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MANAGEMENT DECISIONS IN THE AFRICAN CONTINENTAL FREE TRADE AREA

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ABSTRACT

This analysis comes with several caveats. On the one hand, the results may underes- timate the impacts of AfCFTA because they do not capture (1) informal trade flows or new trade flows in sectors and countries that are not trading in the baseline; (2) dynamic gains from trade (such as productivity increases, economies of scale, and learning by

Introduction

On March 21, 2018, at the 10th Extraordinary Summit of the African Union, almost all countries on the African continent signed the African Continental Free Trade Area (AfCFTA) agreement, thereby creating the largest free trade area in the world. The agreement connected 55 countries and 1.3 billion people. The combined gross domestic product (GDP) of AfCFTA economies is valued at US$3.4 trillion.

The forward-looking policy scenarios were designed by employing the global dynamic CGE model and the global microsimulation framework Global Income Distribution Dynamics (GIDD).3 This approach allows analysis of global development and structural transformation, incorporating the complex interactions of productivity differences at the country, sector, or factor level; shifts in demand as income rises; demographic and skill dynamics in factor markets; and changes in comparative advantage and trade flows from globalization or trade liberalization. Analysis of the distributional outcomes of AfCFTA requires (1) building a new data set on employment doing); and (3) foreign direct investment (FDI)—improving market con- ditions, competitiveness, and business sentiment will likely stimulate FDI in Africa, thereby leading to higher investment and accelerating imports of higher-technology intermediate and capital goods and improved management practices. Therefore, FDI inflows could boost regional income well above the gains predicted in this analysis. On the other hand, the results may overestimate the impacts of AfCFTA because the anal- ysis does≈not capture (1) the costs of lowering nontariff barriers and trade facilitation measures; and (2) the transitional costs associated with trade-related structural change such as employment shifts and potentially stranded assets such as capital. Furthermore, the results are based on a new data set on gender-disaggregated employment and wages, which requires further vetting by country experts. AfCFTA offers big opportunities for development in Africa, but implementation will be a significant challenge. This analysis identifies key priorities for African pol- icy makers. Lowering and eliminating tariffs will be the relatively easy part—even if it comes, in some cases, with the challenge of how to replace tariff revenues. The hard part will be enacting the nontariff and trade facilitation measures, which is where the analysis predicts the largest potential economic gains. Such measures will require sub- stantial policy reforms at the national level, indicating a long road ahead. Achieving AfCFTA's full potential depends on agreeing to ambitious liberalization and imple- menting it in full. Partial reforms would lead to smaller effects.

The agreement officially entered into force on May 30, 2019, after ratification of the agreement by 22 countries (figure 1.1).

AfCFTA addresses the long-standing economic fragmentation of Africa. Trade barriers remain high across the continent. Although statutory tariffs have been reduced to below 5 percent for roughly half of the countries, they remain high for sensitive sectors. Many other barriers are restricting continental economic integration as well— nontariff barriers in services and other sectors, weak and fragmented rules aimed at promoting investment and competition, and inadequate institutions such as customs management to facilitate trade.

Africa accounts for less than 3 percent of global trade and GDP, but 16.7 percent of global population (figure 1.2). The signatory countries trade little with each other—less than 8 percent of their exports are directed to other prospective member countries. Even compared with all intraregional trade in Africa (around 11 percent), this share is low, suggesting that the growth of regional trade is subject to important constraints. Poverty reduction remains a critical priority in Africa. The poverty headcount ratio (percentage of the population living below the poverty line of US$1.90 a day) is high in AfCFTA countries, averaging 32.2 percent.

Madagascar to 0.5 percent for Algeria and Mauritius.1

This study assesses the potential economic implications of AfCFTA, quantifying the impacts using a computable general equilibrium (CGE) model calibrated to the most recent database produced by the Global Trade Analysis Project (GTAP).2 The GTAP database is supplemented by data that quantify some of the other barriers to trade that, if part of the integration package, could support the elimination of tariffs in boosting trade integration and accelerating growth.

