POLICY BRIEF #2

Regional integration and poverty in the EAC

What do we learn from the data and understanding the political economy?

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Direct empirical evidence on the link between regional economic integration and poverty alleviation is hard to find. That is no different for the East African Community (EAC). The lack of evidence about who benefits or not, and why, offers a poor basis for regional decision-making and monitoring of impacts. Beyond a need for greater data and monitoring, this further raises the importance of understanding political interests and power in determining what decisions are made, how they are implemented, and what impact they might have.

This Policy Brief was produced to document evidence on economic integration of the East Africa Community (EAC) and its possible linkages to poverty reduction in East Africa. Special attention is paid to the role of actors and interests in shaping the regional integration agenda and its implementation.[1]

The EAC agenda and poverty

Establishing links between regional integration and poverty is not straightforward in any region. The EAC Treaty, the Customs Union Protocol and the Common Market Protocol aim to liberalise internal trade, establish a Common External Tariff (CET) and "immediately" remove Non-Tariff Barriers (NTBs) as a means to achieve 'growth and development'. Although poverty reduction is not an explicit objective of the agenda, the distribution of impacts among different groups and locations has the potential to significantly impact on poverty, both positively and negatively.

Overall, there is some evidence of declining poverty (both monetary and multi-dimensional) accompanying EAC integration for Rwanda, Tanzania and Uganda. On the basis of both standard headcount measures and multidimensional poverty measures, Burundi has the highest numbers and depth of poverty relative to the other member states, while poverty is lowest in Kenya. The lowest levels of inequality, measured by the Gini coefficient, appear to be in Rwanda, and the highest in Burundi, followed by Tanzania. However, a lack of data on poverty measures in the EAC makes it very difficult to make cross-country comparisons, whether for a single year or for changes over time. This greatly hinders any assessment of the role that the EAC integration process has had in changes in poverty.

And the indirect impacts?

Despite progress on numerous fronts, the customs union is incomplete – the treatment of officially recognised sensitive products means there are divergences in tariff rates against third countries; customs duties are collected at national borders not at the port of first entry; rules of origin remain as do trade remedies; non-tariff barriers are prevalent; and workers still find it difficult to cross intra-EAC borders.

Hence for some goods actual applied tariffs on products are more important than the common external tariff when assessing the impact on incomes and expenditures of the poor. Tariffs on goods consumed by the poor may actually be rising with regional integration for those on the sensitive items list.

Some evidence suggests that the EAC has had a small positive impact on intra-regional trade, and that on balance this has been trade creating as opposed to trade diverting. Trade statistics strongly suggest that while the net effects on the intra-regional shares of trade

[1] For a full discussion of the conceptual framework discussed in this policy brief and its application to the EAC, see Gasiorek et al. (2016), *Regional Integration, Poverty and the EAC: What do we know and what have we learnt?* ECDPM Discussion Paper 202. http://ecdpm.org/publications/regional-integration-poverty-east-african-community/
For a discussion of the empirical evidence on regional integration and poverty linkages see Gasiorek, M and A. Martuscelli (2016), *Regional Integration and Poverty: A review of the transmission channels and the evidence*, CARIS working paper (forthcoming).

Regional integration and poverty: the links

The impact on poverty of regional integration will depend on three S's:

- The *scope and depth* of liberalisation and therefore on which prices change
- The *structure* of the economy
- The *size of the constraints* faced by the poor.

Regional trade liberalisation creates opportunities and challenges. The impact on poverty will depend on the ability of the poor to overcome the constraints to taking advantage of the opportunities, and the constraints to protecting themselves from negative shocks.

These effects on poverty will vary by timescale and level of direct impact:

- *Short-term and direct effects* arising from the price changes impacting on consumers and producers, and changes in tariff revenue which impact on government expenditure.
- In the medium-term as economies adjust to the changed prices, *structural change* with the expansion and contraction of different sectors/industries, affecting employment and wages.
- Longer-term and more indirect effects on poverty will be through changes in *productivity and growth.*

may be small, this masks considerable changes in the composition of trade at a disaggregated level, for example in terms of which products are imported and exported within the EAC, or the numbers of products imported and exported. The exception to this is Uganda who increased its tariffs on adoption of the common external tariff (CET) that came into force with the implementation of the customs union.

All countries except Uganda saw a decline in the contribution of tariff revenue to total government revenues. Towards the beginning of the process of integration the share of tariff revenue in total government revenue was over 17% for Burundi and Rwanda, and between 6-10% for the remaining countries. For Rwanda the share fell to 6.7% by 2014-15. Given the smaller impact on tariff revenues for Kenya, Uganda and Tanzania, the impact on poverty alleviation expenditure may have been easier to manage than for Rwanda and Burundi.

Evidence suggests that intra-EAC investment flows are low, but rising substantially. Though reliable and consistent data on investment is also scarce, what data there is suggests that Uganda and Tanzania receive the highest amounts of FDI as a share of GDP, while Burundi has the lowest share. The second key feature is that FDI fluctuates considerably over time, with little evidence that the process of regional integration has led to any increases in FDI as a share of GDP.

There is also little evidence from the data that EAC integration has impacted significantly on migration. Limited data for the year 2000 suggests that most migration for the Tripartite countries, is intra-regional i.e. within the EAC, COMESA, and SADC. Similarly there is little evidence of a positive impact of the EAC on investment and/or economic growth but this is largely because of the lack of analysis and data rather than a lack of positive results.

