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DISCUSSION PAPER

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242

Hamburgisches Welt-Wirtschafts-Archiv (HWWA)
Hamburg Institute of International Economics
2003
ISSN 1616-4814

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This paper was prepared within the HWWA Research Programme "Trade and Development".

Edited by the Department World Economy
Head: PD Dr. Carsten Hefeker

HWWA DISCUSSION PAPER 242
August 2003

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ABSTRACT

The EAC is on the verge of establishing a customs union. But this is accompanied by fears that the Customs Union would lead to trade imbalances among the Partner States, which would create serious problems for the proper functioning of the Customs Union itself. To mitigate these problems the establishment of a transitional fund is proposed. Based on a study of the trade effects of the Customs Union it is shown that these fears are unfounded, and the establishment of a transitional fund to address imbalances therefore not necessary. Stakeholders views on the establishment of a transitional fund are also analysed to assess their influence on the integration policy in the EAC. The historical background of the fears of a customs union is described and it is shown how these fears continue to present time, in spite of changing economic conditions.

JEL-Classification: F 15, O 55, P 16.

Keywords: Economic Integration, Africa, Political Economy.

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1 Introduction

The East African Community (EAC) including the three countries Kenya, Tanzania and Uganda, is on the verge of establishing a customs union. But this is accompanied by fears that the Customs Union and the intra-regional trade liberalisation would lead to trade imbalances among the partner states, which would create serious problems for the proper functioning of the Customs Union itself. To mitigate these problems the establishment of a transitional fund is proposed. The fund would finance projects to improve the competitiveness of the industrially less developed partner states and would be abolished after the trade imbalances are removed. But a study commissioned by the EAC Secretariat has already established that due to small magnitude of trade effects of a customs union there is no need for such a fund. The question arises therefore why such a firm case has been made in the past for measures to mitigate trade imbalances. To answer this question the paper reviews the stakeholders views to assess their influence on the integration policies of the EAC and describes the historical background of the fears of a customs union.

In Part 2 of the paper the historical background and achievements of the EAC are reviewed. Part 3 describes the fears of a customs union and the proposal for a transitional fund. Based on a study of the trade effects of the Customs Union it is shown in Part 4 that these fears are unfounded, and the establishment of a transitional fund to address imbalances therefore not necessary. In Part 5 stakeholders views on the establishment of a transitional fund are also analysed. The historical background of the fears of a customs union are described in Part 6. In Part 7 it is shown how these fears continue to present time, in spite of changing economic conditions. Conclusions are summarised in Part 8.

2 Historical Background and Achievements of the EAC

The treaty for the establishment of the EAC was signed in November 1999. According to §1, Article 5 of this treaty the objectives of the Community "shall be to develop policies and programmes aimed at widening and deepening co-operation among the Partner States in political, economic, social and cultural fields, research and technology, defence, security and legal and judicial affairs, for their mutual benefit" (EAC Secretariat 2000:12).

The old EAC collapsed in 1977. It took 16 years until the first attempts began to revive the EAC and to clear the way for a new foundation. On 30 November 1993 the three

East African Partner States signed an agreement establishing the Permanent Tripartite Commission for East African Co-operation with a mandate to identify areas of co-operation and propose appropriate arrangements for regional co-operation. The Secretariat was launched in March 1996. This made it possible to adopt the First EAC Development Strategy 1997-2000. The First Strategy formed the basis for the establishment of the Community in 1999. The Strategy defined the guiding principles for co-operation, identified areas for co-operation, defined priorities and made suggestions for strengthening the capacity to improve co-operation. Sectoral Councils and Sectoral Committees were established to articulate on each agreed area of Co-operation.

The second East African Community Development Strategy covers the years 2001-2005. It is based on the lessons learned from the First Strategy and sets out the priority programmes to be implemented in the period 2001-2005. In some areas the EAC has already made remarkable progresses. The intra-regional trade is almost liberalised. Kenya applies 90%; and Tanzania and Uganda 80% tariff reductions. Non-tariff barriers on cross border trade are removed. The establishment of the Customs Union is planned for November 2003. There is also progress by harmonisation of monetary and fiscal policies and by the institutional improvement of capital markets. A court of justice is already established and a competition law is in the planning process.

Other important areas, where co-operation has made progress are industry, investment and customs, private sector development, transport and communication, agriculture, energy, natural resources and environment. EAC has developed also an Industrial Development Strategy, a Private Sector Development Strategy and an Agricultural and Rural Development Strategy.

