

**ASSESSING KENYA'S FREE ZONES CONSISTENCY WITH WTO AGREEMENTS  
ON SUBSIDIES AND COUNTERVAILING MEASURES AND AGRICULTURE**

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**DECLARATION**

I, the undersigned, declare that this is my original work and has not been submitted to any other institution of higher learning except to the University of Pretoria.

.....

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(Candidate)

This mini-dissertation has been submitted for examination with my approval as the student supervisor.

.....

**DR OLUFEMI OLUYEJU**

(Supervisor)

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## **DEDICATION**

To my father:

Your love for me is pure,  
I cherish your undying support.

To my late mother:

She reminds me of the virtues of perseverance and humility.  
(Had she lived to see this achievement, she would be extremely happy).



## **LIST OF ACRONYMS AND ABBREVIATIONS**

AB	Appellate Body
AoA	Agreement on Agriculture
AMS	Aggregate Measure of Support
ASCM	Agreement on Subsidies and Countervailing Measures
COMESA	Common Market for Eastern and Southern Africa
CVD	Countervailing Duty
DSB	Dispute Settlement Body
DSU	Dispute Settlement Unit
EAC	East African Community
EC	European Communities
EPZ	Export Processing Zone
EPZA	Export Processing Zones Authority
EU	European Union
FIAS	Foreign Investment Advisory Service
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GNI	Gross National Income
GNP	Gross National Product
KRA	Kenya Revenue Authority
LDC	Least Developed Country
MFN	Most Favored Nation
NFIDC	Net Food-Importing Developing Countries
NT	National Treatment
OECD	Organization for Economic Co-operation and Development
S&D	Special and Differential

SDG	Sustainable Development Goal
SEZ	Special Economic Zone
SEZA	Special Economic Zones Authority
SME	Small and Medium-sized Enterprise
TAMS	Total Aggregate Measure of Support
TRIMS	Trade Related Investment Measures
UN	United Nations
US	United States
USD	United States Dollar
VAT	Value Added Tax
WTO	World Trade Organization

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the study

A free zone is a part of a territory considered as being outside the customs territory in so far as import duties and taxes are concerned.<sup>1</sup> Free zones created in Kenya take the form of Special Economic Zones (SEZs) and Export Processing Zones (EPZs). They are geographically designated areas where benefits not limited to policies, land use, infrastructure and utilities are provided.<sup>2</sup> EPZs are covered under the Export Processing Zones Act (EPZs Act) and have been in existence since 1990.<sup>3</sup> The EPZs' primary objective is to promote manufacturing of goods and production of services for export. In achieving this objective, EPZs limit their activities to manufacturing, commercial or services.<sup>4</sup>

SEZs were established in 2015 under the Special Economic Zones Act (SEZs Act)<sup>5</sup> as a result of EPZs' shortcomings not limited to stagnation witnessed over the years. Most importantly, SEZs are created as a means of attaining the economic pillar under Kenya Vision 2030. This is aimed at improving prosperity of Kenyans through economic development programme by sustaining Kenya's economic growth of ten percent per annum over twenty five years.<sup>6</sup> It is hoped that SEZ would create job opportunities, promote export diversification and attract both local and foreign direct investment.

The SEZs Act allows for creation of various SEZs including: first, free trade zones where goods are off-loaded for transshipment and storage with the exclusion of manufacturing and processing;<sup>7</sup> secondly, agricultural zones created to facilitate the agricultural sector, its

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<sup>1</sup> World Customs Union International Convention on the Simplification and Harmonization of Customs Procedures (as amended) (The Revised Kyoto Convention) Specific Annex D Chapter 2. Kenya is a contracting party pursuant to an Instrument of Accession lodged on 23 June 2010 through the Ministry of Foreign Affairs.

<sup>2</sup> Kenya SEZs Act 16 of 2015 sec 4(4) & the first schedule; EPZs Act Chapter 517 Laws of Kenya sec 2. The SEZs Act does not repeal the EPZs Act but rather compliments it. I, however, think that a consolidation is necessary.

<sup>3</sup> EPZs Act (n 2 above).

<sup>4</sup> EPZs Act (n 2 above) secs 2, 15(1) & 17.

<sup>5</sup> SEZs Act (n 2 above).

<sup>6</sup> Klynveld Peat Marwick Goerdeler (KPMG) 'Analysis of the Special Economic Zones Act, 2015' [https://r.search.yahoo.com/\\_ylt=A2KLfS1Zc9lc\\_HcADilXNyoA;\\_ylu=X3oDMTEyb25oMHZsBGNvbG8DYmYxBHBvcwM0BHZ0aWQDQjY4MzNfMQRzZWMDc3I-/RV=2/RE=1557783513/RO=10/RU=https%3a%2f%2fassets.kpmg%2fcontent%2fdam%2fkpmg%2fke%2fpdf%2ftax%2fanalysis-of-the-special-economic-zone-act.pdf/RK=2/RS=0Y8O6yMO3463QPhNfb3rlshPMOA-](https://r.search.yahoo.com/_ylt=A2KLfS1Zc9lc_HcADilXNyoA;_ylu=X3oDMTEyb25oMHZsBGNvbG8DYmYxBHBvcwM0BHZ0aWQDQjY4MzNfMQRzZWMDc3I-/RV=2/RE=1557783513/RO=10/RU=https%3a%2f%2fassets.kpmg%2fcontent%2fdam%2fkpmg%2fke%2fpdf%2ftax%2fanalysis-of-the-special-economic-zone-act.pdf/RK=2/RS=0Y8O6yMO3463QPhNfb3rlshPMOA-) (accessed 13 May 2019); see Kenya Vision 2030: The Popular Version at <http://vision2030.go.ke/publication/kenya-vision-2030-popular-version/>.

<sup>7</sup> SEZs Act (n 2 above) secs 2 & 4(6) (a); Activities such as bulk breaking, repacking, sorting, mixing, trading or other forms of handling may be included.

services and associated activities;<sup>8</sup> thirdly, business service parks created to facilitate the provision of services including but not limited to regional headquarters, business processing outsourcing centres, call centres, shared service centres, management consulting and advisory services and other associated services;<sup>9</sup> fourthly, free port zone which is an area where goods introduced are regarded as being outside the customs territory, in so far as import duties are concerned;<sup>10</sup> fifthly, industrial parks created to facilitate the needs of manufacturing and processing industries;<sup>11</sup> sixthly, information communication technology parks created to facilitate the information communication technology sector, its services and associated activities;<sup>12</sup> seventhly, livestock zones created to facilitate livestock marshalling and inspection, livestock feeding or fattening, abattoir and refrigeration, deboning, value addition, manufacture of veterinary products, and other related activities; and<sup>13</sup> lastly, science and technology parks created to facilitate the science and technology sector, its services and its associated activities.<sup>14</sup>

Kenya's free zones offer myriad of fiscal and non-fiscal incentives and these include: full repatriation of all capital and profits; protection of property rights including industrial and intellectual property rights; freedom to enter into contracts and to carry on business with a non-free zone enterprise; right to determine prices of goods; and free, open and competitive investments are some of the non-fiscal incentives offered.<sup>15</sup>

Relevant to this study are fiscal incentives offered that are not limited to stamp duty exemption for free zones enterprises related document; income tax exemptions; exemptions from advertisement and business service permits fees; filming, manufacturing, trade in unwrought precious metals, general liquor and hotel liquor licences exemptions; value-added tax exemptions; corporate tax at the rate of ten percent for the first ten years and fifteen percent for the next ten years; work permits of up to twenty percent of their full-time employees; exemption from duties and taxes under East African Community Customs Management Act of 2005 and Customs and Excise Act; exchange controls waivers for repatriation of profits and capital to parent country; investment deduction up to one hundred

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<sup>8</sup> SEZs Act (n 2 above) secs 2 & 4(6)(f).

<sup>9</sup> As above, secs 2 & 4(6)(h).

<sup>10</sup> As above, secs 2 & 4(6)(c).

<sup>11</sup> As above, secs 2 & 4(6)(b).

<sup>12</sup> As above, secs 2 & 4(6)(d).

<sup>13</sup> As above, secs 2 & 4(6)(i).

<sup>14</sup> As above, secs 2 and 4(6)(e). Tourist and recreational zones and convention and conferences facilities zones are further created.

<sup>15</sup> SEZs Act (n 2 above) sec 34; EPZs Act (n 2 above) sec 29.

percent of capital expenditure; and withholding tax rates on payments made to non-residents and entitlements to dividends paid to non-residents by the free zone entity.<sup>16</sup>

Kenya as a member of the World Trade Organization (WTO) is a signatory to the Agreement on Subsidies and Countervailing Measures (ASCM) and the Agreement on Agriculture (AOA).<sup>17</sup> Though free zones are not specifically mentioned under both agreements, fiscal incentives as is demonstrated in subsequent chapters, constitute subsidies since they are financial contributions, incomes or price supports given by the government or their agencies which result in conferment of benefits.<sup>18</sup>

While concerning itself with specific subsidies,<sup>19</sup> the ASCM proscribes subsidies contingent upon export performance and use of domestic over imported goods.<sup>20</sup> The AoA on the other hand, permits subsidies on agricultural products provided that they are within a country's export subsidy commitments and the domestic support is within a country's domestic support commitments or *de minimis*.<sup>21</sup> Export subsidies are subject to countervailing measures only when it is shown that there is due restraint, injury or threat to injury.<sup>22</sup> The AoA further prevents application of export subsidies that leads to circumvention of export subsidy commitments.<sup>23</sup>

## 1.2 Statement of the problem

The World Bank has on numerous occasions stressed the role of free zones in economic development and in enhancing competitiveness of industries through foreign direct investment.<sup>24</sup> Job creation, piloting new policies and approaches, diversification of exports

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<sup>16</sup> See generally Foreign Investments and Protection Act Chapter 518 Laws of Kenya; Kenya Statistics Act 4 of 2006; Kenya Alcoholic Drinks Control Act 4 of 2010; Tea Act Chapter 343 Laws of Kenya; Trading in Unwrought Precious Metals Act Chapter 309 Laws of Kenya; Films and Stages Plays Act Chapter 222 Laws of Kenya; and Landlord and Tenant (Shops, Hotels and Catering establishments) Act Chapter 301 Laws of Kenya; see also Kenya Revenue Authority 'Investing in Kenya' <https://www.kra.go.ke/en/ngos/incentives-investors-certificate/investing-in-kenya/incentives-investors> (accessed 10 May 2019); SEZs Act (n 2 above) sec 35; EPZs Act (n 2 above) sec 29.

<sup>17</sup> WTO 'Kenya and WTO' [https://www.wto.org/english/thewto\\_e/countries\\_e/kenya\\_e.htm](https://www.wto.org/english/thewto_e/countries_e/kenya_e.htm) (accessed 13 May 2019); Kenya has been a WTO Member since 1 January 1995.

<sup>18</sup> ASCM art 1.1; GATT art XVI: 1.

<sup>19</sup> ASCM art 1.2.

<sup>20</sup> ASCM art 3; RA Torres 'Free Zones and the World Trade Organization Agreement on Subsidies and Countervailing Measures' (2007) *Global Trade and Customs Journal* 2.

<sup>21</sup> AoA arts 1(e) & 7:2(b).

<sup>22</sup> AoA art 13; see WTO 'Export Competition/Subsidies' [https://www.wto.org/english/tratop\\_e/agric\\_e/ag\\_intro04\\_export\\_e.htm](https://www.wto.org/english/tratop_e/agric_e/ag_intro04_export_e.htm) (accessed 13 May 2019).

<sup>23</sup> AoA art 10.

<sup>24</sup> A Gokhan *et al* 'Special economic zone: performance, lessons learned, and implication for zone development' (2008); World Bank 'Foreign Investment Advisory Service (FIAS) Occasional Paper' at <http://documents.worldbank.org/curated/en/343901468330977533/Special-economic-zone-performance-lessons-learned-and-implication-for-zone-development> (accessed 24 May 2019); World Bank 'Special

and attraction of domestic and foreign direct investments are underlying reasons for establishing free zones.<sup>25</sup>

Coppens discusses the importance of giving subsidies to industries by governments. He argues that subsidies are offered as a result of presence of market failures that require government intervention; to shift profit from foreign competitors to domestic firms; to redistributive income among regions as a political tool; and for political-economy reasons.<sup>26</sup> WTO Members are however of the view that subsidies are not only trade distorting but are also a protectionist form of support, hence their recognition of the importance of elimination of subsidies.<sup>27</sup>

When the ASCM took effect on 1 January 1995, it accorded countries with Gross National Product (GNP) of below United States Dollars (USD) 1,000 such as Kenya, exemptions on export subsidy prohibitions under special and differential treatment.<sup>28</sup> Kenya was required to phase out export subsidies over a period of eight years once it reached export competitiveness. Kenya would also be deemed to have graduated from the exemption once its GNP (now Gross National Income (GNI))<sup>29</sup> reached USD 1 000 in constant 1990 dollars for three consecutive years.<sup>30</sup> In anticipation of a graduation from this exemption, Kenya in 2001 made a request to the WTO for an extension.<sup>31</sup> In July 2007, Members of the Committee on Subsidies and Countervailing Measures granted an extension of the transition period for the elimination of export subsidies to 31 December 2013. In addition to this, the Committee gave a final two-year phase-out period which ended on 31 December 2015.<sup>32</sup> Kenya has not however graduated from the export subsidy prohibition exemption since its GNI remains

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Economic Zones: An Operational Review of Their Impacts' (2017) *Competitive Industries and Innovation Program*.

<sup>25</sup> As above.

<sup>26</sup> C Dominic 'WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints' (2014) *Cambridge University Press* at 5-17.

<sup>27</sup> As above.

<sup>28</sup> ASCM art 27 & Annex VII; The exemption took effect after five years of entry into force of the Agreement (counted from 1 January 1995); S Creskoff & P Walkenhorst 'Implications of WTO Disciplines for Special Economic Zones in Developing Countries' (2009) International Trade Department, The World Bank Policy Research Working Paper 4892.

<sup>29</sup> GNI is the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (compensation of employees and property income) from abroad (World Bank national accounts data, and OECD National Accounts data files).

<sup>30</sup> WTO ANALYTICAL INDEX: SCM Agreement – Annex VII (Practice) paragraph 2.

<sup>31</sup> WTO, 'Subsidies: Request Pursuant to art 27.4 of the ASCM & Request Pursuant to the Procedure in Document G/SCM/39 by Kenya' (2001) Committee on Subsidies and Countervailing Measures G/SCM/N/74/KEN.

<sup>32</sup> WTO General Council 'art 27.4 of the Agreement on Subsidies and Countervailing Measures: Decision of 27 July 2007' (July 272007) WT//691.

below USD 1000 in constant 1990 dollars.<sup>33</sup> It therefore continues to enjoy the exemption. This is demonstrated further in chapter three.

In the Bali Ministerial Conference in 2013, WTO Members agreed to eliminate of all forms of export subsidies and disciplines on all export measures and to keep subsidies below members' export subsidy commitments.<sup>34</sup> Further, at the Nairobi Ministerial Conference in 2015, developing country members committed to eliminate export subsidies on farm exports by end of 2018.<sup>35</sup> Specifically, it agreed not to provide export subsidies in excess of its export subsidy commitments.<sup>36</sup> Developing countries further pledged to maintain exemptions on marketing cost and internal transport subsidies until the end of 2023.<sup>37</sup> Least developed countries and Net-Food Importing Developing Countries (NFIDC) such as Kenya were allowed to enjoy these exemptions until the end of 2030.<sup>38</sup> WTO Members further agreed to adopt a permanent solution on public stock holding for food security purposes.<sup>39</sup> Since the decisions are soft laws, a dispute on a violation of any provision cannot be lodged with the WTO dispute settlement system.<sup>40</sup>

It is against this backdrop that this study first, examines whether fiscal incentives granted within Kenya's free zones meet the specificity test or are otherwise non-actionable under the ASCM. Secondly, it examines whether subsidies granted in Kenya's free zones constitute prohibited subsidies under the ASCM. Thirdly, it examines whether subsidies granted are within Kenya's export subsidy commitments and domestic support commitments or *de minimis*. Lastly, it investigates whether subsidies granted adversely affect or seriously prejudice the interest of other countries. The principles of Most-Favoured Nation (MFN) and National Treatment (NT) are also inadvertently examined.

