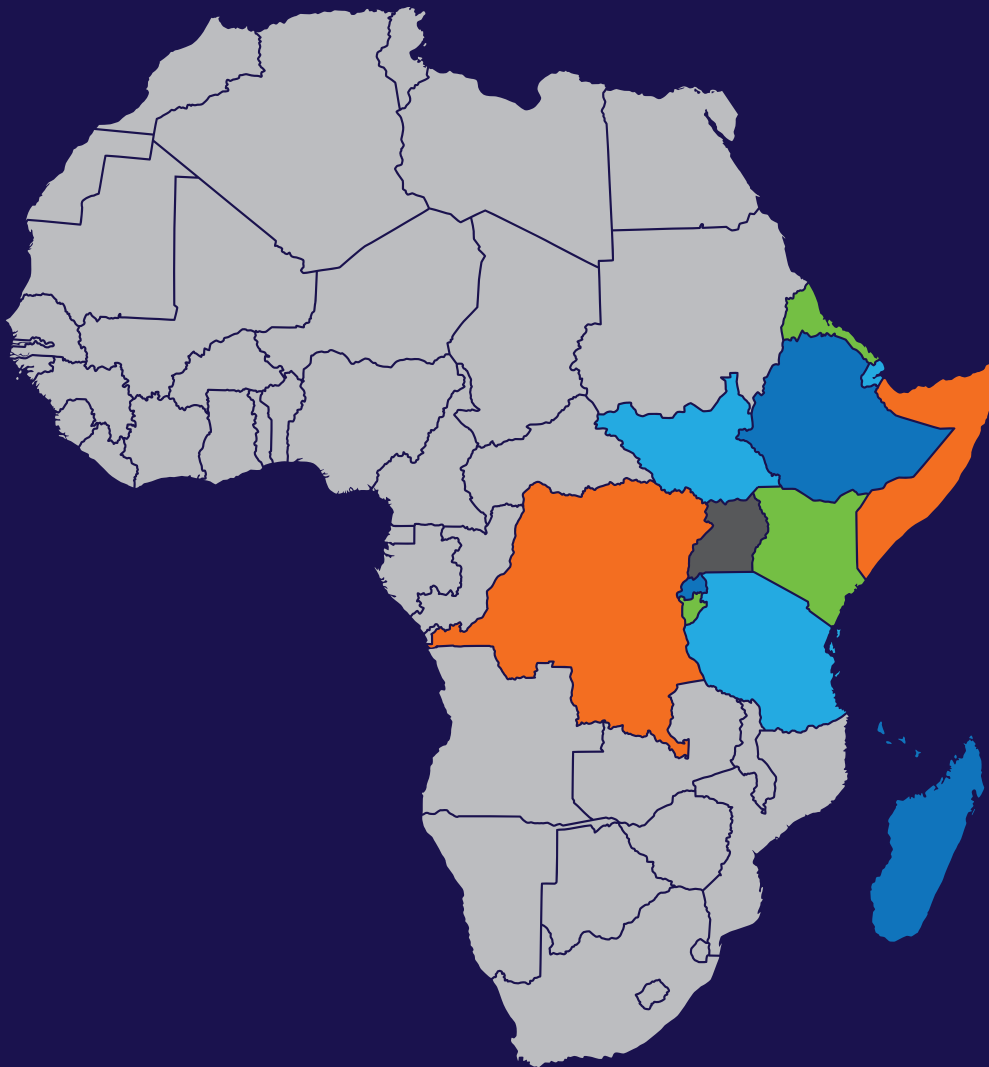




United Nations
Economic Commission for Africa



CREATING A UNIFIED REGIONAL MARKET



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





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Economic Commission for Africa

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LIST OF ACRONYMS

AEC	African Economic Community
AfCFTA	African Continental Free Trade Area
AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
AIDA	Accelerated Industrial Development of Africa
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
AU	African Union
AUC	African Union Commission
BIAT	Boosting Intra-African Trade Initiative
BITs	Bilateral Investment Treaties
CGE	Computable General Equilibrium
COMESA	Common Market for Eastern and Southern Africa
COMTRADE	Commodity Trade Statistics
EAC	East African Community
ECA	United Nations Economic Commission for Africa
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
EDPRS	Economic Development and Poverty Reduction Strategy
EIB	European Investment Bank
EPAs	Economic Partnership Agreements
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
FTAs	Free Trade Agreements
GATT	Generalized Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GTAP	Global Trade Analysis Project

IATA	International Air Transport Association
IGAD	Intergovernmental Authority on Development
IMF	International Monetary Fund
IOM	International Organization for Migration
ISDS	Investor–State Dispute Settlement
KNBS	Kenya National Bureau of Statistics
KSH	Kenyan Shilling
LDCs	Least Developed Countries
MERCOSUR	Southern Common Market
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
NTBs	Non-Tariff Barriers
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PIDA	Programme for Infrastructure Development in Africa
RECs	Regional Economic Communities
SAARC	South Asian Association for Regional Cooperation
SADC	Southern African Development Community
SADCC	Southern African Development Coordination Conference
SIDS	Small Island Developing States
SITC	Standard International Trade Classification
SMEs	Small and Medium Enterprises
TFTA	Tripartite Free Trade Area
TRALAC	Trade Law Centre for Southern Africa
TRIPs	Trade-Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNDESA	United Nations Department of Economic and Social Affairs
UNIDO	United Nations Industrial Development Organization
WEF	World Economic Forum
WTO	World Trade Organization
WTTC	World Travel & Tourism Council

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FOREWORD

Unbeknownst to much of general public outside the region, East Africa has a tremendously dynamic economy. It has been the fastest growing sub-region in Africa since 2013 and is currently expanding at more than double the continental average. Three of the world's ten fastest growing economies in 2019 were located in East Africa (Ethiopia, Rwanda and Tanzania). Despite still low prevailing per capita incomes, there have been some notable social gains as well. For example, East Africans today live 6.7 years longer on average than they did a decade ago – reflecting general improvements in living conditions.

Yet despite these positive trends, the region still suffers from a number of serious vulnerabilities to its ability to sustain this strong economic performance. This report focuses on one particular *Achilles' Heel*: limited intra-regional trade and investment constrain the structural transformation of the sub-region's economies and make it difficult for countries to achieve global, regional and national developmental objectives. In a global economy increasingly dominated by large countries such as the United States, China and India, there is a widespread recognition that small developing economies cannot compete effectively unless they are well integrated into their respective regions.

At the continental level, that realisation is very much rooted in the African Continental Free Trade Area (AfCFTA). In March 2018, at an Extraordinary Summit of the African Union in Kigali, the Continent made a giant stride forward in achieving a unified market when 44 member states signed up to the AfCFTA. Ten other member states have subsequently signed up to the agreement, representing a remarkable degree of consensus across the Continent. As momentous as this was, the hard road of implementation still lies ahead. In July 2019, the African Union launched the operational phase of the AfCFTA, which will come into force in July 2020. To date, five out of 14 East African countries have ratified the agreement, with more countries expected to do so during 2020.

When fully implemented, the AfCFTA will catalyse intra-regional trade and investment integration across the Continent, bringing with it new opportunities for employment creation, income generation and poverty reduction. The implications for East Africa are enormous. Of the 1.2 billion people that the AfCFTA will touch, one-third reside in East Africa. The AfCFTA will facilitate companies' and farmers' access to rapidly growing markets both within the sub-region and across Africa. As this report details, the AfCFTA will lead to a significant diversification of East African economies, a USD1.1 billion boost to intra-regional trade, and the creation of more than 2 million jobs, among other benefits. These gains are conservatively estimated, and the long-term benefits may well be many multiple times larger. As the report stresses, for instance, East Africa has great potential in promoting intra-regional services trade (an area not covered by the existing data). Investment levels in productive activities and infrastructure will rise, making growth more sustainable.

In addition to providing, for the first time, a set of comprehensive impact assessments for the East Africa region, this report highlights the issues at stake, identifying areas where governments and the private sector will need to focus their energies as the region moves forward with implementation. To support this work effectively, we are conscious of the need to build strategic partnerships. At the continental level, for instance, ECA has already joined forces with the African Union, African Development Bank, and the United Nations Conference on Trade and Development to produce its recent ARIA IX report, *Assessing Regional Integration in Africa: Next Steps for the AfCFTA*.

This new East Africa report is fruit of a partnership between TradeMark East Africa and ECA's sub-regional office for Eastern Africa – two organisations that share a pan-African vocation and the conviction that greater intra-regional trade and investment is the way forward. As one of the largest trade facilitation organisations in the world, TMEA brings a wealth of experience in financing measures to reduce trade barriers and facilitate cross-border business. TMEA is planning to heavily support implementation of the AfCTA by working with countries to reduce numerous existing bottlenecks to African trade that, without remedy, will reduce the potential benefits of the AfCFTA. We will do this in partnership with Governments, the Africa Union, ECA and hundreds of partners on the ground. This practical focus on implementation, combined with ECA's convening power and thought-leadership on the AfCFTA, makes for an effective collaboration.

This report will serve as a useful point of departure for deeper discussions among all stakeholders on the way forward. We also hope that it sparks a wider conversation about how to achieve *inclusive* economic integration that benefits all East Africa citizens. At this exciting juncture for East Africa, we stand ready to provide further technical and analytical support to member countries as they strategize how to maximise the benefits from the AfCFTA.



Vera Songwe

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United Nations Executive Secretary of the
Economic Commission for Africa*



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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.

The arguments for implementing the AfCFTA in East 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 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.

The current dynamism of the region's economy has been consumption-led, not investment- or technology-led... A significant proportion of domestic demand is being met by imports rather than regional production.

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

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

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.

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.

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.

The AfCFTA promises to create new opportunities in high value-added services trade, helping countries to achieve their goals of economic diversification and structural transformation.

The benefits of the AfCFTA go far beyond the manufacturing sector. A good example is the trade in 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.

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.

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

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

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 expanded and 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 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 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.

OUTLINE OF THE REPORT

This report provides the first assessment of the potential impact of the AfCFTA agreement on East Africa and discusses the measures and supportive instruments that will be needed to implement the agreement successfully. It is divided into six sections. Section 1 begins with an historical overview of events leading towards the AfCFTA. Section 2 describes existing patterns of intra-regional trade and investment and looks at the contextual background of the current state of the regional economy, highlighting the opportunities created by access to more open domestic and regional markets under the AfCFTA. Section 3 presents a review of existing empirical studies on the benefits of regional integration. Section 4 then provides empirical evidence, based on both partial and general equilibrium analysis, of the impact of the AfCFTA specifically on East Africa. Section 5 discusses the results of the empirical analysis by highlighting the key sources of benefits and policy implications. Section 6 explains the rules of origin and the protocols on investment, competition policy and intellectual property rights and free movement of people. Section 7 describes additional areas where action is required to facilitate the implementation of the AfCFTA in East Africa. Section 8 concludes and provides a set of 5 key recommendations on the way forward.

1. INTRODUCTION - THE HISTORICAL CONTEXT

FTA2018 | 17-21 March 2018 | Kigali,



The signing of the AfCFTA on 21st March 2018 in Kigali by 44 countries represented a milestone on the road towards achieving the long-standing goal of closer African economic and political integration. At the very first session of the then recently founded Economic Commission for Africa (ECA), held in December 1958 in Addis Ababa, those aspirations were expressed by His Imperial Majesty Haile Selassie I. He emphasized that:

...African people must work and cooperate together if the economic development of the continent is to be furthered...concerted action, cooperation, and coordinated policies to improve the economic lot of all African peoples to a standard comparable to that enjoyed in the most highly developed regions of the world... (Selassie, 1960:102).¹

Africa's commitment to regional integration continued to take centre stage in subsequent years. Three distinct but overlapping phases can be identified in post-independence moves to regional integration (Páez, 2016). The first period occurred during decolonization in the 1960s, when integration was closely linked to achieving and preserving independence. The Organisation of African Unity (OAU) was established in 1963 with a mandate to promote independence. The second phase occurred between the early 1980s and 1990s, with regional organizations created either to promote economic integration or to solve regional problems.² The third most ambitious phase started with the Abuja Treaty of 1991, followed by the Sirte Declaration of 1999, leading to creation of the African Union (AU), and envisioning the creation of an African Economic Community (AEC). The AEC was to be established in six phases over 34 years, with the first 3 phases focusing on the creation and strengthening of regional economic communities (RECs)³ which were to serve as the building blocks for the AEC (ECA, AUC and AfDB, 2012: 11). Albeit behind the scheduled 2011 deadline, the AfCFTA (which is also part of the AU Agenda 2063) coincides with the fourth phase⁴ (Figure 1.1).

The signing of the AfCFTA on 21st March 2018 in Kigali represented a milestone on the road to achieving the long-standing goal of closer African economic and political integration.