3 Fears of a Customs Union and the Proposal of a Transitional Fund

The EAC has ambitious goals. The Treaty envisages the establishment of a Customs Union, a Common Market, subsequently a Monetary Union and ultimately a Political Federation. According to the treaty the establishment of the Customs Union had to be prepared by concluding a Protocol within a period of four years. The first draft of this protocol was completed in June 2002. The establishment of the Customs Union is planned for November 2003, exactly four years after the adoption of the Treaty. This will include the elimination of remaining intra-regional tariffs, removing non-tariff barriers and the introduction of a Common External Tariff.

There have been fears that the application of the provisions for the establishment of the Customs Union and the Common Market would lead to imbalances. This is expressed forcefully in almost all relevant documents of the EAC. Article 77 of the Treaty (EAC Secretariat 2000: 52) is titled "Measures to Address Imbalances Arising from the Application of the Provisions for the Establishment of a Customs Union and a Common Market" and it reads like this: "For purposes of this Article, the Partner States shall within the framework of the Protocols provided for under Articles 75 and 76 of this Treaty, take measures to address imbalances that may arise from the application of the provisions of this Treaty". In the First Development Strategy the problem of imbalances is cast in terms of cost and benefits. There it is stated "While there are benefits accruing from regional integration, unequal distribution of the ensuing benefits has been a major shortcoming in many integration schemes, including the well-known case of the collapse of the defunct East African Community. One lesson is clear, that is, unequal distribution of benefits in the absence of appropriate compensatory mechanism is not sustainable ...The problem of distributing the benefits and costs is a critical one and will require special efforts to address it properly" (Secretariat of the Permanent Tripartite Commission for East African Co-operation 1997:17).

The Second Development Strategy again asks for the distribution of benefits and costs and underlines the necessity of taking measures to address imbalances arising from the process of establishing a customs union and a common market. The Strategy envisages a study to be commissioned "to make a systematic and comprehensive survey of experiences from other regional blocs, including the establishment of a fund to address imbalances, with a view to adopting the most appropriate approaches for the EAC" (EAC Secretariat 2001: 56).

The terms of reference for the study cast the problem in terms of imbalances in the budget and/or in the balance of payments. A customs union implies loss of revenue due to abolition of intra-regional tariffs. Another source for loss of revenue is trade diversion. In this case imports from third countries which are subject to tariff are substituted by tariff-free imports from a Partner State. On the other hand, depending on the level of the Common External Tariff (CET) higher revenues may ensue.

Imbalances in the balance of payment raise the question of competitiveness. The assumption is that Kenya is more developed and its industry more competitive than Tanzania and Uganda. Trade liberalisation therefore would lead to heavy deficits in the current account of the two last mentioned partner states. Manufacturing goods, imported from Kenya would displace the domestic production in the two countries. Firms will be closed and labour released. The study had the goal to establish if there is a need for a transitional fund to compensate for these losses due to the intensification of the integration process. Such a fund could finance infrastructure and private industrial projects in the partner countries which incur the most losses, in order to improve their competitiveness. It would be a transitional fund, meaning that it would exist only for a certain period of time and would be abolished after imbalances are removed.

4 Unfounded Fears and Illusionary Need for a Transitional Fund

Are fears of imbalances due to the establishment of a customs union justified? In theory, integration may amplify differences between economies or may create differences by triggering a process of agglomeration (Venables 1997). The question is therefore if such differences in industrial structure or in both structure and income exist among the three Partner States and if they could increase due to the establishment of a customs union? As already mentioned this had to be studied in a study commissioned by the EAC Secretariat. This study is already commissioned and completed in co-operation with Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ GmbH). The study (Gitu et al. 2003), analyses first the competitiveness of the three partner states vis-à-vis each other and then analyses the impact of the Customs Union separately on the Budget and the balance of payments.

The main hypothesis regarding competitiveness maintains that Tanzania is the least competitive and Kenya is the most competitive economy while Uganda occupies an intermediate position. A comparison of the costs of production on the basis of the available data, shows that this hypothesis can not be refuted. But the differences in the level of competitiveness are not large. The trade balance of Tanzania with Kenya is negative but decreasing since 1997 and the international competitiveness of Kenya has been deteriorating since the beginnings of the 1990s. The result is an increasing equalisation of the competitiveness of the two countries.