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<sup>33</sup> WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.16 (14 May 2019).

<sup>34</sup> World Trade Organization 'Export Competition: Ministerial Declaration of 7 December 2013' document WT/MIN(13)/40 and WT/L/915.

<sup>35</sup> WTO 'WTO members secure "historic" Nairobi Package for Africa and the world' [https://www.wto.org/english/news\\_e/news15\\_e/mc10\\_19dec15\\_e.htm](https://www.wto.org/english/news_e/news15_e/mc10_19dec15_e.htm) (accessed 20 May 2019).

<sup>36</sup> World Trade Organization, 'Export Competition: Ministerial Decision of 19 December 2015' (2015) WT/MIN(15)/45(WT/L/980) 1; AoA art 8.

<sup>37</sup> As above (Nairobi Ministerial Decision on Export Competition) paragraph 8.

<sup>38</sup> As above; see Committee on Agriculture 'WTO List of Net Food-Importing Developing Countries for the purposes of the Marrakesh Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries ("the Decision")' Revision, G/AG/5/Rev.10, 23 March 2012.

<sup>39</sup> World Trade Organization, 'Public Stockholding for Food Security Purposes: Ministerial Decision of 19 December 2015' (2015) WT/MIN(15)/44(WT/L/979)

<sup>40</sup> R Bardoneschi 'Opinion on Accelerating the Elimination of Export Subsidies in Agriculture' <https://www.ictsd.org/opinion/accelerating-the-elimination-of-export-subsidies-in-agriculture> (2017) International Centre for Trade and Sustainable Development (accessed 20 May 2019). Rodrigo points to a need to speed up the implementation of the elimination of export subsidies in agriculture.

### **1.3 Research objectives**

The overall objective of this study is to examine the consistency of fiscal incentives offered in Kenya's free zones with the WTO rules on subsidies.

This study is underpinned by the following four specific objectives:

- i) to establish the rationale for granting fiscal incentives in Kenya's free zones;
- ii) to examine whether fiscal incentives offered in Kenya's free zones are contingent on export performance or on use of domestic over imported goods;
- iii) to find out whether subsidies offered in Kenya's free zones are within Kenya's export subsidy commitments and domestic support commitments or *de minimis*; and
- iv) to investigate whether subsidies granted adversely affect or seriously prejudice the interest of other countries.

### **1.4 Research questions**

The core research question guiding this study is: to what extent are fiscal incentives offered in Kenya's free zones consistent with WTO rules on subsidies?

In answering this core research question, this study shall be guided by the following four specific questions:

- i) What is the rationale for granting fiscal incentives in Kenya's free zones?
- ii) To what extent are fiscal incentives offered in Kenya's free zones contingent on export performance or use of domestic over imported goods?
- iii) To what extent are subsidies offered in Kenya's free zones within Kenya's export subsidy commitments and domestic support commitments or *de minimis*?
- iv) To what extent are other countries' interest adversely affected or seriously prejudiced by the subsidies granted in Kenya's free zones?

### **1.5 Thesis statement**

The central argument of this study is that subsidies offered by WTO members to industries operating within their territories should be consistent with WTO rules on subsidies. The fiscal incentives offered in Kenya's free zones should therefore be consistent with WTO rules on subsidies. The fiscal incentives should neither be contingent on export performance nor use of domestic over imported products. They should further be within Kenya's export subsidy commitments and domestic support commitments or *de minimis*. The fiscal incentives should also not also adversely affect or seriously prejudice the interest of other WTO members.



## 1.6 Justification of the study

For the first time research on the area of study is being conducted in relation to Kenya. Importantly, the research is timely owing to the fact that Kenya is in the process of setting up SEZs in various parts of the country following their establishment under the SEZ Act of 2015. Further, Kenya as a WTO member is obligated to eliminate all forms of trade distorting measures such as subsidies. Save for exemptions enjoyed by Kenya under Special and Differential (S&D), it is mandated to eliminate all other forms of subsidies. Once Kenya graduates from export subsidies exemptions, it is expected to eliminate all forms of export subsidies. Kenya's domestic support should also be maintained within *de minimis* levels. This study therefore analyses whether subsidies offered in Kenya's free zones are consistent with these WTO requirements.

This study hopes to be a source of information to other researchers who intend to further their research in this area and to the researcher for further deliberations on the area. It is also expected that the research findings and discussions would be relevant to local and foreign investors desirous of investing in Kenya's free zones; trade and investment practitioners; policy makers; the Government of Kenya, specifically the Ministries of Trade, Foreign Affairs and Finance for future decision making on the subject; and other WTO members establishing or operating free zones.

## 1.7 Literature review

This study acknowledges that it is not a pioneer of research relating to the consistency of fiscal incentives offered in free zones with WTO rules on subsidies. Various studies have been conducted on subsidies under the ASCM and AoA and subsidies' relationship with subjects such as free zones. Alan in his paper gives a historical overview of subsidies and countervailing measures under GATT, ASCM and AoA.<sup>41</sup> His arguments are however economic. Dominic gives the historical underpinnings and rationale for granting subsidies under WTO from a developed and developing countries perspective.<sup>42</sup>

Melaku has written expansively on agricultural subsidies in the context of WTO. Melaku's book does not however encompass discussions on agricultural subsidies offered in free zones.<sup>43</sup> Parthapratim's article investigates the consistency of India's SEZ with ASCM.

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<sup>41</sup> AO Sykes 'The Economics of WTO Rules on Subsidies and Countervailing Measures' (2003) University of Chicago Law School (John M. Olin Law & Economics Working Paper 186) 2<sup>nd</sup> series.

<sup>42</sup> Dominic (n 26 above).

<sup>43</sup> GD Melaku 'The Law of International Trade in Agricultural Products: From GATT 1947 to the WTO Agreement on Agriculture' (2002) *Kluwer Law International*.

His article is limited to India's SEZs and excludes discussion on the consistency of SEZ incentives with AoA.<sup>44</sup>

Raul Torres has written on the regulation of fiscal incentives provided within free zones under WTO ASCM.<sup>45</sup> He postulates that the benefits that industries receive within a particular free zone should be examined in order to determine whether or not the subsidies conferred are prohibited or actionable. He further affirms that it is difficult to generalise the benefits and incentives granted to enterprises since they vary greatly within and amongst countries.<sup>46</sup> Raul's article is founded on a general understanding of the most likely fiscal incentives given within a free zone and is limited to the consistency of the incentives with ASCM. Further, as at the time of writing the article, Kenya's SEZ Act had not been enacted. This study is expected to contribute to the literature on this area of legal topic by analysing the consistency of fiscal incentives granted in Kenya's free zones to not only the ASCM but also the AoA in light of the SEZs and EPZs Acts of Kenya.

Stephen Creskoff and Peter Walkenhorst in their paper provide an overview of the applicability of WTO disciplines to incentives granted in SEZs by developing countries.<sup>47</sup> In so doing, the authors categorise incentive measures depending on their consistency with WTO, prohibition or subject to challenge under WTO and case by case consistency with WTO.<sup>48</sup> In addition to analysing principles under ASCM, the paper considers other WTO principles including Most-Favoured Nation (MFN), National Treatment (NT), prohibitions of quantitative restrictions, requirement that fees reflect approximate cost of services rendered and transparency requirements. The paper was however written a decade ago, during the time Kenya's SEZ had not been established. Furthermore, the analysis of the paper was based on typical SEZ fiscal incentives programmes. Discussions on AoA are further not covered. Michael and others review incentives in EPZs in light of ASCM, GATS and TRIMS Agreement. Similarly, the working paper was written at a time when Kenya's SEZs had not been established.<sup>49</sup>

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<sup>44</sup> P Parthaprati 'Special Economic Zones in India and the WTO Agreement on Subsidies and Countervailing Measures: An Uneasy Coexistence'

<sup>45</sup> Torres (n 20 above).

<sup>46</sup> As above.

<sup>47</sup> C Stephen & P Walkenhorst (n 28 above).

<sup>48</sup> As above.

<sup>49</sup> M Engman *et al* 'Export Processing Zones: Past and Future Role in Trade and Development (Part III. EPZ Policy and Trade Rules)' (23 May 2007) OECD Trade Policy Working Paper 53, TD/TC/WP(2006)39/Final.

Fabrice Defever and others in their paper explore how product and firm level export performance are affected by removing export share requirements within SEZs in the Dominican Republic.<sup>50</sup> Their research is limited to subsidies contingent upon export performance; this is one form of subsidies prohibited under the ASCM. While the paper takes a quantitative approach to discussions on subsidies contingent upon export performance in the Dominican Republic, this study will adopt a qualitative approach by focusing on export subsidies specific to Kenya's SEZs as well as other forms of subsidies prohibited under the ASCM and AoA.

Susan Tiefenbrun gives a historical background to free trade zones in the United States of America.<sup>51</sup> The book elaborates on inverted tariff elimination through tariff rate rationalization.<sup>52</sup> It goes further to analyse various forms of free zones and gives the rationale for their establishment in specific developed and developing countries and European Union. The book also discusses various forms of fiscal incentives offered in US free trade zones. The discussions however, do not cover WTO principles.

Douglas Zhihua discusses in his paper, the experience of China and Africa in SEZs, and the fact that African zones including Kenya's EPZs, are falling behind in terms of investment, job creations and export generation as a result of out-dated or lack of regulatory and institutional frameworks; poor business environment; ineffective zones programmes; inadequate infrastructure; lack of zone management and operational experiences; resettlement issues and challenge of change of government and policy inconsistencies.<sup>53</sup> This study builds on this literature in its second chapter on the conceptual foundation for granting fiscal incentives in Kenya's free zones.

Judith Ogeda's mini-dissertation submitted to the University of Pretoria investigates whether there is any legal conflict between SEZs Act of Kenya and East Africa Community (EAC) and Common Market for Eastern and Southern Africa (COMESA) legal frameworks to which Kenya is a party. She investigates whether SEZs in Kenya have any negative

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<sup>50</sup> F Defever *et al* 'Special Economic Zones and WTO Compliance: Evidence from the Dominican Republic' (2017) Centre for Economic Performance, London School of Economic and Political Science Discussion Paper 1517; See also World Bank Group 'Report on Special Economic Zones in the Dominican Republic: Policy Considerations for a more Competitive and Inclusive Sector' (2016) Trade and Competitiveness Global Practice.

<sup>51</sup> SW Tiefenbrun *et al* 'Tax free trade zones of the world and in the United States' (2012) *Edward Elgar*.

<sup>52</sup> "An inverted tariff relationship exists when the duty rate for an imported component or raw material is higher than that which would apply to an import of the finished product into which the component or raw material is incorporated" Tiefenbrun.

<sup>53</sup> DZ Zeng 'Global Experiences with Special Economic Zones: Focus on China and Africa' (2015) Policy Research Working Paper 7240 World Bank Trade and Competitiveness Global Practice.

impacts on regional integration. The mini-dissertation is limited to the implications of regional trade arrangements on Kenya's SEZ initiatives.<sup>54</sup> This study gives the readers further insight into Kenya's SEZs in so far as fiscal incentives and consistency with WTO rules on subsidies are concerned.

### **1.8 Research methodology**

This study is a library and desk-top based research. It analyses various relevant primary and secondary sources of information, including; WTO instruments, WTO Dispute Settlement Body case laws, Kenyan legislations, books, book chapters, working papers, journal articles, reports and other proposals put forward in the area.

### **1.9 Overview of chapters**

This study is structured into five chapters. The current chapter introduces the study. The second chapter explores the conceptual justifications for granting subsidies within a free zone. The third chapter comprehensively investigates whether fiscal incentives offered in Kenya's zones are contingent on export performance or use of domestic over imported products. The fourth chapter expansively investigates whether fiscal incentives offered in Kenya's free zones are within Kenya's export subsidy commitments and domestic support commitments or *de minimis* levels. The fifth chapter concludes the research.

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<sup>54</sup> JRA Ogeda 'Legal Implications of Regional Integration Initiatives on Special Economic Zones in Kenya' Mini-dissertation submitted to the University of Pretoria (2016) *Pretoria University Law Press*.

## CHAPTER TWO

### THEORETICAL FRAMEWORK FOR FISCAL INCENTIVES OFFERED IN KENYA'S FREE ZONES

#### 2.1 Introductory remarks

Free zones enjoy less stringent policies compared to policies applied to industries operating elsewhere in an economy.<sup>55</sup> Such flexible policies are formulated to aid in the achievement of various objectives for zone creation, including; pioneering new economic policies, creation of employment, attraction of domestic and foreign direct investment and diversification of exports.<sup>56</sup> Such flexible policies are also created as a result of WTO rules flexibilities enjoyed by countries such as Kenya that allows for granting of fiscal and non-fiscal incentives to industries operating within the zones.

Arguments put forth in this chapter are founded on a general understanding of the fiscal incentives granted to industries operating within Kenya's free zones. This chapter does not concern itself with the identification or analysis of the theoretical underpinnings for creation of free zones in Kenya. It does not also concern itself with the theoretical justifications for granting non-fiscal incentives within the zones. It therefore limits its discussion to the conceptual foundations for granting fiscal incentives within the zones.

It is against this backdrop that this chapter identifies and analyses various theories applicable to subsidies granted in Kenya's free zones, including; strategic trade theory, commitment theory of subsidy agreements, theory of optimum subsidy and new trade theory. These theories are elaborated in the subsequent sections.

#### 2.2 Strategic trade theory

Strategic trade theory was first propounded by James Brander and Barbara Spencer in 1985 on the basis of imperfect competition that had been witnessed in world trade since World War II.<sup>57</sup> The theory bases its arguments on monopolistic competition which is dependent on government support for domestic producers.<sup>58</sup> The theory as is demonstrated further in the

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<sup>55</sup> S Creskoff & P Walkenhorst (n 28 above); see also JJ Waters 'Achieving World Trade Organization Compliance for Export Processing Zones while Maintaining Economic Competitiveness for Developing Countries' (2013) volume 63 *Duke Law Journal* 481.

<sup>56</sup> As above.

<sup>57</sup> J Brander & B Spencer 'Export Subsidies and International Market Share Rivalry' (1985) *Journal of International Economics* 18; see J Linbo 'The Development of the Strategic Trade Policy and Its Application in China' (2017) *The Chinese Economy Journal*.

<sup>58</sup> As above.

subsequent paragraphs emphasises the need for government intervention to create benefit to domestic industries by providing support.

The theory analyses the effect of government policies on the interaction of two industries dealing in homogenous final products for exports; one foreign and one domestic.<sup>59</sup> In order to affect the outcome of strategic interaction between these two firms, the government can raise the level of domestic welfare by shifting profits from the foreign firm to the domestic firm through policy formulation.<sup>60</sup> This is termed as ‘profit shifting policies’ by Brander and Spencer in their article titled ‘Export Subsidies and International Market Share Rivalry’ of 1985. Brander and Spencer justify the need for such policies to competitive international markets.

