TRANSFER TAX AND DEVELOPMENT BANK: A NEW LOOK FOR THE EAST AFRICAN COMMUNITY

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I. Introduction

The Treaty for East African Co-operation,[1] between Kenya, Uganda, and Tanzania, born out of negotiations at Kampala and based upon a commissioned report by Kjeld Phillips of Denmark, is an attempt to correct the serious weaknesses which were inherent in the East African Common Services Organization. The weaknesses of the Organization were already apparent by August of 1965 when President Nyerere was forced to inform the East African Central Legislative Assembly that Tanzania could no longer allow the unrestricted passage of Kenyan goods into Tanzania. Nyerere warned that "Tanzania found it imperative for its own development to place quotas on ₤ 2 million of goods imported from Kenya, and that additional restrictions were imminent."[2] Yet, by 1966 Tanzania had an unfavorable balance of trade within the common market of ₤ 11.8 million, and Uganda's unfavorable balance amounted to ₤ 6 million, while Kenya's favorable balance amounted to ₤ 17.8 million.[3] It was in this atmosphere of unfavorable trade balances that the East African Common Services Organization began experiencing a general breakdown:

> Existing interterritorial links were broken in such key fields as tourism, military coordination, and currency administration. A lack of unity was also evidenced in bilateral trade agreements with foreign countries, unilaterally imposed restrictions on interterritorial trade, and university planning.[4]

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[1] Kenya Acts, No. 31/67; Tanzania Acts, No. 42/67; Uganda Acts, No. 28/67.

[2] D. Rothchild, "East African Community; Experiment in Functional Integration," Afr. Rep., 13(1968), No. 4, pp. 42-46.

[3] Ibid.

[4] Ibid.

The disenchantment within EACSO arose because the common feeling of Tanzania and Uganda was that the much more highly industrialized state of Kenya monopolized the benefits of association at the expense of the other two. Actually, the trade figures only served to aggravate a predisposition against the Organization which the two less developed countries had formed from their previous experiences during the High Commission. The major problem with the High Commission as well as with the EACSO was the failure to aid the less developed countries or to compensate those which were deriving the least benefits from the association.

It was not totally unpredictable, and surely not unnatural, that Kenya would benefit most by a common market arrangement. W.S. Wionczek remarks as follows:

> There has long been agreement between East African elites, British civil servants in the East African Common Services Organization (EACSO), and various international experts and missions visiting the region on two major points: (a) that differences between the levels of development in the three former territories are not only substantial but also steadily increasing, and (b) that the distribution of gains from a common market arrangement would be heavily weighted in favour of the most developed member--Kenya.[5]

This must have been obvious to the economist, for even though integration brings about economies of scale and specialization, the less developed associates, by the very nature of the common external tariff agreements, are forced to buy products from the more highly industrialized partner at prices higher than they could get in the world market. Consequently, unless there were some built-in re-allocation mechanisms within the association framework, most of the economic benefits, immediate or otherwise, would accrue to the most developed member. Also, further industrialization, because of natural economic forces,

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[5] W.S. Wionczek, "Economic Integration and Regional Distribution of Industrial Activities: A Comparative Study (Part II: East Africa)," E. Afr. Econ. Rev., 3 (1967), No. 2 (December), pp. 31-43.

tends to concentrate on an accelerating basis in those regions where economy factors are most conducive to further growth, i.e., those areas which are already developed.

The main purpose, then, of the Treaty for East African Cooperation was to equalize among the partners the benefits which would accrue to each, and, especially, to equalize the extent of industrial development in the Partner States. Therefore, new elements were written into the Treaty for East African Cooperation which had not been included in the previous East African Common Services Organization Ordinance.[6] Here we will examine the Treaty for East African Co-operation and point out the two major areas where new approaches to the problem of unequal development have been written into the Treaty.

II. Treaty for East African Co-operation

Part I of the Treaty is a general introduction to the Treaty and is entitled "Principals." It establishes the membership of the Community, enumerates the institutions formed by the Treaty, sets out a general "good faith" clause as to implementation of the Treaty, and, most importantly, outlines the aims of the Community. Although the aims of the Community are many, they can be viewed simply as the means to an end; the end being the "balanced development" of the Partner States.

Most interestingly, Article 1 includes a statement that leads one to believe that the East African Community is meant to be more than a common market:

> By this treaty the Contracting Parties establish among themselves an East African Community and, as an integral part of such Community, an East African Common Market.

While it is true that the East African Community does seem to be more than an Economic Common Market in certain respects, it nevertheless falls short in vital areas of being even a true "common market." For instance, there

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[6] Kenya Cap. 4, Rev'd Laws of Kenya; Tanganyika, Ord. 52/61; Uganda, Ord. 22/61.

is no provision made for the free movement of the factors of production (most notably, the free movement of labor), and there is no indication of any sort of specific common agricultural policy (although a common agricultural policy is one of the enumerated aims). Perhaps the most egregious short-coming is the presence of an internal tariff thinly disguised as a "transfer tax"; yet, paradoxically, it is just this transfer tax which is relied upon most heavily to make the common market arrangement viable.

