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AUTOMOTIVE TRADE REGIME IN THE EAST AFRICAN
COMMUNITY – ANALYSIS ON MARKET ENTRY METHODS

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ITÄ-AFRIKAN YHTEISÖN AUTOKAUPPA – ANALYYSI MARKKINOILLE TULON MENETELMISTÄ

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Tämä opinnäytetyö tehtiin toimeksiantona maailmanlaajuisista toimintaa harjoittavalle kaupallisten ajoneuvojen valmistajalle. Tutkimuksen päätavoitteena oli löytää kaupankäynnin olosuhteiden valossa sopivin markkinoille tulon menetelmä Itä-Afrikan yhteisöön, joka on alueellinen talousliitto, johon kuuluvat Kenia, Tansania, Uganda, Ruanda sekä Burundi. Käytännössä tämä tehtiin tutkimalla tutkimuksessa oleelliset kaupankäynnin olosuhteet, jotka vaikuttavat sekä yhteisön sisäiseen kauppaan että ulkoiseen kauppaan. Yhteisön sisäisen kaupan toimivuuden selvittäminen oli yksi tutkimuksen tärkeimpiä osa-alueita. Lopulta tutkimustulosten valossa valittiin sopivin markkinoille tulon menetelmä. Opinnäytetyössä tutkittiin kahta markkinoille tulon menetelmää. Ensimmäinen niistä on ”Completely Built-Up” menetelmä, mikä on käytännössä suoraa tuontia, missä ajoneuvo lähetetään kokonaisuutena. Toinen menetelmä on ”Completely Knocked-Down”, mikä tarkoittaa ajoneuvon lähettämistä osina ja sen kokoamista markkinoilla, joissa ajoneuvo tullaan myymään.

Tämän tutkimuksen tarkoitus oli markkinoille tulon menetelmän päätöksenteon tukeminen antamalla tärkeää markkinatietoa sekä toimintasuosituksia. Tämä tutkimus ei sisällä kaikkia asioita, mitä tarvitaan oikean markkinoille tulon menetelmän päätöksenteossa, vaan tämä tutkimus keskittyy vain kaupankäynnin olosuhteisiin Itä-Afrikan yhteisössä ja niiden vaikutuksiin markkinoille tulon menetelmiin.

Tutkimus tehtiin pöytätyönä, eli tutkimus tehtiin toissijaisista lähteistä, kuten Internet-sivustoista sekä kirjoista. Uutisartikkelit olivat myös tärkeä tiedonlähde, sillä ne tarjosivat viimeisimmät ajan tasalla olevat tiedot.

Tutkimustulokset paljastivat, että Itä-Afrikan yhteisön yhdistymisprosessi on tuonut monia kaupankäyntiä helpottavia toimenpiteitä yhteisön sisäiseen kaupankäyntiin. Mutta tärkeimmät ongelmat, mitkä estävät vapaan kaupan toteutumisen ajoneuvoille yhteisön sisällä, pysyvät ratkaisemattomina. Tämän opinnäytetyön suosittelema markkinoille tulon menetelmä on ”Completely Knocked-Down” Keniaan. Muihin Itä-Afrikan yhteisön maihin tulee toimittaa kokonaisia ajoneuvoja suoraan tehtaalta, sillä osista kootut ajoneuvot eivät nauti vapaakaupan eduista yhteisössä. Opinnäytetyössä tehty tutkimus ennakoitavissa olevasta tulevaisuudesta paljastaa, että ei ole odotettavissa muutoksia kaupankäynnin olosuhteisiin, jotka vaatisivat markkinoille tulon menetelmän muuttamista.

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This thesis was commissioned by a truck and bus manufacturer which has operations worldwide. The main objective of this research was to find out the proper market entry method from the viewpoint of trade conditions to the East African Community, which is a regional economic community of Kenya, Tanzania, Uganda, Rwanda and Burundi. In practice this was done by researching the relevant trade conditions affecting both intra-community trade and external trade. Finding out the intra-community trade possibilities was one of the main areas in this thesis. In the end the most suitable market entry method within the trade conditions researched was chosen according to the findings. Two market entry methods were researched. One of them is Completely Built-Up method, which is basically direct importing where the vehicle is sent as a whole. Another is Completely Knocked-Down method, which means that the vehicle is sent in pieces and assembled in the markets where it is to be sold.

The purpose of this thesis was to support the market entry method selection process by providing important market knowledge and action recommendations. This research does not cover all the things which were needed in the decision making, but only the part concerning the trade conditions in East African Community and their effect on the market entry method selection.

The research method was a desk research, thus the research was done from secondary sources such as internet pages and books. News articles were also an important source of information as they provided the latest up-to-date information.

The research results have revealed that the integration of the East African Community has brought many measures of trade facilitation for the intra-community trade, but the core issues preventing the completely free trade of automotives in the region have not been solved. The market entry method recommended in the thesis is completely knocked-down method to Kenya, as for the rest of the East African countries completely built-up units ought to be distributed straight from the factory, as the vehicles assembled in Kenya from Completely Knocked-Down kits do not enjoy the benefits of the free trade. The research done in this thesis on foreseeable future outlook does not show any changes to the current trade conditions dictating the market entry method selection.

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ABBREVIATIONS

CBU	Completely Built-Up
CET	Common External Tariffs
CKD	Completely Knocked-Down
COMESA	Common Market for Eastern and Southern Africa
CTH	Change in Tariff Classification
CU	Customs Union
EAC	East African Community
EACB	East African Central Bank
EACJ	East African Court of Justice
EALA	East African Legislative Assembly
FTA	Free Trade Agreement
HS	Harmonised System
MU	Monetary Union
NTB	Non-Tariff Barrier
SADC	South African Development Community
SCT	Single Customs Territory
TFTA	Tripartite Free Trade Agreement
WTO	World Trade Organization

1 INTRODUCTION

This thesis researches the trade conditions within the East Africa Community from a commercial vehicle manufacturer's point of view. First the trade conditions within the East African Community are researched and then the proper market entry method within the researched trade conditions is investigated. The market entry methods researched are Completely Built-Up; which is to send the vehicle as a whole, and Completely Knocked-Down; which is to send the vehicle in pieces.

The idea for this thesis originates from the company for which the writer of this thesis did his internship. The company is a manufacturer of commercial vehicles having operations worldwide. The background for the research lies in the development of African economic communities into more integrated areas. The economic integration of African countries has its' beginning in the Abuja Treaty which was signed in 1991. The Abuja Treaty is an international agreement which sets out a six stage plan for African nations to reach a common economic and monetary union and parliament by 2028. Through the integration intra-community trade within the regions is hoped to become free, so that the multinational companies could have larger markets for their products. This hope and the impressive economic growth figures achieved in the past decade are the reasons for the interest the multinational companies have towards the East African Community. This is also the underlying reason for this thesis.

The goal of this thesis is to provide information about the trade conditions affecting market entry method selection and intra-community trade, and then to give recommendations on the proper market entry method for the case company. The research focuses only on the trade conditions and does not touch other factors which determine the market entry method. Thus the recommendations are done only from the trade condition's point of view.

Before finding about the trade conditions within the East African Community the basic theories about the economic integration are researched. Then the East African Community is seen in the light of these theories, and finally the conclusions are drawn from the findings.

2 BACKGROUND OF THE THESIS

2.1 Purpose of the thesis

The purpose of this thesis is to provide supportive information and action recommendations to the case company on the proper market entry method to the East African Community, hereinafter also referred to as EAC. EAC is the regional intergovernmental organisation of five East African countries; Kenya, Tanzania, Uganda, Burundi and Rwanda. Supportive information is about the trade conditions which determine how does the intra-community trade and external trade work in the EAC. The action recommendations are made by analysing the trade conditions in perspective of selecting the proper market entry method. As the company needs to plan ahead, also the foreseeable future trade conditions are researched in the light of the planned trade agreements.

The market entry methods researched are Completely Built-Up, hereinafter also referred to as CBU, and Completely Knocked-Down, hereinafter also referred to as CKD. CBU means that the vehicle is imported as a whole. CKD is to send the vehicle in pieces and to assemble it in the markets where it is to be sold. A company's failure to properly use CBU and CKD to its advantage leads to a situation where competitors using these methods correctly gain substantial cost advantage and consequently achieve higher sales and stronger foothold in market.

2.2 Research problems

Research problems are as follows:

1. What are the current and future prospects within the East African Community when it comes to the trade conditions affecting the choice of market entry method?
2. What is the proper market entry method to the East African Community within the researched trade conditions for automotive companies?
3. How does intra-community trade within the East African Community work for vehicles assembled from Completely Knocked-Down kits?

4. What are the changes to the trade conditions that require an automotive company to change the market entry method?

Research limitations

This thesis does not research every aspect which has to be taken into consideration when choosing the proper market entry method. This thesis only focuses on trade conditions within the East African Community and how do these conditions have an effect on the market entry method selection. Thus the final recommendations and conclusions are done only from the trade conditions' point of view. For this reason the recommendations must be used only as supportive material when making the decision on the proper market entry method. Also it is to be noted that the trade conditions researched are limited only to matters which have an effect on market entry methods. But there is one exception as the market size for new vehicles-fact is used in this thesis. The three most important trade conditions researched in this thesis are Rules of Origin, Common External Tariffs and Non-Tariff Barriers in the East African Community. These three were selected for more thorough research because they have the most direct and major impact on the issues determining the proper market entry method selection.

2.3 Framework

Theoretical framework will consist of economic integration theory, as that is the best framework to use for understanding how did the East African Community come into being and how it is likely to continue to develop. This theory will be used in the thesis to create a background to which to mirror the development and trade conditions within East African Community. In the economic integration, especially the Customs Union phase is going to be researched in more detail as that is the phase which has the most impact on the trade conditions which are researched in this thesis. Political, economic, social and technical dimensions within the East African Community are looked into in the PEST-analysis. PEST-analysis is used to show relevant economic data and to explain the economic realities which have direct and indirect effects on the trade conditions and to market entry methods.

Conceptual frame of reference describes the process of finding the correct market entry method. Trade conditions that this thesis looks into are especially Rules of Origin, Common External Tariffs and Non-Tariff Barriers. The trade conditions and their effects on both intra-community trade and to external trade are researched. This is because it might be possible to use completely knocked-down method market entry method to one country within the East African Community, but it might not be possible to sell the product to other countries within the trade area duty free. It is only after the overall situation is clear that the options can be weighed and the proper market entry method can be selected. Also the planned future trade agreements and the possible changes they bring to the trade conditions are researched as not only the knowledge about current situation is enough to make the decision about market entry method but the future outlook must be also taken into consideration.

