International Economic Law Clinic

THE EFFECTS OF BREXIT ON ACP-EU EPA.

Assessment of the trade relationship between the UK, EU and African Countries.

December 2019, Nairobi

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Cite this paper as: Lilian Wachira, Rodrick Koome, Joseph Mariga and Stella Mutua, "The Effect of ACP-EU EPA", TradeLab Clinic, 2019

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LIST OF ABBREVIATIONS

ACP- African, Caribbean & Pacific Asia

AfCFTA- African Continental Free Trade Area

CA- Cotonou Agreement

CAP-Common Agricultural Policy

CET-Common External Tariff

CGE-Computable General Equilibrium

COMESA- Common Markets for Eastern and Southern Africa

EAC- East African Community

EDF-European Development Fund

EPA- Economic Partnership Agreement

EEC- European Economic Community

EU- European Union

FTA- Free Trade Area

GTAP- Global Trade Analysis Project

GSP- Generalized System of Preferences

MFN-Most Favored Nation

SADC- Southern African for Development Community

SDG-Sustainable Development Goals

UK- United Kingdom

WTO- World Trade Organization

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EXECUTIVE SUMMARY

This paper conducts an analysis of the trade relations that have been in existence between the UK, EU and ACP states. It provides a brief background on the interdependence of UK and EU, in trade by looking at the value of exports and imports exchanged between them and in terms of financial contribution to be channeled into different economic sectors and courses. One of these courses includes financial aid to ACP countries. The paper provides a summary of how these ACP countries have been negotiating EPAs with the aim of boosting trade between the EU and themselves and also ensuring sustainability in this endeavor. However, with the UK leaving the EU, several uncertainties are identified and bring up the question whether the objective of sustainable development in these countries through trade can still be obtained by ratifying EPAs with the EU regardless. Specifically, the paper analysis the value of goods traded by the EAC bloc, Kenya as the largest member of EAC in terms of contribution to EAC GDP and a member of commonwealth countries. The paper observes and recommends that as much as the EU is a vital trading partner to the EAC bloc and Kenya, the terms of EPAs should be well negotiated especially in favor of the latter who have been experiencing constant trade deficits from the relation. It also encourages bilateral agreements between EU states, UK and African states for optimal trade gains rather than unidirectional trade benefits. Moreover, it forms a sound basis to advocate for AfCFTA which aims at progressively lowering the high tariffs that African producers who export goods to Africa face, in order to encourage intra-Africa trade.

1. Introduction

Since the United Kingdom (UK) held the referendum to leave the European Union (EU) in 2016, now popularly termed as "Brexit", two main possibilities come into consideration: UK being both out of the EU customs union and single market with no trade agreements with EU27 or the UK leaves the single EU market but retain membership in the EU customs union. Both possibilities have an impact on Africa, Caribbean and Pacific Asia (ACP) countries that trade with the EU through the Cotonou Agreement (CA) of 2000. From the CA, Economic Partnership Agreements (EPA) arose that are based on an asymmetric but reciprocal free trade area (FTA).

The main aim of EPAs between EU and ACP member states and regional blocks (enhances efficiency through increased competition and creates new opportunities for exploiting economies of scale) is to promote sustainable development and poverty reduction through trade: regional integration and economic governance, political dialogue and development cooperation in order to achieve industrial development in ACPs countries. The EU's four freedom synergies entail free movement of goods and services, capital and people. All these are expected to work together to enable member states to gain maximum benefit from engaging with one another. Essentially, EU-ACP partnership shall help achieve the 2030 Sustainable Development Goal (SDGs) of Partnership for Goals that has trade among the integration pillars.

Future trade relations between UK, EU 27 and ACP countries remain uncertain due to Brexit. The UK and the EU have coexisted in trade relations since UK joined the union in 1973 which was formally the European Economic Community (ECC). UK has been the third largest contributor to EU with Germany and France being the first and second respectively. Some of the contribution has been towards aid (which many ACP countries benefit from), education, health, pension, defense and EU intelligent services. In terms of trade in goods and services, 45 percent of UK's exports, valued at 291 billion pounds, were channeled to the EU whereas 53 percent of UK imports valued at 357 billion pounds came from the EU as at 2018. The total deficit in the value of goods and services faced by UK in that year was 66 billion pounds. The above statistics formed part of the push for Brexit as the UK felt that the EU needed it more as a destination for its goods and as a source of finances. Moreover, Britain enjoyed a trade surplus valued at 29 billion pounds with non-EU countries sparking the Brexit discussions and the uncertainties surrounding it.

