



United Nations
Economic Commission for Africa



Creating a Unified Regional Market

Towards the Implementation of the African Continental Free Trade Area in Eastern Africa



www.uneca.com



www.trademarkea.com



Creating a Unified Regional Market - Towards the Implementation of the African Continental Free Trade Area in Eastern Africa

Table of Contents

LIST OF ACRONYMS.....	5
ACKNOWLEDGEMENTS	8
EXECUTIVE SUMMARY	9
OUTLINE OF THE REPORT	13
1. INTRODUCTION – THE HISTORICAL CONTEXT.....	14
2. SETTING THE SCENE FOR THE AFCFTA	19
2.1. THE CURRENT STATE OF NEGOTIATIONS.....	19
2.2. THE MACROECONOMIC BACKDROP FOR EASTERN AFRICA	23
2.3. OVERVIEW OF EXISTING PATTERNS OF INTRA-REGIONAL TRADE	24
2.4. A REGION STILL HEAVILY DEPENDENT ON IMPORTED GOODS.....	29
2.5. THE DYNAMISM OF THE SERVICE SECTOR	35
2.6. LOW AND DECLINING LEVELS OF INTRA-REGIONAL FDI	40
3. THEORETICAL AND EMPIRICAL PERSPECTIVES ON REGIONAL INTEGRATION AND THEIR RELEVANCE TO EASTERN AFRICA	45
3.1. WHAT THEORY TELLS US ABOUT THE CONSEQUENCES OF REGIONAL INTEGRATION.....	45
3.2. HOW DOES TRADE GROW IN PRACTICE? MULTILATERAL VS. REGIONAL PROCESSES.....	48
3.3. <i>EX-POST</i> ECONOMETRIC VERSUS <i>EX-ANTE</i> SIMULATION MODELS.....	50
4. THE IMPACT OF THE AFCFTA ON EASTERN AFRICA – RESULTS OF OUR SIMULATION WORK	56
4.1. PARTIAL EQUILIBRIUM.....	56
4.2. GENERAL EQUILIBRIUM RESULTS.....	60
4.3. IMPLICATIONS FOR REVENUE COLLECTION.....	64
4.4 DYNAMIC CGE SIMULATIONS – THE CASES OF ETHIOPIA, KENYA AND TANZANIA	66
5. SOME KEY SOURCES OF BENEFITS EXPLAINED	69
5.1. GENERATING NEW EMPLOYMENT OPPORTUNITIES.....	69
5.2. FOSTERING INDUSTRIALIZATION.....	71
5.3. IMPLICATIONS FOR FIRM SIZE AND ECONOMIES OF SCALE	74
5.4. ENHANCING FOOD SECURITY.....	75
5.5. TACKLING GENDER INEQUALITY	77
6. OUTSTANDING AREAS FOR NEGOTIATION AND PRIORITIES FOR EASTERN AFRICA..	80
6.1. RULES OF ORIGIN	80
6.2. HARMONISING INVESTMENT REGIMES.....	82
6.3. CREATING A MORE COMPETITIVE BUSINESS ENVIRONMENT	83
6.4. DEFINING DEVELOPMENT-FRIENDLY INTELLECTUAL PROPERTY RIGHTS.....	84
6.5. THE FREE MOVEMENT OF PERSONS PROTOCOL	86
7. COMPLEMENTARY INITIATIVES TO THE AFCFTA	89
7.1. BOOSTING INTRA-AFRICAN TRADE (BIAT) ACTION PLAN.....	89
7.2. THE DEVELOPMENT OF THE NORTHERN AND CENTRAL CORRIDORS	91
7.3. LEVERAGING THE BLUE ECONOMY.....	94
7.4. CLOSING THE ENERGY INFRASTRUCTURE GAP.....	95