The aims of the Community are carefully couched in terms indicating the Treaty's overriding concern to protect the interests of the two less-developed partners, Tanzania and Uganda:

> It shall be the aim of the Community to strengthen and regulate the industrial, commercial and other relations of the Partner States to the end that there shall be accelerated, harmonious and balanced development and sustained expansion of economic activities the benefits whereof shall be equitably shared.[7] [emphasis added]

A. The Transfer Tax

The most important device incorporated in the Treaty in order to insure "balanced development" is, of course, the so-called "transfer tax." The transfer tax is explained under a heading entitled "Measures to Promote Balanced Industrial Development":

> As a measure to promote new industrial development in those Partner States which are less developed industrially[,] transfer taxes may, with the aim of promoting industrial balance between the Partner States, be imposed. . . .[8]

The transfer tax is really nothing less than an internal tariff, which is proscribed in Article 11. However, this

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[7] Treaty for East African Co-operation, Art 2, par. 1.

[8] Treaty, Art. 20, par. 1.

internal tariff is only allowed under very special circumstances and is limited in degree and length of applicability.

First of all, the transfer tax may only be levied on "manufactured goods," and then only by a Partner State which is in deficit with the other two Partner States in its total trade in manufactured goods.[9] The transfer taxes may only be imposed to a value which does not exceed "the amount of the deficit in trade in manufactured goods between the State which is imposing the transfer tax and the State of origin of the goods upon which the tax is to be imposed."[10] Also, a state may not tax goods unless "goods of a similar description are being manufactured or are reasonably expected to be manufactured in that state within three months. . . ."[11] However, the industry being protected by the tax must be able to produce a quantity of goods in the ensuing year equal to at least 15% of the domestic consumption of the past year, or enough goods to have an ex-factory value of at least 2,000,000 shillings.[12]

Once it is determined that a particular manufactured good meets the prerequisites (above) of a "taxable" good, it is necessary to determine the extent of that allowable tax. In no instance may the transfer tax exceed 50% of the rate prescribed by the customs tariff of the imposing state, and if there is no existing tariff, then of course there can be no transfer tax.[13] The transfer tax is imposed upon the value of the manufactured goods. "Value," of course, is the subject of extensive explanation and definition in the Treaty.[14]

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[9] Treaty, Art. 13, and Annex III. Apparently, no tariff agreement could be reached on the majority of agricultural products, for most agricultural products are subject to unrestricted internal tariffs.

[10] Treaty, Art. 20, par. 4.

[11] Ibid., par. 6.

[12] Ibid., par. 7.

[13] Ibid., par. 8.

[14] Ibid., pars. 11 and 12; and Annex V.

The authors of the Treaty realized the basic anomaly of the transfer tax in a common market system and therefore provided for its superannuation. No transfer tax can last longer than eight years and all transfer taxes, no matter how old, are automatically revoked on December 1, 1982.[15] Further provision is made for the possible alteration or elimination of the transfer tax before such date:

> Notwithstanding paragraphs 14 and 15 of this Article, the Partner States agree that, for the purpose of evaluating the effectiveness of the transfer tax system as an instrument for attaining the aims of the Community, and in particular its effectiveness as a measure to promote a more balanced industrial development, they will undertake joint consultations to review and reappraise the system five years after the first imposition of a transfer tax under this Treaty.[16]

Provision is also made for the possibility that the imposition of a transfer tax might "deviate" the trade pattern so as to shift trade away from a Partner State, and in such a case ". . . the Partner State which has imposed the transfer tax shall take measures to counteract such deviation. . . ."[17] What those "measures" are is never stated, but the emphasis is, as always, upon cooperation. Similar cooperative action is suggested under those circumstances where manufactured goods are transferred from one Partner State to another at prices lower than cost, thus prejudicing the production of those goods in the other State. In such instances, "Each Partner State shall take effective action. . . ."[18] Certain other situations bring somewhat more definite responses, such as that situation where at least 30% of the total ex-factory value of sales of a good protected by a transfer tax is sold for export to a Partner State or foreign country in which event the former may petition for revocation of any tax.[19] When other protected goods are sold in large quantities to Partner States (without regard to foreign countries) in any 12 month period, ". . . the transfer tax shall be revoked."[20]

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[15] _Ibid._, pars. 14 and 15.

[16] _Ibid._, par. 16.

[17] _Ibid._, par. 17.

[18] _Ibid._, par. 23.

[19] _Ibid._, par. 20.

[20] _Ibid._, par. 19.

The final limitation on the transfer tax denies a Partner State the right to impose any new transfer tax or to reinstate any suspended transfer tax once that Partner's sales of manufactured goods equals at least 80% of her purchases of manufactured goods from other Partner States in any one year period beginning January 1.[21]

B. East African Development Bank

A second Treaty innovation of major importance which falls under the same heading, "Measures to Promote Balanced Development," is the East African Development Bank. The complete charter is set out in Annex VI of the Treaty. Chapter I, Objectives and Membership, seems to capture the importance of the Bank's stature as an institution of major significance in the East African Community. The chapter begins as follows:

> The objectives of the Bank shall be--(a) to provide financial and technical assistance to promote the industrial development of the Partner States;

and then continues with the real spirit behind the Treaty:

> (b) to give priority . . . to industrial development in the relatively less developed Partner States, thereby endeavoring to reduce the substantial industrial imbalances between them. . . .