Brander and Spencer argue for the use of export subsidies to improve the relative conditions of domestic industries to expand their markets and increase profits.<sup>61</sup> The article puts forth various propositions for granting subsidies. The first proposition holds that an increase in domestic subsidy lowers world price of a product which in turn increases domestic profit and reduces foreign profit.<sup>62</sup> The second proposition holds that a government’s decision to grant a subsidy to a domestic industry is a unilateral decision that results in an alteration of the reaction function of the industry. The alteration enables a domestic industry to capture a larger share of profitable international markets.<sup>63</sup> The third proposition holds that subsidies are dependent on the existence of at least one foreign competitor producing for the world market.<sup>64</sup> The fourth proposition is that an exporting country cannot be deterred if another exporting country sets a zero subsidy.<sup>65</sup> The fifth proposition is that jointly optimal subsidy levels enables two producing countries to act as monopoly against the rest of the world since they would be producing the same output.<sup>66</sup> These propositions resonate well with export diversification and pioneering of economic policies objectives for creation of free zones.

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<sup>59</sup> DR DeRemer ‘The Evolution of International Subsidy Rules’ Doctoral dissertation submitted to Columbia University, 26 December 2013; see also Krugman PR (1994) *Rethinking International Trade* Massachusetts Institute of Technology Press.

<sup>60</sup> N Schmitt ‘New International Trade Theories and Europe 1992: Some Results Relevant for EFTA Countries’ (1990) 29 *Journal of Common Market Studies* at 53; see SV Berkun & HV Meijl ‘The application of trade and growth theories to agriculture: a survey’ *The Australian Journal of Agriculture and Resource Economics* at 529.

<sup>61</sup> J Brander & B Spencer (n 57 above).

<sup>62</sup> As above, at 87-89.

<sup>63</sup> As above, at 89.

<sup>64</sup> As above, at 90.

<sup>65</sup> As above, at 95.

<sup>66</sup> As above, at 96.

It then follows that, for such a theory to be operational, there must be a domestic and foreign industry producing homogeneous products for exports. This theory is dependent on full commitment by the government.<sup>67</sup> This should justify, as shall be demonstrated in subsequent chapters, the need for specificity of subsidies and provision by governments or their agencies.

The theory has however been criticised for failing to take into account possible lobbying or retaliation by other foreign firms.<sup>68</sup> Since the theory is dependent on commitment by government, lack of information by the government's or its policy makers is its biggest challenge.

### **2.3 Commitment theory of subsidy agreements**

The commitment theory of subsidies agreement is propounded by Daniel Brou and Michele Ruta.<sup>69</sup> The theory bases its arguments on use of tariffs and domestic subsidies by governments whereby government resort to domestic subsidies where its ability to provide protection is curtailed by tariff binding through trade agreements. It recognises the importance of tariff binding by governments so as to ensure predictability in the multilateral trading system. The theory also advances the argument that trade agreements are motivated by cross-border externalities. Subsidies are thus used by governments to address commitment problems.

The theory postulates that too permissive agreements on subsidies are self-defeating and too-stringent agreements unappealing to governments that justifies domestic public policy objectives. It therefore emphasises the need to strike the balance between the benefits derived from the flexibilities by governments to impose domestic subsidies and the need to secure market access commitments through limitation of government flexibilities under the standard theory of trade agreements. Thus tariffs and subsidies or tariffs only should be used to efficiently address market failures.

This theory builds on Johnson's standard theory of trade agreements which argues that international trade agreements are used to prevent trade wars that would otherwise result if countries were to exploit their international market power by taxing trade. This is achieved

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<sup>67</sup> J Linbo (n 57 above); see also JJ Reimer & K Stiegert 'Imperfect Competition and Strategic Trade Theory: Evidence for International Food and Agricultural Markets' (2006) 4 *Journal of Agricultural & Food Industrialization Organization*.

<sup>68</sup> As above.

<sup>69</sup> D Brou & M Ruta 'A Commitment Theory of Subsidy Agreements' (2012) Staff Working Paper ERS-D-2012-15, World Trade Organization, Economic Research and Statistics Division.

through tariff binding to escape ‘a terms-of-trade prisoner’s dilemma’.<sup>70</sup> This theory further builds on the commitment theory of trade which argues for the need to bind subsidies through signing of trade agreements to eliminate credibility problems. Both standard and commitment theories recognise the important role played by non-violation complaints in multilateral trading system. The theories argue for the need for exemptions where tariff commitments limit government discretion to pursue legitimate domestic goals. The theories further recognise that government may be induced by strict rules on domestic subsidies to use tariff flexibilities in the absence of tariff commitments.<sup>71</sup> The present theory equates this to its ‘policy substitution problem’, discussed further below.

The policy substitution problem results from trade agreements that bind tariffs but gives government discretion on domestic subsidies.<sup>72</sup> This tariffs binding cause governments to introduce domestic subsidies to protect producers in the import-competing sectors who are hurt by trade agreements that lower import tariffs.<sup>73</sup> The theory thus postulates that subsidies are used to undo the effects of tariff reduction.<sup>74</sup> According to this theory, the policy substitution problem can be eliminated by nullification rules that allow WTO members to challenge subsidies that frustrate access to foreign markets as it restores subsidies to subsidy commitment levels.<sup>75</sup>

The theory further identifies a ‘trade policy credibility problem’ that results from inability of governments to avoid distortions resulting from over-investment by capital owners in sectors protected through political considerations in anticipation of high returns.<sup>76</sup> This causes governments to commit a tariff and subsidy agreement in sectors where positive externalities are low. This policy-substitution and credibility problem can however be resolved by tariff commitments and low-domestic distortions. The challenges posed by this theory are the use of a single lobby and assumption that governments have at its disposal only two policy tools; tariffs and domestic subsidies.<sup>77</sup>

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<sup>70</sup> G Maggi & A Rodríguez-Clare ‘A Political-Economy Theory of Trade Agreements’ (2007) 97(4) *American Economic Review*, *American Economic Association*.

<sup>71</sup> D Brou & M Ruta (n 69 above) 29.

<sup>72</sup> As above, at 28.

<sup>73</sup> As above, at 4.

<sup>74</sup> As above.

<sup>75</sup> As above, at 5 & 26.

<sup>76</sup> As above, at 11.

<sup>77</sup> As above, at 30.



## 2.4 Theory of optimum subsidy

This theory was first introduced by Bhagwati and Ramaswami in 1963.<sup>78</sup> It postulates that subsidies may be used by governments to intervene at the point where domestic market distortions occur.<sup>79</sup> Thus, when the intention of the government is to achieve a domestic production or consumption target, a policy directed at that target is preferable.<sup>80</sup>

Bhagwati emphasises the need to rank policy instruments in dealing with different distortions. The theory postulates that a subsidy policy ranks higher than a tariff policy and domestic production tax-cum-subsidy policy if the objective is to secure use of a particular factor and if the intention is to promote domestic consumption.<sup>81</sup> It argues further that where the intention is to reduce trade value, a tariff would be a first-best policy option.

Bhagwati thus analyses various ways of ranking policies to meet different market distortions. First, when market distortion that takes the form of 'divergence between domestic prices and marginal rate of transformation in domestic production' occur, domestic subsidies or tax would be first-best policy.<sup>82</sup> The second-best policy option would be either a tax or subsidy on factor-use or a tariff. Secondly, where domestic consumption externality exists, a consumption subsidy or tax would be a first-best policy option. A tariff would be its second-best and a production tax or subsidy it's third-best. Thirdly, where a factor market distortions or optimal production feasibility policy objective exist, direct tax or subsidy on the use of the factor would be a first-best policy option, production tax or subsidy on the final product, its second and a tariff, its third.

Bhagwati and Ramaswami postulates that no tariff to address market imperfections would yield greater equilibrium than that yielded under free trade.<sup>83</sup> They postulate that where market distortions do not occur but monopoly power in trade exist, imposition of tax-cum-subsidies to yield equilibrium higher than in a free trade is impossible.<sup>84</sup> These

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<sup>78</sup> J Bhagwati and VK Ramaswami 'Domestic Distortions, Tariffs and the Theory of Optimum Subsidy' (1963) 71(1) *Journal of Political Economy* at 44-50.

<sup>79</sup> As above.

<sup>80</sup> See CR Drahozal 'On Tariffs v. Subsidies in Interstate Trade: A Legal and Economic Analysis' (1996) 74 (4) *Washington University Law Quarterly* at 1127-1192.

<sup>81</sup> As above; see also JN Bhagwati 'The Generalized Theory of Distortions and Welfare' in JN Bhagwati & others (eds) *Trade balance of payments and growth: papers in International Economics in Honor of Charles P. Kindleberger* (1971) Amsterdam London, North-Holland Publishing Company at 69-90.

<sup>82</sup> As above; see also W Zhou 'Rethinking National Treatment and the Role of Regulatory Purpose: Lessons from the Theory of Distortions and Welfare' (2015) 12 (3) *Manchester Journal of International Economic Law* at 243-269.

<sup>83</sup> MC Kemp & T Negishi 'Domestic Distortions, Tariffs and the Theory of Optimum Subsidy' (1969) *Journal of Political Economy* 6.

<sup>84</sup> As above.

propositions were however criticised by Kemp and Negishi for two reasons: first, they argue that a tariff may not be maintained in excess of free trade when market distortions occur. Secondly, they argue that unlike in monopolistic situations, production tax-cum-subsidies may not yield greater welfare.<sup>85</sup>

## 2.5 New trade theory

The theory was first introduced by Paul Krugman in the late 1970s. It emphasises economies of scale and product differentiation. Proponents of the theory believe that presence of economies of scale in industrial production increases as a result of increased inputs. The theory puts forth two approaches on economies of scale; external economies of scale and internal economies of scale.

External economies of scale factors are employed by small firms and result in a perfect competition since there are no advantages to large firms.<sup>86</sup> The theory postulates that a cost advantage that results in specialisation arises when a country starts with large production. Such a country, according to the theory, may lose from trade when they have relatively small external economies of scale in their specialisation. Subsidies are therefore used to reverse the specialisation.<sup>87</sup>

Internal economies of scale on the other hand lead to imperfect competition which assumes monopolistic<sup>88</sup> and oligopolistic competition.<sup>89</sup> Monopolistic markets result in the production of variety of goods for consumers resulting from internal economies of scale and product differentiation.<sup>90</sup> Oligopolistic markets on the other hand are based on firms' interdependence. This interdependence results in 'pro-competitive effect' which results from huge market competitions which causes a firm to expand its output which in the long run lowers prices of goods. This therefore causes trade since oligopolists rely on exports as opposed to domestic sale to recoup their inputs. As a result, firms that are unable to recover their costs exit the market. Thus, oligopolistic industries that earn excessive profits can be used by governments to shift profits from foreign firms through provision of export subsidies.<sup>91</sup>

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<sup>85</sup> As above.

<sup>86</sup> SV Berkun & HV Meijl 'The application of trade and growth theories to agriculture: a survey' *The Australian Journal of Agriculture and Resource Economics* at 514.

<sup>87</sup> As above.

<sup>88</sup> SV Berkun & HV Meijl (n 86 above) 515. Large number of similar firms producing differentiated unique products.

<sup>89</sup> As above.

<sup>90</sup> As above.

<sup>91</sup> As above, at 516.

From the foregoing, subsidies can be employed to either reverse specialisation caused by relatively small economies of scale or to shift profits from foreign firms through oligopolistic industries that earn excessive profits. These profit shifting and specialisation techniques for use of subsidies were at the epicentre of debates and are still being debated under the WTO in formulation of rules on subsidies, more so on agriculture. Developing countries have expressed their dissatisfaction with the use of subsidies by developed countries that enjoy economies of scale and monopoly, hence the continuous push for elimination of export subsidies.

## **2.6 Concluding remarks**

In conclusion, this chapter has identified the strategic trade theory which bases its argument on perfect competition. In its analysis of a foreign and a domestic industry dealing in homogenous products for exports, the theory emphasises the need for government intervention to create benefit to domestic industries by providing support. This chapter thereafter discussed the commitment theory of subsidy agreements which bases its arguments on tariff and domestic subsidies. It postulates that subsidies are used to protect producers in import-competing sectors who are hurt by trade agreements that lower tariff. The theory recognises the need to sign trade agreements to eliminate credibility problems and tariff binding to eliminate trade wars. It calls on governments to carefully examine whether to adopt a tariff policy only, a subsidy policy only or both.

Theory of optimum subsidy was also discussed. The theory postulates that subsidies may be used as the first policy option where domestic market distortions occur. This policy decision is arrived at after ranking policy instruments dealing with different distortions. Finally, new trade theory emphasises economies of scale and product differentiation. The theory postulates that subsidies may be used to reverse specialisation caused by relatively small economies of scale or to shift profits from foreign firms through oligopolistic industries that earn excessive profits.

The analyses that have been put forth in this chapter lay the foundation for discussions in the subsequent chapters. The next chapter analyses the consistency of subsidies offered in Kenya's free zones with the WTO Agreement on Subsidies and Countervailing Measures.

## CHAPTER THREE

### KENYA'S FREE ZONES AND WTO AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

#### 3.1 Introductory remarks

As indicated in the first chapter, this chapter analyses fiscal incentives offered in Kenya's free zones and their consistency with the Agreement on Subsidies and Countervailing Measures (ASCM). The first part gives an overview of subsidies granted in Kenya's free zones. An analysis of the subsidies is necessary in determining whether or not they are consistent with the ASCM. The second part discusses in detail the requirement for specificity of fiscal incentives granted in Kenya's free zones.

The third part expansively discusses prohibited subsidies contingent on exports. It begins by analysing the legal requirements for export subsidies before discussing exemptions from export subsidy prohibitions given to Kenya under special and differential treatment (S&D). The fourth part discusses prohibited subsidies contingent on use of domestic over imported products. It begins by discussing the legal framework and thereafter analyses the principle of national treatment in the context of import substitution subsidies. Before concluding the chapter, this study elaborates on actionable remedies in the fifth part and identifies possible remedies when prohibited or actionable remedies are granted in the sixth part.

This chapter relies heavily on the ASCM in so far as subsidies on trade in goods are concerned<sup>92</sup> and as regards measures by a government or public body.<sup>93</sup> Other relevant sources are the General Agreement on Tariffs and Trade (GATT) and Kenya's Special Economic Zones (SEZs) Act and Export Processing Zones (EPZs) Act. Various decisions of the WTO Dispute Settlement Body (DSB) are also widely referred to.

#### 3.2 Analysis of subsidies offered in Kenya's free zones

A subsidy for the purpose of this study is a financial contribution given by a government or public body by foregoing government revenue that is otherwise due and results in conferment of a benefit.<sup>94</sup> Footnote 1 of ASCM excludes from the definition of a subsidy the exemption

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<sup>92</sup> D Coppens (n 26 above).

<sup>93</sup> S Creskoff & P Walkenhorst (n 28 above)

<sup>94</sup> ASCM art 1.1 (a)(1)(ii); see also D Coppens (n 26) at 39-100.

from duties or taxes borne by like products of an exported product destined for domestic consumption or non-excessive remission of accrued amounts of such duties or taxes.<sup>95</sup>

In order to understand whether a subsidy is or not contingent on export performance or use of domestic over imported products, this section shall identify subsidies offered in Kenya's free zones. Herein, fiscal incentives offered in Kenya EPZs and SEZs shall be identified separately beginning with those offered in EPZs.

