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Regional Integration in East Africa: Opportunities and Challenges for Small Business Enterprises in Kenya

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Within the global economic environment, regional integration provides the most favored avenue to foster economic cooperation among states. The European Union (EU) is one of the most successful regional integration platforms and provides valid evidence of the benefits that member states can accrue from such organizations. The East African Community (EAC) is a regional organization that has over time initiated the processes geared towards increasing economic integration to encourage free mobility of labor, goods and services. Whereas regional integration has its benefit, so are the challenges associated with free mobility of goods and services within member states. Small and Medium Business Enterprises (SMEs) offer an opportunity for thousands in terms of employment. Part of the reason for growth and survival of these enterprises is their ability to explore opportunities that large scale investors don not consider as providing an avenue for profit maximization. These enterprises at the same time offer unique services depending on the demand of the area where they are located. This paper seeks to explore the opportunities and challenges associated with the EAC to SMEs in Kenya. What opportunities exist for small business enterprises within the regional integration platform? What are the challenges to accessing wider market opportunities in the East African Community? How can the government of Kenya support SMEs to exploit opportunities in EAC under the common market protocol? The paper is organized into four sections, part one of the paper offers a conceptual understanding of regional integration, part two covers a background on regional integration in East Africa, part three provides an interrogation of opportunities and challenges in regional integration for SMEs in Kenya while part four is the conclusion of the paper.

Key Words: *Integration, Small Business Enterprises, Common Market*

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Introduction

Regional integration gained momentum after the WWII. Within the political prism, it is a process of "building peace in parts" (Nye, 1971). This belief is premised on the fact that countries that are collectively pooling their resources and interests will develop conflict resolution strategies to contain violent conflicts. The formation of the European Economic Community (EEC) in 1958 was perceived as a post-war attempt for peace in Western Europe (Haas, 1958).No wonder regional integration arrangements that initially focus on economic issues evolve aspects of peace building and conflict mediation. This could be seen in the case of Economic Community of West African States (ECOWAS), evolving ECOMOG. This is further supported by Karl Deustch's assertion that integrated region is a form of "Security Community" (l 971). Regional stability is critical in attracting investments and a conducive environment is fundamental for economic activities.

Two theories have been popular in explaining regional integration. The federalist theory and the functionalist theory. Federalism supports "frontal attack on state sovereignty", demanding that states cede aspects of their sovereignties to a regional unit. It anticipates the establishment of a higher supranational authority to which partner states relinquish part of their sovereignty (Haas, 1958, Nye, 1965).Functionalism theory stresses a gradual process of integration, which finally culminates into a political union. This process begins through "functionalist unity", that is the economic, the social, technical and cultural units of cooperation. Unit cooperation forms a basis of integration and finally leads to political cooperation. It sets about five stages; free trade area, customs union, common market, monetary union and the political union. Functionalists believe, this is the most appropriate format to take because states will resist attempts towards sudden integration as required by federalism (Mazzeo, 1980). The above debate continues to feature albeit in muted form as to whether the EAC countries are ready for federation. Many points out that leadership of the EAC states fear losing power and authority to a regional government. Also this regional outfit poses to them the danger of a weakened sovereign in pursuit of national interests.

The key intention of regional integration is to free factors of movements, trade and accelerate growth to higher output levels of the partner states. This belief is based on custom unions, common markets as postulated by Viner's static analysis of the welfare effects of customs unions (Viner, 1950). Viner introduces the concepts of trade creation and trade diversion, where trade creation is explained as a shift in trade from a high cost to a low cost producer; and trade diversion as a shift in the opposite direction. Viner's concept has remained quite an important framework on the effects of integration on production both outside and inside an integrated area.

The above argument echoes economic theory that posits that greater trade (including investment) integration will improve welfare by enabling citizens to procure goods and services from the cheapest source, leading to the reallocation of resources based on comparative advantage, which brings efficiency and productivity. In the case of small and medium business enterprises in Kenya, this translates to wider market opportunities for their goods and services. With the frequent conflicts, wars, massive abject poverty, unemployment and Debt crisis due to natural disasters, governance crisis, the wave of globalization and the HIV/AIDS pandemic, regional integration in Africa can no longer be taken for granted or casually in mere political expression. It is critical if peace, economic development, higher production, trade and self-sufficiency are to be achieved.