1 Similar sentiments were expressed by other great Pan-Africanists. The first President of Tanzania Julius Nyerere, argued that "...we should all encourage Africa to get that realisation more and more that we have to depend upon ourselves, both at national level and at the collective level...we all enhance our capacity to develop if we work together..." (quoted in SARDC, 2014).

2 For example, in the historic Lagos Plan of Action of 1980, African countries declared their commitment to the promotion of economic integration of the continent while the goal of combating colonial and white-minority rule in South Africa led to the establishment of the Southern African Development Coordination Conference (SADCC), later the Southern African Development Community (SADC).

3 Currently, there are eight RECs recognised by the African Union: East African Community (EAC), the Economic Community of Central African States (ECCAS), the Community of Sahel-Saharan States (CEN-SAD), the Common Market for Eastern and Southern Africa (COMESA), the Economic Community of West African States (ECOWAS), the Intergovernmental Authority on Development (IGAD), the Southern African Development Community (SADC) and the Arab Maghreb Union (UMA).

4 The AU aims to have the African Common Market (Internal Market) in place by 2023, five years before the establishment of the African Economic Community (AU, 2019).

Figure 1.1: The AU Continental Integration Agenda



Source: Soininen (2014).

At a time of great global uncertainty and waning faith in the global trading system and multilateralism it is logical that African countries should adopt growth strategies that are more regionally inward-looking and self-reliant.

The AfCFTA comes at a time when the rest of the global economy is looking decisively less stable (IMF, 2019a; World Bank, 2019a). In some quarters, globalization seems to have reached a pause and could even go in reverse. The ongoing trade war between the two largest trading nations in the world, the United States and China, is illustrative of this, but it is not confined to

this case. European integration is being destabilized by the possible imminent exit of the United Kingdom from the European Union (EU), while there are rising trade tensions between the United States and Europe too. Recent estimates from the World Trade Organization (WTO) show that the volume of global merchandise trade grew by just 3 percent in 2018, down from 4.6 percent in 2017. This deceleration represents a major reversal in the expansion of world trade, which picked up in 2017 after a prolonged period of stagnation. By contrast, intra-African trade continues to grow rapidly, rising by 17 percent to USD 159.1 billion (Afreximbank, 2019:99).

Against such a backdrop, at a time of great global uncertainty and waning faith in the global trading system and multilateralism, it is logical that African countries should adopt growth strategies that are more regionally inward-looking and self-reliant in their conceptualization, as Fosu and Ogunleye (2018) acknowledge. The signing of the AfCFTA agreement and subsequent ratification by 24 AU Member States resulted in its entering into force on 30th May 2019,⁵ perhaps reflecting the strength of this realization.

⁵ This date marked 30 days after 22 countries had deposited their ratification instruments with the African Union Commission (AUC) Chairperson – the designated depositary for this purpose, as stipulated in Article 23 and 24 of the Agreement. (AU, 2018).

The case for creating an African continent-wide market is partly based on the fact that Africa's trading relations with the rest of the world over the last several decades have not delivered the promised benefits. Since the early 1970s, African countries have been the supposed beneficiaries of preferential trading agreements (PTAs) that granted reduced tariffs to high-income countries' markets, but the results have mostly been disappointing and have not led to notably stronger export performances or more diversified African economies. The designs of the PTAs are partly to blame, with their impermanence, often limited coverage (excluding, for instance, key agricultural commodities of interest to African countries), gradual 'preference erosion',⁶ strict rules of origin and unnecessarily tough phytosanitary and product standards. The often-lacklustre response of African firms to the new opportunities is, however, also responsible (Mold, 2005; UNCTAD, 2019a).

Africa's trading relations with the rest of the world over recent decades have not delivered the promised benefits.

In addition, most of the PTAs were signed on a concessional basis and they could, therefore, be suspended at any point in time or simply not be renewed. A recent example in East Africa is the suspension in 2018 of Rwanda from exporting to the US market under provisions of the US African Growth and Opportunity Act (AGOA), because of a disagreement over Rwanda's policy of reducing imports of second-hand clothing. But it is not an isolated case. For instance, Madagascar was suspended from AGOA in 2008 over political conditionalities. Kenya has been threatened in the past with suspension due to alleged rules-of-origin violations in its textile sector. The temporary nature of preferential market access essentially makes it difficult for businesses to take a long-term view and commit to investments in beneficiary sectors.

The shift from traditional markets, such as Europe, towards new trading partners, especially China and India, has not brought better results for East Africa, either. The rise of China and India as a source of imports may be good news for consumers, who now pay lower prices for many consumption goods coming from Asia, and for producers importing cheaper capital goods. However, it also implies greater competition in domestic markets, especially for local manufacturers. Around 45 percent of manufactured goods imports into the region were from China and India in 2017 (UNCTADStat, 2019). Between 2013 and 2017, East Africa sustained an average trade deficit of around USD 11 billion with China and USD 6 billion with India (i.e. almost a half of the region's total trade deficit over that period).

Between 2013 and 2017, East Africa sustained an average trade deficit of around USD 11 billion with China and USD 6 billion with India... Around 45 percent of manufactured goods imports into the region were from China and India in 2017.

By contrast, regional trade within Africa has tended to boost both exports and diversification (ECA, 2018d).⁷ The African Continental Free Trade Area (AfCFTA) is fundamentally different from PTAs with other parts of the world, in the sense that the market access it provides is neither concessional nor one-sided, but permanent and reciprocal. It thus puts trading relations among African countries on a much firmer footing. An integrated continental market could provide 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 of continental integration.

⁶ Mold (2005) points out that when PTAs were initially designed in the 1970s, they were intended to give a boost to industrial and manufacturing trade and reduce their dependence on agricultural and primary goods. At the time, average tariffs on industrial goods imposed by high-income economies were very high – often in the region of 15-25 percent. Overtime, through processes of uni-, multi-lateral and regional liberalization (see Section 3), average tariffs have fallen sharply. For instance, the average applied tariff on manufactured goods for the European Union now stands at just 2.4 percent, leaving scarce room for any significant preferential margins. As a consequence, PTAs now typically give 'perverse' incentives in the sectors where tariffs remain high – principally in agricultural sector.

⁷ The RECs have been instrumental in boosting intra-African trade. In 2017, three quarters of intra-African trade took place within the RECs (IMF, 2019b: 39). Section 3.2 of this report highlights key empirical studies on impact of trade liberalization.

The creation of such a huge internal African single market, however, causes some apprehension, especially among the smaller countries of the continent, who may doubt their capacity to compete. Such fears, though legitimate, could be allayed somewhat by referring to the experience of the European countries, in the late 1980s (Sapir, 2011). At that time, the European Commission had an uphill struggle to convince citizens and EU member states, particularly on the ‘periphery’ (e.g. Greece, Spain, Portugal and Ireland), to fully support the implementation of the *Single Market Programme*. The peripheral countries were worried about the consequences of opening their weaker national markets to the high productivity firms of northern Europe. There were widespread fears that the forces of economic divergence would be stronger than those of convergence within the bloc, leading to a difficult adjustment to slower growth, an inability to compete and a corresponding loss of employment (Krugman, 1991).

To counter those fears, a series of in-depth research papers into the costs of ‘Non-Europe’ – i.e. of not proceeding with the SMP – were commissioned (Chechini et al, 1988). The research made a strong case for the Single Market and dispelled some of the fears about the potentially un-equalising impact of deeper regional integration. That worked helped pave the way to the eventual implementation of the SMP on 1st January 1993. Almost overnight, the border posts between Member States were dismantled and goods, services, investment and workers flowed freely across those frontiers. Subsequent research (Mayer et al., 2018) found that the SMP increased intra-European trade by as much as 109 percent, and Member States’ GDP by an average of 4.4 percent. Pointedly, although there were concerns at the time that the benefits from regional integration would be concentrated in the largest Member States; in reality, it was the smaller countries that benefited most from deeper regional integration in Europe.⁸

As Member States prepare to finalise the negotiation and enter into the implementation stage of the AfCFTA... There is widespread need across the region for impact evaluation, technical support and studies that help identify offensive and defensive interests.

Africa currently finds itself at a similar juncture to Europe in the late 1980s. As Member States prepare to finalise negotiations and enter into the implementation stage of the AfCFTA, there is widespread need across the region for impact evaluation, technical support and studies that help identify offensive and defensive interests. There are also pressing needs to raise awareness among stakeholders and civil society about

the nature and the scale of ambition of the project. This report – a joint effort from the Regional Office for Eastern Africa of the United Nations Economic Commission for Africa (ECA) and TradeMark East Africa – presents some answers for the region to what is undoubtedly a complex question about the impact of the AfCFTA on economies, social structures and daily lives.

⁸ It is important to note that the EU was able to effect fiscal transfers to poorer and smaller new members, which is an option currently that has not been fully-evaluated with respect to the AfCFTA (Saygili et al., 2018). To deal with the potential challenge of the uneven distribution of benefits and costs among Member States, the AfCFTA considers different tariff reduction modalities and other mitigating mechanisms. See Section 2.

2. SETTING THE SCENE FOR THE AfCFTA



2.1. The Current State of Negotiations

The AfCFTA will potentially cover all 55 Member States of the African Union (AU), making it the world's largest free trade area since the formation of the World Trade Organization in 1994 in terms of the number of participating countries. To date, 54 AU Member States have signed the agreement – a remarkable degree of consensus in a large, diverse continent.

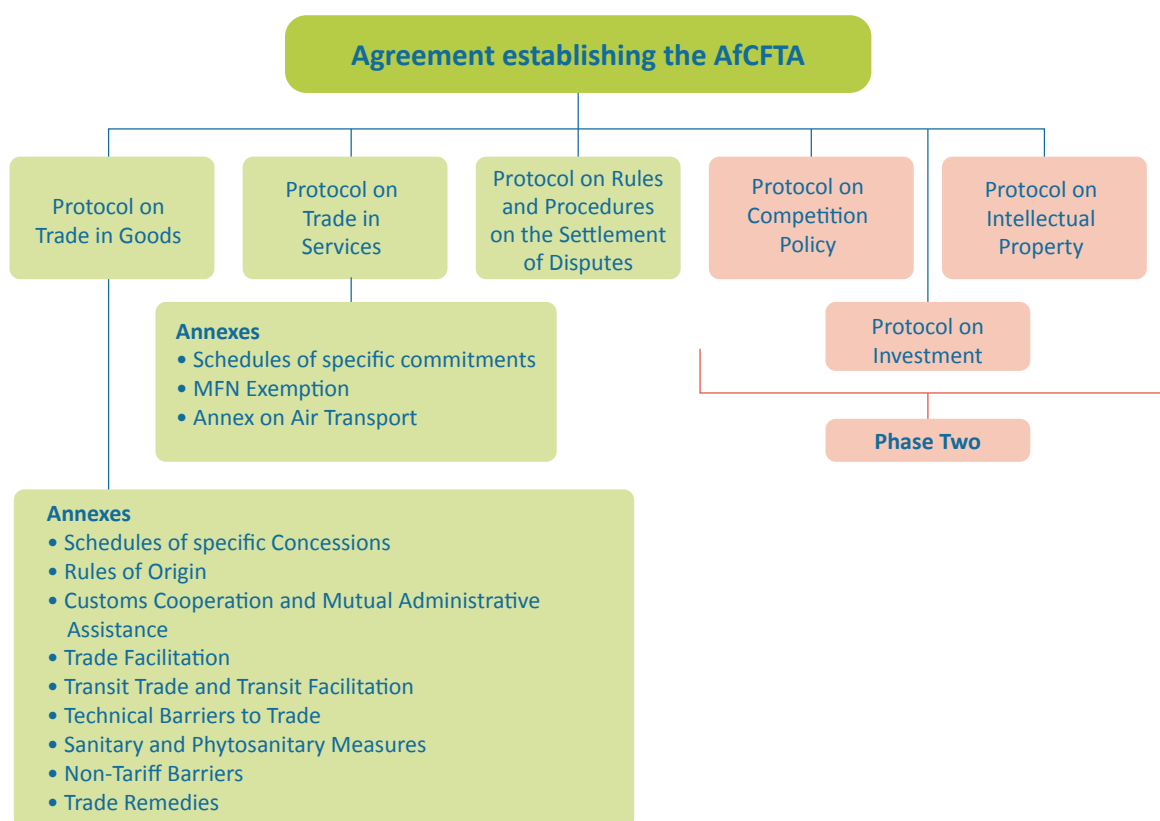
The speed with which the negotiations have been undertaken has also been quite remarkable and much faster than in comparable regional blocs. For instance, negotiations between the European Union and Canada to form a free trade area took eight years. Similarly, negotiations between the 34 countries involved in the Free Trade Area of the Americas took 12 years and in fact were never successfully concluded.

