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## **Implementation of Regional and International Agendas and Other Special Initiatives in the Sub-region: *Progress and Status of the Continental Free Trade Area (AfCFTA)***

### **Key messages**

- The AfCFTA is a tool for driving African industrialization, economic diversification and development. It helps to promote the type of trade that produces sustainable growth, creates jobs for Africa's youth, and establishes opportunities for nurturing Africa's businesses and entrepreneurs.
- The AfCFTA will have only a small impact on tariff revenues while helping to restructure African economies to deliver a more sustainable fiscal base. This is because the AfCFTA helps to pivot Africa's trade away from extractive exports towards more sustainable and inclusive trade that is less dependent on the fluctuations of commodity prices. In an era of increasingly unreliable aid receipts, and the growing importance of domestic resource mobilization, the AfCFTA provides a route towards more sustainable government revenues.
- Africa faces a changing world trading landscape with many evolving external challenges. Against this, the AfCFTA can serve as a platform for African trade policy coherence providing Africa with the strengthened voice of 1.2 billion people in future negotiations, fostering a common position on evolving trade policy issues, and ensuring that individual bilateral arrangements do not unravel the objectives and benefits of continental integration
- To fully utilize the opportunities of the AfCFTA, each country is recommended to develop an AfCFTA Strategy - complementary to the broader trade policy of each respective State Party – that identifies for that particular country the key trade opportunities, current constraints, and steps required to take full advantage of the continental African market. Such strategies can speak to the African Union's Boosting Intra-African Trade Action Plan.

## African Continental Free Trade Area (AfCFTA) for Jobs and Economic Diversification

### Introduction

1. The AfCFTA presents an opportunity to leverage trade for structural transformation, economic growth and job creation in Africa. This is because intra-African trade, which is promoted by the AfCFTA, has a stronger impact on development than other types of trade. Intra-African trade comprises a far larger share of industrial, value-added and processed agricultural products than does Africa's exports to outside the continent, around 75 per cent of which are extractives like petroleum oils and minerals. It is more labour intensive, helping to generate jobs for Africa's bulging youth population, and relies less on the fluctuations of global commodity prices, enabling it to better fuel sustainable economic growth.

2. On the face of it, the AfCFTA may imply adjustments to lower import tariffs on intra-African trade, but it in fact offers a pathway to medium to longer-term fiscal sustainability. This is because, as a stimulant of economic growth, the AfCFTA helps to generate economic activities in other revenue generating areas. Moreover, the quality of economic growth that is generated by the AfCFTA marks a diversification away from fiscal reliance on volatile commodity prices. As diversification engenders structural transformation, the importance of trade taxes among sources of revenue generation declines. However, even in the short term, the revenues currently collected from tariffs on intra-African trade account for only a small share of total trade taxes in Africa, and can be partially offset by other taxes, such as VAT, which tends to be more efficiently levied on imports.

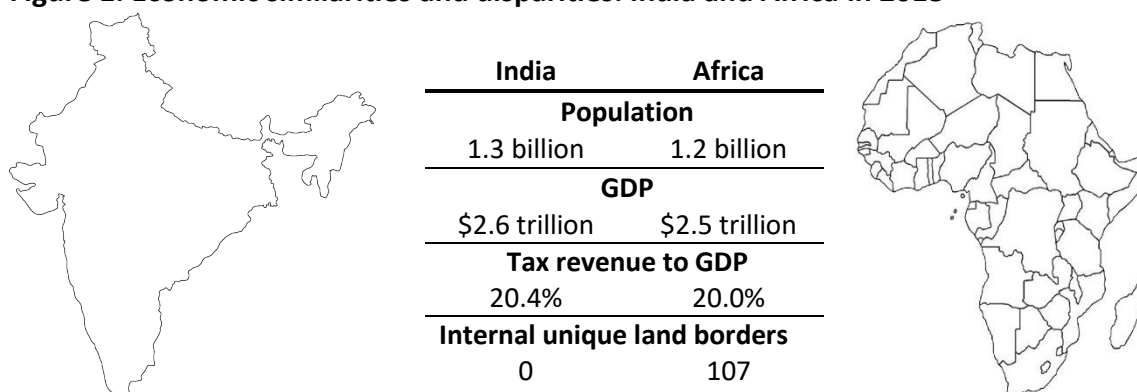
3. This AfCFTA background paper is divided into two sections: the first details the economic and developmental arguments for the AfCFTA, as well as its implications for tariff revenues and trade policy coherence. The second focuses on what countries must do next for the effective implementation of the AfCFTA, including national AfCFTA strategies and flanking policies.