The African Continental Free Trade Area (AfCFTA) provides a unique opportunity for countries in the region to competitively integrate into the global economy, reduce poverty, and promote inclusion. Although Africa has made substantial progress in recent decades in raising living standards and reducing poverty, increasing trade can provide the impetus for reforms that boost productivity and job creation, and thereby further reduce poverty.

AfCFTA can provide this spark. By 2035, we estimate that implementing the agree- ment would contribute to lifting an additional 30 million people from extreme poverty and 68 million people from moderate poverty. Real income gains from full imple- mentation of the agreement could increase by 7 percent, or nearly US$450 billion. As African economies struggle to manage the consequences of COVID-19, AfCFTA can provide an anchor for long-term reform and integration.

AfCFTA would significantly boost African trade, particularly intraregional trade in manufacturing. By 2035, the volume of total exports would increase by almost 29 percent relative to business as usual. Intracontinental exports would increase by more than 81 percent, while exports to non-African countries would rise by 19 percent. This would create new opportunities for African manufacturers and workers.

These gains would come, in part, from decreased tariffs, which remain stubbornly high in many countries in the region. Even greater gains would come from lowering trade costs by reducing nontariff barriers and improving hard and soft infrastructure at the borders—so-called trade facilitation measures. These measures would reduce red tape, lower compliance costs for traders, and ultimately make it easier for African businesses to integrate into global supply chains. These reforms would be difficult, but the rewards would be substantial.

Freer intra-African trade would help women by lowering the gender wage gap, and it would help all workers by increasing decent employment opportunities. A growing manufacturing sector would provide new job opportunities, especially for women. The report estimates that compared with a business-as-usual scenario, implementing AfCFTA would lead to an almost 10 percent increase in wages, with larger gains for unskilled workers and women.

Statement of the Problem

On March 21, 2018, at the 10th Extraordinary Summit of the African Union, almost all countries on the African continent signed the African Continental Free Trade Area (AfCFTA) agreement, thereby creating the largest free trade area in the world. The agreement connected 55 countries and 1.3 billion people. The combined gross domestic product (GDP) of AfCFTA economies is valued at US$3.4 trillion.

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At its launch, the framework agreement establishing the African Continental Free Trade Area (AfCFTA) was signed by 44 countries at a summit of the African Union (AU) held in Kigali, Rwanda, March 21, 2018. AfCFTA was proposed in 2012,1 and it was hoped that an agreement would be reached by 2017. The first phase comprised negotiation of three protocols: Trade in Goods,2 Trade in Services,3 and Rules and Procedures for Settlement of Disputes.

The agreement requires members to progressively remove tariffs on at least 97 percent of tariff lines that account for 90 percent of intra-Africa imports.4 Average tariffs are 6.1 percent, but with high variation across countries and sectors. Intra-Africa trade is highly concentrated, with 1 percent of tariff lines accounting for 74 percent of imports in the average African country. Thus some of the most onerous and protectionist tariffs may be maintained even if countries liberalize most tariff lines. Trade in certain sensitive sectors is expected to be liberalized over a longer period, but other goods are likely to remain excluded from liberalization.5

The AfCFTA annex on rules of origin has not yet been finalized. Rules of origin describe the transformation a product must undergo in the region—such as the share of value added—to enjoy preferential market access. They are used to prevent goods from nonmember countries entering through a low-tariff country and being transshipped duty-free to another member country. Rules of origin that are too restrictive can negate the preferential market access intended by the free trade agreement and prevent global supply chains from functioning. South Africa and Nigeria have expressed concerns that rules of origin too lenient or mismanaged will provoke a flood of extraregional prod- ucts with low levels of value added.

Negotiations on services began in June 2018, and countries have identified five priority sectors: financial services, transport, telecom/information technology, profes- sional services, and tourism. The benefits of services liberalization extend far beyond the service sectors themselves; they affect all other economic activities in which services are inputs. A second phase of negotiations will focus on investment, competition, and intellectual property rights, with the potential of deepening AfCFTA. that deep trade agreements boost trade, foreign investment, and participation in global value chains (Laget et al. 2018; Mattoo, Mulabdic, and Ruta 2017; Mulabdic, Osnago, and Ruta 2017). And yet these areas also involve complex negotiations.