An important effect of integration process is enlargement of markets. The rationale is that larger markets are preferable to smaller ones from the basis of factor efficiency. The pooling of several sub-optimal markets could easily open up investment opportunities whose previous cost was prohibitive before the integration effort i.e., the combined market will expand and exceeds the size needed for reasonably economical investment projects. It is also noted that the idea of specialization becomes a crucial aspect of integration. This could be achieved in three ways; first, the partner states could specialize respectively in manufacturing, agriculture etc. Secondly, there could be inter-industry specialization in manufacturing, mining sector.

This is where questions of comparative advantage a rises with beneficial gains to the partner states. And finally where components of manufacturing and different stages are carried out in separate plants in other words, vertical and horizontal specialization. The principle of comparative advantage as it is designed in classical trade theory assumes that specific countries will specialize in the production of those goods, in which they enjoy superiority (Scitovsky, 1958). Specialization would require agreed regional investment policy and perhaps a policy on compensation, which would propel considerations of factor efficiency.

With the market liberal economic systems taking unprecedented global dominance, the state has found itself confronted by the reality that it has cede aspects of its sovereignty and embrace alliances. These alliances enable countries to pool together and face the challenges of the market economy. The depth of interdependence in the new global economy means that the welfare of all countries is now more closely linked than ever before. Prosperity in any one country is increasingly dependent on prosperity elsewhere. The global economic system has promoted integration through a number of ways; first, the growth of global financial market has transcended boundaries with capital movements becoming the engines and driving force of the world economy. Backed by deregulation and liberalization policy of western countries, international capital has increased both its mobility as well as turnover. The internationalization of capital has made it so difficult to regulate and control within state borders(Schiff and Winters, 2005).Secondly, the end of the Cold War has consequently widened the global market and deepened economic linkages. Most countries have become part of some integrated market arrangement. The contemporary global economy is no longer characterized by ideological supremacy but competition for market and scarce resources.

Third, the growth of corporate activities has expanded into many countries. As a cost cutting strategy in production and maximization of profits, as well as acquiring an edge over other market competitors, multinational corporations are moving beyond their national boundaries and investing in other countries. Fourth, the revolution made in information, communication and transportation technology, which has tremendously reduced telecommunications as well as transportation, costs, thereby diminishing the distance problem in economic activity. The dramatic reduction in telecommunication and transportation costs have in turn, permitted closer integration between markets, consumers, producers and suppliers. Finally, the internationalization of environment problems has necessitated collective action by countries. Global environmental and cross border problems require regional and global solutions, making international cooperation and policy coordination not only important but necessary. Given the internationalization of the world rnarket, globalization is also equally creating an environment of fierce competition in which only powerful and efficient economic entities tend to survive. Therefore nation states resort to regional integration as a response to remain competitive and insulate their economies from global challenges (Cook and Kirkpatrick, 1997).

Regional integration is a package rather than a single policy, whether concerned with economics or foreign policy. The concept goes beyond notions of free trade areas and market cooperation i.e., the integration of a series of national markets into one functional economic unit (Hettne and Inotai 1994). Political ambitions of creating territorial identity, political convergence, collective security and regional coherence seem to be as critical. In actual sense therefore regional integration is a holistic process that goes beyond a single issue but instead attempts to converge different issue areas of common interests to states within a given platform. It is believed that regional integration will help to accelerate growth and development through integration of human, technical and physical resources of mostly small economies to create larger, more competitive and more successful economic space. This is done in order to promote free movement of goods, services and factors of production and to coordinate and harmonize policies. It might involve convergence of trade, fiscal and monetary policies as a prelude to integration.