## The Economic and Developmental Rationale for the AfCFTA

### Opportunities for African Businesses

4. The AfCFTA is a tool that countries in Africa can use to create opportunities for African businesses, and through them drive African's industrialization, economic diversification, and development.

5. Africa has an economic size and structure broadly comparable to that of India: Africa's population is 1.2 billion, while India's is 1.3 billion (IMF, 2017). Africa's GDP is \$2.5 trillion, while India's is \$2.6 trillion (IMF, 2017). Yet India forms a single consolidated market – the 7<sup>th</sup> biggest in the world – allowing scale economies that have produced some of the largest and most competitive companies in the world.

**Figure 1: Economic similarities and disparities: India and Africa in 2018**

Source: IMF (2017) (2018 estimates for population and GDP, 2015 for tax revenue to GDP)

6. Africa's market, conversely, is fragmented over 54 countries and 107 unique land borders (Figure 1). Businesses face average tariffs of 6.9 per cent when they trade across these borders and non-tariff barriers, like excessive documentation and customs delays, as well as divergent regulatory systems, that can be even more burdensome (Table 1). The AfCFTA helps to consolidate the African market, making it easier for its businesses to reach greater economies of scale and scope, promoting the development of regional value chains, and lowering border costs for trading enterprises, businesses and consumers.

**Table 1. Average tariffs faced by exporters within regions (%)**

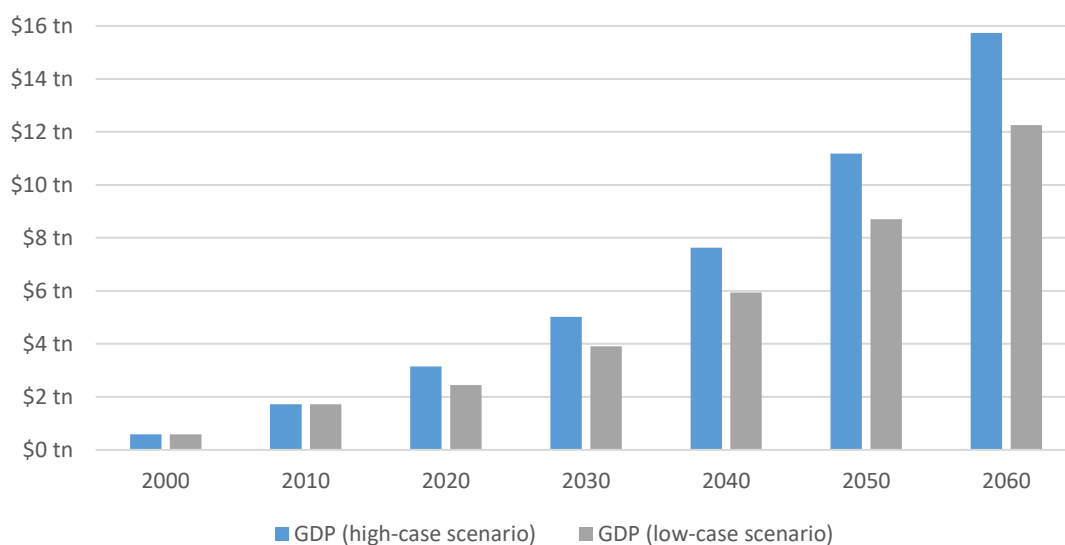
Region	Average tariff on intra-regional trade
Africa	6.9
Western Asia	1.6
Eastern, South-Central and Southern-Eastern Asia	4.8
Pacific	1.2
Latin America & Caribbean	6.2
North America	4.7
Europe	2.5

Source: Reference group weighted average tariffs based on 2013 MACMap-hs6 database