An important question is how AfCFTA will complement Africa's subregional pref- erential trade agreements (PTAs). This analysis compares the legal text of AfCFTA (as signed in March 2018) with the policy areas covered in existing PTAs.6 It indicates that AfCFTA could promote regional economic integration in Africa in two ways. First, in the policy areas already covered by subregional PTAs, AfCFTA will offer a common regulatory framework, thereby reducing market fragmentation created by different sets of rules. Second, Africa's subregional trade agreements tend to be shallow. AfCFTA will be an opportunity to regulate policy areas important for economic integration that are often regulated in trade agreements but that so far have not been covered in most of Africa's PTAs.

This analysis focuses on the following subregional PTAs, which are in force and were notified to the World Trade Organization (WTO) as of September 2019: Common Market for East and South Africa (COMESA), East African Community (EAC), Economic Community of West African States (ECOWAS), South African Development Community (SADC), South African Customs Union (SACU), West African Economic and Monetary Union (WAEMU), and Economic and Monetary Community of Central

Understanding the detailed content of trade agreements beyond tariffs is essential to appreciate their potential effects. Modern-day PTAs are not just the more common instruments of trade policy liberalization; countries participating in PTAs have deepened and expanded their scope.8 The average PTA in the 1950s covered eight policy areas. In recent years, that number went up to 17. "Deep" trade agreements matter for economic development. The rules embedded in these agreements contribute to determining how economies function and grow. For example, trade and investment regimes determine the extent of economic integration; competition rules affect economic efficiency; and intellectual property rights protections matter for innovation.

The inclusion of new policy areas in PTAs is not random. As shown by Mattoo, Mulabdic, and Ruta (2017), trade agreements covering few policy areas generally focus on traditional trade policy areas such as tariff liberalization or customs. Agreements with broader coverage tend to include trade-related regulatory issues such as technical barriers to trade or subsidies. Finally, agreements with large numbers of provisions often include policy areas that are not directly related to trade such as labor, envi- ronment, and migration issues.9 This analysis of the content of AfCFTA and Africa's subregional PTAs focuses on the 20 policy areas most commonly included in trade agreements in force and notified to the WTO.

Two policy areas have largely not been covered in Africa's subregional PTAs but are included in AfCFTA. Intellectual property rights are covered in only one subregional PTA (EAC), and no subregional PTA covers state trading enterprises (STEs).

Finally, although AfCFTA is deeper than any of the existing subregional PTAs, some policy areas are included in individual subregional PTAs but not in AfCFTA (table 2.1). Examples of these areas are state aid (subsidies),10 environmental laws,11 labor market regulations,12 and public procurement.13 The exclusion of these policy areas in AfCFTA does not prevent countries from aiming for common regulations at a later stage and does not affect the commitments made by countries in the context of the subregional PTAs.

An important issue is how inconsistencies or conflict between different jurisdic- tions, subregional or regional, will be addressed. As a general comment, Article 19 of the AfCFTA treaty refers to "conflict and inconsistency with Regional Agreements." Article 19(1) establishes that,

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unless otherwise provided, AfCFTA prevails in cases of inconsistencies. At the same time, Article 19(2) refers to "higher levels of regional integration" than those established in AfCFTA, such as in "regional economic commu- nities, regional trading arrangements and custom unions." In the latter situation, and as a general rule, parties maintain such higher levels among themselves. It remains to be seen how this will be implemented in practice.

DATA AND METHODOLOGY

This analysis quantifies the long-term economic and distributional implications of AfCFTA. It assesses the implications for economic growth, international trade, poverty, and employment, including for female and male workers. It quantifies the short- and long-term implications of tariff revenue. The analysis relies on a global computable general equilibrium (CGE) model and a microsimulation framework to quantify the agreement's impact. The CGE model is calibrated to the most recent database produced by the Global Trade Analysis Project (GTAP). The GTAP database is supplemented by additional data that quantify other barriers to trade. To date, studies on the economic implications of Africa's regional integration have mainly focused on tariff and nontariff barriers (NTBs) in goods. This analysis extends those studies to cover NTBs in services and trade facilitation measures. Most important, the analysis is extended to investigate the implications of AfCFTA for poverty, impacts on unskilled workers, and women.

