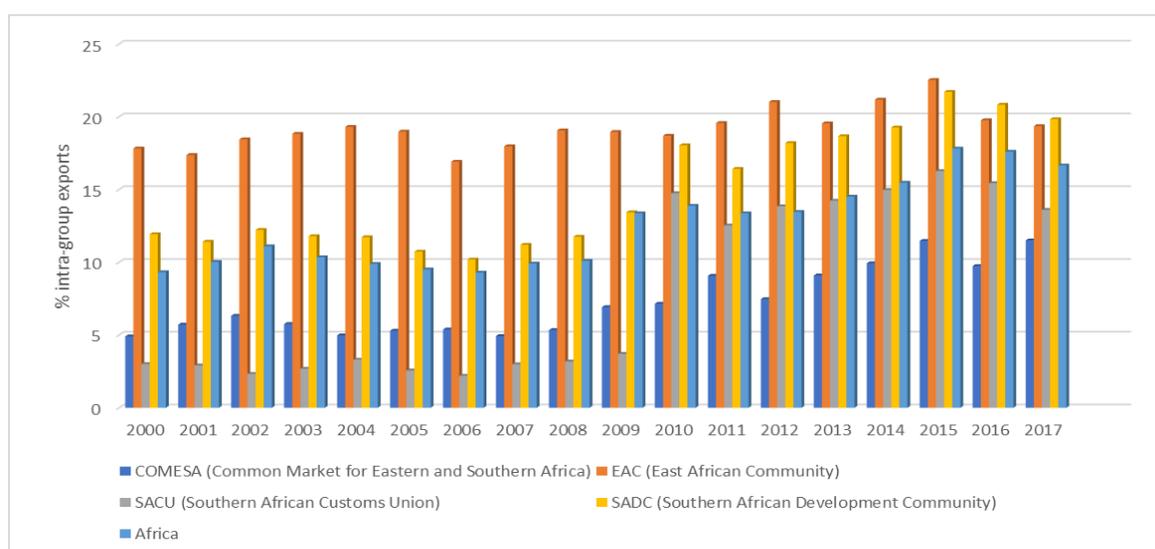
### 3. TRIPARTITE FREE TRADE AREA (TFTA)

The TFTA is a collective membership of 26 countries belonging to the COMESA-EAC-SADC region with a combined population of nearly 683 million people and a total Gross Domestic Product (GDP) of approximately US\$1.3 trillion. TFTA aims to strengthen and deepen economic integration amongst the member states, through three identified pillars, namely Market Integration; Infrastructure Development; and Industrial Development.

#### 3.1 Intra-TFTA Trade

During the year, the SADC region registered the highest intra-trade share 19.8% closely followed by EAC (19.4%) SACU (13.6%) and COMESA (11.5%).

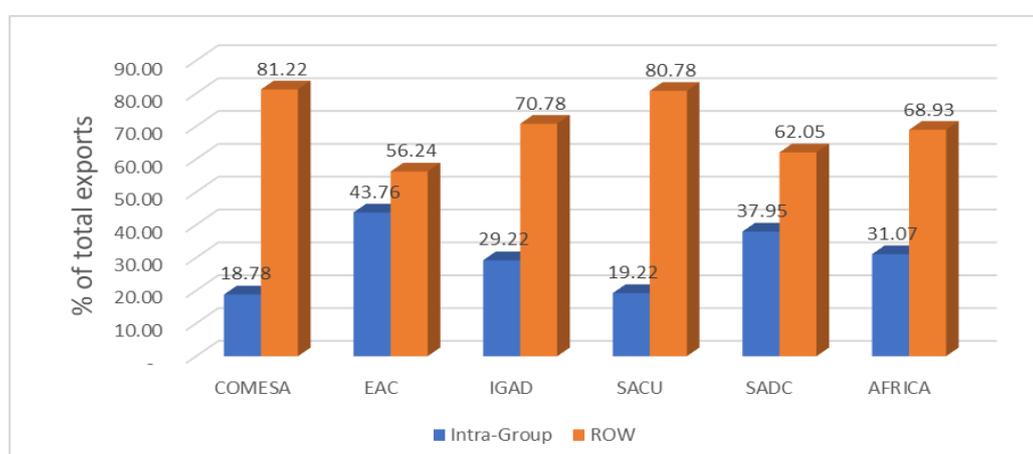
**Figure 1: Intra TFTA Trade by Region 2000-2017**



Source: UNCTADStat (<http://unctadstat.unctad.org/>) accessed on 22nd July 2019.

In terms of the structure of exports, the EAC region trades more in manufactured goods compared to the other RECs as indicated in Figure 2. Except for COMESA and SACU, the other RECs registered more than 20% intra-group trade in manufactures.