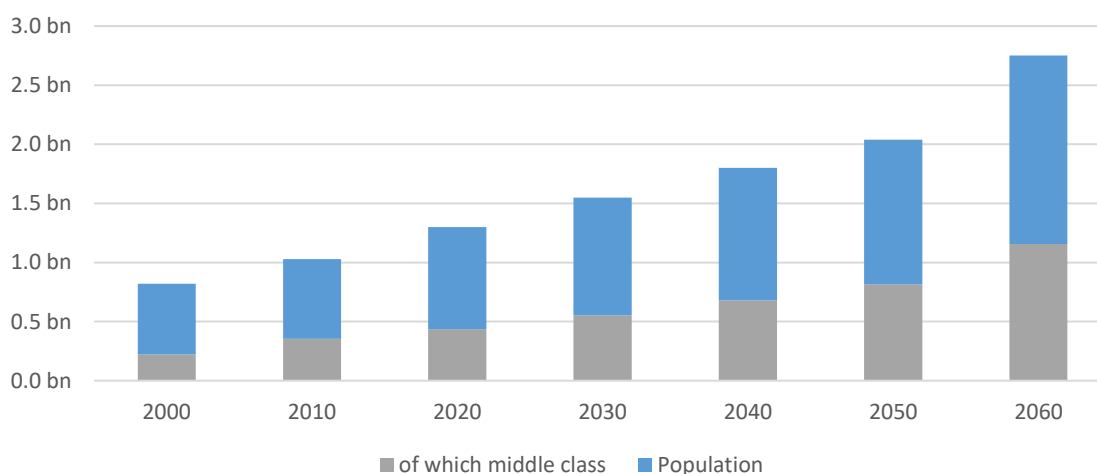
7. It is, however, the dynamics of this market that are perhaps most enticing for African businesses. African gross domestic product (GDP) is forecast to grow rapidly, from an estimated \$3 trillion in 2020 to as much as \$16 trillion by 2060, according to African Development Bank forecasts (Figure 2).

8. The total size of this African market is expected to grow from a population expected to be 1.3 billion in 2020 to 2.75 billion, by 2060 (Figure 3). Moreover, this market is becoming increasingly affluent with a middle class (Figure 3).

9. By reducing trade costs and facilitating business expansion, the AfCFTA provides great opportunities for African businesses to gain from, and contribute to, Africa's rapid market growth.

**Figure 2. Africa's Gross Domestic Product at current market prices (US\$ trillion), forecasts**

Source: AfDB (2011)

**Figure 3. Total population of Africa (billion) and size of the middle class**

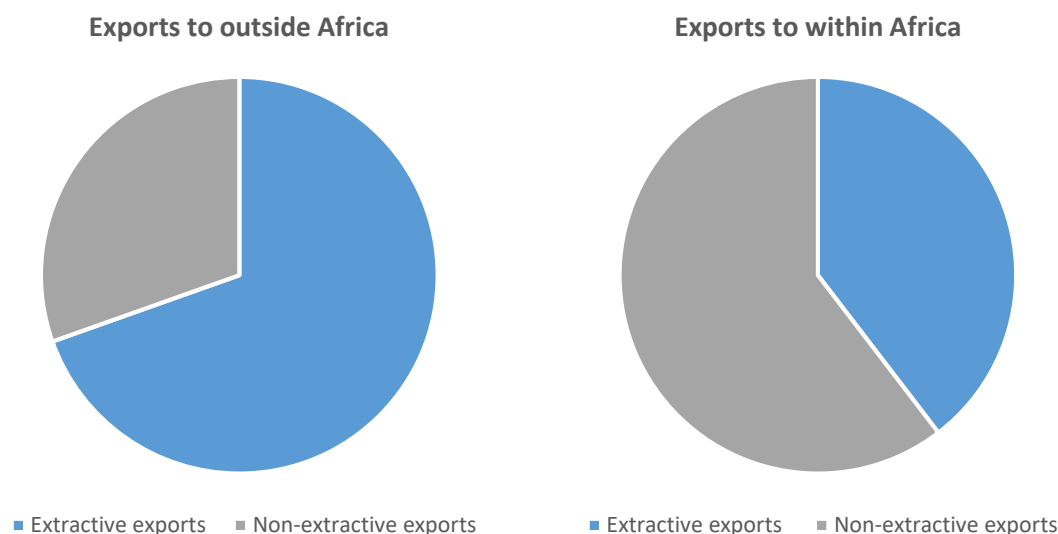
Source: AfDB (2011).

### Boosting intra-African Trade for Sustainable Growth and Jobs

10. ECA forecast that Africa's industrial exports are to benefit most from the AfCFTA. This is important for diversifying Africa's trade and encouraging a move away from extractive commodities, such as oil and minerals, which have traditionally accounted for most of Africa's exports, towards a more balanced and sustainable export base.

11. Over 70 per cent of Africa's exports outside the continent were extractives from 2014 to 2016 while less than 40 per cent of intra-African trade were extractives in the same period.