The forward-looking scenarios were designed using the global dynamic CGE model and the global microsimulation framework Global Income Distribution Dynamics (GIDD). This approach allows analysis of global development and structural transformation, incorporating the complex interactions of productivity differences at the country, sector, or factor level; shifts in demand as income rises; demographic and skill dynamics in factor markets; and changes in comparative advantage and trade flows from globalization or trade liberalization. Analysis of distributional outcomes of AfCFTA required (1) building a new data set on the employment and wages of female and male workers at the industry level across AfCFTA members; (2) building a gender- sensitive CGE model; and (3) updating several household surveys to be used in the microsimulations.

In line with ongoing negotiations, the model assumes reductions in tariff and non- tariff barriers and in trade facilitation bottlenecks. Specifically:

Tariffs on intracontinental trade are reduced progressively in line with AfCFTA modalities. Starting in 2020, tariffs on 90 percent of tariff lines

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will be elimi- nated over a 5-year period (10 years for least developed countries, or LDCs). Starting in 2025, tariffs on an additional 7 percent of tariff lines will be elimi- nated over a five-year period (eight years for LDCs). Up to 3 percent of tariff lines that account for no more than 10 percent of intra-Africa imports could be excluded from liberalization by the end of 2030 (2033 for LDCs).

Nontariff barriers on both goods and services are reduced on a most-favored- nation (MFN) basis. It is assumed that 50 percent of NTBs can be addressed with policy changes within the context of AfCFTA—with a cap of 50 percentage points. It is also assumed that additional reductions of NTBs on exports will be forthcoming.

AfCFTA will be accompanied by measures that facilitate trade through imple- mentation of a trade facilitation agreement (TFA). Estimates of the size of these trade barriers were provided by de Melo and Sorgho (2019). These are halved, although capped at 10 percentage points.

MACROECONOMIC IMPACTS OFAfCFTA

Real income gains from full implementation of AfCFTA could increase by 7 percent by 2035, or nearly US$450 billion (in 2014 prices and market exchange rates). But the aggregate numbers mask the heterogeneity of impacts across countries and sectors. At the very high end are Côte d'Ivoire and Zimbabwe with income gains of 14 percent each (figure O.1). At the low end, a few countries would see real income gains of around 2 percent—including Madagascar, Malawi, and Mozambique. Real income gains from tariff liberalization alone are small, about 0.2 percent at the continental level, although some countries would record gains of more than 1 percent. Constraints to African trade are largely attributable to the high costs of that trade. As a result, the biggest gains would come from the reduction in NTBs and implementation of the TFA. Under combined tariff liberalization and reduction in NTBs, the real income gain would amount to 2.4 percent in 2035 at the continental level. The biggest boost would arise from implementation of the TFA, which would raise the gains for AfCFTA members to 7 percent of income.

AfCFTA would significantly boost African trade, particularly intraregional trade in manufacturing. The volume of total exports would increase by almost 29 percent by 2035 relative to the baseline. Intracontinental exports would increase by over 81 percent, while exports to non-African countries would rise by 19 percent. Intra- AfCFTA exports to AfCFTA partners would rise especially fast for Cameroon, the Arab Republic of Egypt, Ghana, Morocco, and Tunisia, with exports doubling or tripling with respect to the baseline. Under the AfCFTA scenario,

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manufacturing exports would gain the most, 62 percent overall, with intra-Africa trade increasing by 110 percent and exports to the rest of the world rising by 46 percent. Smaller gains would be observed in agriculture—49 percent for intra-Africa trade and 10 percent for extra-Africa trade. The gains in the services trade are more modest—about 4 percent overall and 14 percent within Africa.