The way in which the Bank intends to accomplish the reduction of the "substantial industrial imbalances" between the Partner States can best be seen in the weighted-loan policy:

> . . . the Bank shall ensure that, taken over consecutive periods of five years, . . . it shall so conduct its operations that it shall have loaned, guaranteed or otherwise invested, as nearly as is possible, in the United Republic of Tanzania 38.75 per cent of the total sum which it has loaned, guaranteed, or otherwise invested of its ordinary capital resources and the Special Funds, in the Sovereign State of Uganda

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[21] *Ibid.*, par. 21.

> 38.75 per cent thereof and in the Republic of Kenya 22.50 per cent thereof.[22]

The rate is subject to review after ten years and can be changed only by the agreement of the three Presidents of the Partner States. The capital in the Bank is subscribed to by the Partner States on an equal basis, but provision is made for the "subscriptions of members, other than original members"; in no case, however, shall those subscriptions surpass 49% of the total subscribed capital stock.[23] All of the powers of the Bank are vested in a Board of Directors consisting of at least three and no more than five members. Each Partner State is entitled to appoint one member of the Board and "up to two shall be elected by the [subscribers] other than the Partner States."[24] "The voting power of each member of the Bank shall be equal to the number of shares of the capital stock of the Bank held by that member."[25]

It is left to the Board of Directors to make all financial regulations consistent with the Charter, but each State is vested with the power of the veto over any proposed investment within that State.[26] The Bank is strictly proscribed from engaging in any political activity and to this end, "Only economic considerations shall be relevant to [the Bank's] decisions. . . ."[27] However, besides "economic considerations," the Bank and its Directors are always expected to place paramount importance upon the stated objectives of the Bank, which means that they must never lose sight of the fact that they must ". . . give priority . . . to industrial development in the relatively less industrially developed Partner States. . . ."[28]

III. Conclusion

The Bank is probably a better example of the accomplishments of the Treaty than is the transfer tax in that the

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[22] _Treaty_, Annex VI, Art. B, par. (c).

[23] _Ibid._, Art. 4, par. 4.

[24] _Ibid._, Art. 27, par. 2.

[25] _Ibid._, Art. 29, par. 1

[26] _Ibid._, Art. B, par. (g).

[27] _Ibid._, Art. 14.

[28] _Ibid._, Art. 1, par. 1(b).

Bank is at least an example of a positive effort to spur development in all the Partner States, whereas the transfer tax can be viewed as a measure whose ultimate effect will be to hold Kenya back while Tanzania and Uganda "catch up."

Whereas the built-in equalization mechanism of the transfer tax is the effective authorization for Uganda and Tanzania to place restrictive tariffs on certain Kenyan manufactured goods in order to protect Ugandan and Tanzanian "infant industries" (certainly a negative concept within the free trade/common market framework), the Bank accomplishes the same "equalization of development" concept by the implementation of a weighted-loan policy. The weighted-loan policy is certainly not dynamic, but at least it is more compatible with the Partner States' avowed intention to ". . . abolish certain quantitative restrictions which at present affect trade between them and [to pursue] a policy towards the most favourable development of the freest possible international trade."[29]

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[29] Treaty, Preamble.

APPENDIX

Legislation passed by East African Community subsequent to Treaty passage.

Major Legislation:

Appropriation (1968/69) Act [No. 1/68].
Appropriation (1st December, 1967 to 30th June, 1968) Act [No. 2/68].
Laws of the Community (Revision) Act [No. 3/68].
Official Secrets Act [No. 4/68].
Acts of the Community (Miscellaneous Amendments) Act [No. 5/68].
Supplementary Appropriation (No. 2) Act [No. 6/68].
Supplementary Appropriation Act [No. 7/68].

Subordinate Legislation:

East African Air Navigation Regulations [L.N. 46/65]. L.N. 7, 13, 23, 24, 28, 32 and 33/68; L.N. 2, 4, 7, 9 and 18/69.
East African Civil Aviation Act [No. 22/64]. L.N. 20/68 and L.N. 1/69.

East African Customs and Excise Revenue Allocation Act [Cap. 8]. L.N. 27/68.
East African Customs and Transfer Tax Management Act [No. 12/52]. L.N. 1, 6, 26, 29 and 31/68; L.N. 3, 11, 13 and 17/69.
East African Harbours Corporation Act [L.N. 6/67]. L.N. 15 and 19/69.
East African Income Tax (Management) Act [No. 10/58]. L.N. 4, 8, 14, 15, 22 and 30/68; L.N. 10 and 12/69.
East African Merchant Shipping Act [No. 4/66]. L.N. 12/68.
East Africans Pensions Act [Cap. 9]. L.N. 16/68.
East Africans Railways Corporation Act [L.N. 3/67]. L.N. 16/69.