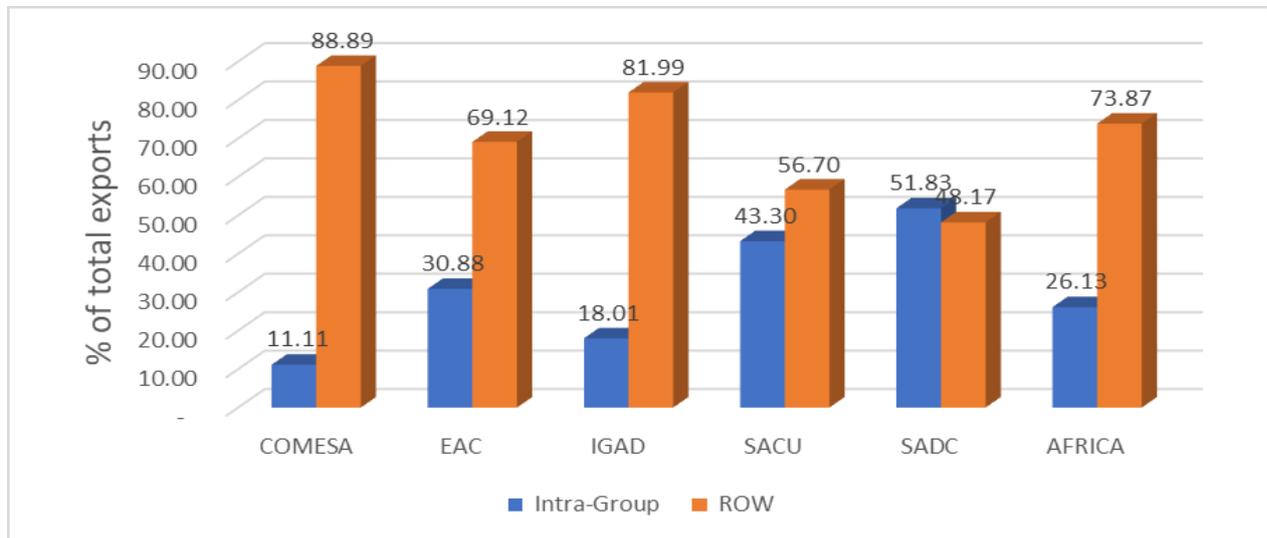
**Figure 2: Intra - Trade in Manufactures, 2017**



Source: UNCTADStat (<http://unctadstat.unctad.org/>) accessed on 22nd July 2019.

In terms of labour-intensive sectors, SADC and SACU trade higher proportions of labour and resource-intensive products. This is mainly in light manufacturing sectors, including textiles and food processed products.

**Figure 3: Intra- Trade in labour intensive and resource- intensive Manufactures, 2017**



Source: UNCTADStat (<http://unctadstat.unctad.org/>) accessed on 22nd July 2019.

Other key intra-trade patterns within the various RECs include:

1. The EAC region trades more in fuels (26%) compared to the other RECs (3-14%).
2. EAC region trades more in low skill and technology intensive sectors (59%) than it does to the rest of the world (41%). These include wood and paper; food, beverages and tobacco; textiles, apparel and leather products. This is contrary to the case of the other RECs whose share is lower vis a vis the rest of the world.
3. EAC region trades more in medium skill and technology-based manufactures (53%) than it does to the rest of the world (47%). Again, it is contrary to the other RECs whose share is lower compared to the rest of the world.
4. Intra-trade in resource-based manufactures lies between 12% and 22% for all RECs.

### 3.2 Status of TFTA negotiations

Negotiations of the TFTA are being conducted in two phases under the Acquis Principles. Under phase 1, the focus is on Trade in Goods i.e. tariff and NTBs elimination, exemptions, trade remedies and ROO. The 2nd phase comprises trade in services, investment, competition and intellectual property. The TFTA has high level ambitions where the duties for all the 5,387 tariff lines are intended to be eliminated. This is despite complexities created by different levels of liberalisation within the three economic blocs.

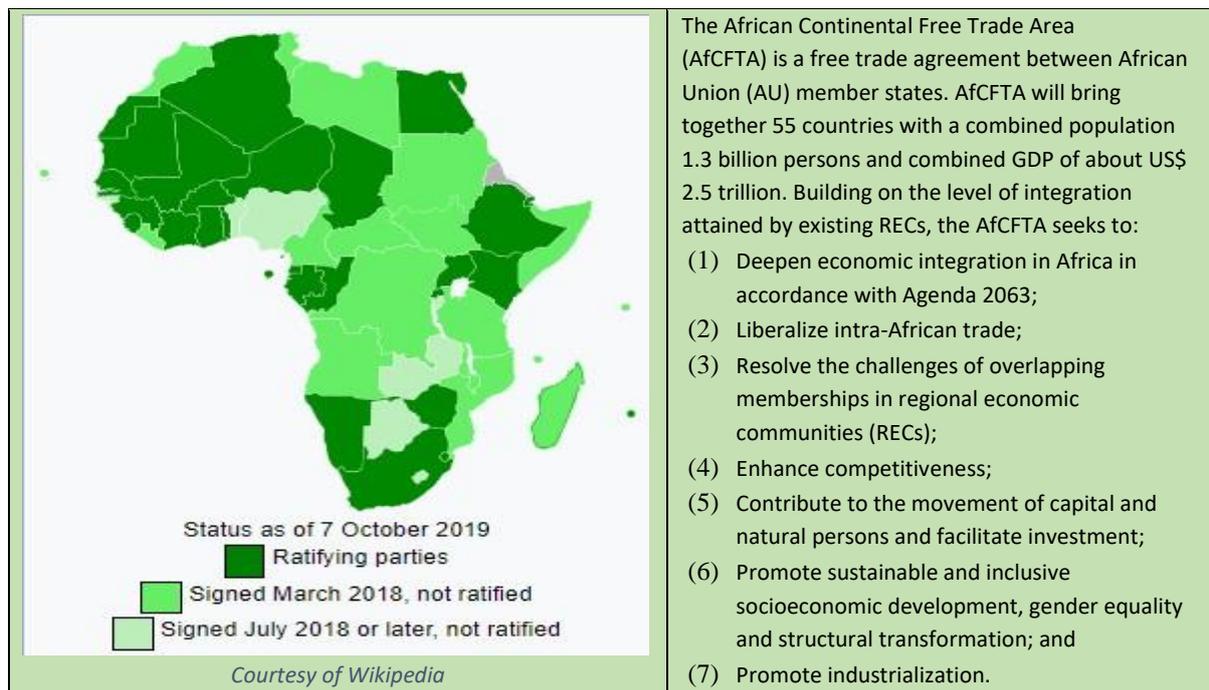
The current status is that for trade between the EAC and SACU, around two thirds of goods will be liberalised immediately, a further 25% over the course of 5- 8 years, and the final 10% will be resolved in due course. For all remaining countries, the EAC has offered COMESA equivalent tariffs, but subject to reciprocity.