Regional Integration in East Africa

Regional integration is a process in which independent entities come together and surrender their obligations, loyalties and expectations to a larger unit which ultimately carries on with the duties previously performed by the independent units. Others view it as a process in which partner states agree collectively to offer preferential trade arrangements within themselves by removing tariffs and non-tariff barriers to trade (Nyon'go, 1990). Regional integration can also be defined as an association of states that share a common geographical region to safeguard their economic and trade. This implies putting the various economic groups together for the sake of economic development as region (Mutharika, 1972). The case for regional integration in Africa is first underpinned on the idea of African unity and the benefit expected in regional integration by member states. In fact in the period after independence, African leaders such as Kwameh Nkrumah emphasized the need for Africa to unite as one confederate state. However such dreams and aspirations were never to be (Tordoff, 2002). Instead the politics of ideology and boundaries issues took center place. This however did not deter integration especially art regional level.

Bela Belassa (1961) contends that economic integration as the abolition of discrimination between economic units belonging to national states. Lowering of barriers to trade and investment is a condition for this to succeed. Belassa identifies the various categories of the integration process according to the kind of discrimination; These include a Free Trade Area- This is characterized by the removal of quantitative restrictions and custom tariffs, Custom Union, this is where there is unification of tariff of the countries within the region against outsiders, Common Market, this is where all restrictions on factor movements within the region are abolished, Economic Union, this is where economic, monetary, fiscal and social and counter-cyclical policies are to some extent harmonized and a Supranational Union, this is where the respective governments abandon completely their sovereignty over the policies listed above and a supranational authority issues binding decisions (Belassa, 1961).

Economic cooperation in East Africa has a relatively long history. Prior to independence, there were a sizeable number of commonly operated services within these countries. For example; Post and Telecommunications, railways and harbors, airways, university, customs and excise, and income tax departments, research and technical services, which was initially known as the East African Common Services Organization (Baregu,2005).Currently the EAC is a regional inter-governmental organization of Kenya, Uganda, Tanzania, Rwanda and Burundi. The first EAC was formed in 1967 comprising of Kenya Uganda and Tanzania. However it collapsed in 1977 following ideological and personal differences between the three heads of state and sharing of benefits between the three East African states. Twenty years after the collapse of the first EAC a new EAC was launched in 1999 in Arusha Tanzania with the signing of the Treaty for the establishment of the East African Community by the East African heads of state(Ajulu, 2005). The launch was preceded by years of protracted negotiations starting with the meeting of the three heads of states, Daniel Arap Moi of Kenya, Yoweri Museveni of Uganda and Benjamin Mkapa of Tanzania in 1991.Currently the EAC has evolved into regional intergovernmental organization comprising the Republics of Burundi, Kenya, Uganda, Tanzania and Rwanda.

The EAC strategy gives emphasis to economic co-operation and development with a strong focus on social dimension. The co-operation and integration as identified by the EAC incorporates:

• Trade, investment and industrial development

• Monetary and fiscal affairs

• Infrastructure and services

• Human resources, science and technology Agriculture and food security

• Environment and natural resources management

• Tourism and wildlife management

• Health, social and cultural activities and

• Cooperation in political matters, including defense, security, foreign affairs, legal and judicial affairs.

The broad goals of the EAC are set forth as; first, the integration of the regional partners in order to improve the standard of living of the population. The establishment of a conducive and stable environment for increased production, trade and investments is imperative for sustained development in the region. The EAC partner states are in agreement that the realization of rapid economic development will depend on their cooperative efforts more than anything else. Therein also include the advantages of economies of scale, widening of markets and enhanced production. Secondly, the treaty establishing the EAC makes provisions for collective efforts on broad areas as; political, economic, social and cultural programmes. This is to be attained progressively through the stages of a customs union; a common market; a monetary union; and finally a political federation (Ajulu, 2005). In summary the key target in integration include; maximization of economies of scale, maximization of comparative advantage, rationalization of the use of resources on a regional basis thereby eliminating waste and duplication, reduction of dependence on other regions among other benefits (Mitrany, 1966).The renewed interest in regionalism is occasioned by the consequence of, and a response to, evolving trends in the international political and economic order .This is further reinforced by the transformation of the contemporary global system in which countries collectively work together for the common good of their regions.