The assessment of the impact of the Customs Union on the budget is based on the study of the African Centre for Economic Growth (ACEG) "Study on Integration in East Africa" (2001). The general finding of this study is that the potential revenue losses arising from implementation of zero rates of internal tariffs would be small. This is due to the fact that the member countries had already substantially reduced their tariff rates in the process of implementing COMESA protocols. The potential losses in tariff revenue from establishing the Common External Tariff (CET) are the larger, the lower the CET is fixed. But even in the case of a low level of CET, the revenue losses are generally low. Minor adjustments in domestic taxes, tax structure and improving the efficiency of tax administration would be sufficient to absorb the revenue losses following from the establishment of a customs union.

The assessment of the impact of the Customs Union on the trade balance is more complicated. For this purpose we have to know how exports and imports of the Partner States change in response to liberalisation of intra-regional trade and the CET. These trade effects are calculated in the Study (Gitu et al 2003) on the basis of a partial equilibrium model. First, trade creation, trade diversion and the total trade effects are calculated. Trade creation, i.e. imports from partner countries which displace the inefficient domestic production, is greatest in Tanzania and almost negligible in Kenya. The same is true regarding trade diversion, i.e. imports from third countries which are replaced by imports from partner countries. Tanzania is therefore the least competitive country while Kenya proves to be the most competitive country. Kenya benefits most from intra-regional trade liberalisation. The general picture that emerges is therefore in accordance with the expectations. But in the case of all three countries, neither trade creation, nor trade diversion is of a considerable magnitude.

The total trade effects of the new CET are also calculated, alternatively for two ranges of Tariffs (20%, 10%, 0% or 25%, 10%, 0% for finished goods, intermediate goods or raw materials respectively). As a result of the establishment of the CET, Tanzania will experience, depending on the respective range, either small additional imports or even a decline in imports. On the basis of these trade effects the impact of the elimination of internal tariffs and the establishment of the new CET on the trade balance can be calculated. The result is, depending on the assumed tariff range, minor trade deficits or even trade surpluses in all three countries.

Based on the calculations of trade effects a firm case can not be made for a transitional fund to mitigate imbalances due to the establishment of the Customs Union. There exist in fact differences in the level of competitiveness among the three Partner States. But the trade effects ensuing from these differences are small and the impact of the Customs Union on the trade balance is almost negligible. The fears that the intensification of the integration process would lead to imbalances which could not be addressed by proper adjustment mechanisms is therefore unfounded.

There is another reason why such fears are unfounded. Krichene has applied the purchasing power parity theory to study the competitiveness among five East African countries, Burundi, Kenya , Rwanda, Tanzania, and Uganda (Krichene 1998). The paper shows that a weaker version of purchasing power parity holds on a bilateral basis among the five countries. The five countries have maintained over the long run their competitiveness with respect to each other, with the implication of a broad long-term equilibrium in their bilateral trade accounts (Krichene 1998: 31, see also footnote 1). The evidence in favour of PPP theory means "that the five countries do constitute an integrated trading zone where arbitrage works efficiently, and where each country has broadly succeeded to preserve its competitive position." (Krichene 1998: 32).

5 Stakeholders and the Proposal for a Transitional Fund

One reason why a case has been made for a transitional fund, may be the influence of stakeholders on the regional integration policy in East Africa. To take influence on the policies of the EAC is provided by the Treaty. In Article 127, § 1b it is said that the Partner States "Provide opportunities for entrepreneurs to participate actively in improving the policies and activities of the institutions of the Community that affect them so as to increase their confidence in policy reforms and raise the productivity and lower the costs of the entrepreneurs" (EAC Secretariat 2000: 96). § 4 of the same article reads "The Secretary General shall provide the forum for consultations between the private sector, civil society organisations, other interest groups and appropriate institutions of the Community" (EAC Secretariat 2000: 97). Therefore, if these interest groups fear imbalances it is easy for them to put there proposal for a transitional fund on the political agenda.

One document where the stakeholders views are recorded and their influence on integration policy can be traced is the final report "The Establishment Of An East African Trade Regime" (Maasdorp 1999). The report confirms the strong perception both in Tanzania and Uganda "that their manufacturing sectors would not be able to compete with the longer-established and larger Kenyan producers in a free trade area". (Maasdorp 1999: 42). In discussing a 10 per cent surcharge on an agreed list of products to protect specific industries and governments revenue the report states that among certain sections of Tanzanian industry it was argued that a 10 per cent surcharge "would be too low to achieve the objective of infant industry protection for some industries, and hence should be raised to 20 per cent or 30 per cent" (Maasdorp 1999: 78). This clearly shows the tendency on the part of Tanzanian industry to protect certain industries by imposing high tariffs on intra-regional trade.