The AfCFTA agreement would also boost regional output and productivity and lead to a reallocation of resources across sectors and countries. By 2035, total produc- tion of the continent would be almost US$212 billion higher than the baseline. Output would increase the most in natural resources and services (1.7 percent), with manufac- turing seeing a 1.2 percent rise. But output in agriculture would contract 0.5 percent (relative to the baseline in 2035) at the continental level. In absolute terms, most of the gains would be realized by the services sector (US$147 billion), with smaller gains in manufacturing (US$56 billion) and natural resources (US$17 billion). By 2035, agri- cultural output would decline by US$8 billion relative to the baseline. As compared with the baseline in 2035, agriculture is growing faster in all parts of Africa except for North Africa, which under AfCFTA is shifting toward manufacturing and services.

The aggregate numbers, however, mask the heterogeneity of impacts across coun- tries and sectors. Ninety percent of countries would see their volume of services grow under AfCFTA, reflecting in part the higher demand for services as Africa' s economy grows. Similarly, 60 percent of countries would see growth in the value of their output of agricultural and manufacturing goods.

AfCFTA's short-term impact on tax revenues is small for most countries. Tariff revenues would decline by less than 1.5 percent for 49 out of 54 countries. Total tax rev- enues would decline by less than 0.3 percent in 50 out of 54 countries. Two factors help explain these small revenue impacts. First, only a small share of tariff revenues come from imports from African countries (less than 10 percent on average). Second, exclusion lists can shield most tariff revenues from liberalization because these revenues are highly concentrated in a few tariff lines (1 percent of tariff lines account for more than three-quarters of tariff revenues in almost all African countries). In the medium to long run, tariff revenues would grow by 3 percent by 2035 relative to the baseline as imports rise and as tariff liberalization is accompanied by a reduction in NTBs and implementation of trade facilitation measures.

Conclusion

African Union Assembly Decision Assembly/AU/Dec. 394 (XVIII) as part of the Action Plan on Boosting Intra-Africa Trade (BIAT).

The overarching aims of the agreement for goods are (1) progressively eliminating tariffs;

progressively eliminating nontariff barriers; (3) enhancing the efficiency of customs, trade facilitation, and transit; (4) promoting cooperation on technical barriers to trade (TBTs) and sanitary and phytosanitary (SPS) measures; (5) developing and promoting regional and continental value chains; and (6) promoting socioeconomic development, diversification, and industrialization across Africa.

The overarching aims of the agreement for services are (1) enhancing competitiveness of services;

(2) promoting sustainable development; (3) fostering investment; (4) accelerating efforts in industrial development to promote the development of regional value chains; and (5) progressively liberalizing trade in services.

A special dispensation for seven least developed countries has also been tabled, providing for a reduced level of ambition on tariff liberalization. At entry into force of AfCFTA, Djibouti, Ethiopia, Madagascar, Malawi, Sudan, Zambia, and Zimbabwe will be expected to meet a reduced level of ambition of 85 percent of tariffs, with a 15-year period to reach 90 percent.

AfCFTA would benefit from the lessons produced by the World Bank's most recent analysis of trade policy and barriers in the Economic and Monetary Community of Central Africa (CEMAC). Fiess et al. (2018) finds that trade within CEMAC remains limited despite a significant regional integration effort.

The analysis of the subregional PTAs draws on the World Bank's database on the content of trade agreements (Hofmann, Osnago, and Ruta 2017). This database is based on a review of policy areas covered in each PTA's main legal instrument or founding treaty.

Note included in this analysis are four regional economic communities (RECs) recognized by the AfCFTA agreement but are not trade agreements that have been notified to the WTO: Arab Maghreb Union (UMA); Community of Sahel-Saharan States (CEN-SAD); Economic Community of Central African States (ECCAS); and Intergovernmental Authority on Development (IGAD). SACU, WAEMU, and CEMAC are not acknowledged as RECs in the AfCFTA agreement (Article 1(t)) but fall within the ambit of Article 19(2) of the AfCFTA treaty.

Preferential trade agreements have always been a feature of the world

trading system, but their prominence has changed in recent years. The number of PTAs increased from 50 in the early 1990s to roughly 300 in 2019. All WTO members are currently party to at least one PTA and often several.
A study of European Union and U.S. trade agreements identified 52 potential policy areas covered in PTAs (Horn, Mavroidis, and Sapir 2010).

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