EPZs are developed pursuant to the EPZs Act of 1990 to provide an enabling environment to facilitate and promote export oriented investments.<sup>96</sup> All licenced industries within an EPZ enjoy numerous fiscal incentives including: corporate tax holiday for the first ten years and twenty-five percent tax thereafter (EPZ commercial licenses are however excluded from enjoying this benefit)<sup>97</sup>; withholding tax holiday for a period of ten years on remittances to non-residents (similarly, EPZ commercial licenses are excluded from enjoying this benefit); investment deduction up to one hundred percent over twenty years on new investment in EPZ buildings and machinery; perpetual exemption from payment of stamp duty on legal instruments; perpetual exemption from VAT and customs import duty on inputs<sup>98</sup>; and VAT exemption on local purchases of goods and services supplied by companies in the Kenyan customs territory or domestic market.<sup>99</sup>

The Kenya Export Processing Zones Authority (EPZA) has also established EPZ Small and Medium-sized Enterprises (SMEs) under the EPZ SME Development Programme. The programme is aimed at fostering SME exporters who wish to set up their businesses within an EPZ provided that the majority shareholders are Kenyans. EPZ SMEs receives similar tax incentives as other EPZs. They also receive a rent rate and service charge reduction of two USD per square feet per annum and ten percent service charge for the first five years of operation. To allow for setting up, they also receive a four months' rent free period.<sup>100</sup>

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<sup>95</sup> See also GATT art XVI.

<sup>96</sup> Kenya Export Processing Zones Authority 'EPZ Program' <https://epzkenya.com/epz-program/> (accessed 13 August 2019). There are over 131 operational EPZs in Kenya and negotiations are underway with some Kenyan county governments to set up more EPZs in the country.

<sup>97</sup> Section 2 of EPZs Act defines a commercial activity as "trading in, breaking bulk, grading, repacking or relabeling of goods and industrial raw materials".

Inputs referred to are raw materials, machinery, office equipment, certain petroleum fuel for boilers and generators, building materials, other supplies.

<sup>99</sup> EPZA (n 96 above); see also EPZs Act (n 2 above) sec 29.

<sup>100</sup> As above.

The SEZs Act of 2015 was enacted to create an enabling environment for the development of all aspects of SEZs including creation of incentives, development of integrated infrastructure and removal of any business related impediments.<sup>101</sup>

Licensed industries operating within SEZs receive various fiscal incentives including: value-added tax exemptions; stamp duty exemption for free zones enterprises related document; income tax, advertisements and business service permits fees, filming, manufacturing, trade in unwrought precious metals, general liquor and hotel liquor licences exemptions; corporate tax at the rate of ten percent for the first ten years and fifteen percent for the next ten years; work permits of up to twenty percent of their full-time employees; exemption from duties and taxes under East African Community Customs Management Act of 2005 and Customs and Excise Act; exchange controls waivers for repatriation of profits and capital to parent country; investment deduction up to one hundred percent of capital expenditure; and withholding tax rates on payments made to non-residents and entitlements to dividends paid to non-residents by the free zone entity.<sup>102</sup>

### 3.3 Specificity test

The ASCM stipulates that an analysis of whether a subsidy is prohibited or actionable is conditional on its specificity.<sup>103</sup> The WTO Appellate Body in *United States - Countervailing Duty Measures on Certain Products from China*<sup>104</sup> was of the view that specificity focuses on whether or not access to a subsidy is limited to specific recipients.<sup>105</sup> The ASCM identifies various rules applicable to subsidies specific to certain enterprises or industries. First, a subsidy is specific if its access is limited to a particular industry.<sup>106</sup> Secondly, it is specific if the amount of and eligibility criteria or conditions are clearly spelled out in law or regulation. The eligibility should be automatic and criteria strictly adhered to.<sup>107</sup> Thirdly, subsidies limited to industries operating within a geographically designated area are considered

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<sup>101</sup> Sec 3.

<sup>102</sup> SEZs Act (n 2 above) sec 35; Kenya Revenue Authority (n 16 above); see also Kenya Ministry of Industry, Trade and Cooperatives 'Kenya to Roll out Special Economic Zones in First Quarter of 2016' <http://www.industrialization.go.ke/index.php/media-center/blog/310-kenya-to-roll-out-special-economic-zones-in-first-quarter-of-2016> (accessed 13 August 2019).

<sup>103</sup> See ASCM art 1.2; see also D Coppens (n 26 above) 100-114.

<sup>104</sup> Appellate Body Report (WT/DS43728); see WTO Analytical Index on SCM Agreement - Article 2 (Jurisprudence).

<sup>105</sup> see also D Coppens (n 26 above) 101 where the WTO Panel in *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada – Recourse to Article 21.5 of the Dispute Settlement Unit by Canada*, WT/DS277/AB/RW held that specificity of a subsidy should be determined at the industry or enterprise and not product level.

<sup>106</sup> As above, art 2.1(a).

<sup>107</sup> As above, art 2.1(b). Footnote 2 indicates that the criteria or conditions should be neutral and economic in nature.

specific.<sup>108</sup> Fourthly, all forms of prohibited subsidies are specific.<sup>109</sup> Finally, a subsidy is also considered specific in the following instances:

...use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy...<sup>110</sup>

To substantiate the specificity of fiscal incentives offered in Kenya's free zones, a reading of the legislations or regulations spelling out the incentives is necessary. EPZs are defined as designated parts of Kenya which are considered as being outside the customs territory in so far as import duties and taxes are concerned.<sup>111</sup> The parts are duly restricted by controlled access and benefits apply wherein. The EPZA has the mandate to ensure that there is adequate enclosure of an EPZ to separate it from the customs territory.<sup>112</sup>

Enterprises allowed to operate within an EPZ must obtain a valid licence from EPZA.<sup>113</sup> The EPZs Act expressly states that it shall extend benefits to an enterprise that has a valid licence.<sup>114</sup> The eligibility criteria for the enterprises are; first, the industry should be incorporated in Kenya for the sole purpose of operating within an EPZ; secondly, the proposed activity should be eligible to be undertaken within an EPZ; thirdly, the activity should be environmentally friendly, should not prove to be a health hazard and should not be a threat to national security; fourthly, the business should be conducted in accordance with the law.<sup>115</sup> These requirements apply verbatim to SEZs.<sup>116</sup>

In addition to the above stated specificity criteria for EPZs which apply *mutatis mutandis* to SEZs, the SEZs Act obligates the cabinet secretary for industrialization and enterprise development on the recommendation of the Special Economic Zones Authority

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<sup>108</sup> As above, art 2.2.

<sup>109</sup> As above, art 2.3; see generally art 3; see also RA Torres (n 20 above).

<sup>110</sup> As above, art 2.1(c). In applying this definition, the extent of diversification of economic activities within the jurisdiction of the granting authority and length of time for the operation of the subsidy shall be considered.

<sup>111</sup> EPZs Act (n 2 above) sec 2.

<sup>112</sup> As above, sec 16(1)

<sup>113</sup> As above; see also secs 9(2)(f) & 19.

<sup>114</sup> Sec 23(1).

<sup>115</sup> As above, subsection 2. One hundred percent foreign ownership of a company incorporated in Kenya is permitted.

<sup>116</sup> SEZs Act (n 2 above) secs 5, 11(f), 26, 27 & 29; see also Special Economic Zones Regulations 2016 regulations 25 & 26.

(SEZA) and in consultation with the cabinet secretary for national treasury and planning to gazette a clearly defined area as a SEZ.<sup>117</sup>

### 3.4 Prohibited subsidies contingent on exports

#### 3.4.1 Export subsidies

The Appellate Body in *United States - Conditional Tax Incentives for Large Civil Aircraft*<sup>118</sup> made it clear that granting of subsidies is not on its own proscribed by the ASCM. Subsidies, with the exclusion of agricultural export subsidies, contingent upon export performance are however prohibited under the ASCM.<sup>119</sup> To establish the existence of export subsidies, it must first be demonstrated that a subsidy exist and secondly, that the subsidy is conditional on export performance.<sup>120</sup>

Export subsidies could be based on law or fact. In law, the subsidy contingent on export should be expressed in a legal instrument. The WTO Panel in *Canada - Aircraft*<sup>121</sup> held that exports credits granted directly or indirectly to support and develop export trade are in law contingent on export performance. The WTO Appellate Body in *United States – Upland Cotton* opined that payments made on proof of exportation are sufficient to establish that they are conditional on export performance.<sup>122</sup>

Export subsidies based on fact need not necessarily be expressly stated in a legal instrument, its availability is based on fulfilling certain conditions of export performance. In such instances, therefore, existence of export subsidies is implied as being conditioned on export performance. Export performance could be the sole condition or one of many other conditions for granting subsidies.<sup>123</sup> The Appellate Body in *Australia – Automotive Leather II*, called for a case by case analysis of whether a subsidy is in fact contingent on export performance.<sup>124</sup> The Appellate Body in *EC and certain member States – Large Civil Aircraft* opined:

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<sup>117</sup> See generally sec 4; see also SEZ Regulations ( n 116 above) regulations 12 & 13.

<sup>118</sup> Appellate Body report and Panel report (WT/DS487/11).

<sup>119</sup> Art 3.1(a); WTO ANALYTICAL INDEX: SCM Agreement – Article 3 (Jurisprudence) paragraph 1. Agricultural export subsidies are covered under the WTO Agreement on Agriculture.

<sup>120</sup> As above, paragraph 4.

<sup>121</sup> Panel Report *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the Dispute Settlement Unit* WT/DS70/RW, adopted 4 August, 2000.

<sup>122</sup> Appellate Body Report *United States – Subsidies on Upland Cotton* WT/DS267/AB/R, adopted 21 March 2005.

<sup>123</sup> As above, paragraphs 5 & 11.

<sup>124</sup> As above, paragraph 29.



The existence of de facto export contingency must be inferred from the total configuration of the facts constituting and surrounding the granting of the subsidy, which may include the following factors: (i) the design and structure of the measure granting the subsidy; (ii) the modalities of operation set out in such a measure; and (iii) the relevant factual circumstances surrounding the granting of the subsidy that provide the context for understanding the measure's design, structure, and modalities of operation.<sup>125</sup>

Basing his analysis on *Brazil – Aircraft (Article 21.5 – Canada)*, Coppens argues that a complaint based on the illustrative list is sufficient to demonstrate that a subsidy is contingent on export performance.<sup>126</sup> This illustrative list is set out under Annex I of ASCM.<sup>127</sup> Of importance to this study are direct subsidies contingent on exports given by a government body to an industry; currency retention schemes; government provision of internal transport and freight charges on export shipments on more favourable terms than domestic shipments; domestic or imported goods or services provision by government to industries producing imported products on more favourable terms than those given to industries producing goods for local consumption; full or partial direct tax exemptions; special deductions on exports in excess of those granted for production of products for local consumption; indirect tax exemptions on the production and distribution of exported products in excess of those granted to products produced or distributed for local consumption; exemption, deferral or remission of prior-stage cumulative indirect taxes on goods and services used in the production of products for exports in excess of those granted for the production of goods for local consumption<sup>128</sup>; drawback of import charges in excess of those levied on imported inputs used in the production of products for exports; provision of export credit guarantee or insurance premiums at rates inadequate to cover the full operation costs; and grants of export credits at below-market rates.

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<sup>125</sup> As above; see also WTO ANALYTICAL INDEX; SCM Agreement, paragraph 18.

<sup>126</sup> D Coppens (n 26 above) 117; see also Report of the Panel ‘*Brazil – Export Financing Programme for Aircraft*’ WT/DS46/R, adopted 20 August 1999.

<sup>127</sup> ASCM; see also the Multi-Donor Investment Climate Advisory Service of the World Bank ‘Special Economic Zones Performance, Lessons Learned, and Implications for Zone Development’ (April 2008) The World Bank Group.

<sup>128</sup> While the exemption, remittance and deferral applies when there is no exemption, remittance or deferral on the sale of products for local consumption, prior-stage cumulative indirect taxes levied on inputs that are consumed in the production of products for exports are exempted (annex I(h)).

### 3.4.2 Exemptions under special and differential treatment

As a formal recognition of the importance of subsidies in developing countries' economic development, the ASCM accorded developing countries such as Kenya exemptions from prohibited subsidies contingent on exports under special and differential treatment of developing countries members since Kenya's GNP per capita was below USD 1 000.<sup>129</sup> All developing countries that were not listed under Annex VII<sup>130</sup> were expected to phase out export subsidies within eight years but could ask for an extension based on their development needs.<sup>131</sup>

Export subsidies for products that reached export competitiveness were expected to be phased out by developing countries over a period of two years. Countries such as Kenya that were listed under Annex VII (b) were expected to gradually phase out over a period of eight years from the date of export competitiveness.<sup>132</sup>

The Doha Ministerial Decision on Implementation – Related Issues and Concerns, stated that Kenya and other countries listed under Annex VII (b) would be deemed to have graduated from export subsidy prohibitions exemptions once their GNI reached USD 1 000 in constant 1990 dollars for three consecutive years. They were also expected to gradually eliminate export subsidies over a period of eight years or less, if export subsidies were inconsistent with their development needs, once a product reached export competitiveness.<sup>133</sup> No developing country has made any notification so far of having reached export competitiveness.<sup>134</sup>

In compliance with the Procedures for Extension under Article 27.4 for Certain Developing Country Members which extended the transition period for certain limited programmes based on annual reviews,<sup>135</sup> Kenya in December 2001 sought for an extension of the transition period for the exemption from the export subsidies prohibition in the light of its

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<sup>129</sup> As above, arts 27.1(a) & 2(b); see also Annex VII.

<sup>130</sup> Other countries that were granted the exemptions include Cameroon, Côte d'Ivoire, Bolivia, Congo, Nicaragua, Dominican Republic, Ghana, Egypt, Guatemala, Guyana, India, Senegal, Zimbabwe, Indonesia, Sri Lanka, Morocco, Philippines, Nigeria and Pakistan (ASCM Annex VII). Honduras was later added.

<sup>131</sup> As above, arts 27.1 (b) & 27.4.

<sup>132</sup> As above, art 27.5; Export competitiveness exists if exports of a product reach 3.25 percent in world trade of that product for two consecutive calendar years (Art 27.6); see also WTO ANALYTICAL INDEX: SCM Agreement – Article 27 (Practice), February 2019, paragraph 11.

<sup>133</sup> WT/MIN(01)17, adopted 20 November 2001, Paragraph 10.1 & 10.5; see also WTO ANALYTICAL INDEX: SCM Agreement – Annex VII (Practice) paragraph 2; countries whose GNI rose above this level was to be re-included dropped below USD 1 000; the Committee on Subsidies and Countervailing Measures was also directed to extend transition period for certain export subsidies (paragraph 10.6).

<sup>134</sup> WTO ANALYTICAL INDEX: SCM Agreement – Article 27 (Practice), February 2019, paragraph 7.