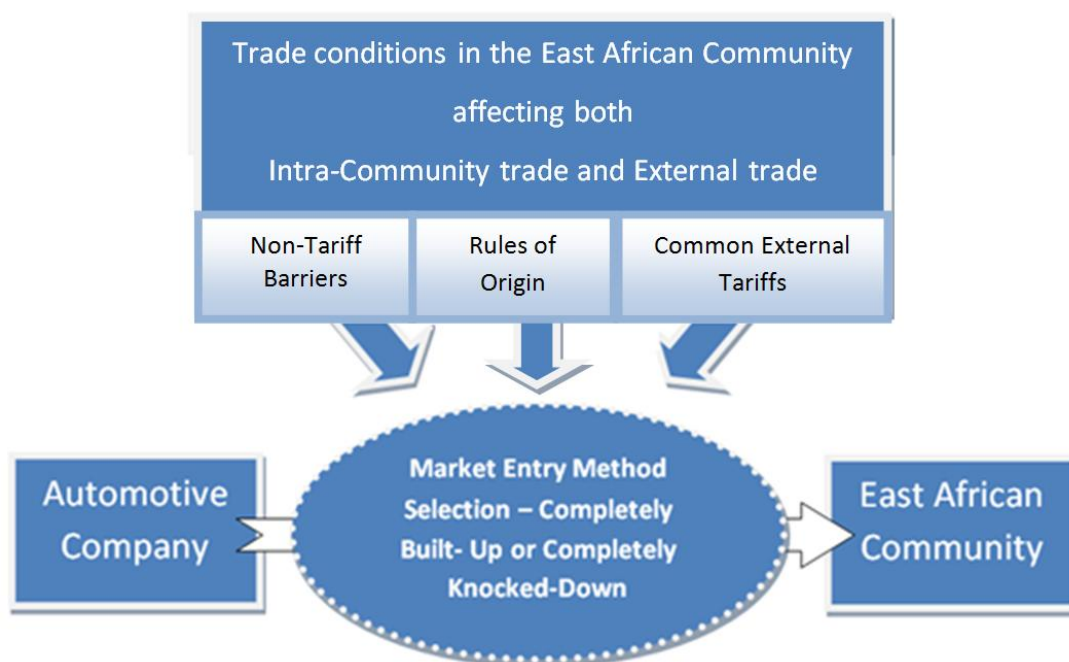


Figure 1. Conceptual frame of reference

2.4 Research Methods

This research is done as a desk research, thus the data used in this thesis is from secondary sources. This means that all the data used in this thesis already exists. The main sources of information are intergovernmental web pages, such as the web pages of the East African Community. Already existing recent study papers on East African

Community's economic development are also used. These study papers are taken from reliable sources, such as studies commissioned or executed by European Union or other well-known economic data producers. Theoretical information on economic development theory is taken from appropriate literary sources.

3 INTRODUCTION INTO THE EAST AFRICAN COUNTRIES

3.1 East African Community Area

In the next chapters each East African country is introduced briefly. After the country introduction a condensed PEST-analysis is done on the East African Community as a whole.

East African Community is a regional economic community of five countries. The countries are Kenya, Tanzania, Uganda, Rwanda and Burundi. Figure 2 below shows the location of East African Community and its countries within Africa.



Figure 2. Africa – East African Community Map (European Commission 2013)

3.2 Kenya



Capital: Nairobi
 Main port: Mombasa
 Population: 43 million
 Area: 580,367 sq. km
 Official language(s): English, Kiswahili
 GDP (PPP): 76 billion USD
 GDP per capita (PPP): 1,800 USD
 (CIA World Fact Book 2013)

Figure 3. Map of Kenya (Google Maps 2013)

Kenya is one of the two coastal countries bordering Indian Ocean in EAC. It is the economic powerhouse of the community, but even so over half of the population was below poverty line in 2000 and according to the 2008 estimate 40% of the population was unemployed. Kenya is the second largest country in EAC. (CIA World Fact Book 2012)

The largest import trading partners for Kenya are China (15.3%) and India (13.8%), other EAC countries only make minor share of Kenya's total imports, amounting only to 255.2 million USD in 2010 (CIA World Fact Book 2012). Being a small amount, it is still a major increase from the numbers in 2006 when the imports were 61.3 million USD from other EAC members (4th EAC Development Strategy 2011, 20-21). On the other hand for the Kenyan export sector other EAC countries are major markets. Kenyan exports, consisting of petroleum products, construction materials, steel and soap, cleansers and polishes, amounted to 1.28 billion USD in 2010 to other EAC countries (CIA World Fact Book 2012). Kenya has by far largest automotive markets, with 24 persons out of 1000 owning motor vehicle (Website of World bank 2012). For an automotive company Kenya is thus the main market to be because of its market size and its strategically good location. GDP growth of Kenya in 2009 to 2011 averaged at 3.225% (CIA World Fact Book 2012).

3.3 Tanzania

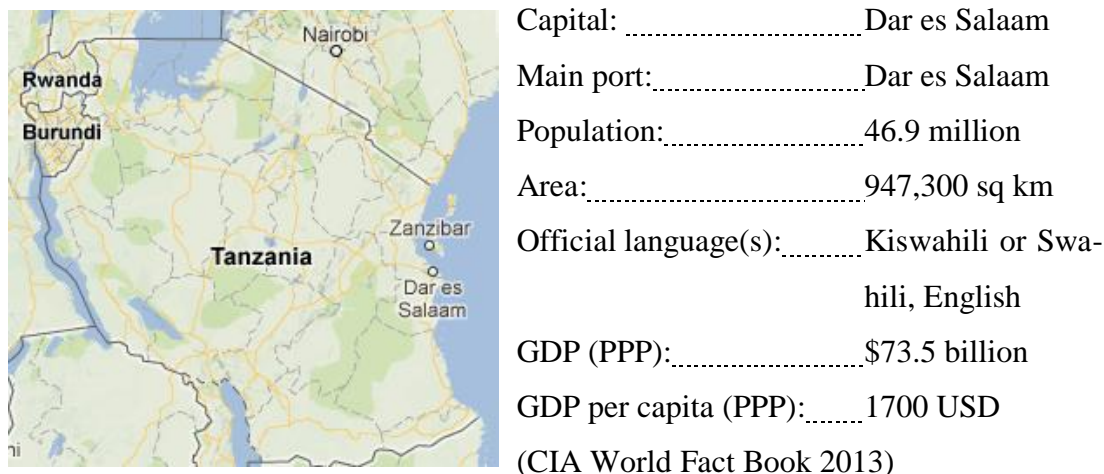


Figure 4. Map of Tanzania (Google Maps 2013)

Tanzania is by far the largest country in EAC and has also the largest population. Like Kenya, Tanzania also borders Indian Ocean and thus serves like Kenya as a distribution channel to EAC. Dar es Salaam is the capital of Tanzania and has the largest port in Tanzania. (CIA World Fact Book 2012)

Tanzania also relies on China and India in its imports, as they constitute nearly 37% of its imports. Kenya is also an important import partner, constituting 5.8% of the imports. Tanzania was the second most prosperous country in EAC in 2011 after Kenya. Tanzania's GDP growth rate for 2009-2011 averaged at 6.63%. (CIA World Fact Book 2012) Tanzania excelled in the perception of the business community towards the quality of transportation within EAC with 46% of positive answers, Rwanda came second with 34% and the rest of the EAC countries were below 30% but over 20% (4th EAC Development Strategy 2011, 20-24).

Rwanda is the most densely populated country in Africa. Rwanda is located south of Uganda and north of Burundi, it also shares a border with Tanzania in the East. The GDP (PPP) per capita is same that of Uganda, but whereas Uganda has 24.5% of the population living under poverty line, Rwanda has 44.9%. Import from other EAC countries, not including Burundi, makes 40.1% of the imports. This makes the intra-trade very important for Rwanda. (Website of CIA World Fact Book 2012)

Rwanda has been very active in renewing its regulatory environment to make it better for businesses, ranking 45th globally. Rest of the EAC countries come far behind; Kenya (109th), Uganda (123rd), Tanzania (127th), and Burundi (169th). Rwanda has implemented 22 reforms to make business easier since 2005; this is more than any other EAC country. (Doing business in The East African Community 2012, 3)

3.6 Burundi



Capital: Bujumbura
 Population: 10.5 million
 Area: 27,830 sq km
 Official language(s): Kirundi, French
 GDP (PPP): 89 billion USD
 GDP per capita (PPP): 600 USD
 (CIA World Fact Book 2013)

Figure 7. Map of Burundi (Google Maps 2013)

Burundi is one of the poorest nations in the world. Burundi is very similar to its Northern neighbour Rwanda when it comes to area size and population. No electricity is offered in rural areas as only 2% of the population gets electricity in their homes. Burundi suffered from civil war from which the reconstruction started only in 2006, which largely explains the overall poor situation of the country. (Website of CIA World Fact Book, 2012) This can be seen in poor legal systems, restrictive business environment, lack of access to education and corruption (Transparency International 2012).

Recently Burundi has made remarkable progress in advancing good business practises. The recent progress shows in the rank of Burundi in the Easiness of Doing Business ranking, which measures and compares the countries of the world in terms of business regulations. In 2011 Burundi's rank was 177th, but in 2012 it had improved to 169th. (Doing Business Ranking 2012) Burundi still faces many challenges, one being the language barrier. Unlike Kenya, Uganda and Tanzania, English is not an official language in Burundi, making the co-operation with neighbouring EAC countries harder. Uganda and Kenya account for 12.9% of the imports. Foreign aid is the major source of income for the government, accounting 42% of the national income. (Website of CIA World Fact Book 2012)

3.7 East African Community in General and PEST-Analysis

EAC is a regional intergovernmental organization of five East African countries. Current community was established first by signing a Treaty of Establishment in 1999 and then entering of the treaty into the force in July 2000. Motives for the creation of the community were promotion of security and good governance as it is written in the EAC treaty of establishment. Through peace and security also social and economic development are to be achieved. (Treaty of Establishment of EAC 1999, 12)

In the treaty of establishment, article 5 (2) the goals are clearly stated; establishment of Customs Union, Common Market, Monetary Union and finally Political Federation. These are done in "order to strengthen and regulate industrial, commercial, infrastructural, cultural, social, political and other relations among the partner states" (Treaty for the Establishment of EAC 1999, 12)

Achievements this far have been the establishment and coming into the force of Customs Union in 2005, and most recently coming in to the force of Common Market. Due to the customs union intra-EAC trade increased by 40% from 2005 to 2009, the growth in trade was complemented by significantly increased gross border investments in EAC. Next step the community is aiming at is the establishment of a Mone-

tary Union and also laying the foundation for the political federation. (4th EAC Development Strategy 2011, 9)

3.7.1 Political

So far the cooperation in political matters has been satisfactory, but the emphasis has been on defence, security and peace. All five countries are republics, with varying legal systems. Kenya, Tanzania and Uganda all have English common law base, but usually mixed systems with other types, such as customary law. Democratization process in EAC is still young and fragile. Democracy is seen as a virtue and a way to achieve sustainable economic growth, thus it is pursued in EAC. Threats to political stability are conflicts in the horn of Africa and the great lakes region. Piracy and terrorism add to the list. EAC countries can be thought to be high risk countries politically when looking at International Country Risk Guide (ICRG) indicators which show Kenya and Uganda as high risk countries. Tanzania is considered as a moderate risk country. Rwanda and Burundi are not listed. (4th EAC Development Strategy 2011, 9, 10, 12, 13, 15, 23, 43, 53; Website of CIA World Fact Book 2012)

3.7.2 Economical

East African Community's aim is to achieve sustained expansion of economic activities, and the national visions are set to achieving a status of a middle-income country (4th EAC Development Strategy 2011, 12). The task is very hard even though the average GDP growth rate combined for the region is impressive 4 percent over the past 6 years (in 2011). To reach the goal by 2020 an average growth rate of 8.5% would be needed from 2012 to 2020. Uganda, Rwanda and Tanzania made it to the top 20 fastest-growing economies in 2005-2009-list with real GDP growth rates of 8.3, 7.9 and 6.9 percent. For the whole EAC area the growth rate was during that time 6.4 percent. In numbers the total GDP of EAC states grew from 30 billion USD in 2002 to 75 billion in 2009. (International Monetary Fund 2011; 52-55)

The composition of traded products in EAC countries shows that there are not much manufactured exports. GDP composition also supports this, as the share of industry

in the GDP is still low compared to the level of agriculture as can be seen from the table 1 below. There has been some progress in lowering the level of agriculture and increasing industry's share.