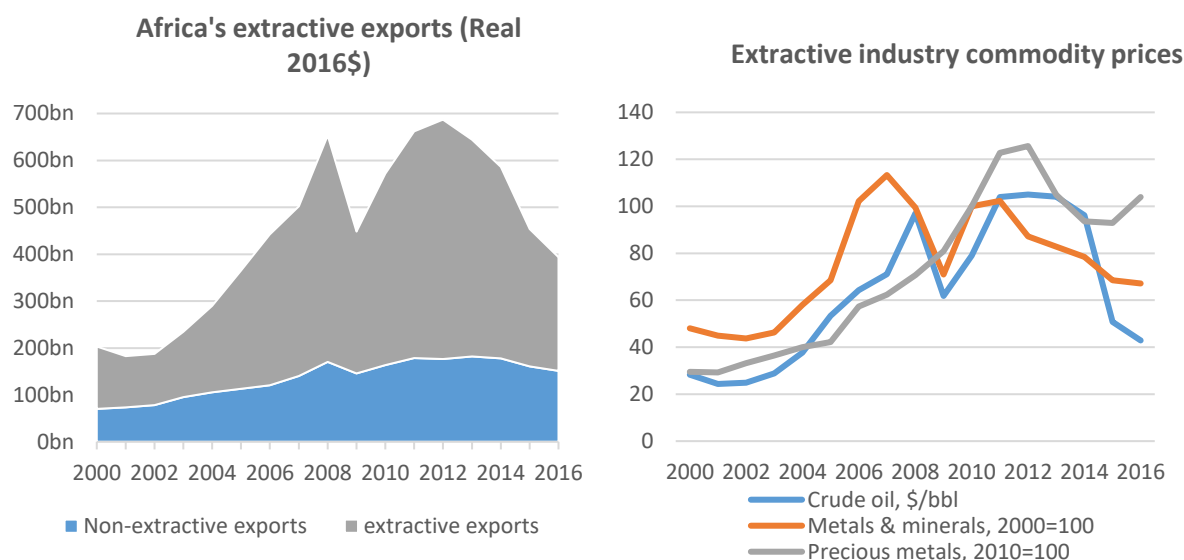
**Figure 4. Composition of Africa's exports to outside and within Africa, extractive and non-extractive exports, 2012 to 2014**



Source: CEPII-BACI trade dataset, three-year averaged exports (2014-2016), extractive exports include petroleum oils, gas, non-ferrous metals, metalliferous ores and metal scrap, crude fertilizers and minerals, coal, coke and briquettes, and the remaining precious metal in HS 71, uranium, and the basic iron products of HS7201-HS7206.

12. The great risk with products like oil and minerals is their volatility. The fiscal and economic fate of too many African countries relies on the vicissitudes of such product prices. Using the AfCFTA to pivot away from extractive exports will help to secure more sustainable and inclusive trade that is less dependent on the fluctuations of commodity prices.

**Figure 5. Volatility of extractive exports, 2000 to 2016**



Source: Africa's Extractive Exports: CEPII-BACI trade dataset, extractive exports include petroleum oils, gas, non-ferrous metals, metalliferous ores and metal scrap, crude fertilizers and minerals, coal, coke and briquettes, and the remaining precious metal in HS 71, uranium, and the basic iron products of HS7201-HS7206. Extractive Industry Commodity Prices: World Bank commodities market data.

13. Perhaps most importantly, the AfCFTA will also produce more decent-paying, good jobs for Africa's bulging youth population. This is because extractive exports, on which Africa's trade is

currently based, are less labour-intensive than the manufactures and agricultural goods that will benefit most from AfCFTA. By promoting more labour-intensive trade, the AfCFTA creates more employment.

### Ensuring Opportunities for African Countries of Different Economic Configurations

14. African countries span a diversity of economic configurations and will be affected in different ways by the AfCFTA. Nevertheless, the benefits from the AfCFTA are widespread and ECA modelling estimates that all African countries experience welfare gains if the AfCFTA reduces tariff and non-tariff barriers.

15. While African countries that are relatively more industrialized are well placed to take advantage of the opportunities for manufactured goods, less-industrialized countries can benefit from linking into regional value chains. Regional value chains involve larger firms or industries sourcing their supplies from smaller producers or suppliers across borders. Such linkages help to diffuse technology and knowhow to up-stream suppliers. The AfCFTA makes the formation of regional value chains easier by reducing trade costs and facilitating cross-border investment.

16. Agriculture-based economies can gain from satisfying Africa's growing food security requirements. The perishable nature of many agricultural food products means that they are particularly responsive to improvements in customs clearance times and logistics that are expected of the AfCFTA.

17. The majority of African countries are classified as resource rich. Tariffs on raw materials are already low and so the AfCFTA can do little to further promote these exports. However, by lowering intra-African tariffs on intermediates and final goods, the AfCFTA will create additional opportunities for adding value to natural resources and for diversifying into new business areas.