Baregu (2005) outlines a persuasive argument that propels integration. In what he calls imperatives, he defines these as the kinds of factors that create the impetus and lead to the drive and desire for integration among members. They include gain imperative, that countries will accrue benefits through regional integration, dominance imperative to assert regional power and threat imperative to insulate themselves collectively from risks. The case of EAC is no exception to the above argument. Despite skepticism, mistrust and suspicion among the partner states, one cannot help notice a resolve to integrate. First as a strategy for survival in the globalized economic system; the EAC countries have a compelling reason to integrate than collapse individually in the face of stiff competition (Nyin'guro 2005).The gains associated with integration thus outweigh the losses.

Kenya, Uganda, Tanzania. Rwanda and Burundi ought to collectively insulate themselves against globalization. This is necessary to forestall political and economic marginalization (World Bank, 2000). Briggid (1992) reinforced the idea that small economies would find it difficult to compete with large economies and cooperation would enhance their bargaining power. Secondly, as Yan'g and Gupta (2005), observe that landlocked countries of Uganda, Rwanda and Burundi would enjoy coastal access in exporting and importing of their products. Kenya equally would have an opportunity for large regional markets with its membership in the EAC. Most important is access to markets by entrepreneurs from the member countries

EAC and Small and Medium Business Enterprises in Kenya

Whereas there is no clear definition of Small Business Enterprises, they are instead identified by their characteristic and nature. They are business enterprises managed by the owner and can employ between 10-49 people. They are more concerned about short term needs, medium term survival as opposed to long term profitability or market share (AFRICOG, 2012).The Kenya Association of Manufacturers define SMEs as business enterprises that are small unit in size, in most cases family owned, specializing in a given business activity and rely on low cost input in their operation.

According to the Capital Markets Authority SMEs consist of firms varying widely in size and characteristics namely from very small start-up firms in an infant stage of development to established SMEs already listed on the stock market (CMA, 2010).Small business enterprises contribute highly to employment in Kenya. According to Kenya's economic survey of 2011, 80% of all jobs created in 2010 were from small and middle enterprises (Business Daily, 2011).The SMEs are therefore critical in providing employment in Kenya and as such should be a key factor in policy making in Kenya. In the sessional paper number 2 of 2005 an SME is defined as an enterprise with between 1-50 employees while the World bank defines SME as a formally registered business with an annual turnover of between Ksh 8million-Ksh100million,an asset base of at least Kenya Shillings 4 million and employing between 5 to 150 employees. Kenya's vision 2030 stresses the role of SMEs in economic development as Kenya seeks to be an economically empowered country that offers a high quality life to her citizens.

In a country where unemployment rate is considerably high especially within the formal sectors both private and government SMEs provide the alternative source of employment while at the same time providing essential services to many who otherwise cannot afford to access mainstream providers. As such attempts must be made to protect them or provide an enabling environment for them to thrive. The East African region is the single most important export destination For Kenyan exports. Export opportunities for Kenyan SMEs exist in both the service sector and value added products. The East African Common Market protocol which entered into force in 2010 allows for free movement of goods labor and capital among member countries. Article 24(1) specifically reiterates that partner stares are expected to undertake the removal of restrictions related to current payments connected to movement of goods and services between the member states. This provides a great opportunity for SMEs that have for a long time been unable to access markets due to (EAC, 2015) trade restrictions to venture abroad. The advantage to this is that it eliminates barriers and national laws, high taxes, bureaucracies that hinder access to wider markets. Theoretically it is a great platform for business activities after all accessing wider markets in itself increases the volume of sales and maximize profits for SMEs. The EAC common market protocol also allows for businesses setting up in the region to be treated in the same way as domestic firms. This further extends to service providers from one country to another without any restrictions.

It is a fact that regional integration can provide sufficient market opportunities for SMEs due to expanded markets. Having taken steps to in integrating markets within the EAC member countries have put in place the necessary infrastructure to combine market consisting of over 140 million people. This in itself is a good thing for SME success (WEDF, 2014).Given opportunity for wider market opportunities especially for border towns,it would be a great oadvantage for SMEs. In his study of the implication of regional intergration specifically EAC on SMEs in Kisumu, Muriuki (2014) contends that the benefits accrued include wider markets and availability of more stocks but the downside being stiffer competition from competitors from the regional partners.This reinforces the idea of gains accrrued from integration especially in regards to market opportunities.