In Annex IV of the report there is a local consultant's report on Tanzania. (Maasdorp 1999: 134-157). Assessing the perception of Tanzanian Business on EAC free trade the report states that : "all the stakeholders insist that the major problem and challenge facing the EAC is the issue of the very major trade imbalances between the Partner States, particularly between Kenya and other Partner States" (Maasdorp 1999: 143). The Tanzanian industrialists share the view that "the imposition of zero internal tariffs would generate trade creation and trade diversion effects in Kenya's favour which would further widen the trade imbalance in Kenya's favour" (Maasdorp 1999: 143). In their perception there exists a real danger the EAC would collapse if the issue of imbalance between Kenya and Tanzania is not properly addressed. The report does not contradict these views and it is recommended to establish a regional fund (Maasdorp 1999: 107)

Four years later, stakeholders views on the need to establish a transitional fund are again discussed in the study on transitional fund (Gitu, 2003). In Tanzania there is a change in style but not in substance. Sectors like manufacturing, agriculture, trade and transport are pointed out by stakeholders as areas for potential gains. But as far as manufacturing is concerned it is expected that it would be hit the most by liberalisation in the short run. The remedy is not seen by the stakeholders in the establishment of a transitional fund with high administrative costs, but in other policy instruments like gradual elimination of internal tariffs and progressively taxing more those, who benefit more from integration (Gitu 2003: 66-68). In Uganda, in contrast, a transitional fund is seen as a vital necessity, given the inevitable possibility that there will be losers after integration.

Stakeholders, whose views are taken care of in the economic policy circles may find it difficult to withstand the temptation to ask for the establishment of a transitional fund to address imbalances which allegedly ensue from intensification of integration. A transitional fund is specially suited for rent seeking purposes. It can be hardly controlled since it always will be easy to make a case for losses due to integration and to claim for more compensation. The institution in charge of the fund will soon grow out of control and would have to handle ever more claims of allegedly heavy losses due to integration.

6 The Historical Background: How Fears of a Customs Union Evolved

Tanzanian fears of imbalances caused by the Custom Union have a long tradition, going back to the old EAC which collapsed in 1977. It has been the view of Tanzanian Stakeholders that "the issue of trade imbalance particularly between Kenya and

Tanzania was a major contributory factor to the collapse of the former East African Community" (Maasdorp 1999: 143). This has been also a common view in the literature on EAC. Maier (2000: 5) mentions the economic dominance of Kenya and the large trade deficits of Tanzania and Uganda vis-à vis Kenya as an important reason for the collapse of the former EAC. According to Newlyn (1971: 348) "it had always been recognised that the gains from East African common market were unevenly distributed between the participating countries. This was a result of the fact that the industry, ... , tended to cluster in Kenya".

By the 1920s Kenya's economy was more advanced than Uganda's and Tanganyika's. The ascendancy of Kenyan industry over the economies of the two partner countries began much earlier and was closely linked to the development of the railway. The rails reached what was to become Nairobi by May 1899. Nairobi was chosen as the headquarters of the railway administration and the future capital of the East Africa Protectorate. This choice was a controversial one and not justified by economic considerations.[1] "The plain on which the town built was swampy and, in the rain season, difficult to drain. Fresh water supply was poor" (Nixon 1973: 21). But in spite of constant criticism of the site and its suitability as the future capital of East Africa (Nixon 1973: 21 and note 4: 157) Nairobi assumed soon the functions of a capital city and featured a rapid population growth. "Thus the railway opened up East Africa, and especially Kenya, for trade and settlement; and the European settlers in particular gave Kenya her agricultural, and later industrial, pre-eminence over the other two countries" (Nixon 1973: 23).

This example of centre-periphery formation shows that agglomeration can be understood as a process not originating out of the physical conditions of the area but out of power relations. Nairobi was chosen as a site for industrialisation due to prevailing power relations at the time and developed into a centre enforcing other parts of the region into a peripheral status.

The localisation of industry in Nairobi began at the turn of the century by European settlers who were responsible for establishing several important agricultural processing projects. In the 1920s the process of Kenyan industrial domination was pushed further. Kenya pursued a policy of high tariff structure to protect agriculture and promote the development of the industry. Uganda, since 1917 in a Customs Union with Kenya,

1 The choice of the site was commanded by an affluent personality with political influence living in the area. As an alternative site Dar, not Nairobi was under serious consideration. Unfortunately, this information can not be verified literally.

opposed this policy and maintained a free trade position (Nixon 1973: 25-6). High import duties, together with the railway's rate structure policy, imposed by Kenya, discriminated against Uganda. A policy of granting preferential rates in favour of local products and high rates on imported products had been used to accelerate the industrial development of Kenya. The profits of the railway were siphoned off into Kenya Treasury (East Africa Protectorate's Treasury), "giving rise to the allegation that Uganda was being exploited in the interests of Kenyan development" (Nixon 1973: 28).