8. CONCLUSIONS AND RECOMMENDATIONS.....	97
8.1. CONCLUSIONS	97
8.2. RECOMMENDATIONS	98
REFERENCES	102

List of Boxes, Figures and Tables

Boxes

BOX 2.1: THE TRIPARTITE FREE TRADE AREA: WHAT HAVE WE LEARNED FROM THE NEGOTIATIONS?.....	22
BOX 2.2: PERSISTENT HIGH TRADE COSTS IMPEDING EXPORT GROWTH – THE CASE OF ETHIOPIA	33
BOX 2.3 : SAHAM – AN EXAMPLE OF PAN-AFRICAN EXPANSION IN THE SERVICE SECTOR	43
BOX 4.1: PARTIAL VS. GENERAL EQUILIBRIUM – RECONCILING THE NUMBERS.....	66
BOX 8.1: ANTICIPATING POTENTIAL OBJECTIONS TO THE AFCFTA.....	100

Figures

FIGURE 1.1:.....	15
FIGURE 2.1: STRUCTURE OF THE AFCFTA.....	19
FIGURE 2.2: REAL GDP GROWTH IN EASTERN AFRICA, AFRICA AND THE WORLD, 2014-2019	23
FIGURE 2.3: SHARE OF TRADE WITH AFRICA, 2015 - 2017 AVERAGE.....	25
FIGURE 2.4: TRADE BALANCE BETWEEN EASTERN AFRICA AND KEY TRADING PARTNERS, USD BILLIONS.....	26
FIGURE 2.5	27
FIGURE 2.6: VARIOUS RECS SHARE OF INTRA-REC AND REST OF THE WORLD IN TOTAL TRADE, 2015-2017	28
FIGURE 2.7: ECONOMIC GROWTH IN EASTERN AFRICA IS MAINLY DRIVEN BY CONSUMPTION	30
FIGURE 2.8: SERVICES TRADE BALANCE AND MERCHANDISE TRADE BALANCE, 2017...	36
FIGURE 2.9: TOTAL CONTRIBUTION OF TOURISM TO REGIONAL GDP AND EMPLOYMENT, 2017.....	37
FIGURE 2.10: FDI INFLOWS TO EASTERN AFRICA (USD MILLIONS), 2008-2018	40
FIGURE 2.11: CROSS-BORDER GREENFIELD INVESTMENT FLOWS WITHIN EASTERN AFRICA, 2008-2018.....	42
FIGURE 2.12: SECTORAL SHARE OF EXTRA-AFRICAN FDI PROJECTS TO THE EAC, 2013-2017	44
FIGURE 2.13: SECTORAL SHARE OF INTRA-AFRICAN FDI PROJECTS TO THE EAC, 2013-2017	44
FIGURE 4.1: GEOGRAPHICAL DISTRIBUTION OF INCREASED INTRA-AFRICAN EXPORTS FROM EASTERN AFRICA AFTER TARIFF LIBERALIZATION.....	58
FIGURE 4.2: CHANGE IN EASTERN AFRICAN EXPORTS TO AFRICA BY SECTOR.....	61
FIGURE 4.3: PERCENTAGE CHANGE IN VALUE OF GDP BY COUNTRY IN EASTERN AFRICA	62
FIGURE 4.4: AVERAGE CHANGE IN IMPORT PRICES, %.....	64
FIGURE 4.5: THE DECLINE OF CUSTOMS AND IMPORT DUTIES AS A SHARE OF TOTAL TAX REVENUE, 2000-2016	65
FIGURE 5.1: AVERAGE ANNUAL INCREASE IN WORKING AGE POPULATION BETWEEN 2015 AND 2030 (MILLIONS OF WORKERS)	70
FIGURE 5.2: MANUFACTURING VALUE-ADDED (% OF GDP), 2010-2018.....	71
FIGURE 5.3: NET PROFIT MARGIN* OF EAST AFRICA'S LARGEST COMPANIES, 2018.....	74
FIGURE 5.4: TOP 10 COMPANIES IN EASTERN AFRICA (TURNOVER IN MILLION USD).....	75
FIGURE 5.5: SHARE OF FEMALE EMPLOYMENT IN AGRICULTURE, INDUSTRY AND SERVICES, 2016	78
FIGURE 7.1: THE NORTHERN AND CENTRAL CORRIDORS	91

FIGURE 7.2: CARGO IMPORTS, EXPORTS AND TOTAL THROUGHPUT (MILLION METRIC TONNES), 2017	92
FIGURE 7.3: LAPSETT CORRIDOR LINK TO THE REST OF AFRICA.....	93