<sup>135</sup> WTO Committee on Subsidies and Countervailing Measures 'Procedures for Extensions under Article 27.4 for Certain Developing Country Members' G/SCM/39, 20 November 2001.

economic, financial and development needs and as an anticipatory measure in the event that it graduated from exceptions that were then in existence.<sup>136</sup> Kenya specifically sought the extension of three programmes, including: export processing zones; export promotion programme under the Customs and Excise Regulations; and manufacture under bond.<sup>137</sup> Following the request for extension, Kenya became eligible for a five-year extension with a two-year phase out period.<sup>138</sup>

The General Council in July 2007<sup>139</sup> adopted procedures for continuation of extensions of the transition period under Article 27.2 (b) for certain developing countries, including Kenya following its anticipatory request for extension. Like the previous extension procedures, the programmes covered included programmes that provided partial or full exemptions from internal taxes and import duties. The extension which terminated in 2012 was subject to annual review from 2008. The last authorized period was 31 December 2013 and a final two-year phase out period which ended on 31 December, 2015.<sup>140</sup> Following the extensions, concerned countries were required to take internal steps to eliminate export subsidies and provide an action plan for elimination of export subsidies under the programme.<sup>141</sup> The Procedures allowed countries, such as Kenya, that had reserved extension rights previously to request for extension of the transition period if its GNI reached USD 1,000 in constant 1990 dollars for three consecutive years between 2008 and 2015.<sup>142</sup>

Kenya's GNI per capita at current dollars were: 736 in 2009; 791 in 2010; 800 in 2011; 939 in 2012; 1,238.6 in 2013; 1,351.0 in 2014; 1,335.5 in 2015; 1,441.2 in 2016 and 1,578.3 in 2017.<sup>143</sup> This was the threshold when the ASCM took effect in 1995. Based on

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<sup>136</sup> WTO ANALYTICAL INDEX SCM Agreement – Annex VII (Practice) paragraph 4; see also WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/N/74/KEN, 21 December 2001. This was in line with paragraph 1(a) of the G/SCM/39 that had been arrived at in November that year.

<sup>137</sup> As above, (G/SCM/N/74/KEN; see also D Coppens (n 26 above) 259.

<sup>138</sup> S Creskoff & P Walkenhorst (n 28 above) 22. This period was scheduled to end on 31 December 2007 and 31 December 2009 respectively.

<sup>139</sup> World Trade Organization 'Article 27.4 of the Agreement on Subsidies and Countervailing Measures' WT/L/691, 31 July 2007.

<sup>140</sup> WTO General Council Decision 'Article 27.4 of the Agreement on Subsidies and Countervailing Measures' WT/L/691, 31 July 2007, paragraph 1 (d) & footnote 4.

<sup>141</sup> As above, paragraph 1 (e) and (f).

<sup>142</sup> As above, paragraph 5 (b) & footnote 7.

<sup>143</sup> WTO Committee on Subsidies and Countervailing Measures 'Subsidies; Annex VII (b)' G/SCM/110/Add.8 (16 June 2011); WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.9 (20 June 2012); WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.10 (11 July 2013); WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.11 (23 June 2014); WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.12 (6 July 2015); WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.13 (19 May 2016); WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.14 (11 July 2017); WTO Committee on Subsidies and Countervailing Measures 'Subsidies'

these figures, Kenya would not have been able to avail itself of the exemptions in 2013. This is, however, no longer the threshold since calculation is currently based on GNI per capita at constant 1990 dollars. The figures for Kenya were: 410 in 2007; 407 in 2008; 403 in 2009; 415 in 2010; 421 in 2011; 427 in 2012; 453 in 2013; 469 in 2014; 474 in 2015; 490 in 2016 and 501 in 2017.<sup>144</sup> These figures shows and according to the Committee on Subsidies and Countervailing Measures (SCM Committee) update on GNP per capita for countries listed under Annex VII (b) of 14 May 2019, Kenya still enjoys exemptions from export subsidies prohibitions granted under Annex VII (b) since its GNI is below USD 1,000 in constant 1990 dollars and has been the case for three previous consecutive years. Other countries that are still listed are Côte d'Ivoire; Ghana; Honduras; Nicaragua; Nigeria; Pakistan; Senegal; and Zimbabwe.<sup>145</sup>

In 2018, Central African Republic on behalf of Least Developing Countries (LDCs) that had graduated from the exemption requested and submitted a decision to be adopted by the General Council for Trade in Goods for an extension of the exemptions.<sup>146</sup> This request was first introduced into the Agenda of the meeting of the Council for Trade in Goods in June 2018 and discussions are currently on-going.<sup>147</sup>

Despite the exemptions on export subsidies, Kenya is mandated to submit a notification not later than thirtieth June each year that it has not maintained or granted any subsidies warranting a notification.<sup>148</sup> Other WTO members are obligated to submit notifications on specific subsidies granted by stating the form of subsidy granted, annual amount budgeted for the subsidy, purpose and duration of the subsidy and statistical data for assessment of the trade effects of the subsidy.<sup>149</sup> According to a 2018 WTO Report, Kenya has not made any notification on its status of subsidies since 1998.<sup>150</sup> In 2013, Kenya notified

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G/SCM/110/Add.15 (20 April 2018); WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.16 (14 May 2019).

<sup>144</sup> As above.

<sup>145</sup> WTO Committee on Subsidies and Countervailing Measures 'Subsidies' G/SCM/110/Add.16 (14 May 2019).

<sup>146</sup> n 135 above, paragraph 2.

<sup>147</sup> WTO Council for Trade in Goods 'Proposed Agenda' G/C/W/754, 28 June 2018, Agenda 8; see WTO Council for Trade in Goods 'Minutes of the Meeting of the Council for Trade in Goods 3 and 4 July 2018' G/C/M/132, adopted 13 March 2019, Agenda 8.

<sup>148</sup> ASCM art 25.6.

<sup>149</sup> As above, arts 25.1, 25.2 & 25.4.

<sup>150</sup> World Trade Organization 'Report (2018) by the Committee on Subsidies and Countervailing Measures, G/L/1272, G/SCM/152, adopted on 23 October 2018, at 8-18.

the SCM Committee that it had not taken any countervailing action and was not anticipating taking any such action in the future.<sup>151</sup>

### 3.5 Subsidies contingent on use of domestic over imported products

#### 3.5.1 Import substitution subsidies

In addition to export subsidies prohibition exemptions that Kenya enjoys pursuant to Article 27. 2 (a) and Annex VII (b) of ASCM, it was exempted from prohibited subsidies contingent on use of domestic over imported products (import substitution subsidies) for five years after entry into force of the Agreement establishing the WTO on 1 January 1995.<sup>152</sup> This period terminated on 31 December 1999.<sup>153</sup>

The ASCM does not prohibit subsidization of domestic production in itself but the granting of subsidies contingent upon use of domestic over imported products.<sup>154</sup> The WTO Analytical Index while making reference to the Appellate Body's decision in *United States - Conditional Tax Incentives for Large Civil Aircraft* observed that:

We recall that, by its terms, Article 3.1(b) does not prohibit the subsidization of domestic "production" per se but rather the granting of subsidies contingent upon the "use", by the subsidy recipient, of domestic over imported goods. Subsidies that relate to domestic production are therefore not, for that reason alone, prohibited under Article 3 of the SCM Agreement. We note in this respect that such subsidies can ordinarily be expected to increase the supply of the subsidized domestic goods in the relevant market, thereby increasing the use of these goods downstream and adversely affecting imports, without necessarily requiring the use of domestic over imported goods as a condition for granting the subsidy.<sup>155</sup>

Coppens argues that it is the only domestic subsidy that is prohibited. He argues further that this forms of subsidies 'focuses on the trade distortion in the input industry and not in the market of the industry receiving the beneficial financial contribution by the government'.<sup>156</sup> According to Coppens, an import substitution subsidy exists when it is demonstrated first that there is a subsidy. Secondly, the subsidy must be contingent on us of

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<sup>151</sup> WTO Committee on Subsidies and Countervailing Measures 'Notification under Articles 25.11 AND 25.12 of the Agreement on Subsidies and Countervailing Measures: Kenya' G/SCM/N/202/KEN, 27 June 2013; See 2018 Report (n 51 above) paragraph 37 and at 19.

<sup>152</sup> ASCM art 27.3. Least developed country members were exempted for eights of entry into force of the WTO Agreement.

<sup>153</sup> n 135 above, paragraph 3.

<sup>154</sup> Art 3.1(b); WTO ANALYTICAL INDEX SCM Agreement – Article 3 (Jurisprudence), paragraph 2.

<sup>155</sup> WTO Analytical Index.

<sup>156</sup> D Coppens (n 26 above) 141.

domestic over imported products.<sup>157</sup> While analysing the Appellate Body decision in *Canada – Autos*, Coppens argues that these forms of subsidies just like export subsidies are contingent on law or fact.

It is therefore imperative that import substitution subsidies, as shall be further espoused in the subsequent section, are discriminatory and should, thus be eliminated. An analysis of whether subsidies offered in Kenya's free zones are inconsistent with this obligation is made later in this chapter.

### **3.5.2 National treatment**

The principle of national treatment prohibits discrimination between imported and domestic products after introducing imported products into a WTO member's territory.<sup>158</sup> GATT expressly obligates member states to accord no less favourable treatment to products imported into its territory than those accorded to domestic products in so far as all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use are concerned.<sup>159</sup> Maintenance of quantitative regulation which requires direct or indirect use of domestic products is also prohibited.<sup>160</sup>

GATT allows for payment of subsidies exclusively to domestic producers. This includes subsidies derived from internal taxes or charges and subsidies granted through purchase of domestic products by government.<sup>161</sup> Coppens argues that discrimination exist 'between domestic and foreign input industries and not between subsidized domestic industry and foreign industry'.<sup>162</sup>

It is therefore imperative that provisions of subsidies to domestic industries is permitted but conditioning subsidies on use of domestic inputs over foreign inputs is discriminatory. Hence, import substitution subsidies are discriminatory since they accord more favourable treatment to the use of domestic over imported products.

### **3.6 Actionable subsidies**

Actionable subsidies constitute subsidies that are not prohibited but may cause injury to other countries' domestic industry; result in the nullification or impairment of benefits accruing to

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<sup>157</sup> As above.  
<sup>158</sup> See S Creskoff & P Walkenhorst (n 28 above) 25.  
<sup>159</sup> GATT art III (4).  
<sup>160</sup> As above, paragraph 5.  
<sup>161</sup> As above, paragraph 8 (b).  
<sup>162</sup> See D Coppens (n 26 above) 142.

other members, particularly concessions benefits bound under GATT;<sup>163</sup> or seriously prejudices the interest of other members.<sup>164</sup>

Any subsidy given by a government or public body should not cause injury to the domestic industry of another WTO member. Coppens argues that a material injury to a domestic industry during the reference period must be demonstrated in the first instance. Secondly, it has to be shown that the causation element is not subsidies but subsidised imports.<sup>165</sup>

A subsidy should not result in impairment of benefits of concessions accruing to other WTO Members. For an impairment of benefits to exist, it must first be shown that a subsidy exists. Secondly, a benefit must exist. Thirdly, there must be an impairment of the benefit resulting from application of a subsidy.<sup>166</sup> According to the ASCM, serious prejudice is deemed to result when the total product ad valorem subsidisation exceeds five per cent; when industry operating losses are covered by a subsidy;<sup>167</sup> or government debts are directly forgiven.<sup>168</sup>

The ASCM further expressly states that the interest of another WTO Member is prejudiced if a subsidy results in the displacement of its imported products. There could be actual serious prejudice or a threat of a serious prejudice. The burden of proving serious prejudice lie on the complaining party. In so doing, the complaining party has to demonstrate that the effect of a subsidy is to displace or impede the imports of its like product into the market of the subsidising country; the subsidy has displaced or impeded exports of a like product of another WTO Member from a third-country market; the subsidy has resulted in a significant price undercutting by the subsidised product in comparison with prices of like products in another country; or the subsidy has resulted in an increase in the world market share of the subsidising country in a particular commodity compared to the average share it had in three previous years.<sup>169</sup>

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<sup>163</sup> ASCM art 5; see also GATT art II. Agricultural products provided for under Article 13 of AoA are not covered.

<sup>164</sup> As above.

<sup>165</sup> D Coppens (n 26 above) 145; See also ASCM art 27.9.

<sup>166</sup> ASCM art 5; see also D Coppens (n 26 above) 146.

<sup>167</sup> One time non-recurrent measures given to provide time for development of long – term solutions and avoid acute social problems are excluded (ASCM art 6.1 (c)).

<sup>168</sup> As above, art 6.1. Fall of actual sales below the level of forecast sales resulting in non-repayment of royalty based financing for a civil aircraft programme does not constitute serious prejudice (ASCM footnote 16).

<sup>169</sup> ASCM art 6.3; see also D Coppens (n 26 above) 148. Displacement resulting in serious prejudice does not result when there is restriction on imports of like products; force majeure; existence of arrangements limiting exports from the complaining member; failure to conform to set standards; voluntary decrease in

Relative market shares variance results when there is an increase in the market share of the subsidised product; when the subsidised product market value remains constant following the provision of a subsidy; or subsidised product value declines at a slower rate following the introduction of a subsidy.<sup>170</sup> Price undercutting is demonstrated by comparing prices of subsidised and non-subsidised products while taking into consideration any factor affecting price compatibility. Export unit values can be adopted when a direct comparison is impossible.<sup>171</sup>

Importantly, products alleged to have been seriously prejudiced must be produced in the complaining party's territory.<sup>172</sup> Effects on other members' products can be adduced as evidence only in support of the complaining member's case. The injury should further be caused to a like product. Article 27.8 of ASCM refutes presumption of serious prejudice by a subsidy granted by a developing country unless evidence to the effect is submitted.

In *Indonesia – autos*, EU and US argued that subsidies granted to the Indonesian automotive industry undercut their prices and impeded or displaced their imports into the Indonesian market.<sup>173</sup> The case demonstrated clear evidence of price undercutting, there was however no proof of volume effects. Similarly, the complainants failed to demonstrate loss of market share value in significant terms.

### **3.7 Remedies for granting prohibited and actionable subsidies**

The first recourse given to a WTO member who has reason to believe that a prohibited or actionable subsidy is being granted is consultation.<sup>174</sup> The aim of consultation is to ascertain facts and possibly reach a mutually agreed upon solution. If no mutually agreed solution is arrived at within thirty days, for prohibited subsidies, and sixty days, for an actionable subsidy, of consultation request, the matter may be referred to the WTO DSB for establishment of a panel unless a DSB decision is reached by consensus that a panel would not be established.<sup>175</sup> While the panel for prohibited subsidies is established immediately, a

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availability for concerned product from the complaining member; and state monopolization in the concerned products trade (ASCM, art 6.7).

<sup>170</sup> ASCM art 6.4.

<sup>171</sup> As above, art 6.5.

<sup>172</sup> As above; see also D Cripps (n 26 above) 151.

<sup>173</sup> See D Cripps (n 26 above) 175; Panel Report *Indonesia – Certain Measures Affecting the Automobile Industry* WT/DS54,55,59,64/R, adopted 23 July, 1998.

<sup>174</sup> ASCM art 4.1 & 7.1. Remedies on actionable subsidies excludes domestic measures and export subsidies that conform to the provisions of the AoA. This is provided for under Article 13 of the AoA.

<sup>175</sup> As above, art 4.4 & 7.3



panel for actionable subsidies is composed within fifteen days from its date of establishment.<sup>176</sup>

Once a panel is established, it may request a panel of experts to assist in establishing whether or not a subsidy is prohibited. The subsidising country will in the process be given audience to substantiate that the measure is not prohibited.<sup>177</sup> The panel is required to give a report to the disputants and circulate amongst WTO members within ninety days and one hundred and twenty days of the date of establishment of the panels for prohibited and actionable remedies respectively.<sup>178</sup> If the measure is found to be prohibited, the subsidising country would be required to without delay withdraw the subsidy. The reports are then adopted within thirty days unless an appeal is lodged or unless the DSB opts not to adopt them.<sup>179</sup>

In case there is an appeal, the appellate body is obligated to give its findings within thirty days of formal notification of intention to appeal.<sup>180</sup> The appellate body report shall be unconditionally accepted by the disputants and the report adopted by DSB unless it in twenty days decide by consensus not to adopt the report.<sup>181</sup>

If the recommendation of the DSB is not followed, the complaining member shall be given authorization by the DSB to take appropriate countervailing measures.<sup>182</sup> In the case of actionable subsidies, where it is shown that a subsidy has resulted in adverse effects to the interest of another member, the subsidising member shall take appropriate steps to either withdraw the subsidy or remove adverse effects.<sup>183</sup> If the adverse effects is not removed or subsidy withdrawn within six months and in the absence of a compensation agreement, the complaining member shall be authorised to introduce a countervailing measure commensurate to the nature and degree of the adverse effects caused unless the request is rejected by DSB by consensus.<sup>184</sup>

A disputant has an option of requesting for arbitration which leads to a determination whether or not a countermeasure is appropriate or commensurate with the nature and degree

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<sup>176</sup> ASCM arts 4.4 & 7.4.