### 3.3 Main Challenges and Constraints to the TFTA

- a. Differences in the stages of integration for the three RECs.
- b. Prevalence of non-tariff barriers
- c. Poor infrastructure
- d. List of exclusions (only 94% of the 5,387 tariff lines have been agreed upon)

## 4. IN SEARCH OF A CONTINENTAL FREE TRADE AGREEMENT

**Figure 4: The AfCFTA**



Mevel and Karingi (2012) indicate that the Regional Free Trade Agreements (RFTA) and the AfCFTA would result in a 2.8% and 4% increase in African exports, respectively. At the sector level, agriculture and food exports would rise the most with the adoption of RFTAs and AfCFTA reforms by 7.2% and 9.4%, respectively. Abrego et. al., (2019) examined the welfare implications of the AfCFTA for 45 member countries, and noted that the welfare gains from combined tariff elimination and reduction of NTBs is about 2% to 4%.<sup>2</sup> More importantly, the overall gains from tariff elimination are modest with the bulk of the gains emanating from reduction of NTBs. This is because applied tariffs are already low on average.

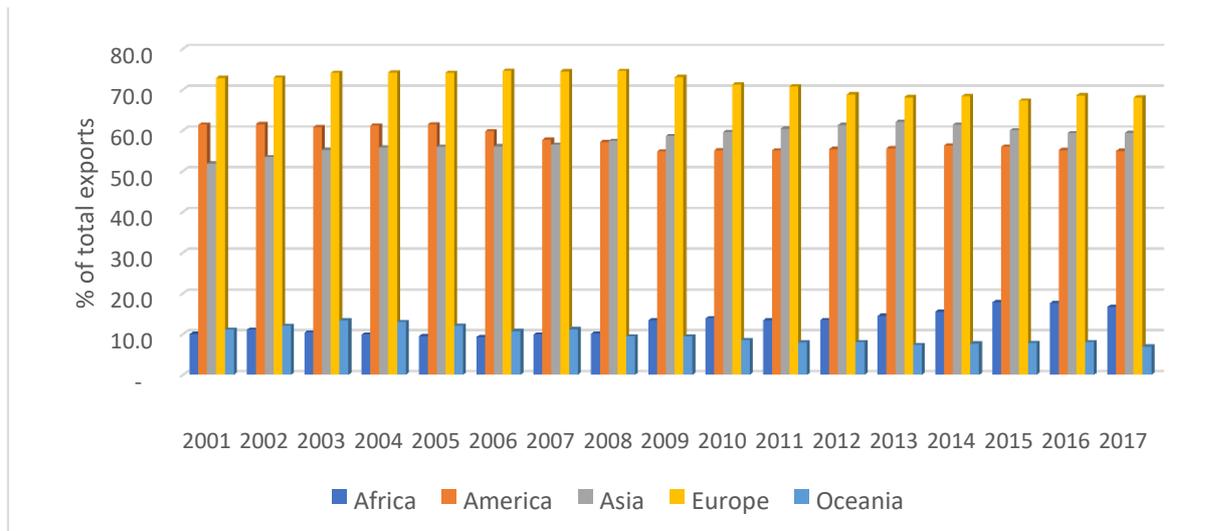
### 4.1 Intra-AfCFTA Trade

Intra-regional trade in Africa is relatively low compared to other regions but has been rising.<sup>3</sup> In 2017, 17% of Africa's total trade was conducted within the continent, rising from 10 percent in 2001.

<sup>2</sup> This depends on the model used

<sup>3</sup> This is compared to 68% in Europe, 68% in Asia and 55% in America.