Tables

TABLE 2.1: SCHEDULE OF LIBERALIZATION ENVISAGED UNDER THE AFCFTA REFORM	20
TABLE 2.2.....	28
TABLE 2.3: GROWTH IN EASTERN AFRICA IS PREDOMINATELY DOMESTIC-LED	31
TABLE 2.4: TRADE BALANCE AS A SHARE OF GDP BY PRODUCT GROUPS, 2017.....	32
TABLE 2.5 : ANTI-EXPORT BIAS (%), 2010 – 2015	33
TABLE 2.6: REQUIRED TIME AND COST TO TRADE IN ETHIOPIA, 2015	34
TABLE 2.7: SERVICES EXPORTS (CURRENT PRICES, USD MILLION).....	35
TABLE 2.8: BENEFITS OF INTRA-AFRICAN LIBERALIZATION OF AIR SERVICES TO THE WIDER ECONOMY	37
TABLE 2.9: INTRA- AND EXTRA-REGIONAL FDI IN SELECTED REGIONAL BLOCS, 2009-2011.....	41
TABLE 3.1: SUMMARY OF CGE STUDIES ON REGIONAL INTEGRATION OF THE AFRICAN CONTINENT	51
TABLE 4.1: INCREASE IN TOP EXPORTS, BY SECTOR AFTER AFCFTA REFORMS	57
TABLE 4.2: INCREASE IN EXPORTS AFTER AFCFTA REFORMS	57
TABLE 4.3: INCREASE IN IMPORTS AFTER AFCFTA LIBERALIZATION	59
TABLE 4.4: TRADE CREATION AND DIVERSION EFFECTS OF AFCFTA LIBERALIZATION (USD MILLIONS)	59
TABLE 4.5: WELFARE (CONSUMER SURPLUS) EFFECT OF THE AFCFTA (USD '000)	60
TABLE 4.6: WELFARE DECOMPOSITION (USD, MILLIONS).....	62
TABLE 4.7: CHANGE IN MANUFACTURING AND FOOD-PROCESSING SECTOR OUTPUT AFTER AFCFTA (%)	63
TABLE 4.8: SUMMARY RESULTS OF TARIFF REVENUE LOSSES.....	65
TABLE 4.9: INCREASE IN THE VALUE OF INTRA-AFRICAN EXPORTS.....	66
TABLE 4.10: SUMMARY OF DYNAMIC SIMULATION RESULTS FOR ETHIOPIA, KENYA AND TANZANIA.	67
TABLE 5.1: AVERAGE PROTECTION (TARIFF RATES) ON AGRICULTURAL IMPORTS AND EXPORTS	76
TABLE 6.1.....	82
TABLE 7.1: SUMMARY OF THE SEVEN PRIORITY CLUSTERS OF THE BOOSTING INTRA-AFRICAN TRADE ACTION PLAN	89
TABLE 7.2: IMPORTS THROUGH THE NORTHERN AND CENTRAL CORRIDORS ('000 METRIC TONNES), 2017	92

Executive Summary

The signing of the African Continental Free Trade Area (AfCFTA) on 21st March 2018 in Kigali by 44 countries represents a milestone on the road towards achieving the long-standing goal of creating a unified continental market. The arguments for implementing the AfCFTA in Eastern Africa are particularly compelling. With a combined GDP of USD 880 billion (measured in Purchasing Power Parities) and a population of 420 million in 2018, the economies of Eastern Africa are still highly fragmented. The levels of intra-regional trade and investment are low and have recently been declining. The two largest economies in the region – Kenya and Ethiopia – barely trade with each other: their annual bilateral trade is worth less than USD 100 million. Intra-regional trade within the East African Community (EAC) is higher, but exports peaked in 2013 at USD 3.5 billion, and by 2017 had declined 31%, to just USD 2.4 billion. The lack of integration represents a serious impediment to the future development of the region. The African Continental Free Trade Agreement, signed by 44 countries (now 54) in Kigali in March 2018, offers hope of a revival of both regional and intra-African trade to boost trade and development in Eastern Africa.

The arguments for implementing the AfCFTA in Eastern Africa are particularly compelling. With a combined GDP of USD 880 billion and a population of 420 million, the economies of the region are still highly fragmented.