Table 1. Sectoral Shares of GDP, 2006-2010 (4th EAC Development Strategy 2011, 22)

Agriculture Share of GDP %					
Country/Year	2006	2007	2008	2009	2010
Uganda	22.6	20.7	21.6	23.6	21.1
Tanzania	26.2	25.8	25.7	24.6	24.1
Kenya	23.8	22.0	22.7	23.9	22.0
Rwanda	38.0	36.0	32.0	34.0
Burundi	48.6	48.4	46.9	47.0	43.9
Industry Share of GDP %					
Uganda	22.3	23.9	24.0	23.8	24.9
Tanzania	20.8	21.2	21.0	22.0	22.3
Kenya	16.4	16.3	17.4	16.9	17.3
Rwanda	14.0	14.0	15.0	14.0
Burundi	19.4	16.4	16.9	16.3	17.5
Services Share of GDP %					
Uganda	49.1	49.0	48.0	46.2	47.7
Tanzania	43.3	43.3	43.8	43.6	43.9
Kenya	49.7	50.8	48.8	48.3	48.9
Rwanda	42.0	45.0	46.0	46.0
Burundi	32.1	35.2	36.3	38.9	38.7

The defect in the composition of manufactured products has been noted in the EAC and value added policy to fix this has been introduced; the method is to expand the manufacturing sector through investments in science and technology. These policies have not been taken seriously yet. (4th EAC Development strategy 2011, 64) In October 2011 EAC was in phase of finalizing its Industrialization Policy and Strategy until 2030, in which promoting national industries plays a big part. The industries that get the main focus, as they are considered having comparative advantage, are Iron-ore and other mineral processing; Fertilizers and agrochemicals; Pharmaceuticals; Petro-chemicals and gas processing; Agro-processing; and Energy and Bio-

fuels. EAC Head of Corporate Communications and Public Affairs Richard Owora also noted in October 2011 that automotive industry was identified as one industry which benefits go beyond national boundaries (Muwanga 2011). It was also agreed to implement a policy to increase the manufacturing industry's share of the GDP up to 25% from the level of 9.7% in 2011. Other similar targets are to increase the employment from manufacturing sector to 2.3 million from the current level of 456,000 in 2011 and to increase the export of manufactured goods to 52% from the current 32%. Economic growth and job creation are driving forces behind the policy. (Rwanda: EAC Concludes... 2011) What are the practical methods the EAC will take to make these goals come true are still unknown, but similar can be found from other countries (chapter 5.5) and lessons can be learned from those.

Interest and inflation rates were in the agenda of 3th EAC development strategy, and goals of achieving single digit interest rates and inflation rates below 5 percent were set. Inflation rate goal was achieved in 2010, as all member countries managed to reduce inflation below 5 percent, except Tanzania which had an inflation rate of 5.5 percent in 2010. Interest rates continue to be high and constraint the economic development as businesses cannot get affordable credit from the markets. All member countries suffered from high interest rates of over 15 percent. Access to credit has been identified as a major problematic factor for doing business in EAC as can be seen from the table 2. (4th EAC Development strategy 2011, 16)

Table 2. The most Problematic Factors for Doing Business in East African Community (International Monetary Fund 2011, 62)

The Most Problematic Factors for Doing Business							
	Burundi	Kenya	Rwanda	Tanzania	Uganda	EAC Average	SG Average
	<i>(percent of responses)</i>						
Access to financing	20.0	12.9	24.9	15.1	15.3	17.6	10.7
Corruption	19.5	21.7	0.6	17.4	21.9	16.2	8.5
Inadequate supply of infrastructure	7.2	9.5	10.9	13.3	13.0	10.8	6.4
Tax rates	7.4	7.2	13.9	9.0	8.9	9.3	6.3
Tax regulations	10.5	5.0	15.1	7.9	4.4	8.6	7.2
Inadequately educated workforce	3.5	1.1	9.6	3.9	5.0	4.6	8.6

3.7.3 Social

Human Development Index (HDI) for years 2006 to 2010 shows that EAC countries have not been able to transfer the growth in economy into the wellbeing of their citizens. Every member country experienced decline in the index. EAC average in 2006 was 0.48 and in 2010 it had declined to 0.39. Despite this the EAC average life expectancy grew during the period from 51.4 to 53.8 years. Poverty is a common problem in each EAC country, as on average half of the citizens in EAC live below the poverty line. Poverty is a direct consequence from the unemployment situation, which is particularly high among young people. On health sector EAC has recently made progress in harmonization of systems, regulations, policies, standards and guidelines, but there is still much to be done to achieve the millennium development goals. (4th EAC Development strategy 2011, 18, 24, 35)

3.7.4 Technological

Poor infrastructure is one of the main limitations to the growth in EAC, main bottlenecks being the main ports in Tanzania and Kenya. The poor railway lines have also caused fears on the future capacity to handle the increasing traffic. The table 3 below shows the situation of infrastructure in EAC. Perceptions on quality and cost of transport are especially low. (4th EAC Development strategy 2011, 24) The Logistic Performance Index shows similar poor results for EAC countries. Burundi taking the last place in the comparison list of 155 countries with 19.5% of points from the highest performer. Rwanda's rank is not so different, 139, but the percentage from the highest performer doubles from Burundi, to 40.5%. Kenya has 45.9 % and Tanzania 52.9 %. Uganda was not scored in 2012, but in 2010 it was by far the best performer in EAC being over 30 ranks higher than the second best in EAC. Overall the transportation unit costs in EAC are extremely high compared to those of China and India, estimated to be six times higher. (Website of World Bank 2012)

Table 3. Level of Access to Affordable and Reliable Infrastructure (4th EAC Development strategy 2011, 24)

Sectoral Criteria	Kenya	Uganda	Tanzania	Rwanda	Burundi	Total average
Quality and cost of transport (roads, railways, air, sea)	24%	29%	46%	34%	28%	32%
Access to water	52%	65%	42%	48%	50%	51%
Access to affordable and reliable energy	33%	38%	38%	41%	25%	35%
Access to affordable and reliable ICT	53%	71%	62%	57%	38%	56%

From the table 3 one can see that the energy sector has still lots of room for improvement. This has been taken as a priority area of development in EAC. Even though the hydropower generation has increased within EAC, the demand has grown faster than the supply. (4th EAC Development Strategy 2011, 24, 26, 27) Logistic and energy problems have been identified as the main bottlenecks limiting the economic expansion, thus numerous actions have been taken to deal with these issues. So far

there has not been rapid progress due to financial and technical problems. (International Monetary Fund 2011, 61)

4 ECONOMIC INTEGRATION THEORY

4.1 Background

The way to understand the current trade conditions and the possible future conditions is to look into the factor which determines the trade conditions. This factor in the case of EAC is the trade agreements that bind the countries together. Currently EAC is a customs union, hereinafter referred to as CU, and it has already signed common market protocol. To understand the current trade conditions in EAC one must first understand what CU is and how it is implemented in the EAC. To also understand the future business conditions, the future trade agreements that come after CU must be also be researched. This is the reason why the Economic Integration was chosen as a framework for this thesis as it has all the integration phases in it.

There are many reasons for countries to create and join various trade agreements. This economic integration process explanation is done from the viewpoint of African Economic Community's integration process, which follows a pre-planned pattern created in the Abuja Treaty of 1991. The treaty envisaged gradual implementation of economic integration phases, with the ultimate goal of having a continent-wide economic and monetary union with a parliament. The implementation order is as follows:

- (1) Creation of regional blocs;
- (2) Strengthening of these blocs;
- (3) Establishment of Free Trade Area and CU in these blocks;
- (4) Establishment of CU with all the African countries in it;
- (5) African Common Market;
- (6) Continent-wide economic and monetary union with a parliament.

The plan is and was ambitious, having deadlines for each phase. The deadlines have not been kept as planned within the different regional blocks in Africa, but the EAC is an exception. (Chauffour & Maur 2011, 113)

4.2 Free Trade Area

The first phase of an economic integration can be thought to be the establishment of a free trade area. A Free Trade Area, hereinafter also referred to as FTA, is a pair or a group of countries which agree to remove trade barriers among each other. The trade barriers are things such as tariffs (taxes imposed on imports) and import quotas. FTA does not include the harmonisation of external tariffs, which comes in the next phase of economic integration; Customs Union. Not having common external tariffs with the countries with whom FTA has been established could lead to trade deflection, which is re-routing of goods through countries that do not have the same level of preferences. This is why rules of origin are also needed when setting up a FTA. Rules of origin are explained in more detail in the chapter 4.3.2. (World Bank Staff 2000, 75-76)

4.3 Customs Union

A customs union is a form of trade agreement. It differs from free trade agreement in the requirement to adjust the tariff structure applied to third-party countries. As in free trade area there is a free trade between member countries, but the integration between countries has been extended to involve not only free trade but also common external tariffs. Custom Unions are not so common compared to free trade areas due to the loss of autonomy and slowness of its implementation. The customs union also requires longer-term commitment from the member countries, making it heavier and more cumbersome option compared to a free trade area. Out of the regional integration agreements notified to the World Trade Organization through 2009 almost 85% were FTA's. (Chauffour & Maur 2011, 111-112)

A customs union can be created with many different purposes in mind. Some are purely economic, but for some it is a step towards deeper integration. One of the

economic benefits of CU is for example a larger single market, thus greater economies of scale and enhanced competitiveness for member countries. Having a common external trade policy is also a major benefit gained from CU. The fact that integration works as a method of decreasing the risk of conflicts, as happened in EU, might be a great incentive to continue integration from FTA to CU for countries suffering from unstable political environment. (World Bank Staff 2000, 63, 123)