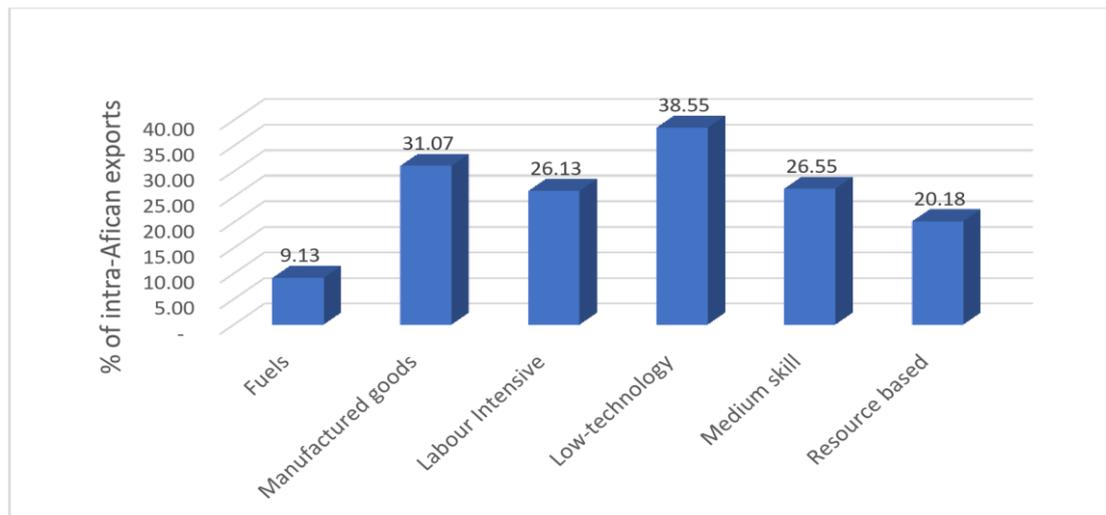
**Figure 5: Intra-Regional trade, 2001-2017**



Source: UNCTADStat (<http://unctadstat.unctad.org/>) accessed on 22nd July 2019.

The largest components of intra-Africa exports are low-technology based products. Followed by manufactured goods and medium skill and labour-intensive goods. South Africa, Egypt and Kenya are the major suppliers of value-added products.

**Figure 6: Structure of Intra-AfCFTA, 2017**



Source: UNCTADStat (<http://unctadstat.unctad.org/>) accessed on 22nd July 2019.

It is envisaged that if fully implemented, the AfCFTA has potential to enhance member countries' GDP by between 1% and 3% and boost intra-Africa trade by an estimated 33%.

#### 4.2 Status of TFTA negotiations

Negotiations are being conducted under two phases. Phase 1 concentrates on Trade in Goods and Services, whereas Phase 2 includes Investment, Competition and Intellectual Property. Liberalization of goods is phased out in three levels. Basically, 4,848 tariff lines (90%) are to be fully liberalised and zero rated in the first level. Second, up to 377 tariff lines (7%) are to be treated as sensitive goods, and thus have an extended transition period. Finally, up to 162 tariff lines, the remaining 3%, will be exempt from free trade entirely.

In these negotiations, each country or CU would eventually have its own set of sensitive list or exempt tariff lines. In addition, the agreement has adopted different transition periods depending on levels of development. The AfCFTA entered into force on 30th May 2019 following the ratification of the agreement by 22 countries. So far, the consolidated agreement has been signed by 49 countries and ratified by 24. The second phase of negotiations were scheduled to commence in August 2018 to negotiate protocols on Investment, Competition and Intellectual Property but they still have not begun.

### **4.3 Constraints and Challenges to the AfCFTA**

- a. EAC bloc comprises of a mix of middle income and LDC countries, hence it is not clear whether it will eventually adopt the shorter or the longer transition periods.
- b. The rate of liberalization during these time periods has not yet been decided.
- c. Regarding negotiation approach, countries within customs unions are negotiating collectively, a practice that extends to the EAC and SACU. All other countries will negotiate individually, unless they agree on a common position.
- d. Tariff lines for the more contentious items such as textiles, agricultural goods, and agro-processed goods are yet to be determined.
- e. The disparities in economic sizes and uneven distribution of manufacturing hubs across the African region raises the fears that the benefits of the free trade area could be shared amongst a few countries at the expense of the relatively weak and underdeveloped economies.

## **5. TRIPARTITE AND THE AfCFTA: THE LEGAL AND ECONOMIC IMPLICATIONS**

### **5.1 Multiplicity and complexity in conducting negotiations**

There is increasing heterogeneity in the trading blocs within the region thereby complicating their harmonization due to different levels of economic integration as well as diverse status in economic development.

### **5.2 The complexities of Rules of Origin (ROO)**

Restrictive ROOs are costly to trade and can hinder utilization of tariff preferences, and subsequently structural transformation. ROO include the substantive criteria of origin as well as ROO procedures.<sup>4</sup> A major challenge lies in establishing an effective implementation framework that would minimize restrictiveness in use of preferences as well as costs of compliance. How ROOs are dealt with will impact the political will to push integration and the outcome of these agreements.