Moreover, the scope and ambition of the AfCFTA is wider than that of a traditional free trade area. The main objectives are to create a single continental market for goods and services – with free movement of business people and investments – laying – the foundations for the establishment of a *Continental Customs Union*. The operational phase of the AfCFTA was launched at the Niamey Extraordinary Summit of Heads of State and Government of the AU on July 7, 2019. The AfCFTA Agreement is a framework agreement, covering Trade in Goods and Services, Investment, Intellectual Property Rights and Competition Policy. The Protocols on Trade in Goods, Trade in Services, and on Rules and Procedures on the Settlement of Disputes are being negotiated in Phase 1. Phase 2 of the negotiations will cover Investment, Competition and Intellectual Property. Figure 2.1 captures the overarching architecture of the AfCFTA.

Implementing the agreement will require a lot of actions on the part of both Member States and Regional Economic Communities. According to Article 4 of the AfCFTA Agreement, for purposes of fulfilling and realising the objectives of the Agreement, Member States shall:

- Progressively eliminate tariffs and non-tariff barriers (NTBs) to trade in goods;
- Progressively liberalize trade in services;
- Cooperate on investment, intellectual property rights and competition policies;
- Cooperate on all trade-related areas between State Parties;
- Cooperate on customs matters and the implementation of trade-facilitation measures;
- Design a mechanism for the settlement of disputes concerning their rights and obligations; and
- Establish and maintain an institutional framework for the implementation and administration of the Continental Free Trade Area

Figure 2.1: Architecture of the AfCFTA



Source: TRALAC (2019).

The AfCFTA promises to promote structural change through economic diversification and the development of regional value-chains. It could also resolve the challenges of multiple and overlapping memberships of Regional Economic Communities. In East Africa, most countries are members of more than one REC, the most salient ones being the Common Market for Eastern and Southern Africa (COMESA); the East African Community (EAC); and the Intergovernmental Authority on Development (IGAD). While the AfCFTA will respect and preserve the autonomy of the existing RECs,⁹ it will liberalize trade between RECs, making it cheaper for the Member States to trade across regional blocks.

African Union Member States have agreed to remove at least 90 percent of their tariffs on goods over a period of between five and 15 years, depending on whether a country is classified as “developing” or “least developed”, with special and differentiated treatment for a group of six countries (Table 2.1). The 10 percent of goods classified as sensitive or initially excluded – based on criteria of food security, national security, fiscal impacts, and effects on livelihoods and industrialization objectives – may be liberalized over longer time frames or indeed exempted from any tariff reductions (AU, 2019). However, the ultimate aim is to fully liberalise intra-African trade for both sensitive and non-sensitive goods (Table 2.1).

Member states of the EAC must arrive at a consensus and move together forward towards the implementation of the AfCFTA, otherwise it risks undermining the Common External Tariff of the regional block.

⁹ Article 19 of the AfCFTA Agreement states explicitly that the RECs will co-exist under the AfCFTA.

In principal, the lists of excluded, sensitive and non-sensitive products will be determined on a country-by-country basis. Pointedly, however, the exceptions include the East African Community (EAC), the Economic Community of Central African States (ECCAS), the Economic Community of West African States (ECOWAS) and the Southern African Customs Union (SACU), for which common lists of excluded products for all Member States within the regional groupings have already been established (ECA, 2019a). The important implication for the EAC is that member states must arrive at a common consensus on the excluded products list and move forward together towards the implementation of the AfCFTA. The alternative is to risk undermining the existing *Common External Tariff* of the regional block. More will be said on this in Section 5 of the report.

Table 2.1: Schedule of liberalization envisaged under the AfCFTA reform

		TARIFF REDUCTIONS		
		For non-sensitive products	For sensitive products	For excluded products
Country classification	Developing Countries	fully liberalized over 5 years (linear cut)	fully liberalized over 10 years (linear cut)	no cut
	Least Developed Countries	fully liberalized over 10 years (linear cut)	fully liberalized over 13 years (linear cut)	no cut
	Group of six (i.e. Ethiopia, Madagascar, Malawi, Sudan, Zambia, Zimbabwe)	85% fully liberalized over 10 years (linear cut); an additional 5% fully liberalized over 15 years	fully liberalized over 13 years (linear cut)	no cut

Note: After recent consultations, Ethiopia, Madagascar, Zambia and Zimbabwe agreed to the level of liberalization of 90 percent to be implemented over 15 years (AU, 2019:4)

Source: ECA (2019b).

The Agreement establishing the AfCFTA entered into force on 30 May 2019 for the 28 countries that had then (or have since) deposited their instruments of ratification.¹⁰ However, critical features of the negotiations (the Schedules of Tariff Concessions, the Rules of Origin and the Schedules of Specific Commitments on Trade in Services) are still outstanding. Without these elements, there cannot be any trade under the AfCFTA. This implies that for the time being trade will continue under the most favoured nation (MFN) rules of the WTO or as provided for by specific REC arrangements.¹¹ Only those countries that have ratified the AfCFTA (or have subsequently acceded) will be bound by the new rules and will enjoy the benefits related to enhanced market access in goods and services. Additionally, countries must also adopt domestic arrangements to ensure that there will be compliance with the commitments undertaken in terms of the AfCFTA Protocols (TRALAC, 2019). There is, in other words, a lot of work still pending for Member States and RECs to undertake prior to being able to reap the benefits of the AfCFTA.

10 The 28 countries that have deposited their instruments of ratification are Ghana, Kenya, Rwanda, Niger, Chad, Congo Republic, Djibouti, Equatorial Guinea, Gabon, Guinea, eSwatini (former Swaziland), Mali, Mauritania, Namibia, South Africa, Uganda, Ivory Coast (Côte d’Ivoire), São Tomé and Príncipe, Senegal, Togo, Egypt, Ethiopia, The Gambia, Sierra Leone, Sahrawi Republic, Zimbabwe, and Burkina Faso (TRALAC, 2019).

11 Article 19 of the AfCFTA Agreement states explicitly that the RECs will co-exist under the AfCFTA

It is also important to flag the need for a change in mindsets. Recent history has often pitted African trade negotiators against economically much more powerful trading partners, such as the European Union and the US. Understandably in such circumstances, success has often been considered to consist in conceding the minimum amount of effective liberalization.

Success [in trade negotiations] has often been considered to consist in conceding the minimum amount of effective liberalization. The AfCFTA negotiations need to be approached in a different, more generous, spirit.

The AfCFTA negotiations need to be approached in a different, more generous, spirit. While the stated objective is to liberalize at least 90 percent of all trade,¹² countries can implement tariff reductions over a longer period in the case of sensitive goods or maintain existing tariffs (where the products are excluded) for the remaining 10 percent of product categories (tariff lines). The Agreement stipulates that the percentage for sensitive products should not exceed 7 percent of the total tariff lines and the exclusion list should not exceed 3 percent of total tariff lines (AU, 2019). Accordingly, the Agreement pays considerable attention to eliminating them, as well as to common disciplines that affect trade, such as sanitary and phytosanitary measures and technical regulations. Valuable lessons in implementation can be learned from previous negotiations under the Tripartite Free Trade Area, which implicates all 14 East African countries (Box 1).

Finally, annexes on trade facilitation and transit require countries to cooperate on simplifying and harmonizing trade procedures and giving fair treatment to goods in transit (ECA, AUC, AfDB and UNCTAD, 2019: 47). Additional efforts to tackle NTBs are especially important for East Africa, where NTBs have been a persistent impediment to higher levels of intra-regional trade (ECA, 2019).

Box 1: What have we learned from the Tripartite Free Trade Area negotiations?

The COMESA-EAC-SADC Tripartite Free Trade Area (TFTA), which was launched in June 2015, aims to establish a single market for 27 African countries. The TFTA is built on three pillars (market integration, infrastructure development and industrial development) and there is a parallel agreement on the movement of business people. Studies have shown that the TFTA would lead to a significant increase in intra-regional trade. For example, Mold and Mukwaya (2017) have shown that the TFTA would increase intra-regional trade by 29 percent, with manufacturing being the biggest beneficiary of the TFTA.

Negotiations on the formation of the TFTA have made significant progress. Tariff liberalization negotiations between the EAC and the Southern African Customs Union (SACU) were successfully concluded in June 2019 (TRALAC 2019). Tariff negotiations between the EAC and Egypt were also completed, while those between SACU/Egypt are nearing completion. Negotiations are advanced on the Tripartite rules of origin and several instruments are ready for use, including the Tripartite non-tariff barrier mechanism, guidelines on implementation of trade remedies, export and import declaration forms and an agreement on the movement of business people.

During negotiations, the principle of REC *acquis* was adopted. This principle means that the negotiations should start from the point at which the COMESA, EAC and SADC trade negotiations

¹² This means that 90 percent of total tariff lines, representing not less than the same proportion of total imports, is to be liberalized (i.e. the double qualification approach).

have reached. Tariff negotiations and the exchange of tariff concessions would be among Member States of the Tripartite FTA that have no existing preferential arrangements in place between them. Those who are in existing FTAs would continue to trade according to the terms of their existing obligations and would not negotiate new trade liberalization schedules. Negotiations would thus only be between States that have not concluded FTAs with each other (TRALAC, 2015). Although there have recently been some encouraging new developments,¹³ the relatively slow progress of TFTA provides a timely warning to AfCFTA negotiators about the dangers of reaching an impressive political consensus while failing to achieve the necessary ratifications and hence delays in actually implanting the agreement. It is disappointing that, over four years after the signing of the original agreement, no trade is in fact being carried out under TFTA rules.

In principle the TFTA could provide an important stepping stone towards the full implementation of the AfCFTA. All 14 countries of East Africa are covered by the provisions of the TFTA. There is also the significant advantage that the constituent RECs have already developed many of the institutions and mechanisms needed for the consolidation of the continental market. For instance, COMESA already has a fully operational Competition Authority and the EAC is the only regional economic community with a formal 'Trade in Services' agreement that exceeds commitments under the WTO's General Agreement on Trade and Services (ECA, AUC, AfDB and UNCTAD, 2019: 14). All these could constitute essential building blocks for the implementation of the AfCFTA in East Africa.

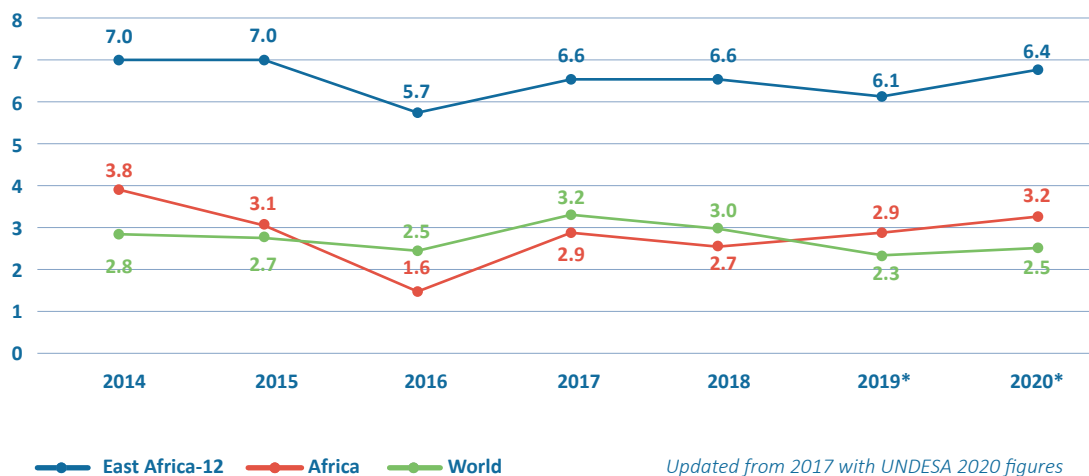
2.2. The Macroeconomic Backdrop for East Africa

In order to appreciate fully the benefits that could be unlocked through the AfCFTA's successful implementation, it is important to understand the conditions under which economies of the region currently operate. Despite the challenges, East Africa has made significant progress in economic development over the past decade. It has become the fastest growing sub-region on the continent, with GDP growth average 6.6 percent since 2014 (see Figure 2.2). Three of the world's fastest growing economies (Ethiopia, Tanzania and Rwanda) are currently located in East Africa, and several other countries in the region (e.g. Kenya, Uganda) are not far behind. Although savings rates generally remain low, fixed investment rates have generally improved, exceeding 20 percent of GDP in some countries. The business environment is generally improving, thanks to reform efforts, while leadership and governments have arguably become more assertive in advancing the continental agenda. One example of this is the significant push to improve regional infrastructure, with large-scale projects such as the Standard Gauge Railway and the Addis Ababa–Djibouti railway.¹⁴

¹³ In June 2019, SACU and EAC concluded bilateral tariff negotiations under the TFTA.

¹⁴ Infrastructure development accounts for a significant share of the budget spending in Uganda (31 percent), Kenya (22 percent) and Rwanda (17 percent) (ECA, 2019b).