Specifically, there is speculation as to whether privileged treatment for Caribbean and Pacific states will continue. This is because the Caribbean and Pacific interactions with the UK are relatively more intense than with the EU27 majorly because it was the UK that called for their association when it joined the EEC in 1973 due to the existing colonial ties. However, since the Caribbean Region signed full EPA unlimited by time in 2008, there should be a shift from only trade to migration as well. The EPA will continue to cover the trade between the Caribbean ACP states and the EU27.

Currently, the Caribbean is negotiating a text for the UK. Once it quits the single market, the UK will have to implement the EU's common commercial policy making it to create her own trade policies. For the Pacific ACP member states, there's provisional implementation of the interim EPA by Papua New Guinea (PNG) and Fiji with limited traded goods and having an inclination to the import of sugar by the UK to the EU. This puts the Pacific ACP member states at a position of uncertainty due to Brexit majorly with the EU-27. This is because it is the UK that called for their association after it joined the EEC due to their strong colonial ties and high trade volumes with them, i.e. an estimated overall 40 percent. This will not only affect trade but also migration synergy, a factor considered by the EU among the four freedoms in its development agenda since there has been influx of people into the region so as to obtain maximum gain by engaging openly with each other.

The biggest concerns thus lie with developing countries especially those in Africa on the loss of preferential access to the UK market. This could lead to reduced trade and risk aversion due to the volatility in the financial markets which could translate to reduction of exports demand and supply chain value. Essentially, countries considered as developing, for instance Kenya in the East African Community (EAC), will revert to trading under higher Generalized System of Preference (GSP) owing to the fact that only Kenya has ratified while Rwanda has signed the EPA in EAC. Reduction in exports will be felt for instance in Kenya, which exports among other things fresh cut roses that amounted to 17 percent of the total exports in 2019 to the UK. With the UK aiming to get out of the single market, Kenya's flowers will be subjected to Most Favored Nations (MFN) duties at a rate of 5.94 percent.

Moreover, it is not certain that the UK will make its negotiations with the poorest and less advanced developing countries a priority. All these will depend on UK's trade policy and the Brexit could significantly impact their economic development through its impact on their trade relations. For instance, through the adoption of duty free quota free (DFQF) market access for Least Developing Countries (LDCs) or favorable rules of origin.

ACP regional groups are a combination of developing countries and LDCs; most of which are highly dependent on trade relationships with the EU. Countries where tariff revenues constitute a significant amount of government budgetary resources may engender sizeable losses in tariff revenue due to the decline in trade. In order to counter the tariff revenue losses during the transitional period (leaving the EU), the UK may decide to either maintain the same type of preferences that developing countries have with the EU through the EPA or ask for World Trade Organization (WTO) waiver and extend the preferential trade regime that the EU is providing to developing countries.

This will give time to negotiate and adjust a form of free trade agreement between the UK and the EPA countries that extend beyond trade in goods to include collaboration on services, and in research innovation and technology. On the other hand, the sudden increase in the level of protectionism by the UK then negotiate years later will lead to instability arising from market segmentation. Since the UK and the EU will be different market segments, the flow of goods from developing countries in the region might be affected.

As soon as the UK leaves the EU it will have no legal basis to discriminate in favor of goods from the ACP countries, unless there is a new separate trade agreement. It may be possible for the UK to quickly introduce preferences in favor of developing countries under the UN's Generalized System of Preferences (GSP). It will take time before the UK can negotiate a new trade deal with some developing countries that have not done so. Without such a trade deal, ACP exports would face new trade barriers in the UK. This will not be the case for exports to EU27 for ACP member states that have either full or interim EPA agreements with EU27. A possible remedy is for the UK to simply carry over the EU EPA.

The future of the EPA needs to be thought of not only in relation to the degree of economic integration it implies between EU27 and ACPs, but also on its stability especially for Africa's own dynamics in relation to Africa Continental Free Trade Area

(AfCFTA) that aims at creating a Continental Free Trade Area (CFTA). The AfCFTA aims at progressively eliminating tariffs on intra-African trade involving all the 55 members of the African Union and this will make it the largest free trade area in the world, in terms of the number of participating states, since the World Trade Organization was formed. EPAs are negotiated to be asymmetrical trade agreements covering not only trade in goods and services but also 'behind the border' issues, such as competition, government procurement, intellectual property and trade facilitation.