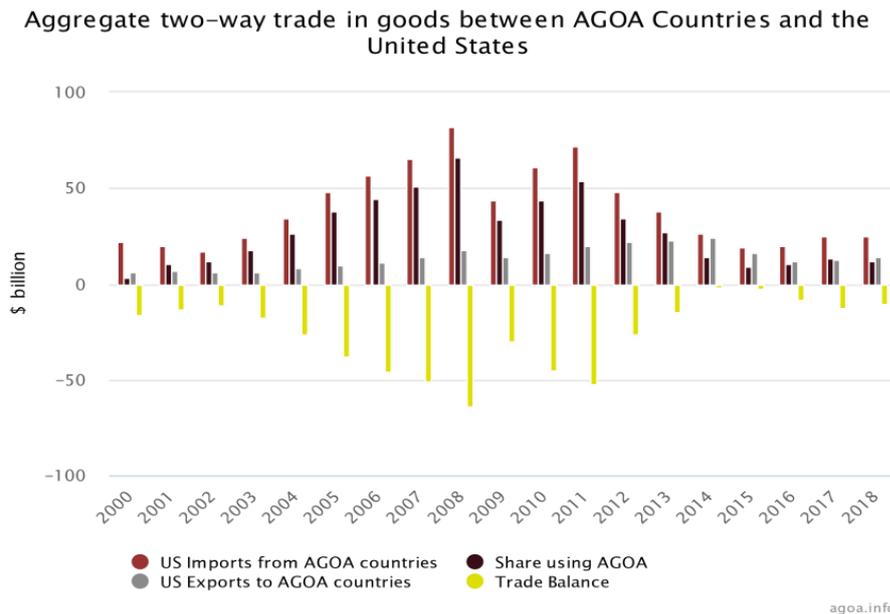
### **5.3 African Growth and Opportunity Act (AGOA)**

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<sup>4</sup> For instance, an important ROO procedure which is part and parcel of the ratified AfCFTA is the opportunity for exporters to make use of a declaration of origin rather than a certificate of origin for shipments from State Parties of anything less than USD 5,000. (i.e. a facility for smaller traders)

The latest AGOA III (AGOA Acceleration Act 2004) is due to expire in 2025. AGOA countries' exports have consistently exceeded imports resulting into significant trade surplus in favour of Africa since 2001 (Figure 7). However, the deficit has been narrowing since 2008 following the global financial crunch. The trade deficit declined to US\$ 10.4 billion in 2018 from US\$ 64 billion during 2008.

**Figure 7: Trade in goods between AGOA countries and the United States**



Source : <https://agoa.info/data/total-trade.html>

The top three sub-Saharan African suppliers to the United States were South Africa (\$8.0 billion), Nigeria (\$7.1 billion) and Angola (\$2.7 billion). In EAC, Kenya leads with \$572 million. Meanwhile, US investment in sub-Saharan Africa stood at \$29 billion in 2016, the latest year available, down 23% compared to \$37.5 billion in 2014. The three largest destinations for U.S. investment were Mauritius (\$6.7 billion), South Africa (\$5.1 billion) and Nigeria (\$3.8 billion). On the other hand, Sub-Saharan Africa foreign direct investment in the U.S. stood at \$4.2 billion in 2016, up 164% compared to \$1.6 billion in 2014.

In relation to the structure of exports from Africa, over 80% of exports constitute of crude oil products which tend to distort the overall trade picture. In terms of non-oil exports, apparels, accessories, primary metal manufacturing and transportation equipment constitute the main products. Thus, beneficiary countries barely utilize the full potentials of the AGOA trade preferences.

The lack of policy coherence within the EAC as well as at the TFTA and AfCFTA may pose challenges to effective utilization of AGOA preferences. For instance, whereas the ban on second-hand clothing was an EAC policy aimed at spurring the development of the EACs textile sector, the opposition of the same by the US government and subsequent reversal by Kenya to pre-2016 tariffs poses a challenge to collective EAC policy. Thus, AGOA could pose a hindrance in the implementation of an agreed common policy aimed at promoting industrial development.

#### 5.4 The EU Economic Partnership Agreement (EPA)

Already the EAC, SADC and some individual countries within the framework of ESA have initiated different interim agreements with the EU under EPAs on trade in goods, while others have signed and ratified the final agreements. In the EAC, Kenya and Rwanda have signed and ratified the EPA

ahead of other partner states. Such external trade agreements further complicate the harmonization of the RECs and the smooth running of CUs thus fueling opposition to regional economic integration.

## 6. KENYA FOCUS: CASE SIMULATION

The Kenyan example indicates the likely implications of the AfCFTA and TFTA on the EAC integration.

SADC/COMESA region leads in supplying Kenya with most products despite the application of EAC common external tariffs. On the other hand, the EAC is a leading source of imports in the following product categories: 1-5; 6-14; 15; 16-24; 41-43 and 64-67.