Despite the prevailing low per capita incomes, over the past decade Eastern Africa has emerged to become the fastest growing sub-region on the continent. This is a major achievement for a region that in the 1980s and 1990s was suffering from a reputation as having one of the poorest and least dynamic economies in the world. Yet the current dynamism has been *consumption-led*, not *investment-* or *technology-led*. A significant proportion of domestic demand is being met by imports rather than regional production, engendering large trade deficits ranging from around 10 to 20% of GDP. These deficits need to be financed, yet ODA to the region is declining and other sources of development finance are often difficult to access. Ultimately, it is a pattern of growth that cannot be maintained.

Against this backdrop, the elimination of tariff and non-tariff barriers and harmonization of standards called for under the AfCFTA represent a unique opportunity to boost intra-regional trade and investment, allowing companies and farmers to tap into rapidly growing markets, both within the region and in other parts of Africa. Its impact will go beyond this. This report stresses the ambitious nature of the AfCFTA: it is not, as its name might imply, simply a ‘free trade area’. It encompasses ambitions to proceed to a single unified Continental Customs Area. It aims to simplify investment and intellectual property regimes and create a common platform for competition policy. It promises to provide the African continent with greater leverage in its negotiations with third parties.

The implementation of the AfCFTA could result in welfare gains amounting to USD 1.8 billion for Eastern Africa, creating 2 million new jobs.

This report provides a first assessment of the potential gains specifically for Eastern Africa. We estimate that the lower cost for goods and services from the implementation of the AfCFTA will result in welfare gains amounting to USD 1.8 billion for the region. Depending on the methodology used, it could boost Eastern African trade by between USD 737 million and USD 1.11 billion, creating 700,000 to 2 million new jobs. Many of those new employment opportunities are likely to emerge in sectors where there is a heavy predominance of female labour, thereby contributing to the economic empowerment of women in the region. This report also stresses that these figures are likely to be rather conservative, as they are static estimates and do not include the substantial benefits from liberalizing services trade, from competition and scale economy effects. The long-term

impact, although difficult to quantify, is likely to be far more significant. The larger regional market will incentivize greater investment by national and multinational investors, opening the door to the emergence of regional value chains (RVCs) and stronger, more resilient, economies.

Crucially, the AfCFTA will accelerate the industrialization of the region, as manufacturing will be among the principal beneficiaries from the increase in intra-regional trade and investment. A breakdown of trade imbalances by sector shows that deficits are driven almost exclusively by manufactured goods imports. The region's heavy reliance on intermediate goods and manufactured products imported from the rest of the world hampers the full utilization of local productive capacities. Currently, manufacturing firms in Eastern Africa are typically operating at around 20% to 40% below their potential. With so much unmet consumer demand, this is unacceptable. The heavy reliance on manufactured imports also results in many missed opportunities to develop deeper regional value chains, both within Eastern African and with the rest of the continent.

The AfCFTA will accelerate the industrialization of the region, as manufacturing will be among the principal beneficiaries from the increase in intra-regional trade and investment.

The benefits of the AfCFTA go far beyond the manufacturing sector. A good example is the trade in food products. Demographic pressures in Eastern Africa are among the highest in the world – with the regional population currently expanding by almost 10 million people every year – and its growing population needs to be fed. While countries in the region register periodic trade deficits in food items, given large climatic variations and a diverse topography within Eastern Africa, a large share of this demand could be met by greater intra-regional and

intra-African trade. To some extent, this is already happening. For instance, in 2016/17, food shortages due to an extended drought in Kenya were largely relieved by higher imports from neighbouring Uganda and Tanzania. The AfCFTA will help remove remaining barriers to such trade, leading to greater food security and accelerating the growth of a crucial sector upon which the livelihoods of two-thirds of the region's population still depends.