Apart from the trade effects of Brexit, there will be changes in the overall political relations between the EU and developing countries, especially those with strong historical links to the UK (Commonwealth countries). Brexit may, therefore, affect the relations between the EU27 and the ACP group. With the UK no longer in the EU, the motivation on both sides for continuing a deep association between the EU and the Caribbean and Pacific countries may diminish. Both the Caribbean and Pacific states have only limited trade and other relations such as aid donations with the EU27, especially given that the UK was the second largest aid donor in Europe in 2018.

The progressive tariff elimination, which will go lower than the current 6.1 percent average that makes it expensive to export within Africa than outside, will enable the African businesses to trade, benefit and cater for the growing African market (Economic commission for Africa, 2018). However, the effect of Brexit for the African countries is uncertain but some studies have been undertaken to predict the dynamics emanating from the trade patterns.

2. Empirical Literature

Longo & Sekkat (2004) conducted a cross country investigation on the economic obstacles of expanding Intra-African trade using gravity model vis-à-vis trade with the

EU, United States of America (USA) and Japan. The study found out that infrastructure, mismanagement of economic resources and political tensions are variables that have negative impact and are specific to intra-African trade. With proper integration of both physical and social infrastructure, AfCFTA will have a smooth take off.

Lionel, David, & Cristina (2010) conducted an impact study using the Partial Equilibrium (PE) Model in order to find the trade creation and diversion effects of sensitive products on EPAs in six existing ACP regions from the demand side of the economy. The study found out that if ACP trade under EPAs, the exports will be 10 percent higher. However, due to the free trade area created, ACP countries were projected to loose tariff revenues of approximately 71 percent on EU imports. However, for many ACP countries, tariff revenues are a major source of government revenue. The study concluded that the importance of tariff revenues in ACP countries depend on the budgetary needs of the government of the day.

Gibb (2016) explored on the impact of export demand of South Africa due to Brexit. Exports to the UK mainly constitute fresh fruits and nuts, precious metals and vehicle and vehicle parts all which constitute 70 percent of exports to the UK. The study evaluated the economic impact of Brexit and found out that it will shrink the UK GDP by negative five percent which possess a marginal effect on SA economy with respect to exports. However, Brexit presents an opportunity to SA to expand its agricultural exports once the UK leaves the Common Agricultural Policy (CAP) of the EU.

Cathline-Abraham (2017**)** examined the short-term effect of Brexit in Africa specifically, Ghana using the Neo-functionalism hypothesis. The purpose of the study was to explain the success of the integration process of the EU so that one can be able to project how Brexit will affect Africa. The study found out that economic development and security docket could stall due to the fact that 40 percent of Ghana's budget comes from EDF. Another negative impact is through the existing agreements for instance, the Forest Law Enforcement and Governance, Trade (FLEGT) Action Plan of 2003: an economic partnership agreement between EU and Ghana could affect exportation of timber produce and products into Ghana. In spite of all of the above, Brexit presents an opportunity for new trading market especially with the strong colonial ties.

Mold (2017) conducted a study on the existing economic implication of Brexit without a deal and thus the UK trades under WTO MFNs tariffs in the East African Community (EAC). The study employed Computable General Equilibrium (CGE) model simulating the Global Trade Analysis Project (GTAP) in order to find out trading patterns. The study found out that in the long run, the direct links of trade and investment have minimal effect even after Brexit. However, the study recommends grounds of renegotiation of EPAs in case of Brexit and that UK Brexit may undermine deeper regional integration which in turn encourages intra-African trade in Africa.

Kohnert (2019) investigated the impact of Brexit on Francophone countries in Africa specifically because they are not Commonwealth countries. The study found out that the UK exported less than five percent of the total trade account as at 2017 when within the EU and a potential decrease of foreign aid where the UK is a major contributor to the European Development Fund (EDF). With Brexit, the study concluded that it presents an opportunity of re-negotiating EPAs.