**Table 1: The structure of Kenyan Imports from SADC<sup>5</sup>, ECOWAS and the rest of Africa**

Chapters	Product descriptions	Share of imports from EAC (%)	Share of Imports from SADC & COMESA (%)	Share of imports from ECOWAS (%)	Share of imports from RoA (%)
1-5	Live animals, animal products	94.90	5.10	-	-
6-14	Vegetable products	69.93	29.99	0.08	-
15	Animal or vegetable fats and oils and their cleverage products	58.04	36.26	5.65	0.05
16-24	Prepared foodstuffs, beverages, spirits and vinegar, tobacco	50.01	49.42	0.57	0.00
25-27	Mineral products	10.78	80.06	7.90	1.27
28-38	Products of chemical or allied industries	6.58	88.65	0.24	4.53
39-40	Plastics and articles thereof, rubber and articles thereof	8.80	85.94	1.19	4.07
41-43	Raw hides and skins, leather, fur skins and articles thereof	87.88	11.75	0.34	0.02
44-46	Wood and articles of wood, wood charcoal, cork and articles of charcoal	63.08	36.92	0.00	0.00
47-49	Pulp of wood or other fibrous cellulosic material, paper or paper boards	42.35	57.38	0.24	0.03
50-63	Textiles and textile articles	43.08	55.63	0.83	0.47
64-67	Footwear, headgear, umbrellas, walking sticks	82.42	16.19	1.37	0.01
68-70	Articles of stone, plaster, cement, asbestos, mica or similar materials	49.66	50.06	0.24	0.04
71	Natural or cultured pearls, precious or semi-porous stones	10.32	89.65	0.03	-
72-83	Ferrous alloys, waste, Semi-finished products of iron or non-alloy steel, rails, tubes, pipes,	6.07	93.46	0.46	0.01
84-85	Ignition parts, electrical equipment, pumps, air vacuums, refrigerators, washing machines, weighing machines, transformers, television cameras, digital cameras and video camera recorders etc	3.93	94.25	0.93	0.90

<sup>5</sup> SADC countries exclude the United Republic of Tanzania.

<b>86 – 89</b>	Transport machineries, equipment, motor vehicles, trailers, aircrafts, parts & accessories etc	2.25	97.48	0.27	-
<b>90- 92</b>	Contact lenses, surveying, photography, accessories & parts, instruments for measurements, hydrometers, wrist watches, clocks, musical instruments, parts etc	1.13	98.70	0.16	0.01
<b>93</b>	Firearms, bombs, grenades, parts & accessories.	-	100.00	-	-
<b>94 - 96</b>	Seats, furniture, mattress supports, lumps & fittings, entertainment articles, brooms, brushes etc	26.36	71.96	1.61	0.08
<b>97</b>	Paintings, drawings and pastels, sculptures and statuary collections of anatomical, historical, archaeological, palaeontological, ethnographic interests etc.	2.87	88.59	8.48	0.06
	<b>Total</b>	<b>37.31</b>	<b>61.09</b>	<b>0.95</b>	<b>0.66</b>

Source: KRA, 2019

## 6.1 Revenue Effects

Once the TFTA comes into effect, removal of tariffs is estimated as the revenue forgone having in mind that all products will be zero-rated, with the exclusion of exemptions. As seen in Table 4, the results indicate that total tariff revenue losses would be modest, estimated at about KES 6.8 billion (US\$ 6.8 million). The results indicate that the following product categories will incur the highest shares of loss in tariff revenues once the full FTA comes into existence: 6 – 14; 16 – 24; and 86-89.

**Table 2: Tariff Revenue Effects from the TFTA**

Chapters	Product descriptions	Foregone Revenues from TFTA (Value in KES)	Share of Revenue Foregone from TFTA (% shares)
<b>1-5</b>	Live animals, animal products	(38,791,562.99)	0.57
<b>6-14</b>	Vegetable products	(2,146,978,955.47)	31.48
<b>15</b>	Animal or vegetable fats and oils and their cleavage products	(36,951,891.36)	0.54
<b>16-24</b>	Prepared foodstuffs, beverages, spirits and vinegar, tobacco	(1,922,510,827.98)	28.19
<b>25-27</b>	Mineral products	(103,307,028.88)	1.51
<b>28-38</b>	Products of chemical or allied industries	-	-
<b>39-40</b>	Plastics and articles thereof, rubber and articles thereof	-	-
<b>41-43</b>	Raw hides and skins, leather, fur skins and articles thereof	-	-
<b>44-46</b>	Wood and articles of wood, wood charcoal, cork and articles of charcoal	-	-
<b>47-49</b>	Pulp of wood or other fibrous cellulosic material, paper or paper boards	-	-
<b>50-63</b>	Textiles and textile articles	-	-

64-67	Footwear, headgear, umbrellas, walking sticks	-	-
68-70	Articles of stone, plaster, cement, asbestos, mica or similar materials	-	-
71	Natural or cultured pearls, precious or semi-porous stones	-	-
72-83	Ferrous alloys, waste, Semi-finished products of iron or non-alloy steel, rails, tubes, pipes,	(291,917,328.90)	4.28
84-85	Ignition parts, electrical equipment, pumps, air vacuums, refrigerators, washing machines, weighing machines, transformers, television cameras, digital cameras and video camera recorders etc	(538,405,302.54)	7.89
86 - 89	Transport machineries, equipment, motor vehicles, trailers, aircrafts, parts & accessories etc	(1,544,275,543.86)	22.64
90- 92	Contact lenses, surveying, photography, accessories & parts, instruments for measurements, hydrometers, wrist watches, clocks, musical instruments, parts etc	(7,761,529.73)	0.11
93	Firearms, bombs, grenades, parts & accessories.	(5,548,333.26)	0.08
94 - 96	Seats, furniture, mattress supports, lumps & fittings, entertainment articles, brooms, brushes etc	(183,563,428.13)	2.69
97	Paintings, drawings and pastels, sculptures and statuary collections of anatomical, historical, archaeological, palaeontological, ethnographic interests etc.	(828,977.23)	0.01
	Total	(6,820,840,710.32)	100

Source: Author's calculations based on KRA data, 2019.