Tanganyika became much later a part of the East African Customs Union. In 1922 it had become a league of Nations Mandated Territory under British control and it lasted until 1927 until the Customs Union was fully operational (Nixon 1973: 26). The issue of trade imbalances between Tanganyika and Kenya was first raised in 1932 in a report by Sir Sydney Armitage-Smith (Armitage-Smith 1932). In this report he argued that the workings of the Customs Union were unfavourable and showed that revenue had been falling while imports had been rising quite substantially. He recommended that Tanganyika should levy duty on imports from her neighbours at the same rate as imports from third countries (Nixon 1973: 27).

The issue of trade imbalances continued to be a topic for discussion and for conflict among the partner countries. In the 1940s the establishment of a system of industrial licensing had to resolve disputes arising from the imbalances in industrial development of the partner countries. But this system did not prove to be successful and had no influence on the pattern of industrial location within East Africa (Nixon 1973: 32). The next step was the publication of the Report of the Economic and Fiscal Commission in 1961 (Raisman et al 1961). This report addressed the issue of imbalances by analysing the question if capital and enterprise might have been attracted to Kenya which would otherwise have gone to Uganda and Tanganyika and if they might have suffered trade diversion. The Commission concluded that there was no evidence for enterprise and capital attracted to Kenya from the other two territories and that any trade diversion suffered by the two territories was compensated for by increased purchases by Kenya from the other two countries (Raisman et al 1961: 23-25). In spite of that the report recognises the inequality in the distribution of benefits due to the large increase in production half of which has occurred in Kenya. Therefore the report proposed the creation of a Distributable Pool of Revenue which should have been financed partly by income tax and partly by customs and excise duties (Raisman et al: 65). A proportion of this Pool should have been providing the High Commission with an independent source of revenue. The rest should have been distributed in equal parts to the three countries.

After independence of the three countries at the beginning of the 1960s and the collapse of negotiations on establishing a Federation, Tanganyika was not ready to accept the common market arrangements unchanged. Therefore an Emergency Committee was appointed "to inquire into the measure necessary to bring about a trade balance between the three East African countries" (cited in : Nixon 1973: 35). The result was the "Kampala Agreement". In this agreement a system of allocation of industries and a system of quotas and other measures to reduce the trade imbalance among the three countries were provided. It did not aim at the fiscal compensation of losses but at directly addressing to equalise the different rates of industrial development, which gave rise to the trade imbalances among the three countries.

The Kampala Agreement never materialised. Only some of its provisions were put into effect. As far as it resulted in an increase of Tanganyika's industrial capacity it led to the creation of surplus capacity elsewhere in East Africa (Nixon 1973: 38). But this means that the adjustment process did not work smoothly and the allocation of new industries in Tanganyika was not accompanied by disinvestments especially in Kenya. Kenya, in other words, which never formally ratified the Agreement, was not ready to accept a change in its dominant industrial status.

In 1967, The Permanent Tripartite Commission for East African Co-operation, known as the East African Community was created. But from the beginning it was characterised by political and economic frictions (Goldstein; Ndung'u 2001). In 1971, a new military government came into power in Uganda. Tanzania did not recognise the new regime and considered its participation in the EAC illegal. The East African Currency Board broke down in the first year of the operation of the EAC. Divergence in economic policy among the three countries developed to a general phenomenon. The countries reacted to the first oil price shocks in 1973 and to the commodity boom in 1976/77 in very different manners, which made co-operation increasingly hard. While Kenya chose a mild form of market economy to attract foreign investment, Tanzania embarked on a "ujamaa" socialist experiment and nationalisation of industry.

The issue of trade imbalances continued to be an important topic. Two measures were especially provided to deal with this issue (Goldstein; Ndung'u 2001: 11). An East African Development Bank (EADB) was established to promote industrial development especially in Tanzania and Uganda. But the risk-adverse clause in its statutes limited the ability of the EADB to function as a redistributive institution. Most of the viable projects were in Kenya where the Bank was supposed to invest less than in the other two countries. The second measure was a tax transfer system. This system aimed at imposing a tariff on imports from a country with which a less developed member had a trade deficit. It was meant to protect the industries of the less developed member. But location advantages in Kenya were strong and kept investors pulling to this country.