The role of non-tariff barriers as an obstacle to integration in East Africa is a common theme in the literature and in practice. Both legal and informal barriers combine with poor infrastructure, weak institutions, human capacity, insecurity and political instability and the lack of private sector development to form a range of constraints to the poor in dealing with changing trade flows and trade barriers. Many of these barriers result from political interests and negotiation between and within countries.

The need to take account of political economy dynamics

Only one recent study explicitly considers the linkage between regional integration and poverty in the EAC (Balistreri et. al., 2016). Using a computable general equilibrium based assessment of the impact of the EAC and the Tripartite Agreement, together with micro-simulations for detailed poverty effects, the study concludes that closer EAC integration could lift up to 5.31 million out of poverty in the region, with the incomes of the poorest 40% rising by between 7.5%-10%.

Interests and power relations between and within EAC member states - including the private sector, civil society, and external agencies and external partner countries of the region - all affect the detail and implementation of regional agreements. This impacts on the channels linking regional integration and poverty, particularly in a weak institutional environment where the consequences of non-implementation of commitments are minimal.

An array of short and long-run actors and factors have influenced progress in the EAC. These reflect, for example, the need for Rwanda, Uganda and Burundi to access goods through the ports in Tanzania and Kenya; the historically lower Tanzanian enthusiasm for regionalism after the experience of the first EAC; and the Kenyan government and business interests around an enlarged EAC market. Different levels of enthusiasm are highlighted by the emergence of the 'coalition of the willing' – Kenya, Uganda and Rwanda, keen to press ahead with further integration, with Tanzania more sceptical, in spite of recent elections and initial enthusiasm for boosting the EAC.

Balancing diverging national and regional objectives in the EAC

Different country circumstances were explicitly taken into account in the design of the EAC. Kenya committed to immediate liberalisation of imports from Uganda and Tanzania who only gradually lowered tariffs on Kenya's exports. Beyond that, negotiations around the Common External Tariff (CET) resulted in 59 'sensitive' items, 31 of which were agricultural, with high levels of protection including 100% on sugar, 60% on dairy, and similarly high tariffs on wheat, maize and rice.

The high tariffs reflect a combination of political and economic factors. As in the case of rice with a CET of 75% this can protect rural producers, but also raises the costs of key consumption goods for poor households across the EAC. The sensitive items appear to reflect a prioritization of the interests of producers (which consist of both small holders and corporate farms) and traders over the region's population. Tanzania banned Kenyan milk processors from buying milk from its farmers for processing in Kenya in 2008, leading to a collapse in prices paid to farmers (Onyango-Obbo, 2011). The 2008 food crisis was also a trigger for Kenyan and Tanzanian maize export bans and temporary tariff suspension, again ostensibly helping poor consumers but hurting the incomes of maize farmers, to the benefit mainly of traders (Vitale et al., 2011).

While the agreed CET provides greater protection for raw materials (13.5%) than semi-processed products (10.1%), Kenya's business has been seeking a higher CET for processed goods to protect its industrial base, while Uganda's interest has been to keep the CET low, for cheaper imports (Stahl, 2015). Kenya nonetheless managed to get the CET on car imports and second-hand clothes raised, benefiting those employed in those sectors but at the cost of the region's consumers.

Kenyan, Tanzania and Ugandan interests align around wheat and maize, while in dairy, Kenya and Tanzania are among the biggest dairy producers in Africa. Kenyans are also the biggest per capita milk consumers (Bingi & Tondel, 2015). But the proximity of Kenyan business and political elites also plays a role - 40% of Kenya's dairy market is owned by a firm with links to the president. Similarly, in Rwanda, the largest dairy processor is affiliated to the ruling political party.

Regional trade facilitation measures are also subject to interests. For Rwanda and Uganda to benefit from NTB removal requires Kenya to address low-level rent extraction among customs agents police, private groups and politicians along transport routes (Booth et al., 2014). Political resistance to liberalising the trucking sector also limits the benefits of declining transport costs (Mathieson, 2016). These types of interests also feed into negotiations and final implementation of regional agreements.

These examples highlight the tension between regional commitments, industrial policy, employment concerns, and implementation, with potential impacts on poverty through both consumption and production channels.

Conclusions and recommendations

The EAC is ambitious in its desire for regional integration and there has been substantial progress in implementing both the Customs Union and the Common Market. The scant evidence and data on poverty (be this monetary or multi-dimensional) suggests declines in poverty in the EAC, without a clear picture of the actual drivers of these reductions. Considerable barriers to integration and constraints to poverty alleviation remain driven by structural characteristics, such as poor physical and institutional infrastructures, in combination with the political economy dynamics both within and between countries.

While regional integration will clearly impact on poverty, it cannot resolve the problem of poverty. In East Africa this is partly due to the presence of large informal sectors poorly integrated with the formal economy Similarly, large segments of the population are not engaged in activities that benefit from trade in goods either as producers or consumers. In part this is because poverty both in its narrower monetary sense and in its broader multi-dimensional sense depends on the physical, institutional, regulatory and fiscal (infra) structure of which trade and regional integration form just a part.

What we need to know to begin to trace the effects of regional integration on poverty is:

- A common, systematic, simultaneous and regular approach to measuring poverty (both monetary and multi-dimensional) across the EAC member states.
- A better understanding of the constraints preventing the poor to take advantage of the opportunities from regional integration; and the constraints to protecting themselves from consequent negative shocks.
- The collection of longitudinal household data, and a coherent way of linking this to estimates of the impact of specified liberalisation scenarios.
- More regular and continuous analysis of the politics around regional processes, the interests of the main actors and how those affect

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