## 6.2 Trade Creation Effects

Assuming the TFTA is a more efficient supplier than the EAC regional suppliers, inefficient suppliers from the EAC region would be replaced by more efficient producers from the TFTA due to elimination of tariffs within the TFTA bloc. As seen on table below, the value of total trade creation effects would amount to about KES 3.8 billion. The largest trade creation effects would occur in the following product categories: 6-14; 16-24; and 86-89. Elimination of tariffs from these products would in a way enhance productivity and generate employment opportunities and facilitate structural transformation within the entire TFTA bloc. Overall, agriculture and vehicle industry would be the main beneficiaries under TFTA.

**Table 3: Trade Creation Effects of the TFTA**

Chapters	Product descriptions	Trade creation effects from the TFTA (Value in KES)	Share of trade creation effects arising from TFTA (% shares)
1-5	Live animals, animal products	23,171,564.32	0.61
6-14	Vegetable products	1,182,015,641.48	30.99
15	Animal or vegetable fats and oils and their cleavage products	22,285,473.53	0.58
16-24	Prepared foodstuffs, beverages, spirits and vinegar, tobacco	955,121,805.04	25.04
25-27	Mineral products	63,269,103.18	1.66
28-38	Products of chemical or allied industries	-	-

<b>39-40</b>	Plastics and articles thereof, rubber and articles thereof	-	-
<b>41-43</b>	Raw hides and skins, leather, fur skins and articles thereof	-	-
<b>44-46</b>	Wood and articles of wood, wood charcoal, cork and articles of charcoal	-	-
<b>47-49</b>	Pulp of wood or other fibrous cellulosic material, paper or paper boards	-	-
<b>50-63</b>	Textiles and textile articles	-	-
<b>64-67</b>	Footwear, headgear, umbrellas, walking sticks	-	-
<b>68-70</b>	Articles of stone, plaster, cement, asbestos, mica or similar materials	-	-
<b>71</b>	Natural or cultured pearls, precious or semi-precious stones	-	-
<b>72-83</b>	Ferrous alloys, waste, Semi-finished products of iron or non-alloy steel, rails, tubes, pipes,	182,325,138.00	4.78
<b>84-85</b>	Ignition parts, electrical equipment, pumps, air vacuums, refrigerators, washing machines, weighing machines, transformers, television cameras, digital cameras and video camera recorders etc	333,927,540.39	8.76
<b>86 – 89</b>	Transport machineries, equipment, motor vehicles, trailers, aircrafts, parts & accessories etc	931,595,057.86	24.43
<b>90- 92</b>	Contact lenses, surveying, photography, accessories & parts, instruments for measurements, hydrometers, wrist watches, clocks, musical instruments, parts etc	4,986,115.88	0.13
<b>93</b>	Firearms, bombs, grenades, parts & accessories.	3,328,999.95	0.09
<b>94 – 96</b>	Seats, furniture, mattress supports, lumps & fittings, entertainment articles, brooms, brushes etc	111,570,719.02	2.93
<b>97</b>	Paintings, drawings and pastels, sculptures and statuary collections of anatomical, historical, archaeological, palaeontological, ethnographic interests etc.	497,386.34	0.01
	<b>Total</b>	<b>3,814,094,544.97</b>	<b>100.00</b>

Source: Author's calculation

## 7. CONCLUSION

The consolidation of the wider Africa integration has potentials to enhance trade, value addition and investments in the region and support structural transformation. Simulation results suggest gains from increased trade and trade creation effects arising from removal of tariffs and other trade barriers. Another positive indicator is the growing political support for a wider free trade area in Africa to enhance intra-Africa trade and increase participation in the global trading system.

Results indicate that agriculture and light manufacture in various sectors would be among the biggest beneficiaries of the TFTA. There would be minimal loss of tariff revenues since the average tariffs have already been lowered. Also, increased exports would enhance production and strengthen tax revenues from non-international trade sources like the VAT and excise tax revenue. The overall impacts will also depend on the nature of the final ROO that will be agreed upon by the participating member states as well as addressing existing non-tariff barriers to trade. Following from these analyses, recommendations are provided for under the section Policy Recommendations.

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## ANNEX: Econometric Model

### Model Specification

The study borrows PEM approach developed by Panagariya (1998, 2000) and Milner et al (2005). The framework distinguishes between those sectors where ROW is the dominant supplier and those where TFTA and/or AfCFTA is the dominant supplier prior to the formation of the trade agreements. The model

distinguishes three blocks of countries i.e. the TFTA and/or AfCFTA, the EAC group and the rest of the world (ROW). In this regard, three components of the trade effects are simulated i.e. consumption effect/revenue effects; trade diversion effects and trade creation effects.