4.4 Common External Tariffs

A well planned and implemented CET is a prerequisite for a CU to sustain. This is why negotiations concerning the CET usually take a lot of time as the member states have different preferences for proper tariff levels. Not only are the government officials involved in the negotiations but also national industries, which lobby the governments to pursue for tariffs that are favourable for them. Balancing the tariffs to proper levels take many meetings and many years to complete. The fact that it took EU 11 years to complete its CET tells a lot about the difficulty there is in making multiple parties agree on common tariffs. (Chauffour & Maur 2011, 113-115)

As the governments have industries and sectors they are not ready to abandon, the final CET tends to have numerous country or sector specific exceptions and sensitive lists. These exceptions are many times created in a way that gives the country or sector some years to adapt to the new tariffs. In practice this is done by gradually increasing or decreasing the tariff to the CET-level from the previous national level. (Chauffour & Maur 2011, 115)

Allocation and Collection of CET Revenue

The challenging issues that the implementation of CET causes are allocation and collection of CET revenues. For developing countries tariff revenues constitute a big part of government's income, which raises the questions of who collects the CET revenues and how the CET revenues are allocated to become a major issue. Thus there are two main questions to be answered when setting up a CU: Who has the claim on the collected customs duties? And where and how should these duties be collected? (Chauffour & Maur 2011, 116)

Ownership of the duties

The question of who owns the duties collected must be answered first. The duties can either be considered as a common property of the CU or as a property of each member state. For developing countries the customs revenues play such a big role in the revenues of their governments, that they are not ready to give the control over the customs duties to other hands. Thus it is a common protocol to treat the customs revenues as individual property of the member countries. Even if there is no trust to give all the customs revenues to one institution in the CU, normally some kind of an organization must be created to collect and allocate the duties according to the agreed principles. (Chauffour & Maur 2011, 116)

Allocation of the revenues

The allocation of the customs duties to the individual members is the next issue to be dealt with. There are two ways of doing this. The first one is to do the allocation according to the final destination of the product entering the CU. The second one is to create a sharing formula which is used to allocate the collected revenues accordingly. The latter would be very easy way to deal with the customs revenue, but finding a formula that pleases everyone is often too difficult, thus the final destination model of doing the tariff revenue allocation is the most popular. In the South African Customs Union sharing formula is used to allocate the revenues. (Chauffour & Maur 2011, 116)

Allocating the revenues using the final-destination-principle is the most popular among the CUs around the world. Final-destination-principle sounds simple but in practice it might require some very expensive and burdensome measures to work. There are no problems if a product from outside the CU comes as a final good, having no need for any input. This way the product can be shipped to the final destination country in bonded facilities. The problem in the final-destination-principle is with the shipments that are first imported into one member country and then transformed slightly and distributed to other CU countries to be sold. The problem in this is that the country where the transformation happens takes all the customs revenues to itself, to which other member countries, especially landlocked countries which are dependent on the coastal country for transportation, will not react nicely. This leads to a situation where there are still internal-controls, guarantee mechanisms and rules

of origin-systems to take care of the fair sharing of the tariff revenues. And by so the benefits that CU was to provide are greatly reduced. (Chauffour & Maur 2011, 116)

Collection of Duties

Collection of duties can be done in the port of entry or in the final destination. If the customs duties are collected in the port of entry there must be a system to identify the shipments according to their final destinations already at port. It is likely to have a collection of duties in the port of entry in a CU that has the customs revenues as a common property. If the duties are property of individual members, the member countries usually do not have enough trust between each other to leave the collection and allocation of duties to a centralized organization. One reason for the mistrust is the previously explained case of small transformation to the imported shipment in one country and then the distribution of it to other members of the CU tariff free. When the duties are collected in the final destination of shipment border controls are needed. (Chauffour & Maur 2011, 117) Totally removing intra-border controls in CU is a goal, but if that cannot be achieved immediately then the lower level of integration can be done by doing these things: harmonizing customs procedures, doing deeper level cooperation, modernizing the customs systems and building more capacity. In customs context building more capacity is usually understood as developing or acquiring the skills, competencies, tools, processes and resources of the administration. (World Customs Organization 2003)

4.5 Rules of Origin

Rules of origin are used to determine whether the traded good between the countries having preferential trading agreements is originating from these countries or not. In practise preferential treatment means lower- or zero tariffs for the products the rules of origin applies. Rules of origin are set up to prevent trade deflection, which is a situation where a third player uses the preferential trade agreement unfairly. This could be done by channelling the goods through one country with better trade agreements than the one from which the good originates. Preventing this is the main idea behind the rules of origin, but it can also be used as a discretionary trade policy instrument. One example of this is the protection of domestic producers through highly restric-

tive requirements in the rules of origin. Rules of origin are an important part of trade agreements, since it affects all stakeholders in the production and export process. (Naumann 2008, 2)

Defining Origin

There are usually no problems in defining the origin for products that are wholly produced in one country. But when it comes to products that are assembled from parts coming from numerous different countries the task of defining origin gets difficult. The basic rule is that the product is eligible for preferential treatment if it has received a substantial transformation in the trade area. The meaning of substantial transformation differs in different agreements as there are different methods to determine what substantial transformation is. There are three main ways of doing it. (Chauffour & Maur 2011, 162-164)

Change in the tariff classification. If the final product has a different tariff classification code than any of the materials that were used in its manufacturing, then it is thought to have undergone substantial transformation. Being a simple method it has its problems, as the Harmonized System (HS) of tariff codes was not created to keep easy track whether the products should receive preferential treatment or not. HS was created to provide a unified commodity classification for definition of tariff schedules and for statistical purposes. Thus there are loopholes that can be exploited, which has led to a situation in which there is not one simple rule but instead many individual rules. (Chauffour & Maur 2011, 162-164)

Value added way to determine the place where substantial transformation took place is clear and simple to specify, granting an easy general rule. The rule is simple; determine a minimum percentage in the value of the product that must originate from local input for receiving preferential rules of origin. Two main problems restrict the value added method. Value added way forces firms to invest into sophisticated accounting systems as they must be able to answer often highly complex accounting questions relating to the materials and processes used in the value adding process. Another reason is the problems born out of exchange rate changes, wages and commodity prices. These are all volatile factors, having the potential to suddenly de-

crease the local input value of a product significantly, and thus making the product invalid to receive the preferential treatment. (Chauffour & Maur 2011, 162-164)

Specific manufacturing process defines the substantial transformation by setting up rules for each product or product group which they must submit to. These rules are about manufacturing or processing operations, that the products must go through. The rules also tell which processes do not confer origin. These are called positive and negative tests. For businesses the system is good as it is very clear and easy to follow. The problems come from changes in technology, as the processes the products go through change as the technology improves. Also the paperwork this system requires and burdensome constant updating of work processes are limiting the use of this system. (Chauffour & Maur 2011, 162-164)

The most common way to determine the origin is by using the change in the tariff classification line method. But it usually done using two methods in the same time in order to close all loopholes, for example a change in tariff line and specific manufacturing process are often used simultaneously to confirm the origin. (Chauffour & Maur 2011, 164)

Local content requirement

In the value added method of determining the origin there are set percentages of local content that must be added to the imported products. According to the World Trade Organization the norm for the domestic content varies between 40 to 60 %. It is thus important for companies importing from outside the trade area to check whether they can input enough value to the product to get the preferential treatment. Usually low-labour cost countries have big problems with achieving the required local content levels as they are usually dealing with high value parts produced outside the trade area and are not really inputting any other value to the product other than the wage costs. (Chauffour & Maur 2011, 165)

Restrictiveness of Rules of Origin can be measured by so called R-Index. It measures how expensive and hard the rules of origin system is in the specific free trade agreement. North American Free Trade Area has a R-index rating of 5, which is the highest rating any FTA has and means that the rules of origin within NAFTA are very

restrictive. Common Market for Eastern and Southern Africa and Economic Community Of West African States have low ratings of 2 and 3, but in practise there are other factors which are not discussed here that make them to be very restrictive. So the amount of rules and restrictions in the FTAs concerning rules of origin cannot be said to be the main indicator for restrictiveness of the specific FTA. The lesson is that when entering a new market not only the rules of origin agreements must be studied; but also the local practises must be researched to find out what potential restrictions there might be. (Chauffour & Maur 2011, 171)

4.6 Common Market

Common Market continues where CU left off. It establishes free movement of goods, labour, services and capital. By doing so the idea is to boost trade and investments within the trade area. The common market takes usually long time to realize, which is why the implementation of the agreed objectives is done progressively. This way the institutions have the time and resources to adapt to the new situation. The institutional framework that must be in the common market includes numerous things, such as: approximation and harmonization of policies, laws and systems; measures to address imbalances; monitoring and evaluation; regulations, directives and decisions. (Suranovic 2010)

Common Market is a big step towards monetary union; this is because the harmonization needed in the common market usually reaches to monetary and fiscal policies. Even though the requirements do not necessarily reach to monetary and fiscal policies, the increased economic interdependence within the region causes policies by one member state to affect others. Thus the monetary and fiscal policies also are harmonized in the common market; and by doing so the foundations for monetary union are created. (Holden 2003)

4.7 Monetary Union

After successfully creating a common market, the next step is to create a monetary union. Monetary union is also known as a currency union. This also means that a

central monetary authority must be established to take care of the monetary policy. (Suranovic 2010)

For a regional community of numerous countries to have a monetary union there must be harmonization in the national policies such as monetary and exchange rate policies and fiscal policies. Not only policies but financial sector, as well as statistic systems must be harmonized to say a few. (Bukuku 2012)

Having learnt from the experiences of the European Monetary Union it has been acknowledged that fiscal discipline, strong surveillance and enforcement mechanism as well as reliable and timely statistics are needed in the union along with other safeguard mechanisms. (Bukuku 2012)

4.8 Political Federation

By definition federation is a “group of states with a central government but independence in internal affairs” (Website of oxford dictionaries 2012). The political federation thus means that a central government must be established. But not all federations share the same structure; there can be different amounts of power given to the central government over the states within the federation. The laws and regulations of the central government are to be higher than those of individual states, but it is also negotiable to what extent the central government is given an authority to rule laws and regulations. The responsibilities and tasks the federal government usually takes over are defence, foreign policy, fiscal and monetary policy, some legislative authority and final appellate court jurisdiction. (East African Community 2009, 9)

5 MARKET ENTRY METHODS

5.1 Market Entry methods for automotive companies

In this section the two market entry methods for vehicles are explained. The methods are Completely Built-Up and Completely Knocked-Down. These two methods are used both because of logistical reasons and because of tariff reasons. Usually vehicles imported as CKD-kits have low tariffs due to the employment effect in the imported country. First the meanings of CBU and CKD are shortly looked into in the following chapter and then in the chapter 5.3 the reasons behind having these two methods are looked into in more detail. In chapter 5.4 the automotive assembly situation in Kenya is looked into. Especially the subcontracting capabilities within Kenya are researched. Finally the chapter 5.5 gives an example of how governments might use CKD assembly as a tool to improve their industry.