Latorre, Olekseyuk, Yonezawa, & Robinson (2019) led an investigation so as to quantify the Brexit losses using both New Quantitative Trade and CGE models. The study found out that UK will have higher losses than the EU due to Brexit. The GDP losses due to Brexit for the UK due to a hard Brexit where it will range from one to seven percent while in the case of a soft Brexit losses would be minimized by half. The study concludes that due to Brexit, the UK could make ACP EPAs that may partially compensate for the GDP losses.

Signé & Ven (2019) investigates on the tenants of the success for the AfCFTA negotiations. The study projects that by 2030, AfCFTA shall have a positive impact on manufacturing and industrial development, tourism and intra- African cooperation which lead to economic transformation in Africa. Specifically, consumer and business spending is projected to be $ 6.7 trillion. The study recommends that issues such as rules of origin, tariffs, schedules of service commitments are Phase I issues while behind the border issues that govern trade regulations are Phase II negotiations that require negotiations.

2.1 Overview of the Literature.

The economic effects of Brexit on EPAs are still a developing and an uncertain phenomenon. In order to analyze Brexit's economic effect, most studies have modelled possibilities such as the UK remaining in the European Economic Area (EEA), a Deep Free Trade Agreement by having a Common External Tariff (CET) such as EU-Canada trade or trade under the World Trade Organization (WTO) Most Favored Nations (MFNs) treatment in which case is the best scenario under no deal. The last two scenarios provide illustrations of long-term trade impact of the UK not reaching a deal with the EU which in turn affects ACP countries.

In spite of this, most studies have only indicated policy changes that are likely to be affected by Brexit including and not limited to changes in and regarding trading relationships and migration rules commonly known as the direct impact.

The study therefore seeks to find out the possible effects of Brexit and the possibility of intra-African trade specifically the possibility of the success of AfCFTA using both qualitative and quantitative data for data analysis.

3. Methodology

The study can begin with an analysis of the international trade in goods statistics (ITGS) that has been in existence between EU28 and African ACP countries and making a comparison between the African trade with fellow African states and with the rest of the world. In this case we analyze the value of goods traded by the East Africa Community (EAC) to represent a regional bloc. EAC is chosen because of its long term relationship with UK and hence bound to be affected by the Brexit. Moreover, the EAC is developing fast by having created its own customs union and common market, and gearing towards a monetary and political federation. Kenya will also be chosen to represent an African state within the bloc for it contributes the highest GDP in the EAC bloc.

3.1 EAC's trade in goods with EU, African states and the rest of the world

The European Union was one of the top trading partners of the East African Community, based on trade in goods, with agricultural goods being the most EU imports from EAC whereas industrial goods being the most EU exports into the EAC in 2018. Figure 3.1 below shows EU28's trade with EAC for the period 2008 to 2018.