Figure 2.2: Real GDP growth in East Africa, Africa and the world, 2014-2020
Annual change, in percent



Note: Data for Eastern Africa is the weighted average (based on current prices gross domestic product (GDP) figures) of the 12 countries (excluding Somalia and South Sudan). *Data for 2019 and 2020 are UNDESA forecast provided at end-2019.

Source: National sources; UNDESA (2019) and ECA calculations.

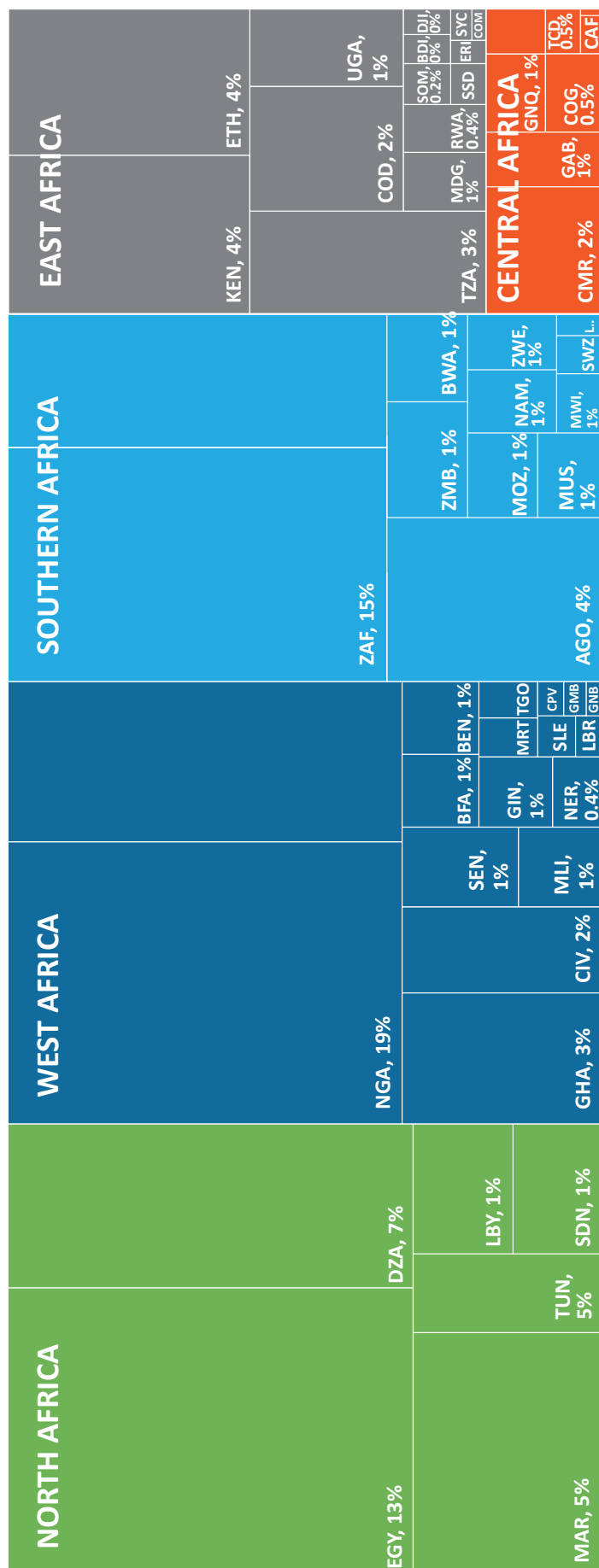
Yet despite this dynamism, low average per capita incomes still prevail. Hence the collective size of the regional economy is the second smallest on the continent, accounting for around 35 percent of Africa's total population, but just 16 percent of total continental GDP (Figure 2.3). Ethiopia and Kenya are the largest economies in the sub-region, contributing around half of regional GDP. At the other end of the spectrum, the island-economies of Comoros and the Seychelles are responsible for less than 1 percent to the total East African economy. The most salient point is that the AfCFTA will give East African producers and service providers access to the much larger continental market. As Sections 3 and 4 will demonstrate, this will remove the small-market constraint on fixed investment and facilitate the evolution of regional value chains. In other words, it will put the region's growth on a firmer footing.

This is important because East Africa still suffers from multiple vulnerabilities that could compromise long-term economic growth and imperil developmental prospects. Growth in most regional economies is excessively dependent on domestic demand. While investment levels have improved, they are still insufficient to attain the ambitious growth targets set in national development plans.¹⁵ Moreover, regional economies exhibit a lack of structural transformation (Martins, 2017) and sustain large trade deficits that act as impediments to sustained economic growth and development (Thirlwall, 2011; Hussain, 1999). Crucially, the regional economy is still highly fragmented, with low levels of intra-regional trade and investment (ECA, AUC and AfDB, 2017). These issues highlight the need for greater regional cooperation and integration, which are at the core of the AfCFTA.

...Regional economies exhibit a lack of structural transformation and sustain large trade deficits that act as impediments to sustained economic growth and development.

¹⁵ The investment shares of most East African countries are lower than countries of similar income levels in Africa. However, several countries in the region - including Djibouti, Ethiopia, Tanzania, Rwanda and Uganda - now spend more than 25 percent of GDP on investment.

Figure 2.3: GDP by sub-region, 2018



Note: ISO country codes are used as labels.

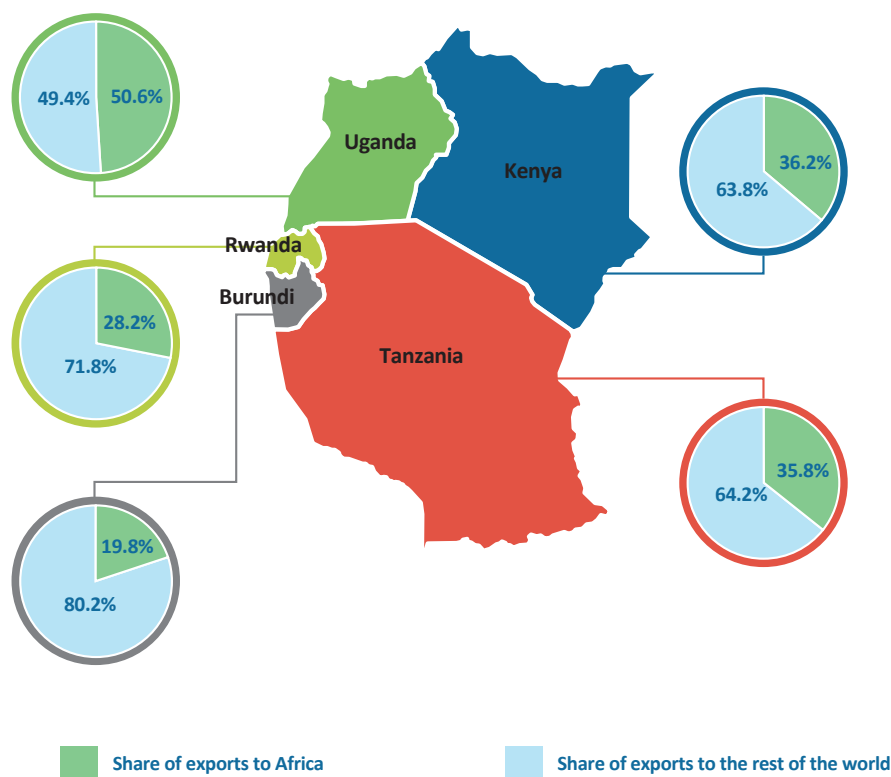
Source: ECA elaboration, from IMF data (2019).

2.3. Overview of Existing Patterns of Intra-Regional Trade

The existing level of intra-African trade varies across the East African countries (Figure 2.4 and Table 2.2). Uganda stands out in terms of the share of exports already going to other African countries, with around half of its exports destined to continental trading partners. For Kenya and Tanzania, too, more than a third of their exports are now directed towards the African market, largely driven by trade with their EAC Partner States.¹⁶ As a major port of entry to the Horn of Africa, Djibouti also has a relatively high share of exports to Africa (though this is principally explainable by re-exports). Conversely, D.R. Congo, Burundi and Rwanda have relatively high shares of imports from Africa.

For some East African countries, the share of imports sourced from other African countries has actually been declining over the past decade.

Figure 2.4: Share of trade with Africa, selected countries
2016-2018 average



Source: ECA calculations for the 2016-2018 three-year average, using UNCTADStat (2019).

Conversely, however, for some East African countries the share of imports sourced from elsewhere on the continent has actually been declining over the past decade, especially in the cases of Uganda and Tanzania, where it has practically halved since the early 2000s. These trends are partly explicable by the sharp rise in competing imports from developing countries in Asia. The low prevailing levels of intra-African trade within the Horn of Africa and the island states of the Indian Ocean (Comoros, Madagascar and Seychelles) also warrant attention.

¹⁶ Uganda has increased its share of exports to Africa, from around 30 percent in early 2000s to more than 50 percent between 2015 and 2017. For a commodity-producing low-income economy, this represents a remarkably high level of intra-regional trade.

Table 2.2. Share of Merchandise Trade with Africa, 2000-2018
in percent

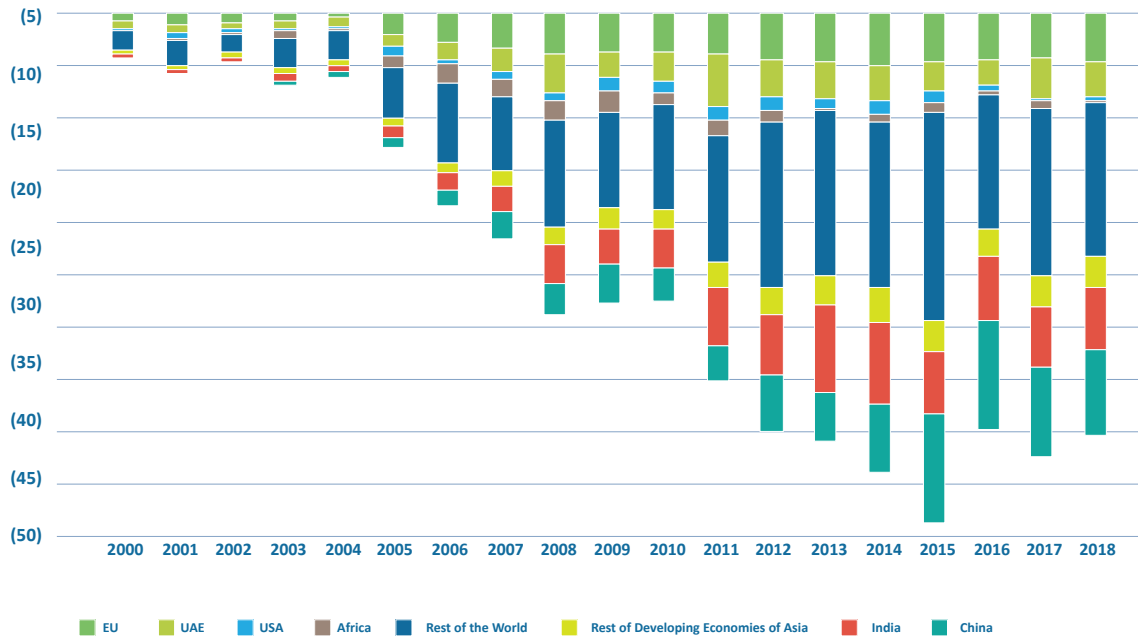
	SHARE OF EXPORTS GOING TO AFRICA				SHARE OF IMPORTS FROM AFRICA			
	2000-2005	2006-2011	2012-2017	2018	2000-2005	2006-2011	2012-2017	2018
Burundi	11	18	17	18	36	38	36	32
Comoros	4	6	7	8	25	17	20	22
D. R. Congo	9	17	19	31	42	52	42	51
Djibouti	53	49	34	33	11	6	5	6
Eritrea	36	14	2	1	7	13	15	17
Ethiopia	23	17	23	23	6	7	4	4
Kenya	40	43	40	33	13	12	10	12
Madagascar	5	6	8	12	15	13	12	13
Rwanda	23	32	43	28	33	42	35	32
Seychelles	5	10	8	7	13	10	11	12
Somalia	5	9	2	9	20	26	13	7
Tanzania	20	32	32	36	25	17	12	13
Uganda	28	42	54	48	42	26	21	23
AVERAGE	23	28	28	31	20	19	15	16

Source: ECA calculations, using UNCTADStat (2019).