5.2 Completely Built-Up and Completely Knocked-Down

Completely Built-Up method means that the automotive is already assembled and in one piece when imported. For automotive company selling their product to foreign countries, CBU is the easiest option as it does not need any investments from the automotive company. (Website of Cambridge Dictionaries 2013)

Completely Knocked-Down on the other hand means that the automotive is delivered in pieces. It does not mean, as its name falsely suggests, that the automotive was dismantled in some point. Instead it represents an accumulation of parts or subassemblies. When the shipment happens, one must not think that the automotive is in one big container in pieces. The shipment happens by bulking up the unassembled parts by category in containers, rather than packing them in production units. (Russel 2000, 281)

5.3 Selecting the right Market Entry Method

Reasons for the existence of Completely Knocked-Down

The reason for not sending the vehicles as Completely Built-Up lies in the government's import regulations and restrictions. Importing an automotive as CBU does not create any extra value to the country it is being imported. But when the automotive is imported as CKD, it means that there must be an assembly factory in the country. This in turn means employment and investments into machinery to assemble the vehicles, thus it is a contribution to the economy of the country the automotive is being imported to. Because of these reasons it is a normal practice for governments to issue higher tariffs for products delivered as CBU than CKD. (Russel 2000, 281)

The first step is to find out the tariff rate difference between CBU and CKD import methods. After which the requirements for the CKD import methods are to be researched. The most common requirement is to have certain percentage of local value addition to the final product or to require certain parts to be made using domestic subcontractors. Sometimes it might not even be possible to locally source certain parts, which practically means that the automotive company must build its own factory in the country. As there are such requirements the market size of the country must be researched and after that, determine whether the market size is big enough to pay the investments off in reasonable time. To assemble the CKD kit there are two options, to outsource the assembly to local assembler or to build own assembly factory. (Maina 2012)

Trade area point of view

In the case where the assembly is planned in a country which is a part of some trade area to which the automotive company wants to sell its products, there is a need for further research. The object to study is whether the trade conditions within the trade area allow the vehicle assembled from CKD-kit to be exported to other trade area countries duty free. As if the assembled vehicles do not receive special tariff treatment from the other countries within the trade area, then the CKD assembly, rather than reduce costs, increases them. Second object of study are the Non-Tariff Barriers, hereinafter occasionally referred to as NTBs, which might make the theoretically free trade between countries impossible. These NTBs might cause significant extra costs

that the automotive company had not thought of. This is especially the case in developing countries where laws and regulations might only exist on paper while in practice they are not implemented. Finally, before deciding about the import method the future prospects must be looked into as the constant evolution of a trade area into more integrated community might change the situation. (Website of East African Community 2012; Website of Trade barriers 2013)

5.4 Completely Knocked-Down Assembly in Kenya

Kenya is the only country in the EAC region which has assembly factories for automotive vehicles. The main reason for this is the size of the automotive market in Kenya, which is substantially larger than the automotive markets in other EAC countries combined. (Juma 2011)

Assembly factories in Kenya

Nowadays there are three major assembly factories in Kenya which are Associated Vehicle Assemblers, Kenya Vehicle Manufacturers and General Motors East Africa. (Juma 2010) Chinese manufacturers are coming into the market by building their own assembly factories. Beiqi Foton Motor Co., Ltd built an assembly factory in Nairobi in 2012. Other two Chinese companies, FAW and Chery Automobile, are also planning to build assembly factories in Kenya in 2013. (Juma 2012)

Local subcontracting

For locally assembled vehicles to be granted zero tariff treatment, every part which can be locally produced must not be imported. Currently locally produced parts consist of tires, tubes, batteries, springs, radiators, brakes pads, cables, windshields, rubber components, transport seating and filters. A number of firms fabricate bodies for commercial vehicles (Website of Kenya Association of Manufacturers 2013). Kenyan suppliers do not have capabilities to supply technically advanced parts. Apart from “must-use” parts the CKD kits are imported as full as possible, parts not in the CKD assembly kit are also imported from outside the EAC. (Okatch, Mukulu & Oyugi 2011, 210) Reasons for this are looked in more detail in the next paragraphs.

Subcontracting issue in Kenya

The level of local involvement through subcontracting is something that the governments want to raise. In Kenya the subcontracting volume is very low. Reasons for this lie in the quality of the local suppliers, which are mostly small and medium-sized enterprises. They are small in size as no economies of scale can be achieved in the relatively small EAC markets in the present conditions. As a consequence of small profits they cannot buy the newest technologies for production of parts, which leads to a poor product quality. Small companies also suffer in many cases from poor management and thus unreliability in delivery of goods and services. High product prices are also a result of not achieving economies of scale. (Okatch, Mukulu & Oyugi 2011, 221)

The Kenyan government has not given incentives to use more local subcontracting, which has led to situation where the assemblers import the assembly kits as complete as possible as they can buy cheaper and better quality outside EAC. Achieving local content requirement of 35% would be a very big challenge in Kenya in the current situation, as the local subcontracting capacity is inadequate. The low wages and high costs of vehicles cause the local content requirement to be even harder to achieve in this industry. (Okatch, Mukulu & Oyugi 2011, 221)

Kenya industrialization strategy (2010, draft 5) sees automotive assembly as a sector to be supported, but EAC industrialization strategy (2012-final) places automotive assembly as the least potential industry out of 20 industries researched and thus will not actively make policies to support it. Thus the future of the vehicle assembly supplying lies in the hands of the Kenyan government. The subcontracting capability in Kenya is not going to increase if the government will not give incentives to the CKD assembly industry. The incentives could for example be limiting the import of second hand vehicles. Second-hand vehicles constitute over 70% of the vehicle markets in Kenya, thus limiting the markets for vehicles assembled from CKD-kits. The government should also promote policies which make the usage of local subcontractors more attractive. (Okatch, Mukulu & Oyugi 2011, 222)

5.5 Completely Knocked-Down as a tool to develop nations industry

To predict and create possible future scenarios one must understand what is the government's stand in matters that affect industries. This is why the government's interest when it comes to CKD is explained below.

A country can use high tariffs for CBU goods as means to improve its own industry. This happens by forcing the companies to use CKD as a method of importation by setting up high tariffs for CBUs. Using the CKD method means practically that assembly factories must be built. To further improve domestic industry the next step is to increase the percentage of localization, which in turn means that the domestic industry producing parts for the complete product must developed. This way a country with no know-how or experience in specific industry can quickly achieve growth and economic development. This is of course an aspect which might cause problems for a company ready to invest in an assembly factory, but not ready to invest more in the future when the requirements are raised. For example Brazil used this way successfully. Starting from 1956 when the country was completely dependent on imported vehicles it imposed high tariffs for all imported vehicles and required 90% localization rate from vehicles produced in Brazil. 22-24 years later Brazil had own production of 1.1 million vehicles. (Rubenstein 2001, 342)

Indian Example

In 2011 India stated that the tariff for cars imported as CKD will be raised to 60% from 10% if the engines are not assembled in India. In practise this means that if the engine is not assembled in India, there are no tariff reductions whatsoever for the car as the CBU tariffs are at the same level of 60%. (Bhattacharya 2011)

The European Union and especially Germany joined the automotive companies in lobbying activities against the new directive; even Germany's chancellor Angela Merkel joined the lobby against the directive during her visit to India in June 2011. (Pankaj Doval & Sidhartha 2011) The result was that the CKD tariff was cut down to 30% for cars that have their engines imported from outside India. The end result was still the one that the Indian government wanted to have; increased domestic manufacturing as now many manufacturers, such as BMW, Volvo, Mercedes Benz and even

Indian domestic maker TATA started to build domestic engine assembly factories in order to avoid the high tariffs and to retain a competitive pricing. (BMW Starts local... 2011; Mukherjee 2012; Patankar 2013)

A high level Indian government official revealed that the target of 25% of the Gross Domestic Product coming from manufacturing after 10 years was the motive for this change in the CKD policy (Bhattacharya 2011) This example shows that after having numerous auto-manufacturers created assembly factories in to the country, the government has an incentive to pass new laws and regulations which make the requirements tighter. This way it can force the manufacturers that already have an assembly factory in the country to invest more in to the country's manufacturing industry and by doing so to promote the nation's economy.

6 ECONOMIC INTEGRATION IN EAST AFRICAN COMMUNITY

6.1 Background

Current economic integration in EAC started from establishing a Customs Union, which came into force in 2005. The next step was in 2010 when the Common Market protocol was ratified and the implementation began. Currently the foundations of Monetary Union and Political Federation are being laid. (Website of EAC 2012) Even though the customs union came into force already in 2005 its implementation is still lacking in numerous points making the progress to exist more on the paper than in reality. The rapid change has brought forward criticism; at EAC students' debate on integration the university students in the region expressed their concern about the fact that the political federation is already in the agenda even though the previously agreed objectives are still not achieved. For example the East African Court of Justice and East African Legislative Assembly still lack the power they need to execute their full mandate, making the progress of integration seem to be more politically inspired than result oriented. (Muramira 2012)

6.2 Customs Union

EAC Customs Union protocol was signed in December 2004 and the five year implementation plan officially commenced on January 2005. The customs union's main objectives were the removal of internal tariffs, setting up of Common External Tariffs and agreeing on the EAC Rules of Origin. (Website of the East African Community 2012) EAC achieved to eliminate all internal tariffs by January 2010 but on other areas there is still a lot to be done for EAC to become a truly fully-fledged customs union (Brief on key issues affecting the private sector in the EAC 2012).

Adoption of common trade documentation standards and procedures is a major goal for the EAC. In 2012 the member countries had not yet achieved harmonization on the customs procedures completely. Uniform custom procedures exist on paper but they have not been applied yet. One main reason for the EAC not being able to enforce the agreed rules is the weak legal and regulatory dispute settlement mechanisms and requisite powers. Domestic tax regimes are still to be harmonized, as excise taxes, Value Added Taxes and income taxes to say a few, still differ in member states. (4th EAD Development Strategy 2011, 10; Brief on key issues affecting the private sector in the EAC 2012)

6.2.1 Common External Tariff

Common External Tariffs, hereinafter also referred to as CET, was established as a part of customs union protocol. In the CET the tariffs of the member states were harmonized. The tariffs were divided in three categories, which are primary raw materials with 0% tariff; industrial inputs with 10% tariff and capital equipment or finished goods with 25% tariff. (East African Community 2012) Currently EAC does not have properly working CET, as each member country has practically its own external tariffs. This is because the EAC countries have many ways to get around the agreed tariffs. These ways, or cracks in the CET agreement are such as country lists, the exemption regime, duty remission schemes, trade arrangements with third parties, and discretionary actions by partner states. Uganda, Burundi and Rwanda, 3 out of 5 EAC countries have their own country list of goods exempt from application of the

CET. (Kitenga 2012) Each year the partner states come with stay applications of the CET for all kinds of products. For example in June 2012 East African Community Gazette; Uganda, Burundi and Rwanda all stay application of CET for one year and apply duty rate of 0% for road tractors for semi-trailers. In other words they applied for exception from usage of CET. Industry pressure has a lot to do on what products are selected to be applied to have the exempt duty rates.