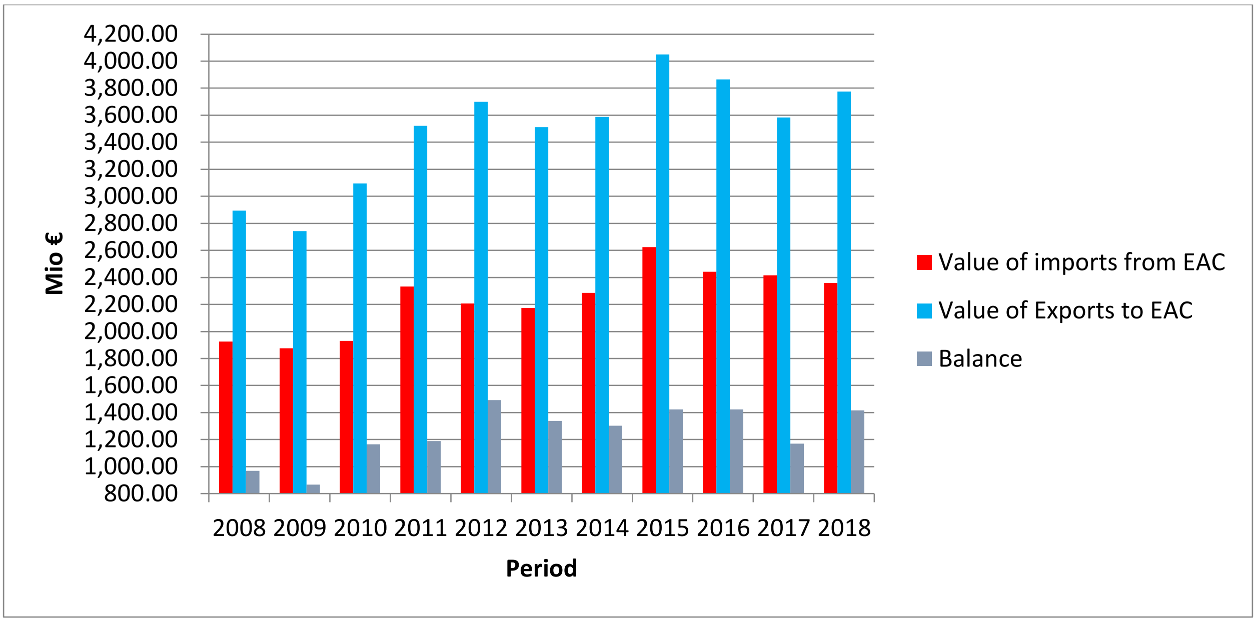

Figure 3.1: EU28's trade with East African Community

Source: Authors' computation from Eurostat comext- Statistical regime 4

The graph shows that the value of exports into the EAC from EU28 and imports form EAC into the EU has increased steadily since 2008. However, there exists consistent trade deficit in favor of the EU28. The same applies to EU 27 which excludes UK in the goods value analysis.

The EU took the second largest share of 14.9 percent of total EAC trade whereas China lead with a 16.8 percent share. India came third with 11.3 percent while South Africa (a member of Southern African Development Community) was the most traded with African state, coming sixth with a 5 percent share. 21 percent of EAC imports valued at 6,161 million Euros came from China while EU contributed the second largest of the imports with a 12.6 share valued at 3,621 million Euros. South Africa ranked 7th with a 4.3 percent share of the imports valued at 1,245 million Euros. As for the exports, the EU was the major export destination of EAC goods taking a 22 percent share valued at 2,054 million Euros. South Africa and DR Congo which are members of SADC ranked 4th and 5th respectively with a cumulative share of 13.8 percent of total exports valued at 1,289 million Euros. South Sudan, now a member of EAC, ranked 8th with a 3.6 percent share valued at 335 million Euros. China ranked 10th with 2.7 percent share valued at 256 million Euros indicating a huge negative balance of trade the EAC faces with China trade (International Monetary Fund, 2019).

3.2. Kenya's trade in goods with the EU, African states and the rest of the world

Kenya is the biggest EAC region's GDP contributor with a 39 percent share. An analysis of its total trade in goods indicates that China is the biggest partner with 16.1 percent share valued at 3,193 million Euros followed by EU at 14.8 percent valued at 2,934 million Euros. Uganda is 6th with a 4.7 percent share valued at 930 million Euros while South Africa is 10th with a 2.9 share valued at 579 million Euros. Kenya imports goods from China valued at 3,100 million Euros making China the largest source of goods imported into Kenya while EU follows with 1,836 million Euros worth of goods. South Africa and Uganda are the African states in the top 10 list ranking 7th and 9th respectively with a collective 955 million Euros value of the goods. As for the Kenyan exports, EU is the top destination taking up 21.4 percent valued at 1,098 million Euros. Uganda comes 2nd with the United Republic of Tanzania, Egypt, Rwanda, Democratic Republic of Congo and Somalia filling the list from 6th to 10th place respectively with a cumulative 26.2 percent share of the imports valued at 1,336 million Euros. Notably, all these African countries share common regional blocks: the EAC, COMESA, IGAD and SADC (International Monetary Fund, 2019; Eurostat comext, 2019).

The agriculture sector is the sinew of Kenya's economy with a contribution of 29.3 percent to the Gross Domestic Product (GDP) and accounting for 80 percent of employment in the country. The Kenya Economic Survey of 2017 indicated that horticulture was leading with the value of flowers, fruits and vegetables increasing by 16, 23 and 3 percent respectively as compared to 2016. The substantial increase was attributed to increased prices from traditional and new markets as well as the improvement of the quality of fruits. Flowers took 71 percent share of 115.322 billion Kenyan shillings (total value of horticultural exports), fruits took 7.8 percent whereas vegetables took 20.9 percent. This contributed to the floriculture sector's continued growth in value and volume of cut flowers and has made Kenya the leading exporter to the EU against competitors with about 38 percent of all cut flower imports into the European Union coming from Kenya. The main EU28 markets are Netherlands, United Kingdom, Germany, France, and Switzerland in that order (Kenya flower council, 2018; Republic of Kenya, 2018).