18. The cost of being landlocked includes higher costs of freight and unpredictable transit times. The AfCFTA provides particular benefits to these countries: in addition to reducing tariffs, the AfCFTA is set to include provisions on trade facilitation, transit and customs cooperation.

19. Nevertheless, there are also precautions built into the agreement and safeguards to which countries may seek recourse. Countries may reserve 10 per cent of their imports as either sensitive products, which are accorded a more gradual pace of liberalization, or else excluded products, which are not subject to liberalization. The least-developed countries are to be accorded a more gradual implementation period of 10 to 15 years. There are protections for infant industries and countries suffering balance of payment issues, as well as provisions allowing for trade defence measures should import surges of a product cause or threaten to cause serious injury to domestic producers. Rules of origin buttress the agreement to ensure that exports from non-African countries do not falsely circulate under AfCFTA preferences.

## Opportunities for Vulnerable Groups

### *Informal cross-border traders*

20. By reducing tariffs, the AfCFTA makes it more affordable for informal traders to operate through formal channels, which offer more protection. This can be further enhanced by simplified trading regimes for small traders, such as the Simplified Trade Regime in the Common Market for Eastern and Southern Africa (COMESA), which provides a simplified clearing procedure alongside reduced import duties that provide particular help to small-scale traders.

### *Women*

21. Analyses of the impact of the AfCFTA at the household level suggest that the effect between male and female headed households is broadly quite balanced; both gain by differing degrees in different countries. However, women in particular can benefit from improvements to the challenges they face as informal cross-border traders. Women are estimated to account for around 70 per cent of informal cross-border traders in Africa, and in such positions are particularly vulnerable to harassment, violence, confiscation of goods and even imprisonment (Ghils, 2013).

### *Youth*

22. Sixty per cent of Africa's population are aged 24 or younger and are about to enter the workforce (ECA, AU and AfDB, 2017). The traditional approach to supporting youth employment has been to look at the labour supply side, by focusing on education, health, and skills upgrading. However structural transformation is increasingly also recognised as being required to produce new jobs for young people and to absorb these new entrants into the labour force. Otherwise, these young Africans face the prospect of dangerous out-migration, such as that over the Mediterranean, to find opportunities elsewhere. The AfCFTA can help by contributing to the kinds of export diversification and structural transformation that promote labour-intensive industry and help to pull Africa's youth into productive activities.

### *Smallholder farmers*

23. Smallholder farmers represent some 53 per cent of Africa's agricultural producers (ECA, AU and AfDB, 2017). By reducing trade barriers, the AfCFTA can help to connect smallholder farmers to the increasing demand for agricultural products by Africa's expanding population. In particular, smallholder farms, and the aggregators which often market their products, can benefit from simplified rule-of-origin requirements and with trade facilitation measures that help them to meet sanitary and phyto-sanitary export standards.

## The AfCFTA and Tariff Revenues

24. The AfCFTA has the potential to contribute to growth and structural transformation in Africa, but also to affect revenues from tariffs on intra-African trade. Removing tariffs on African trade under the AfCFTA will reduce tariff revenue, however such a reduction will be small and gradual for several reasons:

- i. Imports into African countries from other African countries currently account for only 14 per cent of total imports in Africa. Existing tariffs will be retained on the remaining 86 per cent of imports.

- ii. 56 per cent of these intra-African imports occur through pre-existing REC free trade areas, in which most trade is already fully liberalized. Where the AfCFTA will give valuable tariff reductions is instead predominantly on trade between the RECs as well as African countries that are not part of pre-existing REC free trade areas.
- iii. Countries will be allowed to exclude a certain amount of tariff lines from liberalization. As intra-African trade tends to be highly concentrated in a small number of tariff lines, it may be possible for countries to exclude a large share of the tariff lines that are important for raising tariff revenue. The exact size of the allowed exclusions, which is to be determined in the next negotiating forum to be held in May, will provide further clarity on the extent of exclusions.
- iv. Tariff reductions in the AfCFTA are to be gradually phased in, over a period of 5 years for developing countries and 10 years for least developed countries (LDCs). There is an even longer phase-in period for “sensitive” products of 10 years for developing countries and 13 years for LDCs.