<sup>177</sup> As above, arts 4.5 & 7.5

<sup>178</sup> As above, arts 4.6 & 4.7.

<sup>179</sup> As above, arts 4.8 & 7.6.

<sup>180</sup> As above, arts 4.9 & 7.7.

<sup>181</sup> As above. The time periods set for the multilateral approach may by mutual consent be extended (ASCM footnotes 6 & 20).

<sup>182</sup> ASCM art 4.10. Disproportionate countermeasures are disallowed since the subsidies are prohibited (ASCM footnote 9).

<sup>183</sup> As above, art 7.8.

<sup>184</sup> As above, art 7.9.

of the existing adverse effects.<sup>185</sup> In *Brazil – Aircraft*, the arbitrator opined that in the case of prohibited export subsidies, a countermeasure is appropriate if its amount corresponds to the total amount of subsidy.<sup>186</sup>

A complaining member is allowed to impose a provisional countervailing measure before the termination of a countervailing duty investigation if an investigation has been instituted at least sixty days before and an opportunity accorded to other interested members for consultations. The countervailing measures should be necessary to prevent injury caused by an actionable subsidy.<sup>187</sup> Article 19.4 of ASCM stipulates that a countervailing measure should not exceed the subsidy amount.

### **3.8 Analysis of the consistency of fiscal incentives offered in Kenya free zones with the ASCM**

Based on the discussions that have been put forth in the preceding sections of this chapter, two inferences can be made. First, fiscal incentives offered in Kenya's free zones are consistent with WTO rules on export subsidies. The justification for this is that, Kenya has since 1995, when the ASCM took effect, been exempted from export subsidy prohibition since its GNI per capita has remained below USD 1000 in constant 1990 dollars. This is reaffirmed in the 14 May 2019 list of developing countries that still enjoy the exemption. Kenya is therefore allowed to impose export subsidies.

Secondly, fiscal incentives offered in Kenya's free zones are consistent with the rules on import substitution subsidies. Kenya is estopped from granting import substitution subsidies following the termination of exemptions granted under the ASCM on 31 December 1999. An analysis of the fiscal incentives offered (discussed at length in the second part of this chapter) shows that Kenya is not maintaining any export substitution subsidy since it is not conditioning any subsidy on the use of domestic over imported products.

### **3.9 Concluding remarks**

This chapter began by defining a subsidy as a financial contribution given by a government to a particular industry that results in conferment of benefits. It identified various forms of

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<sup>185</sup> As above, arts 4.12 & 7.10. Disproportionate countermeasures in case of prohibited subsidies are prohibited (ASCM footnote 10).

<sup>186</sup> D Coppens (n 26 above) 204; see decision by the Arbitrators *Brazil – Export Financing Programme for Aircraft – Recourse to Arbitration by Brazil and Article 4.11 of the ASCM* WT/DS46/ARB, 28 August 2000; see also decision by the Arbitrator *Canada – Export Credits and Loan Guarantees for Regional Aircraft – Recourse to Arbitration by Canada under Article 22.6 of the Dispute Settlement United and Article 4.11 of the ASCM* circulated 17 February 2003.

<sup>187</sup> D Coppens (n 26 above) 245.

subsidies offered in Kenya's free zones for SEZs, EPZs and EPZs SMEs. It then analysed that subsidies offered in Kenya's free zones are specific since the benefits are granted to licensed industries operating within geographically designated areas. It further pointed out that the subsidies are granted by law and duly registered authorities.

This chapter thereafter put forth arguments on export subsidies contingent on law or fact. It discussed the exemptions on export subsidies prohibitions granted to Kenya under Article 27.2 (a) and Annex VII (b) of ASCM by giving an overview of the applicability of the exceptions to Kenya since the ASCM took effect. The analyses show that Kenya to date still enjoys the exemptions since its GNP per capita has remained below USD 1 000 in constant 1990 dollars. On import substitution subsidies, this chapter noted that conditioning subsidies on use of domestic inputs over imported inputs is discriminatory.

Discussions on actionable subsidies were thereafter put forward. This study made the argument that actionable subsidies are not prohibited per se but should not cause injury to other countries' domestic industry. It should also neither result in impairment of benefits accruing to other members nor seriously prejudice the interest of other members. The chapter thereafter made arguments for remedies available to an aggrieved party in the event a prohibited or actionable remedy is maintained. While putting forth propositions that export subsidies should be eliminated for free zones to be in conformity with ASCM,<sup>188</sup> this chapter concludes that Kenya is permitted under ASCM to grant export subsidies. Kenya is however prohibited from granting import substitution subsidies.

As indicated in the first section of this chapter, the ASCM covers subsidies on trade in goods with the exclusion of agricultural products covered under the Agreement on Agriculture (AoA). To fully understand the consistency of subsidies offered in Kenya's free zones with WTO rules on subsidies and in addition to the discussions that have been put forth in this chapter, the next chapter shall comprehensively analyse the consistency of fiscal incentives offered in Kenya's free zones with the AoA.

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<sup>188</sup> R Toress (n 20 above).

## CHAPTER FOUR

### KENYA'S FREE ZONES AND WTO AGREEMENT ON AGRICULTURE

#### 4.1 Introductory remarks

As has been previously stated, subsidies within the auspices of the World Trade Organization (WTO) are covered under the Agreement on Subsidies and Countervailing Measures (ASCM) and Agreement on Agriculture (AoA). The ASCM as discussed in the previous chapter covers subsidies on trade in goods and agricultural subsidies that do not conform to AoA. The ASCM similarly contains rules for dealing with the negative effects of harmful subsidies.<sup>189</sup> Specific provisions in the General Agreement on Tariffs and Trade (GATT) are also applicable to agricultural products not specifically addressed under AoA. The AoA therefore contains specific rules on the use of agricultural subsidies.<sup>190</sup> Hence, ASCM and GATT apply subject to AoA provisions.<sup>191</sup>

In analysing the consistency of fiscal incentives offered in Kenya's free zones with AoA, this chapter is divided into six sections. The first section gives an overview of fiscal incentives offered in agriculture related free zones in Kenya. Secondly, this chapter examines the relationship between the export subsidy provisions in the AoA with the framework for the provision of fiscal incentives in Kenya's free zones. Thirdly, domestic support measures are broadly discussed in light of fiscal incentives offered in Kenya's free zones. Fourthly, the peace clause in the AoA in relation to both export subsidies and domestic support are briefly discussed. Fifthly, the mechanisms for resolving disputes arising from violation of domestic support and export subsidies for agricultural products are discussed. This chapter then concludes with a summary of the salient points.

#### 4.2 Kenya's free zones and AoA

Agricultural products covered under AoA include: basic agriculture products,<sup>192</sup> processed agricultural products, trade in wine, spirits and tobacco products, fibres and raw animal skins destined for leather production,<sup>193</sup> livestock, meat, dairy products and wool.<sup>194</sup> The AoA expressly excludes in its coverage fish and fish products and forestry products.<sup>195</sup>

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<sup>189</sup> See generally the ASCM.

<sup>190</sup> See generally the AoA; see D Coppens (n 26 above) 280.

<sup>191</sup> AoA art 21.1.

<sup>192</sup> AoA art 1 (b). Basic agricultural products for domestic support commitments are products close to the point of first sale.

<sup>193</sup> AoA art 2; see Harmonized System, Chapters 1 – 24; see also WTO ANALYTICAL INDEX Agreement on Agriculture – Article 2 / Annex 1 (Jurisprudence), December 2018, paragraph 3.

Following the enactment of the SEZs Act in Kenya, two kinds of agricultural related zones are recognised: agricultural zones created to facilitate the agricultural sector, its services and associated activities and livestock zones created to facilitate livestock marshalling and inspection, livestock feeding or fattening, abattoir and refrigeration, deboning, value addition, manufacture of veterinary products, and other related activities.<sup>196</sup> These zones are however yet to be established in Kenya.

Like other SEZs that have been identified under the previous chapter, agricultural and livestock zones enjoy various fiscal incentives as has been similarly espoused in the previous chapter. This chapter would therefore proceed to analyse whether the incentives are consistent with the AoA. Specifically, export subsidies and domestic support commitments in light of the fiscal incentives are examined in the subsequent sections.

### **4.3 Export subsidies and Kenya's free zones**

#### **4.3.1 Export subsidy requirements**

The AoA defines export subsidies as subsidies contingent upon export performance.<sup>197</sup> A subsidy has not been defined under AoA but has been construed to have a similar meaning as that provided for under ASCM subject to the provisions of AoA.<sup>198</sup> Unlike the ASCM which limits subsidies to financial contributions, the AoA allows for payment of export subsidies on agricultural products in kind. This is discussed further in the subsequent paragraphs.<sup>199</sup> An agricultural subsidy has also been defined differently in WTO jurisprudence. Coppens, for example, analyses the case of *Canada – Dairy*<sup>200</sup> where the Appellate Body included in its definition of an agricultural subsidy ‘transfer of economic resources from the grantor to the recipient for less than full consideration’.<sup>201</sup>

The GATT permits the granting of direct or indirect subsidies even if they result in an increase in the export of primary products from its territory, provided that they do not cause a contracting party to have more than an equitable share of world export trade in that

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<sup>194</sup> See also Panel Report in *United States – Subsidies on Upland Cotton* WT/DS267/R, adopted 21 March 2005.

<sup>195</sup> Annex 1.

<sup>196</sup> SEZs Act (n 2 above) secs 2 & 4(6) (f) & (i).

<sup>197</sup> AoA arts 1 (e) & 6.3; see also WTO ANALYTICAL INDEX Agreement on Agriculture – Article 6 (Jurisprudence) of December 2018, paragraph 1.2.

<sup>198</sup> D Coppens (n 26 above) at 281-282.

<sup>199</sup> See AoA arts 9.1 (a), (b) & (e) on forms of payments in kind.

<sup>200</sup> Appellate Body Report *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products* WT/DS103,113/AB/R, adopted 27 October 1999.

<sup>201</sup> D Coppens (n 26 above) 282.

product.<sup>202</sup> From 1 January 1958, GATT contracting parties were prohibited from granting subsidies on any other product other than primary products which results in the sale of the product for export at a lower price compared to price of similar products sold for domestic market.<sup>203</sup>

The AoA does not prohibit use of export subsidies provided they are within a member's export subsidy commitments.<sup>204</sup> Export subsidy commitments were construed by the Appellate Body in *US – FSC*<sup>205</sup> to mean obligations relating to export subsidies pursuant to AoA provisions on incorporation of concessions and commitments, export competition commitments and export subsidy commitments.<sup>206</sup> Export subsidies on agricultural products should thus be within the budgetary outlay and quantity commitment levels specified in WTO members' schedules.<sup>207</sup> This definition is dissected in the subsequent paragraphs.

The export subsidy commitment levels of a given year constitute the maximum level of expenditure that may be allocated in the case of budgetary outlay reduction commitments and the maximum quantity of agricultural products for export quantity reduction commitments.<sup>208</sup> Export subsidy commitments cover both scheduled and unscheduled agricultural products.<sup>209</sup> WTO members are estopped from providing subsidies for any agricultural product not listed in their schedules.<sup>210</sup> For listed commitments, developing countries agreed to cut export subsidies by twenty four percent and quantities of subsidised exports by fourteen percent over ten years from 1995.<sup>211</sup> Kenya did not however specify any agricultural products in its schedules.<sup>212</sup> Kenya was therefore barred from introducing any list of export subsidies afterwards but was allowed to enjoy the benefits granted to developing countries under special and differential treatment.<sup>213</sup>

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<sup>202</sup> As above, Art XVI.3.

<sup>203</sup> As above, Art XVI.4.

<sup>204</sup> Art 3.1, 3.2 & 8; see also World Trade Organization 'Export competition/subsidies' [https://www.wto.org/english/tratop\\_e/agric\\_e/ag\\_intro04\\_export\\_e.htm](https://www.wto.org/english/tratop_e/agric_e/ag_intro04_export_e.htm) (accessed 7 August 2019).

<sup>205</sup> Appellate Body Report *United States – Tax Treatment for Foreign Sales Corporations* WT/DS108/AB/R, adopted 20 March 2000.

<sup>206</sup> See arts 3, 8 & 9.

<sup>207</sup> As above, art 3.3.

<sup>208</sup> AoA art 9.2 (a).

<sup>209</sup> WTO ANALYTICAL INDEX Agreement on Agriculture – Article 10 (Jurisprudence), December 2018, paragraph 1.

<sup>210</sup> As above. Export subsidy commitments in the schedules limit subsidization.

<sup>211</sup> WTO 'Agriculture: fairer markets for farmers' [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm3\\_e.htm#exportsubsidies](https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e.htm#exportsubsidies) (accessed 8 August 2019). Developed countries agreed to cut by 36% over 6 years from 1995. Developed countries agreed to cut quantities of subsidised exports by 21% over 6 years (from 1986-1990 base period) and export subsidies levels by 36 percent by 2000.

<sup>212</sup> Only twenty six members did; see D Coppens (n 26 above) 291.

<sup>213</sup> As above, p 292; see AoA art 9.4.

Export subsidies are subject to reduction commitments and anti-circumvention requirements.<sup>214</sup> Reduction commitments cover only scheduled agricultural products and constitute a pledge to reduce the level of export subsidies.<sup>215</sup> The AoA lists export subsidies that are subject to reduction commitments to include; direct subsidies provided by governments or their agencies; government disposal for export of agricultural non-commercial stocks at prices below those charged for like products in the domestic market; payments for agricultural products exports through governmental action; subsidies provided to help in reducing agricultural products exports market costs; government provision of internal transport and freight charges on export shipments on more favourable terms than those given for domestic shipments; and subsidies on agricultural products contingent on their incorporation in exported products.<sup>216</sup> WTO members are estopped from applying all other subsidies in a manner that lead to circumvention of export subsidy commitments.<sup>217</sup>

Direct subsidies to agricultural producers contingent on export performance exist if these subsidies are tied to export performance and are provided by governments or their agents to an industry or producers of agricultural products.<sup>218</sup> The Appellate Body in *Canada – Dairy* construed payments to include payments made in kind for example by way of goods or services as a form of direct subsidies.<sup>219</sup> In *Canada – Dairy ((Article 21.5 – New Zealand and US))*,<sup>220</sup> the Appellate Body reaffirmed that mere governmental action is not sufficient to demonstrate existence of an export subsidy instead there must be a demonstrable link between the governmental action and financing of payments.<sup>221</sup>

In 2001, Kenya submitted its proposal for negotiations on agriculture wherein it recommended for complete elimination of all trade distorting subsidies by developed countries.<sup>222</sup> It cited the failure of comparative advantage in agricultural products owing to trade distortions by major producing countries through export subsidies. This according to Kenya was jeopardising the economic efficiency of trade liberalization. Concerns were also raised on the effects it had on small-scale farming in developing countries such as Kenya due

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<sup>214</sup> D Coppens (n 26 above) 281.