Figure 3.2 below shows the value of EU28 exports into Kenya and its imports from Kenya in the period 2008 to 2018.

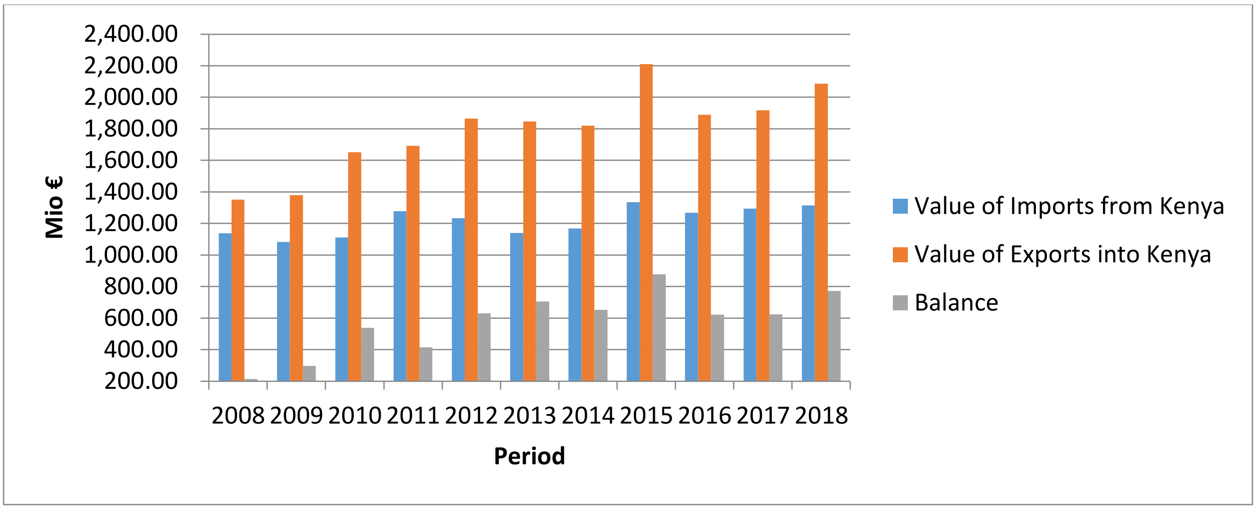

Figure 3.2: EU28's trade with Kenya

Source: Authors' computation from Eurostat comext Regime 4

The figure shows the value of all goods Kenya imports from EU28 and exports into the EU28 increasing steadily while the negative balance of payment on the Kenyan side is maintained.

Moreover, in 2018, 18 percent of the total trade Kenya participated in was intra-Africa. 80 percent of this trade was with member states of EAC, COMESA and IGAD. Intra-Africa imports accounted for 12 percent of Kenya's total imports whereas intra-Africa exports accounted for 35 percent of total exports. Kenya's top 10 intra-Africa export products accounted for 40 percent of the country's total intra-Africa exports. The main products exported were tea (accounted for 11 percent of intra-Africa exports); medicaments, petroleum oils, flat-rolled iron or non-allow steel, and cigars (each accounted for 4 percent of intra-Africa exports); palm oil and its fractions (3 percent); articles for the conveyance or packaging of goods, sugar confectionery, and food preparations (each accounted for 2 percent of intra-Africa exports).

Kenya's top 10 intra-Africa import products accounted for 42 percent of intra-Africa imports. The main intra-Africa imports were flat-rolled products of iron or non-alloy steel (8 percent of intra-Africa imports); sugar (7 percent); maize (6 percent); dried leguminous vegetables, mixtures of odoriferous substances (additive used in the food and beverage industry), milk and cream or coal (each 4 percent); semi-finished iron or non-alloy steel (3 percent); and lastly unmanufactured tobacco and motor cars (2 percent).

4. Overview of Trade and Conclusions

From the above, a conclusion is made that the EU28 is a major trade stakeholder in the East African Community bloc and in Kenya, a member of the bloc. Trade in agricultural products, fishery products and industrial products exchanged between EU, EAC and Kenya has contributed significantly to the region.