Major problem affecting the CET is the individual memberships of EAC countries in other trade agreements than EAC. Having a customs union and CET but still belonging into other trade agreement means that the CET cannot work in practice, as the countries in other trade agreements have also agreed on other tariff rates with their partners. This leads to legal uncertainties and confusion as more than one agreement applies in the same time. (Kamau 2012)

The CET within EAC states that completely knocked-down-kits for vehicles have 0% tariffs. The precondition for this is that every part which can be locally produced is not included within the CKD-kit, but bought locally. Vehicles imported as completely built-up have 25% tariffs. (EAC Common External Tariff 2012; Okatch, Mukulu & Oyugi 2011, 215)

6.2.2 Rules of Origin

East African Community Customs Union Rules of Origin

EAC Rules of Origin state that goods shall be considered originating in a partner state when they have been wholly or partially produced within a partner state. If imported materials are used, their value must not exceed 60 percent of the total cost of the materials used in the production of the goods. Also the value added in the manufacturing process must be at least 35 percent of the ex-factory cost. Finally, manufactured products must become classified under different tariff heading than the tariff headings for the imported materials. Simply mixing or assembling imported components does not confer origin. (East African Community Customs Union Rules of Origin, 5)

Certificates of Origin

The practical application of EAC Rules of Origin is done by issuing two types of certificate of origin. They are called EAC Proof of Origin and Simplified certificate of Origin. Simplified certificate of origin is used for products which value does not exceed US \$ 500. It was created to facilitate small scale cross border trade. (Manual on the Application of East Africa Community Rules of Origin 2006, 30)

Change in Tariff Heading Issue

Currently an issue in EAC is the application of Change in Tariff Heading, hereinafter also referred to as CTH, clause from the Rules of Origin into assembled vehicles. For Completely Knocked-Down vehicles CTH cannot be done. This is because the rule is that there must be a change in the 4-digit level in the Common External Tariff Harmonised System Codes for a product to obtain substantial transformation in EAC. Both the completely built-up vehicles and completely knocked-down-kits are in the same 4-digit level thus the CTH is impossible for assembled vehicles in EAC. This problem was discussed in East African Legislative Council in December 2010, and proposal was to amend the current structure of the HS under heading 87.01, 87.02, 87.03, 87.04 and 87.16 by removing the tariff lines of an assembled kit. (Report of the Proceedings of the East African Legislative Assembly 2010, 8)

In 2012 continuation came as East African Community Sectorial Council on Trade, Industry, Finance and Investment issued a directive to collapse tariff lines for the un-assembled motor vehicles under Chapter 87 in the HS code list. This would make the assembled vehicles to become classified under a different tariff heading, but the practical problems of having to deal with over 4000 parts in import process has caused Kenya Association of Manufacturers and vehicle assemblers in Kenya to protest against this directive by saying the directive threatens the whole assembly sector with closure. The directive has not yet entered into force and the situation is still open. (Maina 2012)

The Non-Recognition of CTH-rule for assembled vehicles from Kenya has been a trade barrier in EAC for vehicles. This is discussed in the chapter 6.2.3 which is about Non-Tariff Barriers.

Calculation method of local content for vehicles

Not being able to prove the local value addition for vehicles is a problem in EAC. Whether the 35% local content rate can be achieved or not by using local suppliers depends highly on the model of the vehicle and on the calculation method, especially on the issue of what constitutes a production process. Even the Kenyan authorities said they need more information on what constitutes a production process which is used in calculating the value addition. If there are doubts whether the value addition has really happened, partner states can send verification teams to verify are the claims really true. This takes a lot of time and often the producers are not willing to give the detailed technical information about their production process. (Omondi 2010)

East African Community Rules of Origin – Future outlook

The EAC Rules of Origin will remain in force and the cessation of the Rules of Origin is not in sight in the foreseeable future. Reasons are numerous; mainly the overlapping memberships in regional trade agreements, poor accounting and fraud. The future Single Customs Territory and the development of Common Market do not solve the main issues thus the cessation of the Rules of Origin is not going to happen through these developments. (Hermann & Terhechte 2012, 502)

6.2.3 Non-Tariff Barriers

Non-Tariff Barriers are barriers of trade which restrict trade but are not tariffs in their nature. They come in many forms, but usually appear in the form of rules, regulations and laws that have a negative impact on trade. NTBs exist for reasons such as safeguard mechanisms against unwanted influences, protection of domestic industries, safeguarding of national security and finally, to safeguard against revenue losses. (Website of EAC 2013)

East African Community Non-Tariff Barrier Survey

In December 2012 the EAC NTB survey was published. It showed that rather than eliminating the barriers even new ones had emerged. While there were 36 cases resolved, 35 remained unresolved added to the 10 new NTBs that had surfaced. These

NTBs come in many forms, mainly weighbridges, roadblocks and unnecessary delays at border posts. Poor infrastructure and lack of harmonization in the import and export standards, documents and procedures between member states also cause unnecessary costs to the businesses. Electronic Customs Data Interchange Systems are not yet fully used in every port and border crossings; lack of steady supply of electricity is one reason to this. Other recognized NTBs according to Mr. Sirma, Kenya's minister for EAC Affairs are such as non-recognition of EAC certificates of origin, lack of mutual recognition of quality marks, retesting of products, delays by statutory boards in releasing the results of analysis of samples and delays in issuance of import licenses. (Ligami 2013; Ubwani 2012)

The reason for the difficult situation partly lies in the inexistence of legally binding framework between member countries. The NTBs have been dealt in a government level, making the process of removing these barriers slow. Situation in November 2012 was that the legal framework had been developed, but it was now waiting for the comments from the member states. Also laws to punish violators were drafted and submitted to the parliament. (Ligami 2013)

Change in Tariff Heading criteria as a Non-Tariff Barrier

Tripartite Free Trade Area Non-Tariff Barrier Reporting, Monitoring and Eliminating Mechanism – website follows and reports the new and current NTBs in the context of three trade areas, which are EAC, COMESA and SADC. The complaint of non-recognition of EAC Rules of Origin CTH-criteria for motor vehicles was reported in the system in March 2012. The complaint is reported to be “active” and “in the process”. EAC secretariat was planning to send a verification team in April 2012 to Kenyan assembly factories to check whether the motor vehicles fulfil the criteria set in the EAC Rules of Origin. 2012 November NTB Survey reported the problem as the table 4 shows. (Website of Trade Barriers 2013)

Table 4. Lack of Recognition of Change in Tariff Heading Criteria. (Status of Elimination... 2012, 26)

	NTB summary description	Affected countries	NTB source & Ministry/ Department/ Agency for action	Impact to businesses	Prioritized Action	Bottlenecks or Success Factor	Status / Recommendations	Time-frame
29.	Lack of recognition of CTH criteria in the EAC ROO for motor vehicles	Kenya	Tanzania, Uganda and Rwanda	Loss of business	Recognition of CTH Criteria in the EAC Roles of Origin		TRA, URA and RRA requested to recognize the CTH criteria and allow vehicles manufactured in Kenya to their market <i>EAC Secretariat to provide a status report on the subject in conformity with the Council decision.</i>	December, 2012

Ease of trading across borders

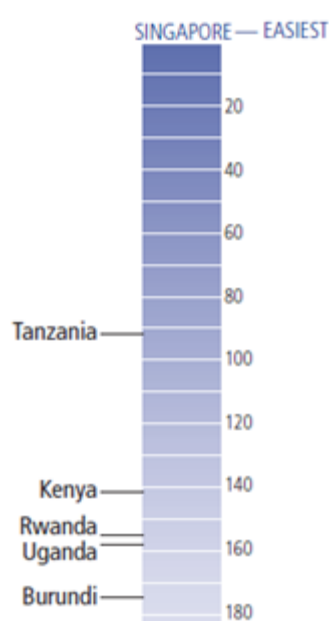


Figure 8 shows the EAC countries ranking compared to 180 other countries when it comes to ease of trading across borders. The ranking is done by investigating how long it takes to import and export, how costly it is and how burdensome are the requirements when it comes to import/export documentation requirements. For Rwanda, Uganda and Burundi the low rankings are understandable as logistic costs and transport durations are high to the landlocked countries. The reasons for especially high transportation costs lie in the weighbridges, roadblocks and unnecessary delays at border posts. (Doing Business 2012; Ubwani 2012)

Figure 8. How do EAC countries rank in the ease of trading across borders? (Doing Business in the East African Community 2012, 59)

6.2.4 Single Customs Territory

As of January 2013 EAC was not yet fully-fledged customs union, as Single Customs Territory, hereinafter also referred to as SCT, is the final phase of it. Having a SCT would mean free circulation of goods in the customs territory, cessation of Rules of Origin, minimal or removal of internal border controls and a system of information exchange between agencies involved. None of these have been achieved in the EAC this far. (Muwanga 2012)

Politically the Single Customs Territory has been agreed upon as the heads of state gave their green light to the SCT. Destination model of clearance of goods, with the duty collection happening in the first point of entry and then remitting it to the partner states was selected as the method of allocation and collection of revenues. High Level Task Force was set up to propose modalities to make the destination model work and to present mechanism for its operationalising. (Website of Federation of East Africa Freight Forwarders 2012)

As the destination model was chosen as the way to allocate revenues, and not the sharing formula type of allocation, the border controls are to remain. This is because of the reasons explained in chapter 4.4 under “*Allocation of Revenues*” title. But to remind: a minor change to the imported product creates a situation where one country takes tariff revenues from others by claiming the product originates from it because it went through “substantial transformation”. But as others might not recognize the process as substantial transformation, the border controls are needed to safeguard that these products do not enter the country tariff free.

Thus the planned EAC Single Customs Territory will not grant completely free movement of goods within the trade area, but will work as a trade facilitation mechanism. The measures that can be taken to achieve this are harmonization of standards, creating common legal framework, creating an interconnected payment system and collecting the tariff revenues at the point of entry (Website of EAC 2013). It is yet to be seen how the coming of the SCT will affect the EAC Rules of Origin, as it has been stated that the coming of the SCT will require the Rules of Origin to be reviewed.