The AfCFTA also promises to create new opportunities in high value-added services trade, helping countries achieve their goals of economic diversification and structural transformation. Most countries in Eastern Africa currently post a better trade balance in services than they do in merchandise trade. Five of the fourteen countries enjoy surpluses in service trade (Djibouti, Kenya, Madagascar, Tanzania, and Seychelles). Kenya and Tanzania, for instance, had a net service trade balance of over USD 1.6 billion and USD 2.1 billion, respectively, in 2017. The intra-African liberalization of services trade could bring great benefits to Eastern Africa. With better access to business and financial services from across the continent, the region will become more competitive. Intra-regional tourism, a good example of the growing intra-regional trade in services, has been gaining prominence and already constitutes 30% of total international tourist arrivals in the East African Community (EAC), for example.

Ultimately, however, it is the citizens of Eastern Africa that will be the principal beneficiaries of the AfCFTA. They will benefit in several ways. Firstly, they currently suffer the effects of anti-competitive practices. This report highlights several instances of anti-competitive behaviour in sectors such as telecommunications, beer, cement and foodstuffs. By fixing prices, cartels can limit the benefits of the AfCFTA, while the phenomenon of dumping harms industrialization and destroys jobs. Through the reduction of import prices, the harmonisation of competition laws and the strengthening of regulatory rules, the AfCFTA can improve the protection of consumers and achieve a major reduction in the prices of common consumer goods and services.

Under the Protocol on the Free Movement of Persons, a more open continental labour market will go a long way towards addressing skill shortages that constrain the growth of important strategic sectors of our economies.

A second area of major benefit for the general public is the implementation of the Free Movement Protocol. Easing the ability of Africans to travel to or to work in other African countries is an intrinsic part of the AfCFTA agreements. Eastern Africa has a lot of talented young people – often university graduates – who are un- or under-employed in their home countries. Under the Protocol on the Free Movement of Persons, a more open continental labour market will go a long way towards addressing skill-shortages that constrain the growth of important strategic sectors in the region and provide the freedom for individuals to live and work where their talents are best rewarded.

The Regional Economic Communities should take a protagonistic role in both negotiating and implementing the AfCFTA.

To achieve these gains, however, the report stresses that there is a need for Member States to act rapidly. The timeline for negotiations is ambitious, with tariff offers and rules of origin under a July 2019 deadline for merchandise trade and the end of 2019 for services. There are opportunities for aligning regional policies and regulatory regimes stemming from the Protocols on Competition, Intellectual Property, and

Investment. This will require the active engagement of Member States and their respective Regional Economic Communities (RECs) at all stages of the negotiations. To avoid wasteful duplication of resources, Member States will need to coordinate their industrial policies to a much greater degree than in the past and redouble implementation efforts. This report argues forcefully that the RECs in the region – particularly the EAC, the Intergovernmental Authority on Development (IGAD), and the Indian Ocean Commission (IOC) – need to take a protagonistic role in both negotiating and implementing the AfCFTA.

Rules of origin can make or break the AfCFTA, exporters would rather pay tariffs than comply with strict rules of origin, leading to low utilisation rates of tariff reductions. Additionally, research has also shown that trade deflection - firms importing goods from a non-member country of the FTA to take advantage of lower tariffs within the FTA- is unprofitable for most countries. Therefore, negotiators should agree on the simplest rules of origin possible and strive for convergence of the different RECs' rules of origin to resolve overlapping membership issues

The AfCFTA will touch on so many aspects of people's lives, both directly and indirectly, that there is a simultaneous need for an intense period of dialogue between civil society, the public and the private sectors. Accompanying measures will be required. The elimination of tariff barriers will be futile without the necessary supporting infrastructure. Work across the region to establish one-stop border posts needs to be expanded and accelerated. The inter-connectivity of the region will depend on improvements

There is a need for an intense period of dialogue between civil society, the public and the private sectors.

in port facilities and greater investments in roads and inland waterways in the Great Lakes region. These constitute vital arteries in the transport corridors of the region.

Looking forward, further to the signing and ratification of the AfCFTA, a crucial next step for Member States in Eastern Africa is to develop national and regional AfCFTA implementation strategies. The Economic Commission for Africa and Trademark East Africa stand ready to provide support for awareness creation (for countries that are yet to ratify the agreement) and help in designing and developing national strategies (for countries that have ratified the agreement). The agenda for action is ambitious but realizable with the necessary political will. Although the AfCFTA will not address all the region's problems, it will go a long way to strengthening the regional economies, helping to put the region on a more sustainable growth path.