25. Moreover, the effect of the AfCFTA on total government revenues may even be positive, especially over the medium-term, for the following reasons:

- i. Import duties are only a small component of government revenues, accounting on average for only 15 per cent of total tax revenue in Africa (African Tax Administration Forum, 2017). This means that reductions to tariff revenues – which are anyway expected to be limited – will only affect a small share of tax generation.
- ii. While the AfCFTA will reduce tariff revenues, it is expected to stimulate economic growth by as much as a 1 to 6 per cent increase in GDP, which would increase the broader tax base and boost revenue collection from other sources (De Pietris Chauvin and others, 2016; UNCTAD, 2017). In addition, these estimates of the economic impact of the AfCFTA are likely to substantially under-estimate the true size of the economic gains, as they leave out the impacts of liberalization in services and investment, alongside a number of other benefits that are not fully modelled (African Union Commission and others, 2017).
- iii. Moreover, the sectors which are expected to gain from the AfCFTA, such as manufacturing and processed agriculture, are those which tend to produce more sustainable growth, in turn better contributing to fiscal sustainability.
- iv. Initial modelling of the impacts of an AfCFTA in services suggest further economic gains that could add to growth, generating additional tax revenues (see Jensen and Sandrey, 2016).

26. If fact, a bigger concern than tariff revenue losses may therefore be that overly generous exclusions risk eroding the value of intra-African trade liberalization. UNCTAD found that if countries were to exclude the single most protected sector from liberalization, then the welfare gains to Africa from the AfCFTA would be reduced from \$16 billion to \$11 billion (UNCTAD, 2017).

27. However, exclusions also have an important role to play in comforting less-competitive domestic sectors that may feel threatened by the AfCFTA. It is therefore important that, in the upcoming AfCFTA negotiations, countries seek a balance to allow sufficient exclusions for protecting

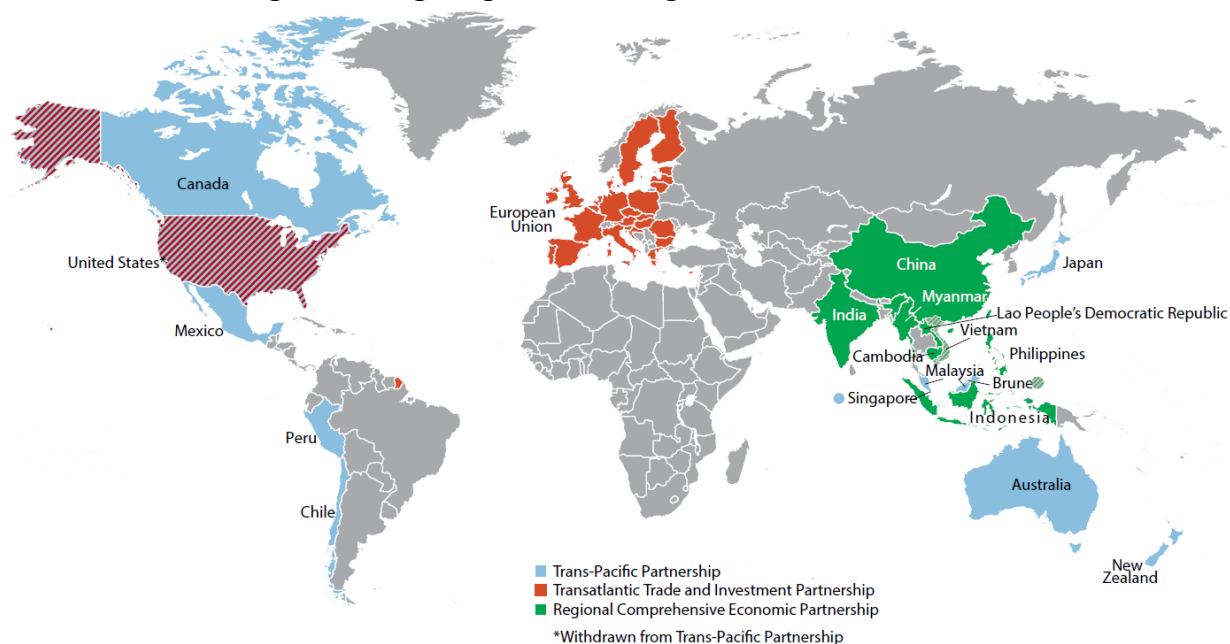


vulnerable sectors, without allowing so many exclusions as to eroding the value of the AfCFTA by creating a relatively 'empty' agreement.