**Case 1: Consumption Effects only**

In the sectors where the TFTA and/or AfCFTA regions are globally efficient and therefore the dominant supplier to the EAC market before the formation of the agreements, it can be assumed that only consumption effects would follow from the TFTA and/or AfCFTA. Thus, for the sectors where the TFTA and/or AfCFTA is the dominant supplier, consumption effect alone ( $\Delta M^C$ ) can be estimated relative to the existing TFTA and/or AfCFTA import levels as follows:

$$\Delta M^C = \left[ \frac{t}{1+t} \right] \cdot e_M^D \cdot M_0^{TFTA/CFTA} \cdot UV_0^{TFTA/CFTA} \dots\dots\dots (1)$$

Where  $t$  is the current tariff against imports from the TFTA,  $e_M^D$  is the price elasticity of demand of imports,  $M_0^{TFTA/CFTA}$  is the current volume of imports from the TFTA and/or AfCFTA and  $UV_0^{TFTA/CFTA}$  is the current

average unit value of imports from the TFTA and/or AfCFTA. The revenue ( $\Delta R^C$ ) and welfare ( $\Delta W^C$ ) effects associated with this are correspondingly:

$$\Delta R^C = -t \cdot UV_0^{TFTA/CFTA} M_0^{TFTA/CFTA} \dots\dots\dots (2)$$

$$\Delta W^C = 0.5t \cdot \Delta M^C \dots\dots\dots (3)$$

**Case 2: Trade Diversion with Consumption Effects**

For those sectors in the EAC where the ROW is the dominant supplier, further assumptions regarding the competitiveness of TFTA and/or AfCFTA supply to the EAC is required. If  $P_{TFTA/AfCFTA} < P_{tROW}$  then, given constant cost technology over the relevant range, the TFTA and/or AfCFTA will divert all the imports for ROW to the TFTA and/or AfCFTA. Thus, the upper limit of the value of trade diversion ( $\Delta M^{TD}$ ) is:

$$\Delta M^{TD} = M_0^{ROW} \cdot UV_0^{ROW} \dots\dots\dots (4)$$

Where  $M_0^{ROW}$ , is the current quantity of imports from ROW and  $UV_0^{ROW}$  is the current average unit of imports from ROW. The tariff revenue effect ( $\Delta R^{TD}$ ) due to this trade diversion is given by:

$$\Delta R^{TD} = -t UV_0^{ROW} M_0^{ROW} \dots\dots\dots (5)$$

For these sectors, there will also be consumption effects ( $\Delta M_{TD}^C$ )

Given that one may not have information about where the price of TFTA and/or AfCFTA imports may lie between PROW and PtROW, one can take an average of the two and assume that is where PTFTA/AfCFTA lies as follows:

$$\Delta M_{TD}^C = 0.5 \left[ \frac{t}{1+t} \right] \cdot e_M^D \cdot M_0^{ROW} \cdot UV^{TFTA/CFTA} \dots\dots\dots (6)$$

Given the assumption about PTFTA/AfCFTA, the overall welfare ( $W^{TD}$ ) can be approximated impact of trade diversion with consumption effects as follows:

$$W^{TD} = 0.25t\Delta M^{TDC} - 0.5tUV^{OROW}M^{OROW} \dots\dots\dots (7)$$

**Case 3: Trade Creation with Consumption Effects**

Assuming that the TFTA/AfCFTA is more efficient supplier than the ROW, if the duty free supply price from the EAC partner lies over the relevant range between PtROW and PTFTA/AfCFTA, then all of the current imports from the region to the home country will be replaced by more efficient production from the

TFTA/AfCFTA. Therefore, the maximum value of trade created ( $\Delta M^{TC}$ ) for the TFTA/AfCFTA by this deflection from EAC region sources can be estimated by:

$$\Delta M^{TC} = M_0^{EAC} \cdot UV^{EAC} \dots\dots\dots (8)$$

$M_0^{EAC}$ , refers to the current quantity of imports from EAC partner and  $UV^{EAC}$  is the current average unit value of imports from EAC partner. Where

In order to estimate consumption effects in these sectors ( $M_{TC}^C$ ), assume that the price from the EAC partner is as high as the tariff-inclusive price from the TFTA/AfCFTA regions. In this case, the pre-TFTA/AfCFTA tariff rate against the TFTA/AfCFTA imports provides an (upper) estimate of the extent to which the import price can fall as a result of the TFTA/AfCFTA. Thus:

$$M_{TC}^C = 0.5 \left[ \frac{t}{1+t} \right] \cdot e_M^D \cdot M_0^{EAC} \cdot UV^{TFTA/CFTA} \dots\dots\dots (9)$$

The combine welfare ( $\Delta W^{TC}$ ) effects of trade creation with consumption effects can be identified by:

$$\Delta W^{TC} = 0.5t \cdot M_{TC}^C + (UV^{EAC} M_0^{EAC} t) \dots\dots\dots (10)$$