Another important phenomenon has been the changes in the geography of regional trading partners. Over the past decade, countries in the region have been rapidly diversifying their trade away from traditional markets (particularly Europe) towards new trading partners (e.g. Asian countries such as China and India) (ECA, 2018c). While the share of exports to the new trading partners from the region is still quite low, reliance on them as key sources of imports is of concern. For instance, the unbalanced growth of East African trade with China and India resulted in deficits of around USD 16 billion in 2017, which is almost half of the region's overall trade deficit (Figure 2.5).¹⁷

¹⁷ The evidence on the impact of the developing Asian nations' rising involvement in East African economies is mixed. Increased imports from China and India may be good for consumers, who are now paying lower prices (for items like consumer durables – televisions, radios, motorcycles, mobile phones, refrigerators, etc.), but such imports from these sources may have an adverse effect on East African industrialization (see Mold, 2017; Jeanneney and Hua, 2015; Giovannetti and Sanfilippo, 2009; Jenkins and Edwards, 2006).

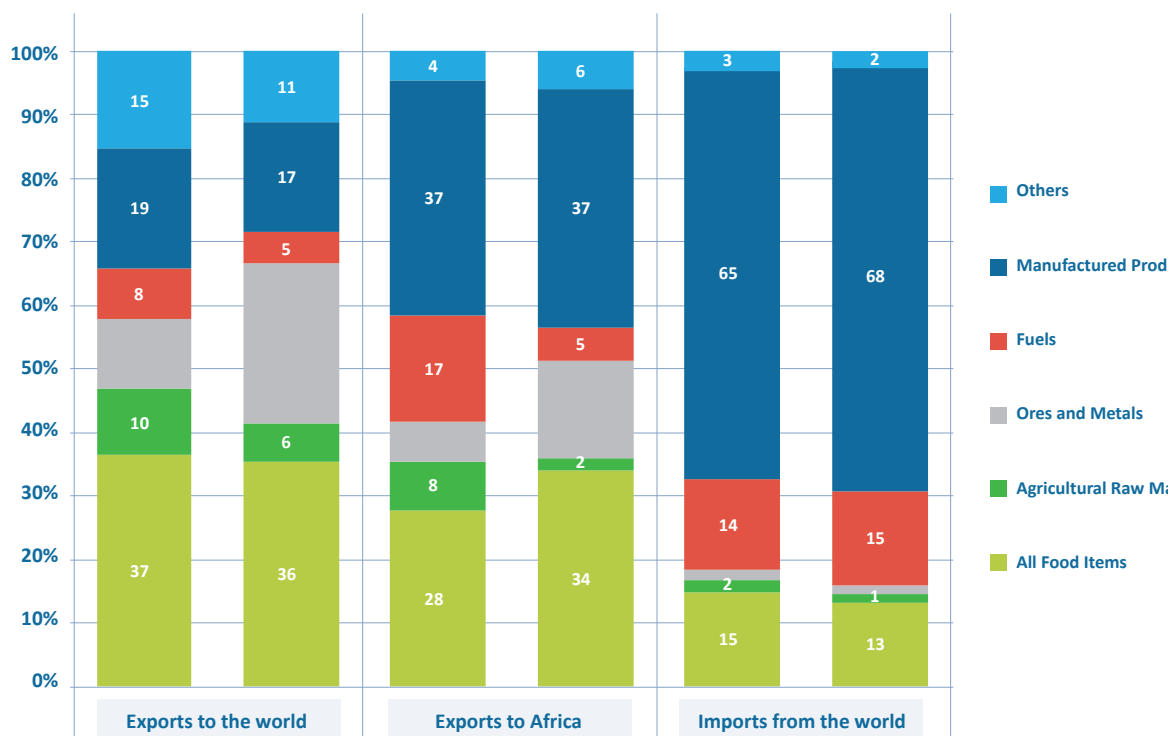
Figure 2.5: Trade balance between East Africa and key trading partners, 2000-2017
in USD billions



Source: UNCTADStat (2019).

At odds with the pronounced geographic shift in trading partners, the sectoral composition of the region's exports and imports has changed little over the past decade. Primary commodities still account for a large proportion of the region's exports to the rest of the world, thus making East Africa highly vulnerable to adverse external shocks. Food items, ores and metals and agricultural raw materials together accounted for 77 percent of the region's exports to the rest of the world between 2016 and 2018. Taking the example of the EAC, for instance, the export composition of the region's intra-Africa trade, however, is markedly different, with manufactured goods being the dominant exports, signifying the importance of intra-African trade for the development of regional value chains and industrialization (Figure 2.6).

Figure 2.6: Composition of Eastern Africa exports by main products, 2016-2018 in percent



Source: UNCTADStat (2019).

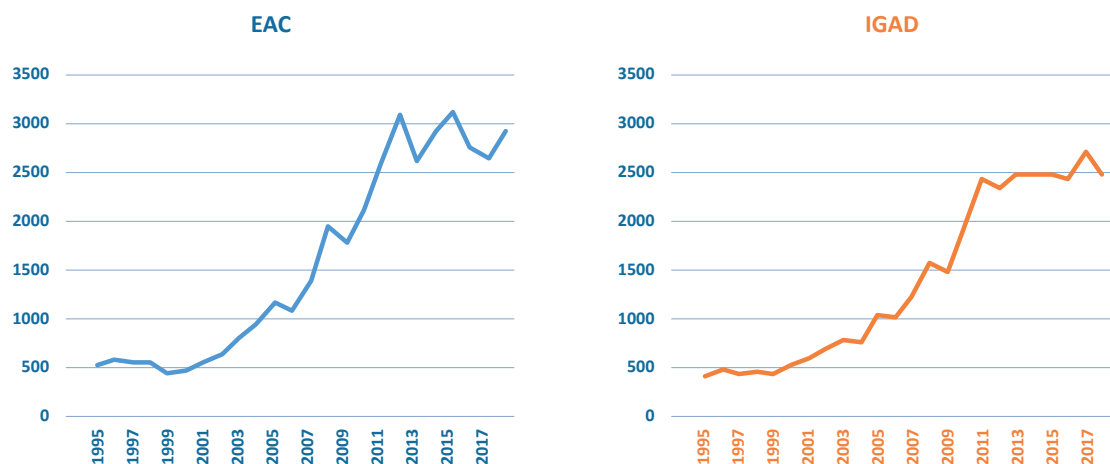
By some metrics, East Africa is doing relatively well in intra-regional trade. The EAC, for instance, has achieved one of the highest shares of intra-regional trade of any African REC, surpassed only by the SADC (Table 2.3). According to the African Regional Integration Index – a composite index tracking performance towards deeper regional integration on the continent- the EAC is also currently the best performing REC, achieving a particularly high score in trade integration (ARII, 2018).

Although one of the best performing RECs in Africa, intra-EAC trade has suffered a serious decline since 2014.

Nevertheless, trends in intra-regional trade are not currently going in the right direction in East Africa. According to national sources, intra-EAC trade, for instance, actually declined from 2014 to 2017: in 2013, intra-EAC exports peaked at USD 3.5 billion, but that amount had fallen to USD 2.4 billion by 2017 – a 31 percent decline, although recently released data registers a recovery in 2018.¹⁸ These stagnating or declining trends in regional trade – depicted in the graphs in Figure 2.7 – are clearly of some concern. However, this report argues that by providing a new stimulus to regional integration, by bringing down economic barriers throughout the continent and by contributing to economic growth and industrialization, the full implementation of the AfCFTA could contribute to a revival of dynamism in intra-regional trade. This is a point that will be developed in later sections.

¹⁸ The decline of intra-regional exports of both Kenya and Tanzania drove the downward trend. Kenya’s intra-EAC exports declined from USD 1.6 billion in 2012 to USD 1.1 billion in 2017. Tanzania’s contribution to the decline in intra-EAC exports was proportionately even greater – peaking at over USD 1.1 billion in 2013 but declining to just USD 318 million by 2017. While the tariff barriers on intra-regional trade have been eliminated, trade within the EAC is still constrained by the prevalence of NTBs (ECA, 2019). More encouragingly, figures from the EAC Secretariat show that there was a recovery in intra-EAC exports to the EAC, growing by 5.6 percent and 33.7 percent to USD 3.1 billion (EAC, 2019).

Figure 2.7: RECs intra-African trade in total trade, 2015-2018
in USD millions



Source: UNCTADStat (2019).

Table 2.3: Intra-regional trade as a share of total trade for African RECs, 2019
in percent

REPORTING ECONOMY (NUMBER OF MEMBER STATES)	INTRA-REC	REST OF AFRICA	TOTAL INTRA- AFRICA TRADE
SADC (15)	21	2.7	23.7
EAC (5)	11.5	10.1	21.6
COMESA (19)	7	9.3	16.3
ECOWAS (15)	10.7	5.6	16.3
IGAD (8)	7.3	8	15.3
ECCAS (11)	2.8	9.5	12.3
CEN-SAD (28)	7.5	4.1	11.6
AMU (5)	3.3	2.5	5.8

Source: UNCTADStat (2019).

The persistence of both tariff and non-tariff barriers to trade limits the ability of firms to build competitive productive capacities and reap the efficiencies springing from economies of scale. To address this, the removal of existing tariffs on a minimum of 90 percent of trade under the AfCFTA is an essential first step – a necessary, but not by itself sufficient, condition – to promote greater intra-regional trade in East Africa. While the exports of the EAC face average applied tariff rates of 6 percent, the rates are much higher in some cases. For example, the average applied tariff on EAC exports to Ethiopia reaches an average of 16.5 percent, revealing significant room for further trade liberalization within East Africa (Table 2.4).

The persistence of both tariff and non-tariff barriers to trade limits the ability of firms to build competitive productive capacities and reap the efficiencies springing from economies of scale.

Table 2.4: Applied tariffs on EAC exports of goods, 2014
in percent

	EAC	EU	NORTH AMERICA	ASIA	REST OF AFRICA	ETHIOPIA
Processed food	0	0	1.9	8.3	15.1	26.9
Light manufacturing	0	0	0.6	1.8	8.6	23.2
Meat and livestock	0	0	0.2	0.6	6.2	13.6
Textiles and clothing	0	0	0.5	4.2	4.9	23.4
Heavy manufacturing	0	0	0.1	1.0	4.2	13.8
Grains and crops	0	0	0.1	7.6	1.8	7.0
Extraction	0	0	0.0	0.2	1.1	7.6
Average	0	0	0.5	3.4	6.0	16.5

Source: Calculations based on GTAP 10.0 database.

Bilateral trade between Ethiopia and Kenya – the two largest economies in East Africa – currently amounts to less than USD 100 million a year.

This may help explain the extremely low level of trade flows between the two largest economies in the region: bilateral trade between Ethiopia and Kenya currently amounts to less than USD 100 million a year, while the bilateral trade between neighbouring Tanzania and Mozambique amounts to less than USD 20 million. In economic terms, then, some countries in the region live “back-to-back” against each other and their neighbours, despite sharing long common borders. An impediment for the development of the manufacturing sector in the region is the fact that processed foods and light manufactured goods tend to suffer from the highest tariffs. Given the relatively high shares of processed foods in manufacturing value-added for most East African economies, as well as the strong backward linkages of the processed food sector to the agricultural sector, this is of particular concern.

A famous economist once quipped that, just because your trading partner has thrown rocks into its own harbour does not mean you should do the same.¹⁹ The sentiment is pertinent to advancing the agenda of the AfCFTA. The prevalence of both tariff and non-tariff barriers means that intra-African trade liberalization will not, in itself, suffice to increase the volume of intra-regional trade; the removal of non-tariff barriers and more investment in infrastructure will be needed (see Sections 4 and 7 in this report), though liberalization is a necessary first step. Indeed, all the evidence suggests that non-tariff barriers inhibit intra-African trade more than tariffs (IMF, 2019b).

¹⁹ The quote in question is commonly attributed to Cambridge economist Professor Joan Robinson.