<sup>215</sup> n 210 above, paragraph 1.

<sup>216</sup> As above, art 9 (1).

<sup>217</sup> As above, art 10 (1).

<sup>218</sup> D Coppens (n 26 above) 283-284; See also *Canada – Dairy*.

<sup>219</sup> WTO ANALYTICAL INDEX Agreement on Agriculture – Article 9 (Jurisprudence), Paragraph 4.

<sup>220</sup> Appellate Body Report *Canada – Measures Affecting the Importation of Milk and the Importation of Dairy Products – Recourse to Article 21.5 of the Dispute Settlement Unit by New Zealand and the United States* WT/DS103,113/AB/RW, adopted 18 December 2001.

<sup>221</sup> As above, paragraph 18.

<sup>222</sup> WTO Committee on Agriculture Special Session ‘WTO Negotiations on Agriculture: Proposal by Kenya’ G/AG/NG/W/136, 12 March 2001.

to competition against corporations that enjoyed economies of scale and monopoly.<sup>223</sup> It then pushed for an imposition of penalty or countervailing measure in the event that subsidised goods displaced domestic production in developing countries.<sup>224</sup>

Under the Revised Draft Modalities for Agriculture, developing countries agreed to eliminate scheduled and unscheduled products subsidies by 2016. Developed countries with scheduled export subsidy entitlements agreed to eliminate them by 2013.<sup>225</sup> This was however made conditional on completion of Doha Round negotiations. Developing countries were further given until 2021 to eliminate subsidies granted pursuant to exemptions on marketing cost and internal transport subsidies provided for under AoA.<sup>226</sup>

During the Bali Ministerial Conference in 2013, it was recognised that export subsidies are trade distorting and protectionist in nature. The commitment to eliminate all forms of export subsidies was also reaffirmed.<sup>227</sup> It was further agreed upon to maintain export subsidies below export subsidy commitments and to exercise utmost restraint while using any form of export subsidy.<sup>228</sup>

Further, during the Nairobi Ministerial Conference in 2015, a commitment was made to abolish export subsidies for farm exports. While developed countries pledged to immediately remove export subsidies,<sup>229</sup> developing countries<sup>230</sup> pledged to do so by end of 2018.<sup>231</sup> It was further agreed not to apply export subsidies in a manner that would lead to circumvention of obligation to eliminate or reduce export subsidies.<sup>232</sup>

The 2015 United Nations Sustainable Development Goals (SDGs) recognises the contribution of WTO to the promotion of sustainable development through its role in international trade.<sup>233</sup> SDG 2 on zero hunger emphasises the need to eliminate subsidies that

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<sup>223</sup> As above.

<sup>224</sup> As above, recommendation 3.

<sup>225</sup> D Coppens (n 26 above) 297.

<sup>226</sup> WTO Committee on Agriculture 'Revised Draft Modalities for Agriculture' TN/AG/W/4/Rev.1, 8 February 2008.

<sup>227</sup> WTO Bali Ninth Session Ministerial Conference 'Export Competition: Ministerial Declaration of 7 December 2013' WT/MIN(13)/40 WT/L/915, 11 December 2013.

<sup>228</sup> As above.

<sup>229</sup> Developed countries that had a right to use exports subsidies include Australia, Canada, EU, Iceland, Norway, Switzerland and United States.

<sup>230</sup> Developing countries that had a right to use export subsidies include Brazil, Colombia, Indonesia, Israel, Mexico, South Africa, Turkey, Uruguay and Venezuela.

<sup>231</sup> WTO 'Briefing note: Agriculture Issues' [https://www.wto.org/english/thewto\\_e/minist\\_e/mc10\\_e/briefing\\_notes\\_e/brief\\_agriculture\\_e.htm](https://www.wto.org/english/thewto_e/minist_e/mc10_e/briefing_notes_e/brief_agriculture_e.htm) (accessed 11 August 2019); see also Nairobi Ministerial Decision on Export Competition (n 34 above) paragraphs 6 & 7.

<sup>232</sup> Nairobi Ministerial Decision on Export Competition (n 34 above) paragraph 9.

<sup>233</sup> WTO 'The WTO and Sustainable Development Goals' [https://www.wto.org/english/thewto\\_e/coher\\_e/sdgs\\_e/sdgs\\_e.htm](https://www.wto.org/english/thewto_e/coher_e/sdgs_e/sdgs_e.htm) (accessed 11 August 2019).



cause distortions in agriculture in order to contribute to food security by promoting fairer more competitive markets.<sup>234</sup>

#### 4.3.2 Export subsidies notification

The GATT mandates a contracting party to notify other contracting parties of any subsidy introduced or maintained in its territory which results in an increase in exports of a product from or decrease in imports of a product into its territory.<sup>235</sup> Once a notification is submitted, the Committee on Agriculture is mandated to review its implementation.<sup>236</sup> This mandate was emphasised during the Nairobi Ministerial Conference in 2015.<sup>237</sup> The review of the implementation takes into consideration the negative effects resulting from excessive inflation rates.<sup>238</sup>

Kenya submitted its agricultural supporting table in 1995 indicating that it was not using any export subsidies.<sup>239</sup> In 1997, Kenya also notified the Committee on Agriculture that it had not granted any export subsidy to agricultural products in 1995, 1996 and 1997.<sup>240</sup> No further notifications have been made by Kenya since then.

#### 4.3.3 Special and differential treatment

As has been stated previously in this section, developing countries were permitted to provide export subsidies to reduce the cost of marketing exports of agricultural products and subsidies contingent on incorporation of agricultural products in exported products.<sup>241</sup> They were however mandated not to apply the subsidies in a manner that would circumvent reduction commitments. This exemption was given a ten-year implementation period.<sup>242</sup>

In its 2001 proposal for negotiations on agriculture, Kenya expressed its dissatisfaction with the provisions on special and differential treatment for its failure to address and strike a balance between its crucial development objectives such as food security and rural poverty alleviation and its commitments to progressively liberalize its markets due

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<sup>234</sup> As above.

<sup>235</sup> Art XVI.1; see also Art 18.3.

<sup>236</sup> AoA art 18.1 & 2.

<sup>237</sup> Nairobi Ministerial Decision on Export Competition (n 34 above) paragraph 4.

<sup>238</sup> AoA art 18.4.

<sup>239</sup> As above.

<sup>240</sup> WTO Committee on Agriculture 'Notification' G/AG/N/KEN/1, 12 December 1997; WTO Committee on Agriculture 'Notification' G/AG/N/KEN/2, 12 December 1997; WTO Committee on Agriculture 'Notification' G/AG/N/KEN/3, 12 December 1997.

<sup>241</sup> AoA arts 9.1 (d) & (e) & 9.4; see also D Coppens (n 26 above) 292-293; see also World Trade Organization 'Export competition/subsidies' [https://www.wto.org/english/tratop\\_e/agric\\_e/ag\\_intro04\\_export\\_e.htm](https://www.wto.org/english/tratop_e/agric_e/ag_intro04_export_e.htm) (accessed 7 August 2019).

<sup>242</sup> As above.

to limitation to provision of favourable thresholds and longer implementation periods of its commitments.<sup>243</sup> Kenya in the proposal gave a recommendation for the establishment of a development box for consolidating and operationalizing special and differential treatment for developing countries so as to facilitate relaxation of policies to meet Kenya's development needs.<sup>244</sup>

The ten-year implementation period for exemption on marketing costs and internal transport subsidies was extended in 2003 during Cancun Ministerial Conference and later in 2005 during the Hong Kong Ministerial Conference.<sup>245</sup> During the Nairobi Ministerial Conference in 2015, developing countries pledged to maintain these flexibilities until the end of 2023.<sup>246</sup> Least developed countries and net-food importing developing countries such as Kenya were allowed to enjoy these flexibilities until the end of 2030.<sup>247</sup>

#### **4.4 Subsidies in Kenya's free zones and domestic support commitments**

##### **4.4.1 Domestic support requirements**

Domestic support is identified in three boxes; first, green box covers subsidies that are permitted.<sup>248</sup> Secondly, amber box covers subsidies that need to be reduced. Domestic support measures that distort trade fall under this category. Thirdly, blue box relates to programmes that limit production.<sup>249</sup> These boxes are discussed at length in this section.

National treatment provisions under GATT do not prevent the payment of subsidies to domestic producers either from proceeds of internal taxes and charges or through purchase of domestic products by the government.<sup>250</sup> Domestic support in favour of domestic producers should be within domestic support commitments for products close to the point of first sale<sup>251</sup> and should have no trade distorting effects on production.<sup>252</sup> It should further be

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<sup>243</sup> WTO Committee on Agriculture Special Session 'WTO Negotiations on Agriculture: Proposal by Kenya' G/AG/NG/W/136, 12 March 2001.

<sup>244</sup> As above.

<sup>245</sup> D Coppens (n 26 above) 292-293.

<sup>246</sup> Nairobi Ministerial Decision on Export Competition (n 34 above) paragraph 8.

<sup>247</sup> As above; see Committee on Agriculture 'WTO List of Net Food-Importing Developing Countries for the purposes of the Marrakesh Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries ("the Decision")' Revision, G/AG/5/Rev.10, 23 March 2012.

<sup>248</sup> As above; see AoA arts 3.1 & 3.2.

<sup>249</sup> WTO 'Domestic support in agriculture: The Boxes' [https://www.wto.org/english/tratop\\_e/agric\\_e/agboxes\\_e.htm](https://www.wto.org/english/tratop_e/agric_e/agboxes_e.htm) (accessed 7 August 2019).

<sup>250</sup> Art III.8(b)

<sup>251</sup> AoA art 1(b). definition of basic agricultural product

<sup>252</sup> AoA art 3.1 & 3.2; see also Annex 2(1) & (5). 32 Countries made commitments to reduce trade-distorting domestic supports. They include: Argentina, Australia, Brazil, Canada, Colombia, Costa Rica, European Union, FYR of Macedonia, Iceland, Israel, Japan, Jordan, Korea, Mexico, Moldova, Montenegro, Morocco, New Zealand, Norway, Papua New Guinea, Russian Federation, Saudi Arabia, South Africa,

provided through a publicly-funded government programme and should not have the effect of providing price support to producers.<sup>253</sup>

Domestic support reduction commitments which take the form of base total aggregate measure of support<sup>254</sup> and annual and final bound commitment levels are applicable to domestic supports measures for agricultural products save for domestic measures that are not subject to reduction commitments.<sup>255</sup> During the Uruguay round, developed country members of the WTO agreed to reduce the base total aggregate measurement of support by twenty percent over six years and developing country members agreed to make thirteen point three percent cuts over ten years. Least-developed country members were not required to make any cut.<sup>256</sup>

Annual compliance with domestic support reduction commitments occur when the domestic support in favour of agricultural products is within the corresponding annual or final bound commitment level.<sup>257</sup> This constitute the current total aggregate measure of support which omits in its calculation product specific domestic support that is less than five percent of the total value of production and non-product specific domestic support which is less than five percent of total agricultural production.<sup>258</sup>

Programmes that provide services or benefits to agriculture and rural development are exempted from domestic support reduction commitments.<sup>259</sup> They include: research, pest and disease control, training services, extension and advisory services inspection services, marketing and promotion services and infrastructural services programmes.<sup>260</sup> In 1998, Kenya notified the Committee on Agriculture that it was maintaining domestic agricultural support measures for agricultural education for training of agricultural officers; agricultural extension for support of agricultural and livestock extension; livestock development services for purchase and maintenance of machinery and equipment; veterinary services for disease control; and rangeland development services for promotion of range management for

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Switzerland-Liechtenstein, Chinese Taipei, Tajikistan, Thailand, Tunisia, Ukraine, United States, Venezuela and Viet Nam.

<sup>253</sup> As above, annex 2(1).

<sup>254</sup> This is the sum of all domestic support provided for agricultural producers (AoA, art 1 (h)). Aggregate measure of support is calculated on a product-specific basis (AoA annex 3 (1)).

<sup>255</sup> AoA art 6(1); see also L Brink 'The WTO Disciplines on domestic support' in D Orden *et al* *WTO Disciplines on Agricultural Support: Seeking a Fair Basis for Trade* (2011) Cambridge University Press at 28.

<sup>256</sup> AoA, art 15(2); see WTO ANALYTICAL INDEX Agreement on Agriculture – Article 15 (Practice); see also WTO 'Agriculture: fairer markets for farmers' [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm3\\_e.htm#exportsubsidies](https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e.htm#exportsubsidies) (accessed 8 August 2019).

<sup>257</sup> AoA art 6.3.

<sup>258</sup> As above, art 6.4.

<sup>259</sup> AoA annex 2.

<sup>260</sup> As above annex 2(2).

conservation of range resources.<sup>261</sup> Domestic support for food security purpose in the form of strategic reserve operations was also maintained.<sup>262</sup>

Exemptions from domestic support reduction commitments are also given on revenue foregone for accumulation and holding of stocks for food security purposes based on predetermined targets.<sup>263</sup> The process is expected to be transparent and purchases by the government made at current domestic prices.<sup>264</sup> In 2015 Ministerial Conference, Members committed to adopt a permanent solution on public stockholding for food security purposes by December 2017.<sup>265</sup> This objective was not met.

Exemptions from domestic support commitments are further provided for revenue foregone for the provision of food aid to needy populations based on nutritional objectives.<sup>266</sup> It was later reaffirmed in 2015 during the Nairobi Ministerial Conference.<sup>267</sup> The AoA further exempts payments made directly under production limiting programmes based on fixed area and yields or if payment is made on eighty five percent or less or production base level or if payment on livestock is on a fixed number of head.<sup>268</sup> This has hardly been used by developing countries.<sup>269</sup>

#### 4.4.2 De minimis

WTO members that did not have the average amount of non-exempted support from 1986 to 1988 in the form of base total aggregate measure of support were required to maintain their domestic support within *de minimis* levels.<sup>270</sup> If an aggregate measure of support is lower than ten percent for developing countries; five percent for developed countries and eight point five percent for China, of the product nominal value of production or nominal value of total agricultural production for non-product specific aggregate measure of support, it is excluded from the calculation of aggregate measure of support.<sup>271</sup> Brink notes that *de minimis* does not apply to support on a measure by measure basis but to the whole aggregate measure

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<sup>261</sup> WTO Committee on Agriculture ‘Notification’ G/AG/N/KEN/4, 2 March 1998.

<sup>262</sup> As above.

<sup>263</sup> AoA annex 2(3).

<sup>264</sup> As above.

<sup>265</sup> WTO Tenth Session Ministerial Conference ‘Public Stockholding for Food Security Purposes: Ministerial Decision of 19 December 2015’ WT/MIN(15)/44 WT/L/979, 21 December 2015.

<sup>266</sup> AoA annex 2(4).

<sup>267</sup> Paragraphs 22, 23 and 24.

<sup>268</sup> Art 6.5(a); see also L Brink (n 256 above) 29; see also D Coppens (n 26 above) 316-317.

<sup>269</sup> D Coppens (n 26 above) 317.

<sup>270</sup> D Coppens (n 26 above) at 319; see AoA art 6.4(b) & 7.2.

<sup>271</sup> See above, at 31; see also D Orden *et al* (n 256 above) 5-6.

of support.<sup>272</sup> *De minimis* is therefore defined as “the amount within which an aggregate measure of support is excludable from the current total aggregate measure of support”.<sup>273</sup>

Kenya did not schedule a final bound total aggregate measure of support commitment, it therefore implies that its current total aggregate measure of support is constrained at zero and thus its aggregate measure of support should be kept below the *de minimis* levels.<sup>274</sup> Kenya is thus allowed to provide domestic support not exceeding ten percent of the value of agricultural production.