### The AfCFTA as a Platform for African Trade Policy Coherence

28. The AfCFTA is being negotiated in a changing world trade environment. The multilateral trading system is in crisis after the failure of the Doha Round and populist anti-globalization sentiments in several large trading nations have sparked concern of “trade wars”. The rapid rise of emerging market economies has caused a fundamental shift in the trade patterns of many African countries. Controversies surrounding the Economic Partnership Agreements (EPAs) and Brexit require new thinking on restructuring trade relations with Europe. Africa’s trading relationship with the United States, having developed under the African Growth and Opportunity Act (AGOA), is likely to transform into reciprocal arrangements by 2025 in a post-AGOA agenda. The so-called “mega-regional” trade agreements that once threatened Africa’s preferential trade with established partners, now have evolved into a different threat of protectionism (Figure 6). Finally, new modes of trade such as e-commerce are putting pressure on demands for new trade rules.

**Figure 6. The AfCFTA among other mega-regional trade agreements**



Source: ECA, AUC and AfDB (2017) Assessing Regional Integration in Africa

29. What’s at stake is that future external negotiations risk unravelling regional integration in Africa. This has already posed a challenge to African regional economic communities that are nascent customs unions, such as ECOWAS and CEMAC. These comprise free trade areas and a common external tariff, and are working towards single market status with the free circulation of goods. Individual FTAs unravel this progress by 'breaking' the common external tariff; those countries with external FTAs would have a different tariffs with such external countries than others within such customs unions. Without a functioning common external tariff it is impossible for these regions to move forwards towards free circulation of goods.

30. Amongst these changes there has never been a greater urgency for Africa to consolidate its trade policy. Doing so provides Africa with the strengthened voice of 1.2 billion people in future negotiations, provides for a common position on evolving trade policy issues, and ensures that individual bilateral arrangements do not unravel the objectives and benefits of continental integration. The AfCFTA provides a strengthened platform for exactly such trade policy coherence in Africa.

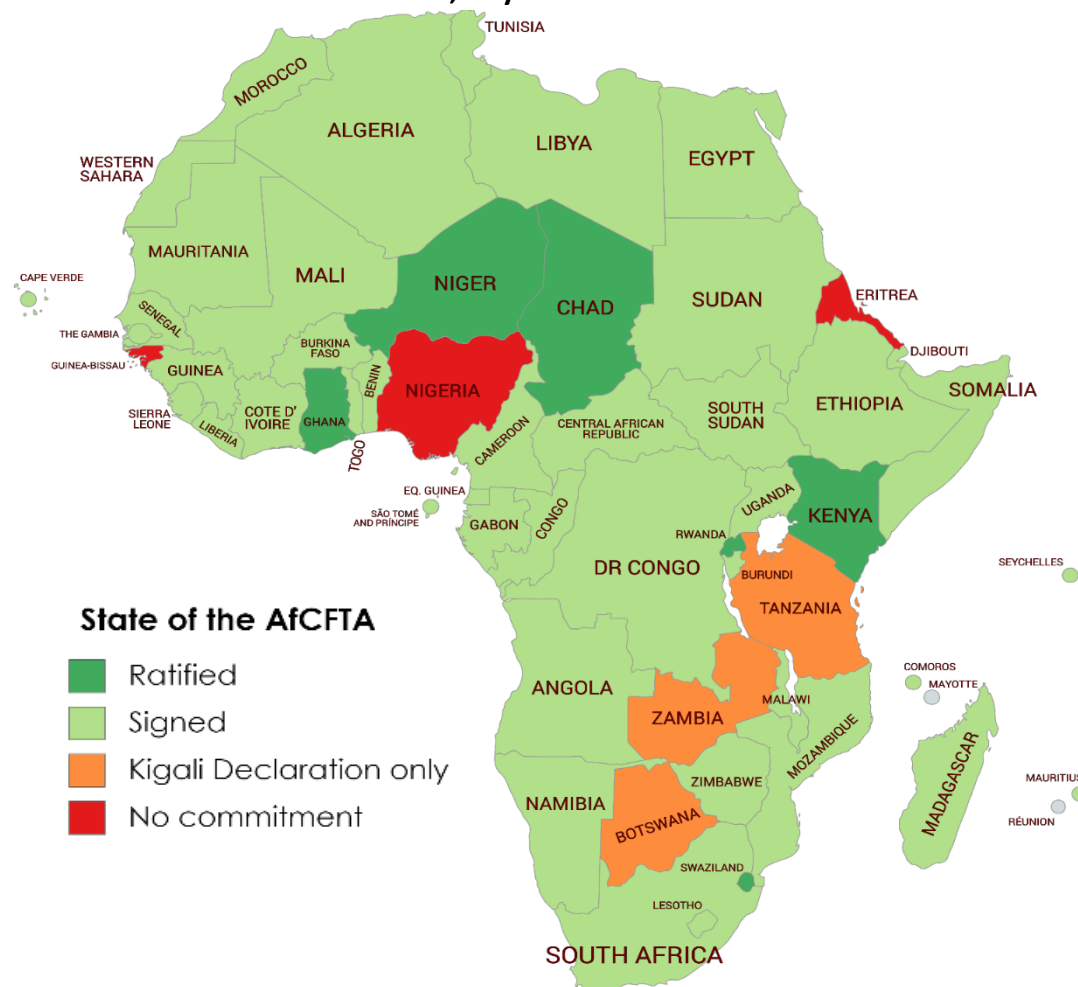
### What must countries do next for the effective implementation of the AfCFTA?