The counter argument to this free mobility of goods and services is the nature of these businesses and whether they can afford to exploit markets fuurther outside their traditional territories.High transport costs due to poor road networks for instance greatly hinder access to markets in some parts of the region. This is further complicated by the inability of SMEs due to their limited capital output to take advantage of market opportunities that require large volumes of production, regular supply and transportation of huge or large quantity of goods. There is also lack of information of available market opportunities to SMEs. This is largely due to the fact that integration to some level has remained as an elitist concept. Perhaps EAC should consider a combined effort at infrastructural development to reduce cost, support SMEs in accessing regional markets by participating in regional trade fair (Earnst and Young, 2009).It is admirable that one of the proposals under the common market platform is to establish cordinated efforts geared towards coordinated and harmonised transport policies to provide competitive transport network for the member states.

As of 2012 Kenyan exports were dominated by agricultural commodity exports, with tea, horticulture and coffee being the leading commodity exports. Uganda remains the leading export destination followed by Tanzania, UK, Netherlands and the US, in that order. In 2012, the fact that Uganda and Tanzania are the leading export destinations for Kenyan goods highlights the importance of regional integration to Kenya. In 2013 the East African region continued to be an important export destination for Kenya (Kenya National Bureau of standards, 2014).Overall, Kenya’s volume of trade in the region has grown tremendously from Ksh 102.7 billion (US$ 1.2 billion) in 2009 to Ksh 164.6 billion (US$ 1.94 billion) in 2012, an increase of 60.3 per cent (Kenya National Bureau of Statistics, 2013).Of these exports, Uganda took 50 per cent, followed by Tanzania (34%), Rwanda (12%) and Burundi (4%) (Figure 9.8). During the same period, Kenya’s imports from the region increased by 14.7 per cent from Ksh 26.9 billion (US$ 316 million) to Ksh 30.9 billion (US$ 363 million) between 2011 and 2012 (Kenya National Bureau of Statistics, 2013). Kenya’s products to the regional markets include beverages, food and live animals, tobacco, metal containers, beer, paper and paper products, iron and steel products, chemicals, pharmaceuticals, and cement. However the export business portend certain challenges to SMEs .For instance the unpredictable foreign exchange rates and age-old perceptions that the export business is too risky to be financed by commercial banks are preventing local manufacturers and small medium enterprises from venturing into international markets. Enterprises operating informally experience challenges that hinder their growth, as they have limited access to financial services, infrastructure, inter-firm linkages and the market opportunities.Information on Kenya's SME exports to the EAC is quite limited if not sufficiently covered.This may be due to the fact that the SMEs have not exploited the EAC market region regardless to the opportunities available due to a host of challenges.

Conclusion

The objective of the paper was to interrogate the opportunities available for Small and Medium Business enterprises in Kenya within the EAC and strategies that the Kenyan government can employ to support them to access these markets.The paper concludes that regional intergration provides great opportunity for SMEs in Kenya in as far as accessing the regional market is concerned.A combined market access of Uganda, Tanzania,Rwanda and Burundi offers an impeccable opportunity for movemnet of goods and services without restrictions and higher taxes.The nature of Kenyas economy is characterised by an ever expanding SME sector.The adoption of the Common Market for East Africa offers an enabling environment for inter state trade.

However lack of access to information about markets, the limited ability of SMEs to invest in large scale production, coupled with infrastructural challenges is a major impediment to access to the wider markets within the EAC.As such it is possible that the common market protocol may ultimately not benefit SMEs in the long run. Regardless of the wide availability of market opportunities within the EAC it is unlikely that SMEs will benefit from this arrangement unless the government provides support for them to access wider markets. The paper suggests that the government should offer support to SMEs in as far as getting information on markets is concerned, coordinate with banks to offer financial support for expansion in order to be able to be export oriented and continuously provide support both in terms of subsidies and tax incentives to export oriented SMEs. The government should also consider setting up a department that facilitates export advice and information for SMEs that want to export their goods and services. In fact it is in the best interest of the government given the employment potential of SMEs to formulate a trade policy that is oriented towards supporting SMEs to expand through exports to the EAC region. Otherwise the benefits of integration may ultimately be missed by SMEs in Kenya.

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