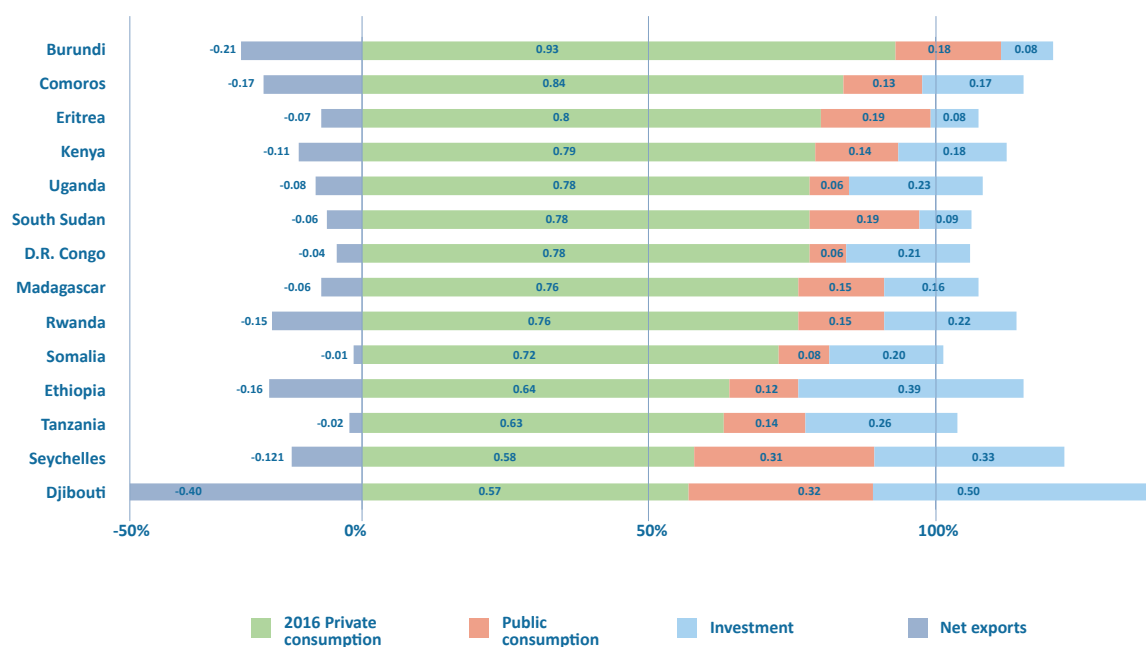
2.4. A Region Still Heavily Dependent on Imported Goods

In 2018, the joint GDP of the Eastern African economy,²⁰ measured at market exchange rates and current prices, amounted to around USD 342 billion, with a population of 437 million. Measured however in Purchasing Power Parities, which arguably better reflects the size of regional economies,²¹ the regional economy is 2.6 times larger, standing at USD 879 billion in 2018. If the current growth momentum is maintained, this implies that East Africa's economy will surpass USD 1 trillion by 2021, making it a very sizeable market indeed. The illustration on the page opposite maps out this dynamic.

If the current growth momentum is maintained, East Africa's economy will surpass USD 1 trillion by 2021, measured in purchasing power parities, making it a very sizeable market indeed.

While it is true that over the last decade economic activities have received a welcome boost through higher rates of fixed investment (particularly infrastructure projects), private consumption has been the main driver of growth, accounting for over 70 percent of total regional demand. Public sector consumption (by governments) has contributed an additional 12 percent (Figure 2.8).

Figure 2.8: Shares of GDP from a Demand Perspective, 2017
in percent



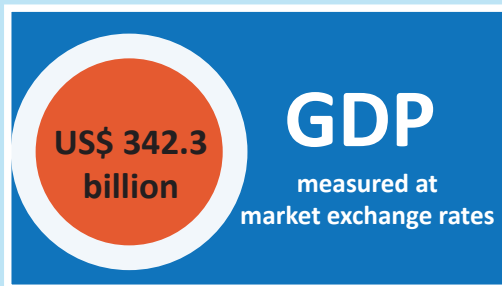
Source: UNdata (2019).

20 For the United Nations Economic Commission for Africa (ECA), Eastern Africa is a region comprising 14 countries: Burundi, Comoros, D.R. Congo, Djibouti, Ethiopia, Eritrea, Kenya, Madagascar, Rwanda, Seychelles, Somalia, South Sudan, Tanzania and Uganda.

21 See Callen (2007) for an explanation.

How Large is East Africa's Economy?

The size regional market is much bigger than commonly understood

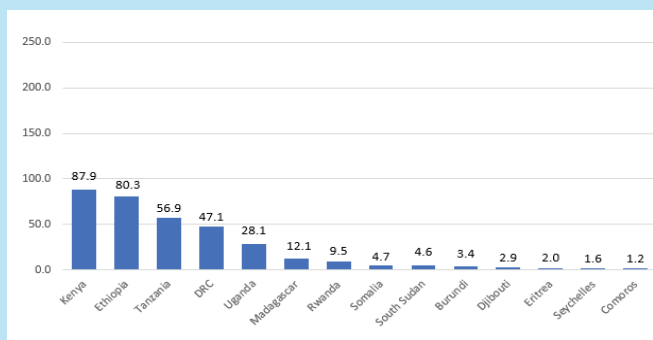


The regional market is 2.6 times when measured in Purchasing Power Parities

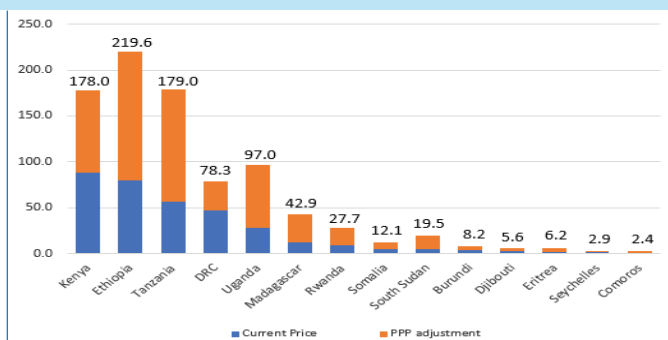
**At current growth rates,
East Africa's economy will surpass
US\$ 1 trillion by 2021**



Regional GDPs in current US dollars



Regional GDPs at PPPs



Why?

The price of non-tradeable goods and services tend to be much lower:

- A haircut in Nairobi is cheaper than in New York.
- A taxi ride is cheaper in Bujumbura than in Brussels.



Measuring the size of the market in terms of GDP doesn't pick up on this, and therefore underestimates the purchasing power of citizens in low-income countries.

The extent to which growth has recently been demand- and consumption-driven, rather than export-led, can be seen by a simple decomposition analysis. Following Chenery (1979), growth in a particular country can be classified as either domestic demand-led (DD), export-led (EE) or import substitution-led (IS), according to whichever contributes the largest share to GDP growth.²² For the domestic demand-led countries, growth can be further classified into countries where export expansion contributes to over 20 percent of GDP change as (DD1) and otherwise as ‘highly domestic-demand led countries’ (DD2). Table 2.5 summarizes the results for 13 East African countries, over five-year periods, between 1990 and 2015.

Table 2.5: Growth in East Africa is predominately domestic-led, 1990-2015

	1990-1995	1995-2000	2000-2005	2005-2010	2010-2015
Burundi	--	--	DD2	DD2	DD2
Comoros	EE	IS	DD2	DD2	DD2
D.R. Congo	--	--	EE	DD1	DD1
Djibouti	IS	IS	DD1	DD1	DD2
Eritrea	DD2	DD2	--	--	DD1
Ethiopia	DD2	DD1	DD1	DD2	DD2
Kenya	DD1	DD2	DD1	DD2	DD2
Madagascar	--	DD2	DD2	DD1	EE
Rwanda	--	DD2	DD2	DD2	DD2
Seychelles	DD2	EE	--	DD1	DD2
Somalia	--	DD2	DD2	DD2	DD2
Tanzania	DD1	DD2	DD1	DD1	DD1
Uganda	DD2	DD2	DD2	DD1	DD2

Note: DD, EE and IS refer to countries in which domestic demand, exports and import substitution are the major demand-side components of economic growth, respectively. In DD1 countries, export expansion contributes to over 20 percent of GDP change and domestic demand remains the major source of GDP growth. DD2 countries are the remaining DD countries which could be considered as ‘highly domestic demand led’. Countries with negative GDP growth are not classified.

Source: ECA calculations from UNdata (2019).

The results are enlightening about patterns of regional growth. Between 1990 and 2015, domestic demand was the major driver of economic growth in the region (16 classified as DD1 and 32 classified as DD2, accounting for around 90 percent of all observations). The results are in line with the work by Chenery et al. (1986) that shows the importance of domestic demand for countries in the early stages of development.²³ By contrast, there are only four incidents of export-led growth, and three of import substitution-led growth in East Africa during the same timeframe.

Between 1990 and 2015, domestic demand expansion was the major driver of economic growth in the region.

22 These three components are identified through the following equation

$$(Y_t - Y_{t-1}) = \alpha_{t-1}(D_t - D_{t-1}) + (\alpha_t - \alpha_{t-1})S_t + \alpha_{t-1}(X_t - X_{t-1})$$

GDP increase Domestic demand Import substitution Export effect

where Y = GDP, D = domestic demand (i.e. Y+M-X), S = total supply (i.e. Y+M), X = total exports of goods and services (fob), M = total imports of goods and services (cif), α = GDP as share of total supply (i.e. Y/S), t = final year of period and t-1 = initial year of period.

The rapid expansion of domestic demand in East Africa has been met to an excessive extent by surging imports. The resulting trade deficits are large and cause persistent shortages of foreign exchange, constraining economic growth.

The region's rapid economic growth thus suffers from a significant Achilles' heel – its weak trade performance. Despite regional and national efforts at both export promotion and attempts to *recapture domestic markets*,²⁴ these policies²⁵ have generally fallen short of their objectives (Gebreyesus and Demile, 2017; ECA, 2017a) – see Box 2. As a consequence, the rapid expansion of domestic demand has been met by surging imports, to an excessive extent. The resulting trade deficits are large and cause persistent shortages of foreign exchange, constraining economic growth (Thirwall, 2011; Mold and Naliaka, forthcoming). With the notable exception of D.R. Congo (the leading commodity exporter in the region), all countries sustain large trade deficits, ranging from 5 percent to 38 percent of GDP. Moreover, when the trade balance is broken down by products, it is clear that these large deficits are being generated principally by manufactured goods imports (Table 2.6).

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Table 2.6: Trade balance as a share of GDP by product groups, 2017
in percent

COUNTRY	FOOD ITEMS	AGRICULTURAL RAW MATERIALS	FUELS	MANUFACTURED GOODS	ORES, METALS, PRECIOUS STONES AND NON-MONETARY GOLD	OTHERS
Burundi	-2	0	-3	-13	2	0
Comoros	-9	-1	-1	-21	0	0
D.R. Congo	-2	0	2	-8	14	1
Djibouti	-7	0	-1	-32	0	1
Eritrea	-5	1	-1	-11	3	0
Ethiopia	1	0	-2	-15	0	0
Kenya	0	1	-3	-12	0	0
Madagascar	0	0	-4	-17	6	0
Rwanda	0	0	0	-14	7	-1
Seychelles	15	-1	-4	-42	0	0
Somalia	-8	2	0	-2	0	0
Tanzania	2	0	-8	-22	6	0
Uganda	2	0	-2	-6	1	0

Source: ECA calculations, derived from data from UNCTADStat (2019).

23 For instance, even in the cases of the Republic of Korea (1955-1971) and Taiwan Province of China (1956-1971), two 'role models' of 'export-led growth', the expansion of domestic demand actually contributed to 68 percent and 55 percent of economic growth respectively, compared to the contribution of export expansion of 35 percent and 43 percent respectively (Chenery et al., 1986).

24 A set of policies which used to be termed 'import substitution' but has now be reconceptualised as 'recapturing the domestic market'.

25 For example, Made in Uganda, National Export Strategy in Rwanda and Tanzania, National Export Development and Promotion Strategy in Kenya, and Industrial Development Strategy in Ethiopia.

This outcome, in turn, reflects the weak ‘productive capacities’ of firms in East Africa. Manufacturing companies across Africa generally perform significantly worse than firms in other parts of the world, as reflected by lower productivity levels and growth rates (McMillan

and Rodrik, 2014). Yet those weaknesses may not prove insurmountable. Econometric research by Harrison et al. (2014) suggests that, once the disadvantages of geography, infrastructure, political competition and the business environment are controlled for, African manufacturing firms actually exhibit a conditional advantage in productivity levels compared with non-African firms. This is especially true in low-tech manufacturing. The message is simple – remove the constraints, and African firms could perform just as well or even better than their peers in other parts of the world. These findings suggest that there is no inherent ‘curse’ that hinders the development of regional manufacturing and that East African firms should be able to thrive, given the right opportunities and measures to address the infrastructure deficits and unpredictable business environments. The AfCFTA provides one such opportunity.

When the trade balance is broken down by products, it is clear that these large deficits are being generated principally by manufactured goods imports.

Box 2: Persistent high trade costs impeding export growth – the case of Ethiopia

Ethiopia has been pursuing an export-led development strategy since the early 2000s. Yet despite extensive export-promotion activities by the Government,²⁶ export growth has been declining, falling by around 15 percent to USD 2.9 billion in 2016/17 – from 3.3 billion in 2013/14 (NBE, 2016/17). Gebreyesus and Kebede (2017) suggest that the country’s current tariff and exchange rate policies have been inconsistent with its export-promotion strategy, making the domestic market more lucrative than the export market.

Their analysis reveals that Ethiopia’s overall *anti-export bias*²⁷ has been large, reaching up to between 200 percent and 300 percent in key export-oriented sectors such as the textile and leather industry (Table 2.7). This implies that the value-added obtainable in the domestic market is two to three times greater than that obtained from exporting. It is evident that trading costs, as a result of time delay caused by logistical inefficiencies and customs procedures, are the largest source of the anti-export bias. According to the World Bank’s Doing Business Report (2015), the required time for either exporting or importing in Ethiopia is 44 days (Table 2.8).