6.3 Common Market

The Protocol on the Establishment of the East African Community Common Market entered into force on July the 1st 2010. The common market protocol of EAC has the following annexes which tell the freedoms and rights to be granted. These are the free movement of goods; the free movement of persons; the free movement of la-

bour; the right of establishment; the right of residence; the free movement of services; and the free movement of capital. These are going to be implemented progressively, but no specific deadlines have been set. (Website of EAC 2012) The progress in the harmonization of domestic legislations and ensuring compliance with the protocol has been poor as the member states have not amended their laws. One main reason for this is that the authorities who were supposed to mandate the laws were lobbied in their own countries causing the process to get stuck. The World Trade Organization's regional trade specialist Paul Brenton stated that in EAC there are not even mechanisms to monitor the implementation process of Common Market protocols. (Constantine & Zaphania 2012)

6.4 Legal Framework

The weak legal framework prohibited the EAC to enforce the rules that were agreed on paper. In the period of 2011 to 2016 the strengthening of the legal framework has been set as one objective. This is done by strengthening East African Legislative Assembly, hereinafter referred to as EALA, and The East African Court of Justice, hereinafter referred to as EACJ. EALA is envisioned to be strengthened in capacity and enhanced in mandate. In practice these are done by establishing communication and reporting mechanisms between EALA and national assemblies and by strengthening the legislative, oversight and representation functions of EALA. EACJs' jurisdiction is to be extended and its capacity enhanced. (4th EAC Development Strategy 2011, 47-48, 70)

6.5 Monetary Union

Establishing a Monetary Union, hereinafter also referred to as MU, is the next step the EAC is trying to take. The planned date for the MU protocol to be signed was already in November 2012, but now the heads of states agreed to push the signing of the protocol to November 2013. (Kiragu 2012) Reasons for the delay lay in the political view disparities, fears of impacts of a single currency, limited national resources and capacities and weak institutional and legislative frameworks. The foundations for the common currency are to be laid until 2016. The actions are for example harmoni-

zation of monetary and exchange rate policies, harmonization of fiscal policies and integrating banking and financial markets. The region has agreed that the monetary union will not be established within 10 years after the signing of the protocol for the establishment of MU. The central bank which is to be created will be called East African Central Bank. After the MU protocol has taken effect, all foreign currency transactions by EAC governments will be carried through the East African Central Bank. (4th EAC Development Strategy 2011, 104)

6.6 Political Federation

The final phase of the integration process is the political federation, in which the socio economic and political development is in line with the African Union aspirations. The EAC is now in the process of laying foundations for the Political Federation. This is done by establishing policy frameworks and institutional structures through development of regional policies. The structure of the planned Political Federation was discussed in the 26th meeting of the Council of EAC which was held in November 2012 (4th EAC Development Strategy 2011, 59-60)

The detailed structure and the model of the future political federations in EAC are still to be negotiated between the partner states. In the 26th meeting of the council of EAC, which was held in November 2012, model and structure of EAC political federation were discussed. (Website of EAC 2013)

6.7 Tripartite Free Trade Agreement

As figure 9 shows, the EAC member countries are all participating in other free trade agreements besides EAC as well. Not only the Common Market for Eastern and Southern Africa, hereinafter also referred to as COMESA, and South African Development Community, hereinafter also referred to as SADC, overlap with EAC but also the Economic Community of Central African States, as Burundi and Rwanda are members of it too. Tripartite free trade area is planned for EAC-COMESA-SADC. Combined the countries of the three regional economic communities have a popula-

tion of 527 million people and Gross Domestic Product (GDP) of US\$ 624 billion. (Website of comesa-eac-sadc-tripartite 2013)

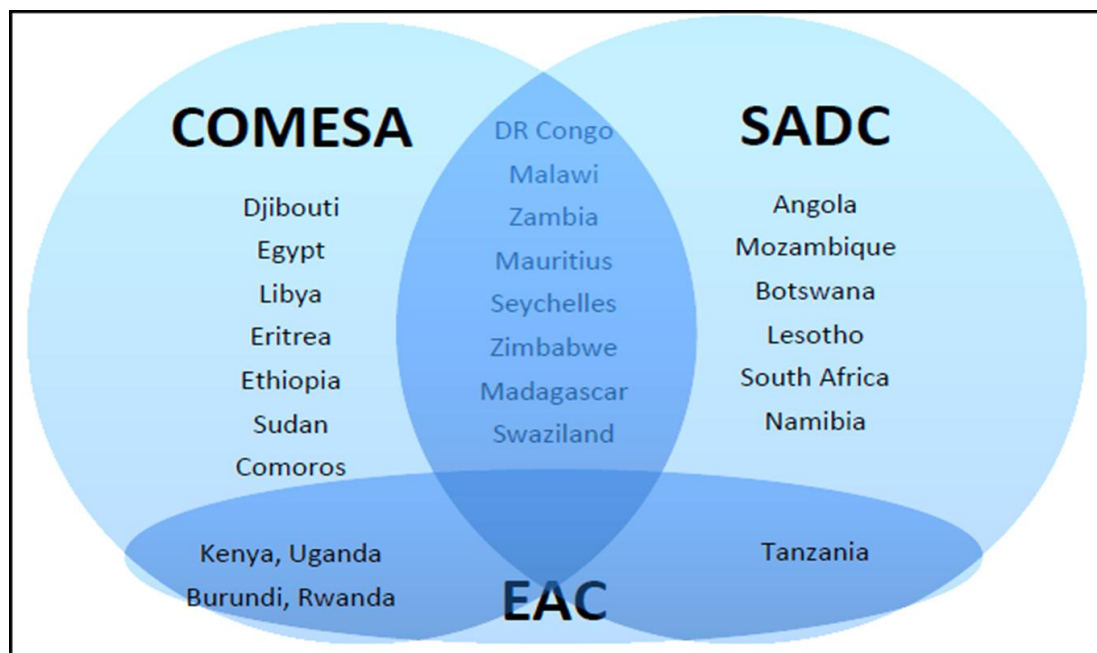


Figure 9. Overlapping memberships in regional trade agreements (Maasdorp, Kalaba, Oyoo & Charalambides)

Overlapping regional trade agreements create a situation where common external tariff is impossible to achieve due to numerous agreements being in the force in the same time. The overlapping also causes unnecessary administrative and financial costs, complicates the tariff structure and makes the business more difficult due to the increased bureaucracy. To deal with this situation the tripartite negotiations to establish a wider regional market for the 26 countries were set up in June 2011. The idea was established in 2006, and in 2008 the heads of states of EAC, COMESA and SADC agreed on the Tripartite Free Trade Area, hereinafter referred to as TFTA, roadmap, scope and processes. (Website of comesa-eac-sadc-tripartite 2013)

Goal of the TFTA is to set up a single market and eventually a customs union by removing internal tariffs and non-trade barriers between the 26 countries of the three Regional Economic Communities. The main benefits to be gained from the TFTA are increased competitiveness through trade and transport facilitation at borders and infrastructure development. In the future the negotiations are going to continue as agreed in the roadmap for establishing the TFTA. The 4th EAC Development Strate-

gy also states the TFTA cooperation to be continued. (Website of comesa-eac-sadc-tripartite 2013)

7 ANALYSIS ON RESEARCH FINDINGS

7.1 Answering the research questions

The chapter 5 and 6 in this thesis have the detailed descriptions about the trade conditions asked in the first question. But here the chapter 7.2 about the general trade conditions in the East African Community has a condensed answer with all the most important issues. Also the following chapters all revolve around the trade conditions and their effects. This is because the research questions were so interconnected when it comes to the trade conditions.

What is the proper market entry method within the trade conditions was the second research question. This is answered in the chapter 7.3, which starts with the explanation of the research process. Then the recommended market entry method to the EAC is given with the reasoning about the relevant trade conditions.

After deciding that CKD is the market entry method to be used in Kenya, the chapter 7.4 continues with the third research question, which asks if the free trade is possible within EAC for vehicles assembled from CKD-kits. As the answer is no, the chapter finally explains the scenarios where free trade within EAC could be possible for vehicles assembled from CKD-kits.

The chapter 7.5 gives answer to the final question, which asks when must the case company change the market entry method. The research results already show that there are no changes coming to the trade conditions in the foreseeable future. So the scenarios explained in the chapter 7.5 are highly hypothetical, but they serve the purpose of preparing the case company for any situation and also educate on the possible risks there are when using the CKD market entry method.

7.2 General trade conditions in the East African Community

Current prospects

General trade conditions in the East African Community are not as promising as they seem to be on paper. The numerous non-tariff barriers, differing external tariffs between member states, multiple memberships in trade agreements, disputed rules of origin clauses and the lack of harmonisation in laws, regulations and customs procedures are the main hindrances. Despite this the common market protocol has been signed and monetary union protocol is to be signed in November 2013. The problem with rapid development of the trade area is that the practical application of already agreed commitments is coming far behind due to lack of legislative power of EAC to enforce the contracts and agreements and also due to budgetary constraints of East African countries. Currently free trade is not a reality within EAC for commercial vehicles assembled from CKD-kits. Namely the problems are currently the change in the tariff classification-clause in the EAC rules of origin and achieving the local content rate, but the underlying reason behind the difficulties in achieving free trade for automotives is the fact that only Kenya benefits from the motor vehicle assembly industry having tariff free trade within the area. For other member states tariff free trade for assembled vehicles would only mean loss of revenue source. Not having mutual benefit makes the solving of the problems affecting the motor vehicle assembly industry difficult.

Future outlook

The current problems are however noted and institutions and systems are being set up to deal with these problems. Further development of the Common Market, coming of the Single Customs Union and the integration of the three Regional Economic Communities of EAC, COMESA and SADC into one big trade area, are all going to bring many measures of trade facilitation. But in case of EAC the intra-border controls and Rules of Origin are not going to disappear even after common market protocol coming into effect or after establishment of the single customs territory. This is due to poor accounting, overlapping Regional Trade Agreements and fraud, and finally due to the fear of losing tariff revenues because of Kenyan assembled vehicles, which are not seen to confer to the EAC rules of origin. Also the different Value Added Taxes and excise taxes between member countries require intra-border con-

trols to remain. The single customs territory could have been the answer were the model of clearance of goods been a sharing formula and not the destination model of clearance of goods, which has already been agreed on principle.

7.3 Market Entry Method Selection

Finding the answer to the second question about the proper market entry method is a process which starts from researching the market conditions within the East African countries. The research results show that the market sizes for new trucks and buses within other East African countries than Kenya are so small compared to Kenya, that it would be unwise to have a CKD assembly factory anywhere else than Kenya. Having a CKD assembly factory elsewhere than Kenya would mean that most of the products have to be transported long distances to the markets they are to be sold. This would mean high logistic costs and longer lead times. Kenya is also the only country within EAC having CKD assembly factories. Thus the answer to the second research question was narrowed down first to find out the best market entry method for Kenya, because only after answering that question, the market entry method for other EAC countries could be researched.

Market Entry Method to the East African Community

The research shows that the best market entry method for Kenya is Completely Knocked-Down. The main reason for this is the fact that the common external tariffs state that CKD-kits have 0% tariff rates whereas Completely Built-Up units have 25% tariff rates. The precondition for getting the 0% tariff from CKD-kits was to locally source all the parts which can be locally produced. As currently the parts produced locally are simple and do not constitute significant extra costs compared to cheaper Indian and Chinese parts, the choice to use CKD method is clear. The market size of the Kenya is also large enough to bring down the costs of CKD assembly to a reasonable level, as the economies of scale are achieved. Thus even after all the expenses the CKD method causes there are still significant savings to be done as compared to paying the 25% tariff if imported as completely built-up units. Not to use the CKD method would grant the competitors using the CKD method a significant price advantage. The EAC rules of origin are not relevant as long as all the parts

which can be locally sourced are bought locally. With governments' support of the CKD assembly there are no Non-Tariff Barriers especially aimed at imports of CKD-kits.