The EAC broke down in 1977, when Tanzania closed its border with Kenya.

7 Continuing Fears of a Customs Union Under Changing Economic Conditions

As shown in Part 6, the history of customs union and common market in East Africa begins with a real perception of the economic dominance of Kenya over the two other partner countries. The industrialisation process begins first in Kenya and it is characterised by a policy of protection. Kenya develops to the main supplier of industrial goods to its partner countries. In the context of a common market this superior position evokes the claim for compensatory mechanisms by the partner countries. Attempts to apply such compensatory mechanism prove to be a failure. At the inauguration of the new EAC in 1999 the long memory of trade imbalances was still alive. The treaty and other documents ask, therefore, for measures to address imbalances arising from the intensification of the integration process and the establishment of a Customs Union. But, as we argued, the establishment of the Customs Union, would not result in large and lasting imbalances. This is due to fundamental changes in economic conditions due to liberalisation policies in the three countries since the mid 1980s.

In Tanzania, policies have been focused since the mid 1980s on stabilising and subsequently on rolling back the commanding role of the state in the economy (IMF 1999). In 1986 the first Economic Recovery Program was adopted with the aim of promoting a market-based open economy. The focus of the Program was on macroeconomic stabilisation and liberalisation. In addition the liberalisation of the trade sector was initiated, focussing on phasing out of trade restrictions prevailing throughout the 1970s and early 1980s. In the early 1990s the reform measures focused on improving fiscal management and reforming the public sector, which included civil service reform and privatisation of state enterprises. Macroeconomic and structural adjustment policies were reinforced since 1995. The focus of macroeconomic stabilisation has been on fiscal consolidation. This included the reform of tax administration and tax structure; introduction of the VAT and a strict cash management system. The reform of the financial sector focused on the liberalisation of financial transactions and safety and soundness of the financial sector. Major progress was also made in parastatal reform, including the restructuring of state-owned financial institutions.

A policy reform was launched in Uganda with the Economic Recovery Program in May 1987 supported by the IMF and the World Bank. It focused on stabilisation, growth and strengthening of the institutional framework. Key to the reform package was a national currency reform. A new currency was introduced and the exchange rate was devalued. A consultative conference in 1989, where all stakeholders participated, laid the foundation for a radical liberalisation of the foreign exchange market system (Holmgren et al 1999: 20). The World Bank supported the reform program with two Economic Recovery Credits for the period 1987-1992. Key measures were interest rate reform; measures to contain the fiscal deficit; trade liberalisation; revitalisation of the private sector; public sector management and measures to develop the banking industry. In the early 1990s wide-ranging fiscal and monetary measures were undertaken to restore macro-economic stability.

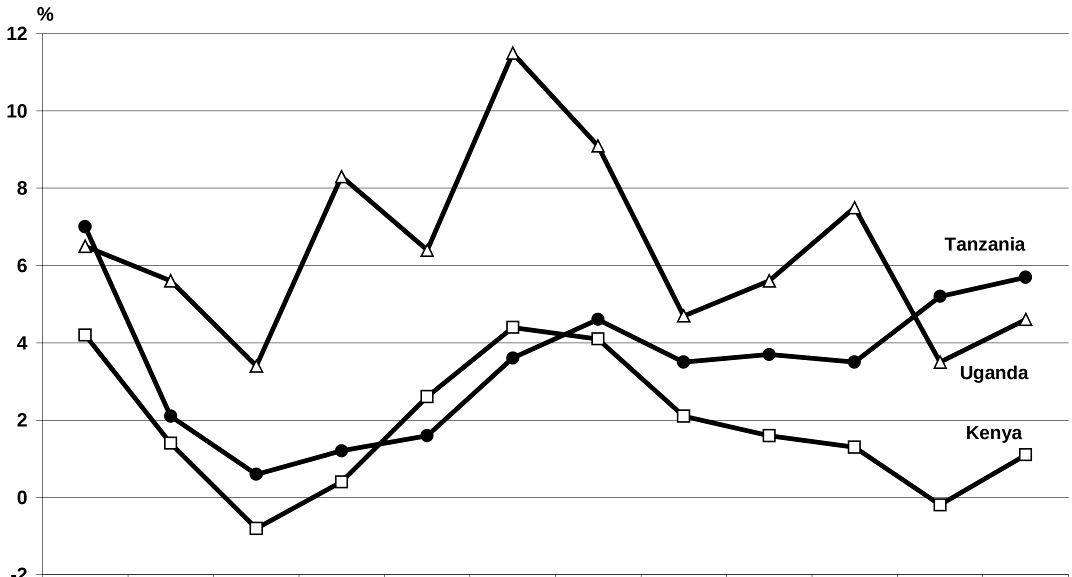
In 1994 a three-year ESAF program was agreed with the IMF and a structural adjustment credit with the World Bank. Structural reforms, fiscal objectives and reserve accumulation belonged to the main contents of the program. Tax rate changes were introduced, an independent revenue authority established, the export tax on coffee abolished and the monopoly of the Coffee Marketing Board removed (Holmgren et al 1999: 23). In 1997 followed a further ESAF. This program focussed on maintaining the macroeconomic stability, private sector promotion, export oriented growth and structural and institutional reforms. Current account restrictions were removed and full capital account convertibility established. The World Bank granted a third Adjustment Credit in the same year (Holmgren et al 1999: 23).