#### **4.4.3 Special and differential treatment**

In addition to agricultural domestic support boxes discussed previously in this section, there exist exemptions in terms of special and differential treatment or development for developing countries.<sup>275</sup> The AoA notes that special and differential treatment for developing countries is essential in negotiations under the reform programme.<sup>276</sup>

The AoA exempts from domestic support reduction commitments investment subsidies available to agriculture and agricultural-input subsidies available to low-income producers in developing countries so far as they encourage agricultural and rural development.<sup>277</sup> Domestic support that encourages diversification from growing illicit narcotic crops in developing countries is also exempted.<sup>278</sup> In 1995, Kenya submitted its agricultural supporting table indicating that it was exempted from reduction commitments and that its domestic support measures were designed to improve agricultural productivity and development.<sup>279</sup>

### **4.5 Peace clause**

#### **4.5.1 Export subsidies**

Export subsidies that are in conformity with export subsidy commitments can only be subjected to countervailing duties once it is has been demonstrated that an injury or threat to injury has been occasioned to the volume and price of products or if there is any other

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<sup>272</sup> As above.

<sup>273</sup> As above. *De minimis* varies from year to year due to variance of the nominal value of production.

<sup>274</sup> AoA art 7; L Brink (n 256) at 31.

<sup>275</sup> n 250 above.

<sup>276</sup> Preamble.

<sup>277</sup> Art 6.2; n 250 above.

<sup>278</sup> As above.

<sup>279</sup> WTO ‘Supporting Tables Relating to Commitments on Agricultural Products in Part IV of the Schedules’ G/AG/AGST/KEN.

adverse effect or serious prejudice.<sup>280</sup> These provisions however expired in 2003. In its 2001 proposal for negotiations on agriculture, Kenya made a recommendation for non-extension of peace clause beyond 2003.<sup>281</sup>

#### 4.5.2 Domestic support

Domestic support measures that conform to the provisions of AoA are considered non-actionable and are not in contravention of GATT provisions on subsidies and ASCM provisions on actionable subsidies.<sup>282</sup> Domestic support measures that are within *de minimis* levels and those in compliance with domestic support commitments are exempted from imposition of countervailing measures unless if it is determined that an injury or threat to injury has been occasioned.<sup>283</sup> Such measures are exempted from being notified to other members as to the existence of any subsidisation and from possible limitation of subsidization. They are further exempted from claims of adverse effects resulting from granting a subsidy. No serious prejudice would similarly result.<sup>284</sup> Kenya in its 2001 proposal for negotiation on agriculture, recommended that domestic support measures on food security be made non-actionable.<sup>285</sup>

#### 4.6 Consultation and dispute settlement

Disputes on domestic support and export subsidies are resolved in the first instance through consultation.<sup>286</sup> During Nairobi Ministerial Conference in 2015, members committed to consult, upon request by another member who has substantial interest as an exporter, in relation to any export subsidy used by that member.<sup>287</sup>

If consultation fails, a complainant may request the WTO DSB for an establishment of a panel.<sup>288</sup> The panel can, after hearing arguments from both parties, recommend the defending party to bring its measures into conformity with its obligations. Appeals, if any, can be lodged with the Appellate Body based on points of law.<sup>289</sup> There has hardly been any

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<sup>280</sup> AoA art 13(c).

<sup>281</sup> WTO Committee on Agriculture Special Session 'WTO Negotiations on Agriculture: Proposal by Kenya' G/AG/NG/W/136, 12 March 2001, Recommendation 6.

<sup>282</sup> AoA art 13(a).

<sup>283</sup> AoA art 13(b).

<sup>284</sup> As above, See GATT art XVI.1; ASCM Art 5 & 6.

<sup>285</sup> n 282 above.

<sup>286</sup> GATT art XXII.

<sup>287</sup> Paragraph 11.

<sup>288</sup> L Brink (n 256 above) 36.

<sup>289</sup> As above.

case on domestic support within the DSB owing to the high level of final bound total aggregate measure of support which was derived from 1966-1988 base years.<sup>290</sup>

The burden of proving the existence or not of export subsidies rest with the party which claims that any quantity exported in excess of a reduction commitment level is not subsidised.<sup>291</sup> A complaining party is therefore not required to establish a prima facie case.<sup>292</sup> No dispute on violation of export subsidies and domestic support commitments has been lodged against or by Kenya. Kenya has however participated as a third party in *EC – Export Subsidies on Sugar*,<sup>293</sup> complaint lodged by Australia against the European Communities (EC) for imposition of export subsidies beyond its export subsidy commitment levels. The panel in its report held that the EC had failed to demonstrate that the export of sugar above its annual commitment levels were not subsidised and was therefore in contravention of AoA provisions on export competition commitments and the need to maintain export subsidies within quantity commitment levels. On appeal the appellate body reiterated the Panel Report.<sup>294</sup>

#### **4.7 Analysis of the consistency of fiscal incentives offered in Kenya’s free zones with the AoA**

Based on the discussions that have been set forth in the preceding sections of this chapter, the following conclusions are reached: first, agricultural related zones have not been gazetted in Kenya hence no inference can be made on the consistency or not of fiscal incentives with export subsidy requirements under AoA. The fiscal incentives promised under the SEZs Act, however, show that they are consistent with AoA rules on export subsidies. This is the case because; none of the fiscal incentives promised under the Act is contingent on export performance. Kenya as a Net-Food Importing Developing Country is also allowed to grant export subsidies to reduce cost of marketing agricultural products exports and subsidies contingent upon incorporation of agricultural products in exported products until 2030.

Secondly, an analysis of whether or not the fiscal incentives are within Kenya’s *de minimis* levels cannot be made since agricultural related zones are yet to be gazetted. Kenya has however in the past maintained that it has fully complied with this requirement.

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<sup>290</sup> As above, at 37.

<sup>291</sup> AoA art 10.3.

<sup>292</sup> See D Coppins (n 26 above) 312.

<sup>293</sup> Panel Report *European Communities – Export Subsidies on Sugar-Complaints by Australia* WT/DS265/R, adopted 19 May 2005; see also WTO ‘European Communities – Export Subsidies on Sugar’ [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds266\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds266_e.htm) (accessed 12 August 2019).

<sup>294</sup> Appellate Body Report *European Communities – Export Subsidies on Sugar* WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005.

#### **4.8 Concluding remarks**

In conclusion, this chapter has continued the discussions that were made in the previous chapter by linking fiscal incentives offered in agricultural related zones to the WTO AoA. Particular agricultural related zones identified are agricultural and livestock zones that were recognised under the SEZs Act of Kenya. No area has however been declared as such, hence this chapter proceeded on the general understanding of the fiscal incentives provided for under the SEZs Act that would be granted in the zones once they are established.

This chapter has identified and analysed various provisions of AoA dealing with export subsidies and domestic support in light of the fiscal incentives offered in Kenya's free zones. In so doing, focus has been placed on the commitments and notifications lodged at the WTO by Kenya in so far as granting and elimination of export subsidies and domestic support are concerned. Discussions put forth in this chapter and those made in the previous chapters are summarised further in the next chapter.



## CHAPTER FIVE

### CONCLUSION

#### 5.1 Introduction

This chapter summarises the discussions that have been put forth in the preceding chapters of this study on whether or not fiscal incentives offered in Kenya's free zones are consistent with the Agreement on Subsidies and Countervailing Measures (ASCM) rules on subsidies contingent on export performance or use of domestic over imported products and the Agreement on Agriculture (AoA) rules on agricultural export subsidies and domestic support.

This study began by laying the foundation for fiscal incentives offered in Kenya free zones; SEZs and EPZs. It made an argument that fiscal incentives offered in these zones should be consistent with WTO rules on subsidies. In addressing this core argument of this study, various research questions which formed the basis of discussions in the second, third and fourth chapters were formulated. These questions include; what is the rationale for granting fiscal incentives in Kenya's free zones?; to what extent are fiscal incentives offered in Kenya's free zones contingent on export performance or use of domestic over imported goods?; to what extent are subsidies offered in Kenya's free zones within Kenya's export subsidy commitments and domestic support commitments or de minimis?; and to what extent are other countries' interest adversely affected or seriously prejudiced by the subsidies granted in Kenya's free zones?.

These research questions were expansively analysed and a summary of the discussions put forth are made in the subsequent section of this chapter. The section is divided into five sections beginning with a summary of the conceptual foundation arguments made in the second chapter. Secondly, the consistency of the fiscal incentives with export subsidies requirements under the ASCM is summarised. Thirdly, the consistency of the fiscal incentives with import substitution requirements under ASCM is summarised. Fourthly, the consistency of the fiscal incentives with agricultural subsidies requirements under AoA is summarised. Fifthly, the consistency of the fiscal incentives with domestic support requirements under AoA is summarized. The last section of this chapter concludes the findings of this study.

## **5.2 Summary of salient arguments**

### **5.2.1 Conceptual justification**

This was expansively discussed under chapter two. The chapter identified the strategic trade theory which roots its argument on perfect competition. In its analysis of a foreign and a domestic industry dealing in homogenous products for exports, the theory emphasises the need for government intervention to create benefit to domestic industries by providing support. This chapter thereafter discussed the commitment theory of subsidy agreements which bases its arguments on tariff and domestic subsidies. It postulates that subsidies are used to protect producers in import-competing sectors who are hurt by trade agreements that lower tariff. The theory recognises the need to sign trade agreements to eliminate credibility problems and tariff binding to eliminate trade wars. It calls on governments to carefully examine whether to adopt a tariff policy only, a subsidy policy only or both.

Theory of optimum subsidy was also discussed. The theory postulates that subsidies may be used as the first policy option where domestic market distortions occur. This policy decision is arrived at after ranking policy instruments dealing with different distortions. Finally, new trade theory emphasises economies of scale and product differentiation. The theory postulates that subsidies may be used to reverse specialisation caused by relatively small economies of scale or to shift profits from foreign firms through oligopolistic industries that earn excessive profits

### **5.2.2 Subsidies contingent on export performance**

Subsidies contingent on export performance have been comprehensively covered under chapter three. Various fiscal incentives offered in Kenya's free zones have been identified and justification made that they constitute financial contributions or price support given by the Kenyan government or its agencies and result in conferment of benefits. It has been demonstrated that the fiscal incentives meet the specificity test since they are granted by government agencies to validly licensed industries operating within geographically designated areas in Kenya.

An analysis has been made that subsidies contingent on export performance in law or fact are prohibited under the ASCM. An illustrative list on what constitute subsidies contingent on export performance has been clearly set out. It has been demonstrated that countries such as Kenya was exempted from prohibited subsidies contingent on export performance under special and differential treatment since its GNP per capita was below

USD 1 000 at the time the ASCM took effect on 1 January 1995. Kenya was expected to graduate from this exemption once its GNI rose above USD 1000 in constant 1990 dollars for three consecutive years. It has been shown that Kenya's GNI is still below USD 1000 in constant 1990 dollars. Kenya is therefore allowed to grant or maintain subsidies contingent on export performance. Kenya is required to annually notify the WTO of any such subsidies granted or maintained in its territory.

### **5.2.3 Subsidies contingent on use of domestic over imported products**

Subsidies contingent on use of domestic over imported products have been comprehensively discussed under chapter three. It has been shown that Kenya was exempted from the prohibition of such import substitution subsidies for a period of five years from the time the ASCM took effect on 1 January 1995, this period ended on 31 December 1999. Kenya was thereafter required to eliminate this form of subsidies. Import substitution subsidies as shown is contrary to the principle of national treatment as it requires WTO members not to discriminate between imported and domestic products after introducing imported products into their territories.

An analysis of fiscal incentives promised under the SEZs and EPZs Acts of Kenya demonstrate that Kenya is not conditioning the incentives on use of domestic over imported products. The fiscal incentives are therefore consistent with the WTO rules on subsidies contingent on use of domestic over imported products. No case has been lodged against Kenya at the WTO on an alleged violation of this obligation.

### **5.2.4 Agricultural subsidies contingent on export performance**

Agricultural subsidies contingent on export performance have been expansively analysed under chapter four. It has been shown that the SEZs Act of Kenya allows for creation of agricultural and livestock zones. Fiscal incentives offered in these forms of zones are covered under AoA since they cover agricultural products.

Export subsidies on agricultural products as has been shown, are not prohibited under the AoA provided that they are granted or maintained within export subsidies commitment levels. Such subsidies should also not cause the granting WTO member to have more than an equitable share of world export trade in a product. It has been shown that scheduled agricultural products are subject to reduction commitments. It has also been shown that export subsidies should not be applied in a manner that lead to circumvention of export subsidy commitments.

Kenya's notification at the WTO shows that it has not used export subsidies. As a net-food importing developing country, it is allowed to maintain export subsidies to reduce the cost of marketing exports of agricultural products and subsidies contingent on incorporation of agricultural products in exported products until 2030. Though agricultural and livestock zones are yet to be gazetted; an analysis of the fiscal incentives promised under the SEZs Act shows that Kenya is complying with the requirements on agricultural export subsidies.

### **5.2.5 Domestic support**

Domestic support measures have been comprehensively discussed under chapter four. It has been shown that domestic support measures are not prohibited provided that they are within domestic support commitment levels and should have no trade distorting effect. They are also conditioned on their provision by a government or their agency.

Domestic measures, with the exclusion of programmes that provide services or benefits to agriculture and rural development and those not subject to reduction commitments, are subject to reduction commitments in the form of base total aggregate measures of support. Exemptions were also given on revenue foregone for accumulation and holding of stocks for food security purposes based on predetermined targets and for provision of food aid to needy populations based on nutritional objectives.

It has been demonstrated that WTO members that did not have the average amount of non-exempted support from 1986 to 1988 in the form of base total aggregate measure of support were required to maintain their domestic support within *de minimis* levels. Kenya falls in this category. Kenya's domestic support should therefore not exceed ten percent of the value of agricultural production. Since agricultural and livestock zones are yet to be gazetted, an inference as to whether or not fiscal incentives offered are consistent with these domestic support measures cannot be made but an analysis of the SEZs Act suggest that they are consistent.

### **5.3 Recommendations**

The only possible recommendations that this study can give to the Government of Kenya is to, first, ensure that once agriculture related zones are created, agricultural subsidies on agricultural products should be granted only to the extent that they are necessary to either reduce the cost of marketing exports of agricultural products or to allow for incorporation of agricultural products in exported products. Secondly, domestic support given to industries

operating within the agriculture zones should not exceed ten percent of the value of agricultural production.

#### **5.4 Conclusion**

In conclusion, this mini-dissertation has expansively demonstrated that subsidies are necessary according to the strategic trade theory, commitment theory of subsidy agreements, theory of optimum subsidy and new trade theory to achieve two overarching objectives; first, subsidies are used to shift profits from a foreign firm to a domestic firm; and secondly, subsidies are used to protect producers in import-competing sectors who are hurt by trade agreements that lower tariff.

This study concludes further that fiscal incentives offered in Kenya's free zones are consistent with ASCM rules on subsidies contingent on export performance and use of domestic over imported products for the reasons that Kenya is allowed to grant export subsidies and none of the subsidies offered under the EPZs Act and SEZs Act require the use of domestic over imported products.

Finally, though agriculture related zones are yet to be established in Kenya, it has been demonstrated that the fiscal incentives offered under the SEZs Act are consistent with AoA requirements on agricultural subsidies contingent on exports and domestic support requirements or *de minimis*. Lastly, no other WTO member's interest has been adversely affected or seriously prejudiced by the fiscal incentives granted in Kenya's free zones.

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