#### Ensure prompt ratification and conclusion of the implementation roadmap

31. Riding on the momentum of an historic 10<sup>th</sup> Extraordinary African Union Summit and AfCFTA signing ceremony, in Kigali, on 21<sup>st</sup> March 2018, 49 African Union member states have now signed the AfCFTA with 6 having further ratified the agreement. African businesses have had their interests piqued, political leadership at the highest level is committed, and the world is watching.

32. A further three African Union member states signed instead the Kigali Declaration, declaring their intention to sign the Agreement after concluding domestic legal processes. Three member states are yet to signal commitment to the AfCFTA (Figure 6).

**Figure 7. Status of Adherence to the AfCFTA, July 2018**



Source: Created with mapchart.net

33. This impetus must be seized. There is a real risk that, without firm ministerial guidance, the process could derail and delays set in, as is what happened with the Tripartite Free Trade Area negotiations which have yet to be concluded despite their “launch” in June, 2015.

34. To bring the AfCFTA into effect, countries must first ratify the agreement through their respective domestic legislative processes. The agreement will then enter into force once 22 African Union member states have deposited their instrument of ratification with the African Union Commission.<sup>1</sup>

35. To operationalize the AfCFTA, State Parties to the agreement must also conclude the implementation roadmap. This involves developing and submitting schedules of concessions for trade in goods. These detail, for each State Party or – as the case may be - customs union - the particular 90 per cent of products that are to be liberalized for each State Party, as well as the sensitive products that are to be liberalized over a longer time period and the excluded products that are to be temporarily exempted from liberalization.

36. A related complement to the schedules of concessions for trade in goods is the list of product-specific rules of origin which, alongside the general rules of origin, will enable the application of preferences under the AfCFTA.

37. For trade in services, negotiators have agreed that five sectors are to be prioritized: communications, financial services, transport, business services, and tourism. Negotiators are now working to similarly develop and submit schedules of concessions for these sectors, identifying how barriers to entry, such as local presence regulations, can be eased to allow the local operation of service suppliers from other African countries.

#### National AfCFTA strategies and flanking policies

38. While all countries have something to gain from the AfCFTA, it will nevertheless be vital that it is supported with accompanying measures and national strategies to realize its full opportunities (Box 1).

39. Less-industrialized countries can benefit from the implementation of the programme for the Accelerated Industrial Development of Africa; domestic investments in education and training can ensure the necessary complementary skills.

40. Implementation of the Africa Mining Vision can complement the AfCFTA, by helping resource-based economies to strategically diversify their exports into other African markets.

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<sup>1</sup> . In addition to the 6 countries that have already ratified, it is understood that the ratification process is at an advanced stage in 7 more countries including South Africa. The African Union Commission is confident that the 22 ratifications required for the agreement to enter into force will be achieved by the first anniversary of the signing of the AfCFTA in March 2019.

41. However, the Boosting Intra-African Trade (BIAT) Action Plan is the principal accompanying measure for the AfCFTA. It outlines the areas in which investments are required, such as trade information and access to finance, to ensure that all African countries can benefit from the AfCFTA.

**Box 1: National AfCFTA strategies**

To fully utilize the opportunities of the AfCFTA, each State Party is recommended to develop an AfCFTA Strategy - complementary to the broader trade policy of each respective State Party – that identifies for that particular country the key trade opportunities, current constraints, and steps required to take full advantage of the continental African market. Key features may include:

- **Export review:** covering existing intra-African and global trade performance within the context of any existing trade policy framework;
- **Opportunity sectors:** identifying AfCFTA export potential – based on a statistical analysis of AfCFTA market access offers and existing trade potential – and prioritizing target sectors;
- **Constraints to target sectors:** analysis of the constraints faced by exporters in target sectors in their intra-African trade;
- **Strategic actions for boosting identified target sectors:** including solutions to identified constraints, approaches to attracting sector investment, the prioritization of low-cost actions, and the allocation of institutional responsibilities for strategy implementation.

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