In Kenya, the history of adjustment is characterised by disputes between the country and the Bretton-Woods institutions. After a long history of relations since 1979 the first three year ESAF was agreed between IMF and Kenya in May 1989. Performance criteria continued to be disappointing during the three years of the program. In the following years several other programs were approved with unsatisfactory results. "A continued high level of corruption was indeed the main explanation for IMF and World Bank withholding of balance of payments support during 1997" (Levin 1998: 144). On August 1, 2000, the World Bank approved a Economic and Public Sector Reform Credit. Kenya's structural reforms included parastatal reform and privatisation; energy and water sector reforms; civil service reform and the reform of the coffee sector. According to the IMF "the implementation of the structural reform components of the

Fund- and World Bank-supported Program has been very slow and disappointing" (IMF 2002 b: 26).

The reviewed history of adjustment since the mid 1980s in the three countries shows that compared to Kenya, Tanzania and Uganda were much more successful in initiating fundamental reforms of their economies. While Uganda could realise high growth rates over the whole period, in Tanzania growth resumed not until the mid 1990s. In contrast the economy of Kenya is virtually stagnating (Figure 1).

Figure 1: GDP Growth in % 1990-2001



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Tanzania	7,0	2,1	0,6	1,2	1,6	3,6	4,6	3,5	3,7	3,5	5,2	5,7
Uganda	6,5	5,6	3,4	8,3	6,4	11,5	9,1	4,7	5,6	7,5	3,5	4,6
Kenya	4,2	1,4	-0,8	0,4	2,6	4,4	4,1	2,1	1,6	1,3	-0,2	1,1

Source: World Bank, World Development Indicators, CD Rom 2003.

At least in the case of Tanzania this development did not remain without a positive impact on the evolving pattern of trade imbalances. As Table 1 shows, until 1998 the trade pattern corresponded to the expectations, according to which Tanzania is losing ground to Kenya. Beginning 1999 this pattern changes. Kenya's exports decline while imports from Tanzania surge so that Kenya's trade surplus vis-à-vis Tanzania reduces to one fourth of its level in the mid 1990s. This is a tremendous development and an indicator of increasing intra-regional competitiveness of the Tanzanian economy. This comes to the fore also in the competitiveness analysis by the World Economic Forum

(IMF 2003: 58). Overall competitiveness is measured as an average of the six indices: openness, government, finance, labour, infrastructure, and institutions. As Table 3 shows, in 1997 Tanzania was placed at the 16th position out of a total of 22 African countries. Three years later the ranking improved and Tanzania was placed at the 13th position.

Table 1: Kenya's trade with Tanzania in Mill US $ 1994-2001

	1994	1995	1996	1997	1998	1999	2000	2001
Exports	172	216	239	237	229	87	85	93.4
Imports	21	26	14	15	10	31	42	46.0
Balance	151	190	198	186	219	56	43	47.4

Source: IMF, Direction of Trade Statistics, Yearbook 2001 and different quarterly issues.

Table 2: Kenya's trade with Uganda in Mill US $ 1994-2001

	1994	1995	1996	1997	1998	1999	2000	2001
Exports	208	277	306	278	288	304	350	386.5
Imports	3	3	n.a.	8	1	1	1	1.3
Balance	205	274	n.a.	270	287	303	349	385.2

Source: IMF, Direction of Trade Statistics, Yearbook 2001 and different quarterly issues.

