United Nations
Economic Commission for Africa

TRADE MARK EAST AFRICA
Growing Prosperity Through Trade

CREATING A UNIFIED REGIONAL MARKET

TOWARDS THE IMPLEMENTATION OF THE AFRICAN CONTINENTAL FREE TRADE AREA IN EAST AFRICA

EXECUTIVE SUMMARY

The signing of the African Continental Free Trade Area (AfCFTA) by 44 countries on 21st March 2018 in Kigali was a momentous milestone on the road towards achieving the long-standing goal of creating a unified continental market. The arguments in favour of implementing the AfCFTA in East Africa are particularly compelling. With a combined GDP of USD 880 billion (measured in Purchasing Power Parities) and a population of 420 million, the economies of East 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 percent, 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 in Kigali in March 2018 now has 54 signatures, and offers hope of a revival of both regional and intra-African trade to boost trade and development in East Africa.

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Despite the prevailing low per capita incomes, over the past decade East 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 percent of GDP. These deficits need to be financed, yet official development assistance (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.

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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.

This report provides a first assessment of the potential gains specifically for East Africa. We estimate that the lower cost for goods and services from the implementation of the AfCFTA will result in welfare gains

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amounting to USD 1.8 billion for the region. Depending on the methodology used, it could boost East African trade by between USD 737 million and USD 1.1 billion, creating more than 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.

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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 East Africa are typically operating at around 20 percent to 40 percent 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 East African and with the rest of the continent.

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The benefits of the AfCFTA go far beyond the manufacturing sector. A good example is the tradein food products. Demographic pressures in East Africa are among the highest in the world – with the population currently expanding by almost 10 million people every year; this 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 East 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 East 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 East 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 percent of total international tourist arrivals in the East African Community (EAC), for example.

Ultimately, however, it is the citizens of East 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.

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. East 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.

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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.

The Regional Economic Communities should 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 needed to address the bottlenecks that have hindered trade

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across countries in the region. Development of trade digital corridors will be required to improve efficiency in the transport and logistics sectors which are crucial drivers of intra-regional trade. Work across the region to reduce delays and improve efficiencies at existing one-stop border posts also needs to be expandedand accelerated. The inter-connectivity of the region will depend on improvements in port facilities and greater investments in roads and inland waterways in the Great Lakes region. These constitute vitalarteries 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 both develop national and regional AfCFTA implementation strategies and prepare actionable plans to implement the agreement effectively. The Economic Commission for Africa and Trademark East Africa stand ready to provide the necessary support for these endeavours. 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.