7.4 Possibility of Free trade for commercial vehicles

What to do with the rest of the EAC countries is the question to answer next. But since we have established that the CKD-assembly is not an option to consider for other EAC countries than Kenya, the question is now considered from the angle of the possibility of distributing the vehicles which are assembled in Kenya to other East African countries. To answer this question the EAC Rules of Origin, Non-Tariff Barriers and the overall economic situation within the EAC become relevant. The viewpoint is to see whether the vehicles assembled in Kenya can be sold within the EAC tariff free. This viewpoint is very important to understand, as it is one of the main questions asked in this thesis. The whole interest in EAC from multinational companies is based on a hope that they could sell their products in the whole EAC region as one market rather than having to export into each country individually. In the case of automotive companies the hope is to be able to manufacture or assemble the products somewhere within EAC and then to distribute them duty free within the EAC.

Trade conditions as a barrier of trade

The rules of origin of EAC state that there must be a 35% local content rate achieved for products to be eligible for free trade in EAC. Another requirement is to have a change in the tariff heading of a product which is built, assembled or manufactured within EAC using imported materials. Currently it is very hard to achieve the local content rate due to the limited capabilities of local suppliers. Also the high value of commercial vehicles makes the value addition in a cheap labour country very difficult. As for the change in the tariff heading requirement, it is impossible within the current Common External Tariff classification system. This is because the CKD-kits are in the same 4-digit classification group as the completely built-up units; thus making the change in the tariff classification-criteria impossible to achieve under

current regulations. Due to these circumstances the commercial vehicles assembled in Kenya using CKD-kits have not been distributed within the EAC tariff-free.

The underlying reason preventing duty free trade for commercial vehicles can also be seen to be the fear of losses in tariff revenues in other EAC countries than Kenya. The fear is highly connected to the idea that the balance of trade within East African Community would favour only Kenya were the borders opened for truly free trade. This fear of centralization of trade to Kenya and the following revenue losses for other East African countries also partly explains the numerous non-tariff barriers which are especially aimed at Kenya, as the governments want to safeguard their tariff revenues.

Because of the previously explained reasons the free trade within the East African Community is not possible currently for automotives assembled from CKD-kits.

Market entry method for other East African countries than Kenya

As it is not possible to distribute vehicles assembled in Kenya from CKD-kits within EAC duty free, the only option left is purely from the viewpoint of trade conditions to export completely built-up units from the main factory directly to other East African countries. This is because the CKD-kit assembly in Kenya would bring extra costs compared to CBU-units, these costs are such as: assembly costs, which are thought to be 10% of the final products value, and higher costs of locally produced parts than for example Chinese parts which could be used in CBU-units. There are also other highly viable options other than direct importing to be considered, but because of the limitations of this thesis they are not researched here. The Recommendations-chapter has the other options listed and points out the research objects which need to be researched before doing the decisions.

In the following paragraphs the possible scenarios in which the borders would open for tariff free trade for vehicles assembled in Kenya are explained. These explanations are highly theoretical and the reason for explaining these scenarios is to bring more light into the situation which prevents free trade from happening in EAC.

The first scenario is the liberalization of EAC Rules of Origin for vehicles assembled from CKD-kits. This measure could happen from a mutual agreement from Partner States to make trade more free in the trade area. Only Kenya would gain from this agreement while other Partner States were to lose tariff revenues, which makes this kind of agreement highly unlikely.

The second scenario is the cessation of Rules of Origin. This happens when there is no longer a need to have border controls with Customs Union Partner States. In the East African Community setting this would mean becoming a Single Customs Territory with a sharing formula for tariff revenues; collecting duties in the point of entry and remitting them to Partner States according to agreed formula. In the EAC the destination model of allocation of tariff revenues has already been chosen as the model for the future SCT, thus the cessation of rules of origin is not going to happen in the coming SCT. Cessation of rules of origin is also highly unlikely in the foreseeable future as problems of poor accounting, overlapping Regional Trade Agreements and fraud prevail.

The third scenario is to achieve the EAC Rules of Origin requirements. Prerequisite for this scenario is also that the EAC Partner States come up with common interpretation, implementation and enforcement of EAC Rules of Origin value addition computation methods and all disputed issues; currently the main one being the change in the tariff heading rule. If a solution to make the CKD assembled vehicles to become classified under different tariff heading becomes possible someday, then theoretically free trade should be possible. In theory achieving the rules of origin is already possible through value addition, but in reality the Kenya's subcontracting sector is too small and unable to deliver enough parts to truly achieve the 35% local value addition.

7.5 Possible scenarios in which the market entry method must be changed

The following hypothetical scenarios are explained to prepare the case company for the future situations which require the market entry method to be changed. In the current situation it is however very hard to see that either of these scenarios could hap-

pen, as the Kenyan government supports the assembly industry and would not do harm to it on purpose, as the industry is seen as being good for the overall economy.

Having established that completely knocked-down market entry method should be used for Kenya, the scenarios explained below are about changing the market entry method to completely built-up units. These two scenarios were selected as they were the most probable scenarios which could happen from the viewpoint of trade conditions.

The first scenario is the requirements for the CKD-imports are tightened so much, that considerable investments should be done to continue the tariff free importation. As learned from the Indian example explained in chapter 5.5 such changes to the requirements can and do happen in countries aiming to improve their manufacturing industry. And as the Kenyan governments and East African Community's industrial development plans reveal, the improvement and expansion of manufacturing industry within EAC is on the agenda thus making this threat real.

The second scenario is where the market situation for vehicles assembled from CKD-kits is weakened greatly. This could happen if the Common External Tariffs for completely built-up units were to be cut down from the current 25% to lower levels. The tariffs can be brought lower also by other means, as the country lists and exceptions to the CET are common in East African countries. Such measures could bring down the tariffs to very low levels or even remove them, thus making the direct importation of completely built-up units much more lucrative than selling the vehicles assembled from CKD-kits. Also if the restrictions on the second hand vehicle market were lowered significantly, the market situation for new vehicles assembled from CKD-kits could weaken greatly.

8 CONCLUSIONS AND RECOMMENDATIONS

8.1 Conclusions

The development of the East African Community has not fulfilled all the hopes of the automotive companies wanting an easy access to large markets. But the interest towards East African Community has not been completely misguided, as the economic integration has brought many measures of trade facilitation within the community and thus making the business environment easier for multinational companies to operate in.

From the trade conditions the East African Community's Rules of Origin came out to be the main obstacle to the free intra-community trade for automotives. The Kenyan subcontracting industry is not developed enough to be able to provide enough advanced parts to achieve the local value addition to the vehicles assembled in Kenya. But it is also the fear of losing tariff revenues which makes the automotive trade issue within the East African Community to become so difficult to solve. This same fear can also be seen to be behind the numerous Non-Tariff Barriers which continue to trouble the automotive trade within the community.

This however is not enough big reason to decide not to use CKD market entry method to Kenya, as Kenya's large market size alone justifies the usage of CKD method, which grants 0% tariffs. As for the rest of the East African countries further research is needed on the best distribution method to these countries, but it is clear that CBU should be the method as the markets are too small to justify building of an assembly factory. The Single Customs Territory and the Tripartite Free Trade Area are now in making, but it can already be known that they are not going to bring changes to the trade conditions restricting the free trade of automotives. However the developments of the coming trade agreements still ought to be followed as they might changes to the current trade conditions. The situations where the CKD method should be changed to the CBU method in Kenya are highly unlikely, but to minimize the risks it is recommended to closely monitor the Kenyan government's plans and strategies towards the country's automotive assembly industry.

8.2 Recommendations for further research

As the case is that not only one market entry method is enough for the whole East African community, other options are also looked into next. The options are:

1. Sell the Kenyan CKD-assembled vehicles, even though duties must be paid.
2. Export directly to the buyer from the overseas factory.
3. Set up a bonded warehouse(s) in strategic location/locations from where to distribute the vehicles.

These three options must be carefully weighed as they all have their advantages and disadvantages. Advantages with the option one is that the products are close to the buyer and thus the lead times are short, but the added costs from the assembly and usage of local parts raise the price of the final product. But does it raise the price more than the warehousing costs in the option three, where the completely built-up units are imported from the factory directly? It is important to calculate also the costs and trouble of having a large amount of equity in the warehouse sitting and doing nothing. In the case of commercial vehicles, where the units are very valuable, these costs might become considerable. The second option would be easiest as it is very simple and does not require any investments, but the very long lead time might be a factor which drives away potential buyers to competitors who have the products ready for immediate delivery.

8.3 Future situation follow-up

As the situation is alive and can change when new trade agreements are done, the development of the planned Single Customs Territory within East African Community and the Tripartite Free Trade Area of EAC, COMESA and SADC must be followed. The topic to follow is especially how the Rules of Origin is defined within these trade arrangements, as if the requirements are lowered then the free trade could become possible for vehicles assembled in Kenya form CKD-kits.

Another important topic to follow is the development of the subcontracting capabilities for the automotive assembly industry in Kenya. The Kenyan government's support to the industry is vital for the development of the local subcontracting industry,

which needs to develop greatly in order that the local content rate could be achieved someday. Thus the actions taken by the Kenyan government to support the subcontracting industry must be followed.

A possible threat which must be followed is about how the Kenyan government plans to develop the automotive assembly industry. If the development is pursued through tighter local content requirements, as happened in India, then having an assembly factory in Kenya could become a very expensive investment.

The most current topic to follow is how the change in the tariff heading issue is going to be solved. As it is this issue that namely prohibits the free community-trade from happening currently for vehicles assembled in Kenya from CKD-kits.

9 FINAL WORDS

This thesis on the market conditions within the East African Community took me very deep into the laws, regulations and contracts which create the trade areas and determine their development. Researching and analyzing the trade agreements within the East African Community and their practical applications widened my understanding a great deal in topics such as market entry, trade conditions, economic development and international trade regulations. Looking backwards I can now see that I could have been more efficient by concentrating only in the relevant issues, but it is also because of those trips to the unknown that I learned to distinguish between relevant and irrelevant information. The most challenging part of the thesis was to pick up the most relevant information to answer the research questions. The research questions came out to be highly interconnected with each other, making the writing of the answers in a reader-friendly way also a big challenge. But I managed to do this by categorising the findings in a logical order while explaining the importance of each finding to the research questions.

The information and recommendations from this thesis could be used immediately in the case company. The thesis also provided future outlook with possible scenarios lists, thus preparing the case company for the future events. Finally recommendations were done on further research topics which are to be followed. Being able to do my part on the market entry process encouraged me to move forward in my career with confidence that I can do even large undertakings and succeed in them. I am also pleased to the fact that even though the thesis concentrates on automotive industry, the general trade conditions researched in this thesis still apply for other businesses as well, thus making this thesis valuable also for everyone interested in trade conditions within the East African Community.

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