Table 3: Competitiveness of EAC-Countries Relative to 22 African Countries

Country	Competitive Ranking		Improvement Ranking		Optimism Ranking	
	1997	2000	1992-1997	1996-1999	1997-1999	1997-2001
Kenya	13	21	9	13	13	13
Uganda	14	16	1	5	3	10
Tanzania	16	13	3	1	2	2

Source: World Economic Forum, The Africa Competitiveness Report, Genua 1998 and 2000/01 cited in IMF, Tanzania: Selected Issues and Statistical Appendix, IMF Country Report No. 03/2, January 2003, p. 66.

Kenya and Uganda, both were ranked better than Tanzania in 1997, but lower in 2000/01. Especially the position of Kenya deteriorated clearly. The table shows also two other performance indices. The improvement index is backward-looking and indicates changes in the business community's assessment of various policies and costs of doing business in the year of survey relative to the previous five years. The forward-looking optimism index shows expected changes in the same areas up to two years in future. According to the improvement index the business environment has improved most in Tanzania. The ranking in case of Uganda is also high while Kenya remains behind. In Tanzania, as the optimism index shows, further improvements in the business environment are also expected.

The competitiveness of manufactured exports in Tanzania in 1997-99 suffered from the real overvaluation of the currency. But overall, "although Tanzania's manufacturing sector is weaker than Kenya's, the growth performance of all categories, except clothing, has been better than Kenya's in recent years" (IMF 2003: 60).

Trade policy reforms in Uganda have eliminated the bias against exports, but this was not enough to improve export performance. In its attempt to increase exports Uganda is highly dependent on few primary commodities especially coffee. To improve its export capacity the country has yet to diversify its exports (Morrissey; Rudaheranwa 1998).

The performance of Kenya's exports since 1995 has been evaluated as poor by the IMF (IMF 2002a: 31), in spite of a more liberalised trade and exchange rate regime. There exist several constraints on export performance (IMF 2002a: 35-43): wild fluctuations of the real effective exchange rate, which can not be explained by changes in terms of trade; fall of relative price of tradable to nontradeables; increase of overall unit labour costs by about 30% between 1990 and 1999; lack of access to credit and high costs of doing business (high real interest rates, inefficient utility sector, delays in reforming key sectors, deteriorating security situations, governance problems).

Kenya could have the capacity to become the economic centre and engine of growth for East Africa. It had to invest in their industrialisation process and to import heavily from them and so to provide them with a market for their goods partly manufactured by Kenyan firms. But in the 1990s "The Kenyan expansion on the East African market, however, was based more on its location and the very low manufacturing capacity in the neighbouring countries than on efficiency of its own production. In fact it appears to have taken place with little innovation and productivity growth in the Kenyan industries (Mc Cormick; Pedersen 1999: 26). Due to its low efficiency the Kenyan industries failed to become a source for imports from neighbouring countries.

8 Conclusions

Fears of trade imbalances following from intra-regional trade liberalisation and the establishment of a customs union due to the higher industrial development of Kenya comparing to the other two Partner States have been for years characteristic for the EAC. To address these imbalances a transitional fund is proposed to compensate for losses born by the less developed Partner States. But cautious calculations show that the magnitude of trade imbalances due to intensification of the integration process in the EAC is not large and it is absolutely possible to cope with them through simple adjustment mechanisms.

Stakeholders in Tanzania and Uganda are of different views regarding the proposal for a transitional fund. While the problem is taken seriously by both groups, the stakeholders in Tanzania prefer other instruments to mitigate imbalances instead of a transitional Fund with high administrative costs. The stakeholders in Uganda, in contrast, look at the transitional fund as a vital necessity. Since it always will be easy to make a case for losses and to claim for compensation, a transitional fund could get easily out of control due to pressure from stakeholders.

In East Africa and especially in Tanzania the issue of trade imbalances is seen as a major contributing factor to the collapse of the old EAC. It has been a topic for discussion and conflict among the partner countries since the 1930s. Dominated by interests of white settlers Kenya was for a long time opposed to the industrial ascendancy of other East African regions. All attempts for compensation and mitigating the imbalances failed.

Stabilisation policies and structural reforms since mid 1980 in Tanzania and Uganda have changed the economic conditions gradually and have undermined the case for a transitional fund to mitigate trade imbalances. But fears of trade imbalances due to the higher industrial development of Kenya are still alive and can be traced in all official documents of the EAC. This is the case although there is presently room for fears that Kenya is lagging behind due to its slow growth and decreasing international competitiveness.

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