26 The export-promotion strategy was transformed into a comprehensive Industrial Development Strategy (IDS) in 2002, identifying sectors such as textile, garment, leather and leather products as priority export sectors..

27 This is defined as the percentage excess of the domestic value added obtainable as a result of protection in producing for domestic market vis-à-vis that obtainable in exporting in the international market.

Table 2.7: Anti-export bias, 2010 – 2015
in percent

SECTOR	DUTY RELATED EFFECTS	FREIGHT COST EFFECTS	TIME DELAY COST EFFECTS	TOTAL EFFECTS
Tanning & leather products	148	10	160	354
Footwear	145	10	148	336
Textiles	68	7	120	202
Apparel	71	8	108	185
Dairy & animal products	39	19	112	179
Wood & paper products	43	20	55	171
Cereals & grain milling	21	17	119	159
Prepared food	50	13	44	98
Metals & mineral products	23	19	38	98
Vegetables and fruits	22	19	69	97
Chemicals & medicines	17	23	35	80
Other manufacture	53	14	21	69

Source: Gebreyesus and Kebede (2017).

Table 2.8: Required time and cost to trade in Ethiopia, 2015

STAGES	EXPORTS		IMPORTS	
	TIME (DAYS)	COST (USD)	TIME (DAYS)	COST (USD)
Customs Clearance and inspections	7	290	5	390
Documents Preparation	27	520	29	700
Inland Transport and handling	7	1,300	7	1,600
Ports and terminal handling	3	270	3	270
Total	44	2,380	44	2,960

Source: Doing Business (2015).

Moreover, the country's domestic currency (the Birr) has been significantly overvalued in the recent past, leading to the deterioration of the competitiveness of the country's export commodities. By 2016/17, the real effective exchange rate had appreciated by almost 71 percent cumulatively since the nominal devaluation of October 2010. This has further aggravated the disincentive to export. In sum, Gebreyesus and Kebede (2017) argue that the additional incentives provided to investors to export tend to be marginal and not able to compensate for the anti-export bias created by the existing policy regime. The case study reminds us that the AfCFTA alone will not be sufficient to improve the export performance of the region; accompanying measures will be required, in the form of the appropriate micro- and macro-economic policies.

2.5. The Dynamism of the Service Sector

As part of the AfCFTA's goal to bolster intra-African trade, there is also a commitment to liberalize services trade. The services sector has become one of the key drivers of economic growth and structural transformation for African countries (UNCTAD, 2016a:3). In Kenya, for instance, the growth in the services trade has surpassed that of manufacturing and financial services; ICT, transport and tourism have been the main drivers (Khanna et al., 2016). In addition, many services act as inputs into manufacturing processes, so the sector is also a key determinant of the competitiveness of manufacturing (Newman et al., 2016). In East Africa, the contribution of service exports to GDP is generally on the rise, with several countries registering close to or more than a three-fold increase since 2005²⁸ (Table 2.9). For several countries (e.g. Comoros, Ethiopia, Rwanda and Seychelles), service exports are now the single largest source of foreign exchange.

No less than 6 of the 14 countries in East Africa have positive balances in services trade. For several countries, service exports are now the single largest source of foreign exchange.

Table 2.9: Services exports
Current prices, in USD millions

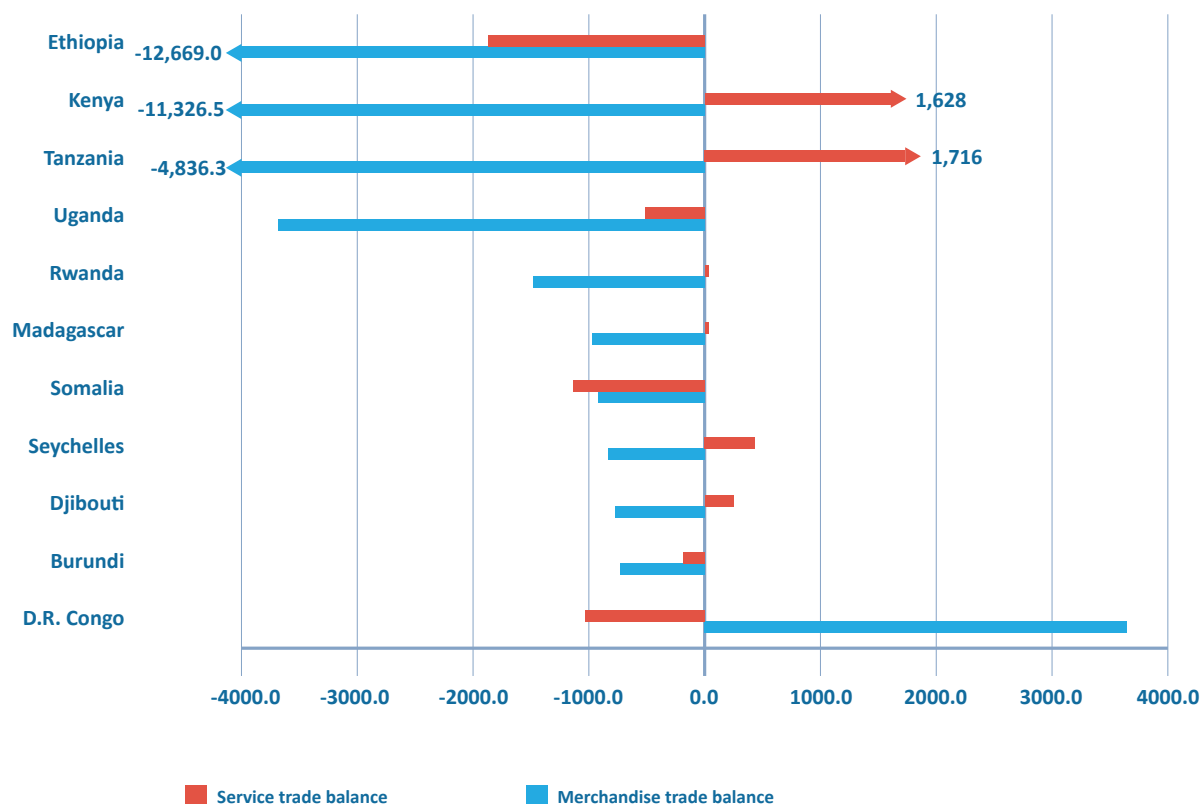
	2005-2009 AVERAGE	2010-2015 AVERAGE	2016	2017	2018
Burundi	47	90	73	64	
Comoros	54	78	79		
D.R. Congo	529	367	128	108	
Djibouti	273	367	406	418	451
Ethiopia	1,393	2,807	3,095	3,606	4,909
Kenya	2683	4,616	4,155	4,648	5,319
Madagascar	857	1,176	1,170	1,269	
Rwanda	272	567	835	998	1,093
Seychelles	428	681	894	998	1,015
Somalia		297	373	391	405
South Sudan		62	178	195	217
Uganda	719	1,925	1,907	1,635	1,960
Tanzania	1,705	2,857	3,607	3,850	3,769
Total	8,960	15,890	16,898	18,180	19,136

Source: UNCTADStat (2019).

Moreover, whereas only one country in East Africa has a surplus in merchandise trade (with all 13 of the others sustaining quite large deficits), six countries in the region already enjoy positive balances in services (Figure 2.9). Even in the cases where there is a deficit in the services balance, such deficits are generally much smaller than those in merchandise trade. It is, therefore, a sector that merits special attention in discussions about patterns of regional trade and the AfCFTA.

²⁸ For instance, from a value of just USD 120 million in 2005, Rwanda's services exports increased to over USD 1.1 billion in 2018 (UNCTADStat, 2019).

Figure 2.9: Services trade balance and merchandise trade balance, 2018
in USD millions



Note: The services trade balance of Burundi, D.R. Congo and Madagascar are as of 2017. The merchandise trade balance of Burundi and Madagascar are also as of 2017.

Source: UNCTADStat (2019).

Services trade faces challenges related to policy and regulatory issues, the slow pace of implementation of key continental agreements and skills shortages.

Despite its dynamism, the development of the services sector in East Africa continues to face several challenges. Chief among these is the lack of appropriate national and regional policies that could foster strong linkages with the rest of the economy and encourage the emergence of regional and continental value chains. Some countries in the region have continued to maintain stringent regulatory regimes which, coupled with unfavourable policies and a lack of adequately skilled human capital, result in a high cost of services (UNCTAD, 2017).

For instance, despite good initiatives like the EAC’s Northern Corridor One Area Network, challenges in the communication sector have led to high roaming charges for both voice and data within the region. The impact of the Northern Corridor One Area Network Initiative was less than anticipated, reportedly due to a lack of co-ordination between tax authorities (Wakabi and Anyanzwa, 2018). Similarly, again within the EAC, the matter of free movement of persons remains contentious (Ubawni, 2017), despite the fact that the common market protocol came into force over eight years ago. As a result, there is only limited movement of professional services across the region. The situation is exacerbated by the lack of mutual recognition of professional qualifications.

The ratification of the AfCFTA thus provides a unique opportunity to not only address these challenges, but also to reap the benefits in other service sector industries, such as business services and the tourism industry. Some of these reforms would significantly help to reduce business costs and hence improve the general competitiveness of East Africa. A study conducted for IATA (2014) shows, for example, that the increased air service levels following the implementation of the Yamoussoukro Decision (a treaty liberalising air services markets endorsed by 44 members of the African Union in 1999) would stimulate growth and employment in the aviation industry, ranging from increased passenger numbers and baggage handling, to operating, servicing and maintenance of aircraft. Focusing on 12 countries in the sub-Saharan region, the analysis estimates the generation of approximately USD 1.3 billion in GDP and the creation of 155,100 jobs in aviation, tourism and the wider economy (IATA, 2014: 53).²⁹ The estimated impact on the East African countries is shown in Table 2.10.

Table 2.10: Benefits of intra-African liberalization of air services

	AVIATION SECTOR		TOURISM SECTOR			TRADE, INVESTMENT AND PRODUCTIVITY	
	Direct Employment (Jobs)	Indirect Employment (Jobs)	Direct Employment (Jobs)	Indirect Employment (Jobs)	Incremental Tourism Spend (USD Million)	Total Employment (Jobs)	Incremental GDP (USD Million)
Ethiopia	600	900	4,700	4,100	92.5	4,500	25.7
Kenya	1,200	1,800	4,600	4,000	132.2	4,300	18.7
Uganda	1,200	1,900	5,100	4,500	74.3	5,900	23.5
Total	3,000	4,600	14,400	12,600	299	14,700	67.9

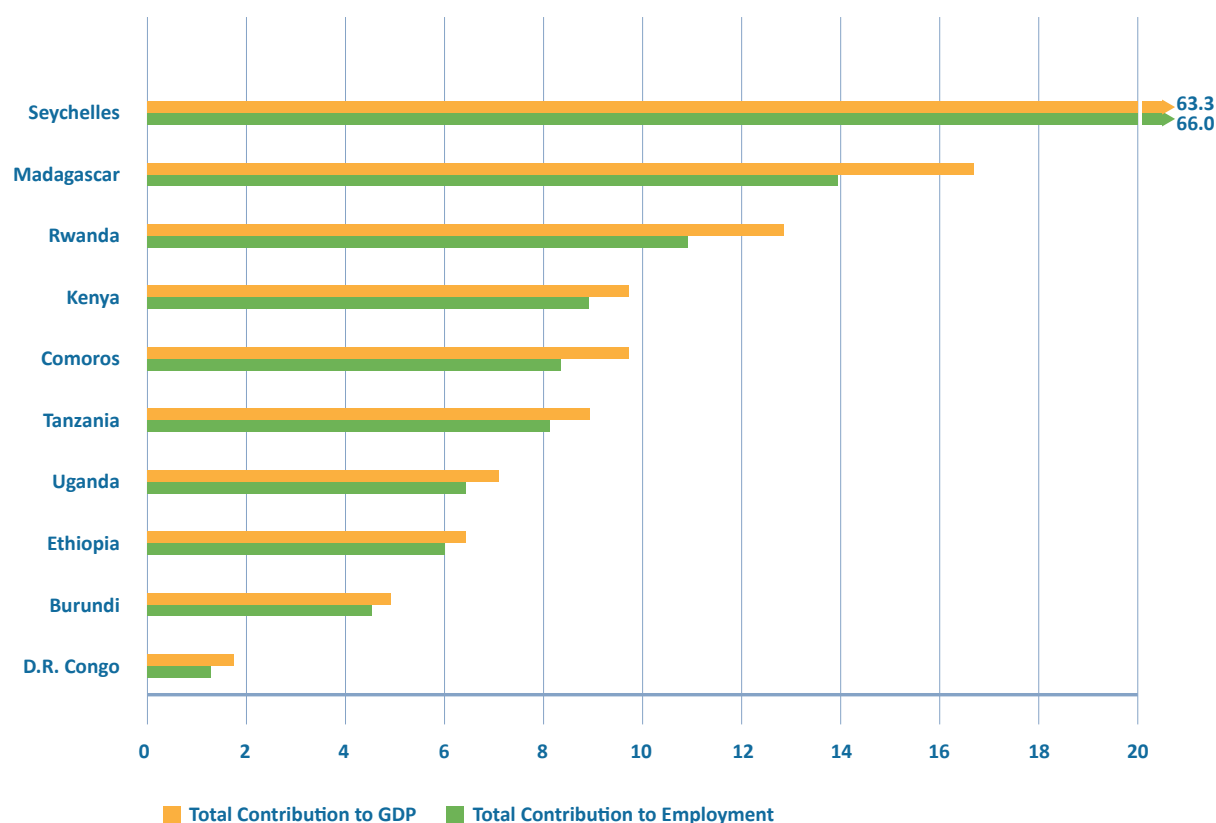
Source: IATA (2014).