The trade plays a big role in its contribution to GDP in Kenya based on the huge value brought about by horticultural exports. It is also clear that the United Kingdom was the second contributor in this. With Brexit, the EAC bloc, and Kenya as the highest beneficiary of this trade, needs to negotiate trade terms with Britain to ensure that the countries maintain or increase trade between them. This was boosted by Theresa May (the then Britain's Prime Minister) in 2018 where she stated that Kenya would continue to enjoy tariff-free export of flowers to Britain. In addition, half of tea consumed in Britain comes from Kenya. This was backed up by the fact that Britain has been among top three destination of tea valued at 10 billion Kenya shillings annually. On the other hand, Netherlands, the number one importer of Kenyan flower cuttings, remains a part of EU27. Consequently, for a country like Kenya, it is clear that trade it engaged with EU28 was majorly with the United Kingdom. As it goes, the trade partnership between the two is promising. However, there is need for Kenya to renegotiate trading terms with the EU27 especially regarding bridging of the negative trade deficit suffered by the East African Community.

In terms of intra trade between the African states, several observations can be made. Firstly, countries tend to trade most with other countries that are in the same economic bloc and the geographical location with the closest countries in intra-Africa blocs trading the most. Uganda receives most of Kenyan exports while Tanzania, Egypt, Rwanda Democratic Republic of Congo and Somalia rank after. Kenya, Uganda, Egypt and Rwanda are members of COMESA whereas Somali, Uganda and Kenya are members of Intergovernmental Authority on Development (IGAD). In addition, South Africa and Tanzania are both members of SADC. Boosting of trade between countries in different geographical location and economic blocs such as those of West Africa can be achieved by the AfCFTA. This trend is also reflected in the EU28 trade where UK's main trading partners are those in the same geographical location such as Republic of Ireland, Germany, Belgium, and Netherlands. The EU member states in Eastern and Southern Europe are less connected to the UK through trade. This will make them less affected by the Brexit and any free trade agreement between the UK and them would be less beneficial. Republic of Ireland, Netherlands and Belgium are poised to have the largest losses to GDP. Perhaps this is a vital point to be considered when gearing towards intra Africa trade (Africa regional integration index, 2019).

Many countries in Africa have an average and above average dimension score regarding key social economic categories that are fundamental to Africa's integration. Kenya ranked top in EAC, IGAD and COMESA in a cumulative index depicting trade integration, free movement of people, productive integration, regional infrastructure and financial & macroeconomic integration. This indicates that most African countries have been embracing integration in trade between each other. However, there is need to consider the possibility of overlapping trade agreements within the region. One case is the conflict that might arise between existing tripartite FTA among COMESA, EAC and SADC of 2015, and the rising of the AfCFTA. Furthermore, countries like Tanzania, which tend to depend highly on tariff income, may take time to ratify intra Africa trade agreements.

Trade with the rest of the world is also a mainstay in the push for sustainable development in Africa as most machinery and infrastructure, designated to grow local industries, is sourced from these regions. The EAC had committed a market access offer consisting of liberalization of 82.6 percent of imports from the EU for a period of 25 years starting 2010 to 2022, and to implement in three phases. Approximately 17.4

percent of EAC imports from the EU are excluded from liberalization under EPAs. However, only Kenya and Rwanda have so far ratified the EPA agreement. EAC members like Burundi and Tanzania find it unbeneficial to them, in a manner that makes sense, to ratify the EPA for they enjoy better trade terms from the WTO rules regarding Least Developed Countries (LDCs). Moreover, Burundi is highly dependent on the UK in terms of Bilateral Aid Support and should prioritize such bilateral agreements. In conclusion, Africa ACP countries should embrace intra Africa trade agreements and be keen in negotiating bilateral agreements with the rest of the world, such as the UK, especially before signing full EPAs with the EU27 that are deemed beneficial to a few African states.

UK is a service economy and exports services such as finance accounting to approximately 40 percent of the world's GDP. In addition, UK exports more services than it imports. Global context under currently existing EPAs, it is only the Caribbean EPA that includes a context of services which account to 70 percent of the GDP in that region. However, issues such as market orientation, sectoral composition of the economy and specialization hinder the cross-border distribution of services especially from the Caribbean member states to the UK. EAC bloc could tap into these challenges by vigorously advertising and exporting tourism, tradesman ship of services such as pluming in order to increase the volume of services traded in the region. Through negotiating trade in services terms with the UK, EAC can benefit from the huge trade in services balance suffered by Africa (Office for national statistics UK, 2018).

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