Tourism is another service sector with enormous potential for growth in East Africa. The industry's total contribution to regional GDP was already over USD 24 billion in 2017, accounting for around 20 percent of the continental total, and the sector's contribution to GDP and employment is sizeable in many countries in the region (Figure 2.10). As an earner of foreign exchange, tourism accounts for over 30 percent of total export earnings in Seychelles, Ethiopia, Comoros and Rwanda (WTTTC, 2019).

As an earner of foreign exchange, tourism accounts for over 30 percent of total export earnings in Seychelles, Ethiopia, Comoros and Rwanda.

²⁹ The study focused on 12 countries in the sub-Saharan region: Algeria, Angola, Egypt, Ethiopia, Ghana, Kenya, Namibia, Nigeria, Senegal, South Africa, Tunisia, and Uganda.

Figure 2.10: Estimated contribution of tourism to regional GDP and employment, 2017
in percent



Source: WTTC (2019).

Member States and Regional Economic Communities are developing strategies to attract at least 80 percent of tourism arrivals.

The focus on the development of regional tourism within the AU’s Agenda 2063 is of special interest to the debates around the AfCFTA. There has been a steady growth of both outbound and domestic tourism, both in terms of numbers and receipts. The importance of intra-regional tourism is evidenced by the fact that the leading tourism market for Kenya is Uganda, while Kenya is the leading market for Tanzania (Gicobi, 2018).³⁰ As a result, several Member States and RECs are now developing strategies to attract at least 80 percent of arrivals from within the region. Kenya, Rwanda and Uganda have national campaigns promoting domestic tourism, while Tanzania is currently working on its domestic tourism strategy. At the REC level, the Intergovernmental Authority on Development (IGAD) is currently implementing its 10-year tourism master plan with an emphasis on regional tourism, while the EAC is also working on an intra-regional tourism marketing strategy. In its first ten-year implementation plan (2014-2023), the AU seeks to double intra-African tourism by 2023 to lift it from its comparatively low level by global standards.

Better and cheaper regional ICT infrastructure would also facilitate cross-border services and merchandise trade (UNCTAD, 2016a: 23). The *M-Pesa* money transfer programme is widely recognised to have revolutionized financial transactions in Kenya and the wider East Africa region by increasing

³⁰ Tanzanians have held the top position since 2015 as the leading spenders on outbound tourism at USD 900 million in 2017, followed by Ugandans (USD 470 million), Ethiopians (USD 430 million) and Rwandans (USD 310 million) (WTTC, 2019).

access to financial services. This has proven especially important for small traders and the informal sector. In Kenya, M-Pesa transactions now reportedly outweigh, in value, the amount of transactions in the formal banking sector.³¹ Overall, an estimated USD 30 billion in East African regional cross-border mobile money transfers was reached in 2015, while the rate of transfers is increasing by up to 30 percent a year (Wexler, 2015).

Such growth has been brought about by the rapid expansion of the mobile economy and internet access, essentially facilitated by a high mobile-phone adoption rate. According to *The Mobile Economy: Africa*, as of 2015 the continental mobile phone adoption rate was 46 percent, contributing 6.7 percent of GDP worth USD 153 billion (GSMA, 2016). Smart-phone adoption in African countries was only 30 percent in 2016, compared to the global average of 51 percent – a gap of 21 percent – but that gap is expected to narrow to less than 9 percent by 2020 (GSMA, 2016). With the current investments in undersea cable networks and the reduction in smart-phone prices, Africa's internet penetration and smart-phone usage will certainly continue to increase rapidly in the coming years. A study by Hjort and Poulsen (2019) shows that high-speed internet has large positive effects on employment in both higher skilled and less educated worker groups on the continent.

Kenya's iHub is already one of the most established in Africa, having around 150 companies and more than 13,000 members.

In this context, Member States, such as Rwanda and Kenya, have embraced ambitious ICT strategies in their development blueprints: *Vision 2020* and *Vision 2030*, respectively. In Kenya, a "tech city" is currently under construction with the Korean Advanced Institute of Science and Technology as a strategic partner (Konza City, 2019). Kenya's iHub is already one of the most established in Africa, having around 150 companies and more than 13,000 members. Hubs like this can provide a *manufacturing* ecosystem in the form of technical support (internet and ICT services), manufacturing makerspace (equipment and shared spaces), skills development (training in hardware engineering, coding, digital fabrication, internet of things, and blockchains) and incubators (support for product formation, conceptualisation of ideas, business development, networking, and funding support). This is crucial to ensure that such hubs do not operate in silos but are integrated with the rest of the manufacturing sector (Afreximbank, 2019: 42).

The emergence of platforms such as M-Pesa, M-Shwari, M-Akiba in Kenya, M-Pawa in Tanzania and Mokash in Rwanda and Uganda has boosted economic activities in the areas of money transfers, e-commerce, savings and investment.

In consonance with the rise in mobile phone and internet usage, there has been a rapid growth in digital trade on the continent, surpassing the global average. In East Africa, reflecting the high rate of mobile phone subscriptions, Kenya, Uganda and Tanzania are currently leading the rise of digital trade. In Kenya alone, e-commerce is reported to have grown by more 27 percent in 2017 (Afreximbank, 2019: 118). The emergence of platforms such as M-Pesa, M-Shwari, M-Akiba in Kenya, M-Pawa in Tanzania and Mokash in Rwanda and Uganda has boosted economic activities in the areas of money transfers, e-commerce, savings and investment.

Dominating the rise of digital trade in East Africa are major online shopping platforms like Kilimall and Cheki. Financial companies like Aledin Nano and Jamii Africa are also contributing by providing innovative financial products that provide micro-lending and -insurance services to low-income customers. Another already well-established pan-African e-commerce portal promoting cross-border digital trade within the region

³¹ In 2018 there were an estimated USD 40 billion worth of transactions via M-Pesa, compared to some USD 30 billion that was traded by all the banks in Kenya (Obbo, 2019).

Another already well-established pan-African e-commerce portal promoting cross-border digital trade within the region is Jumia, which successfully went public on the New York Stock Exchange in 2019.

New continental-wide policies under the umbrella of the AfCFTA could provide a major boost to cross-border digital trade, helping the region to catch up with other parts of the world, where the role of digital trade is far more prevalent.

is Jumia, which successfully went public on the New York Stock Exchange in 2019. The company's operations extend to 14 African countries including Kenya, Rwanda, Tanzania and Uganda. Jumia has built partnerships with 81,000 local African companies and individuals across the continent, helping to promote economic growth and the expansion of intra-African trade.

Regardless of these positive developments, the prevalence of digital trade in the region remains excessively low, even by developing country standards. New continental-wide policies under the umbrella of the AfCFTA could provide a major boost to cross-border digital trade, helping the region to catch up with other parts of the world – such as Latin America³² and the EU³³

–where the role of digital trade is far more prevalent. For instance, the EU prioritized the creation of a Digital Single Market to harmonize policies for a more effective digital marketplace, and the ASEAN region has established a coordinating committee on e-commerce to enable cooperation on digital trade facilitation, access to payment solutions and online security. The East Africa region could likewise reap benefits through the establishment of an African Single Digital Market.

2.6. Low and Declining Levels of Intra-Regional FDI

East Africa has done well over the last decade in increasing its capacity to attract Foreign Direct Investment (FDI) inflows, with the total almost doubling in the decade since the global financial crisis – a quite stellar performance given the global context. As a consequence, collectively East Africa's share in African total FDI inflows has increased from around 16 percent of the continental total in 2008 to almost 27 percent 2018 (Figure 2.11).³⁴ Ethiopia is exemplary of this shift in fortunes, where, attracted by cheap loans and subsidies, generous tax breaks and affordable labour, foreign investors have injected a sizeable amount of money into its manufacturing industry, helping to take the foreign investment total from USD 109 million in 2008 to over USD 4 billion in 2017. The Democratic Republic of Congo and Tanzania are other regional examples of a significant uptick in FDI inflows, although in these cases it has been principally driven by natural resources.

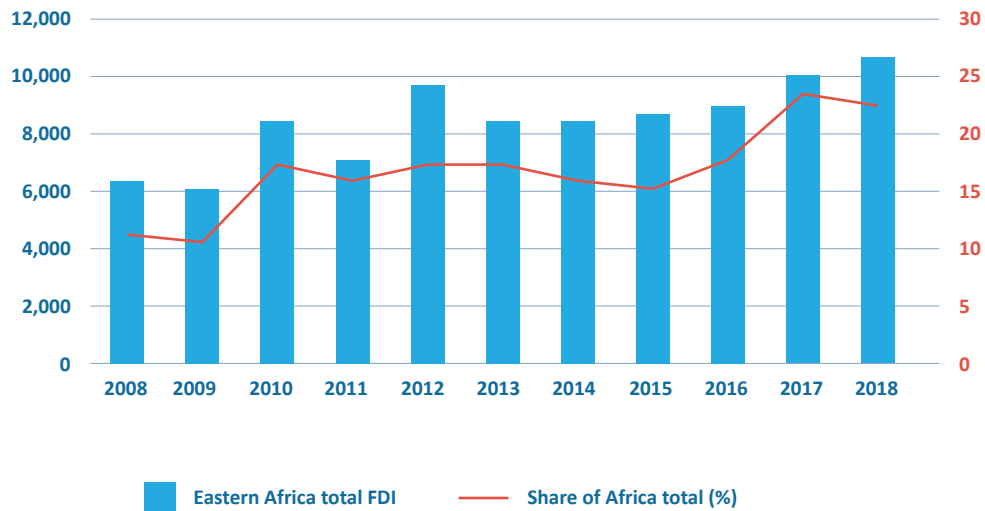
Despite these positive trends, the intra-regional FDI story – and this is the one that matters from the perspective of deeper regional integration – is rather different. While it is true that intra-regional FDI tends to be lower than extra-regional FDI in regional blocs across the world (Table 2.11),³⁵ there is worrying evidence of a declining trend in intra-regional FDI flows in East Africa. For instance, we estimate that greenfield intra-East African investment declined from an average of around USD 372 million from

³² According to data from eBay, Chilean online sellers export their products to an average of 28 markets, which contrasts with the 18 percent of Chilean offline traders which export typically only to two markets (Afreximbank, 2019: 120).

³³ Digital trade in the EU is increasingly the main vector of transactions, and the growth has been phenomenal, especially since the adoption of the EU Single Digital Market. More than 1 million EU businesses are already selling goods and services via online platforms, and more than 50 per cent of small and medium enterprises (SMEs) selling through online marketplaces sell across borders. By 2017, the European B2C e-commerce turnover was forecast to reach EUR 602 billion, at a growth rate of nearly 14 percent (Afreximbank, 2019: 121).

³⁴ Since the global financial crisis, global FDI flows have never recovered to the pre-crisis record level of more than USD 1.9 trillion in 2016 and reached just USD 1.4 trillion in 2017 (UNCTADStat, 2019).

Figure 2.11: FDI inflows to East Africa, 2008-2018
in USD millions



Source: UNCTADStat (2019).

2011-2017 to USD 224 million in 2018 (Figure 2.12). This represents barely 3 percent of the value of total greenfield cross-border investment – far lower than the level of intra-regional trade (which stood at 10 percent in 2017). The largest source economy of FDI in the region – Kenya – does have a presence in other East African countries (representing around 5-6 percent of the investment stock in neighbouring Tanzania, Uganda and Rwanda) (ECA, 2019a).³⁶ However, Kenyan FDI’s role has fluctuated over time and, arguably, outside the financial services industry, has not reached its full potential.

Greenfield intra-East African investment represents barely 3 percent of the value of total greenfield cross-border investment received by the region – far lower than the level of intra-regional trade.

35 Directional FDI data is very patchy, despite efforts by some organisations to bridge the gap (e.g. UNCTAD’s FDI bilateral database or the IMF’s FDI survey data).

36 ECA calculations from National Foreign Investment Surveys for Kenya, Uganda, Rwanda and Tanzania.

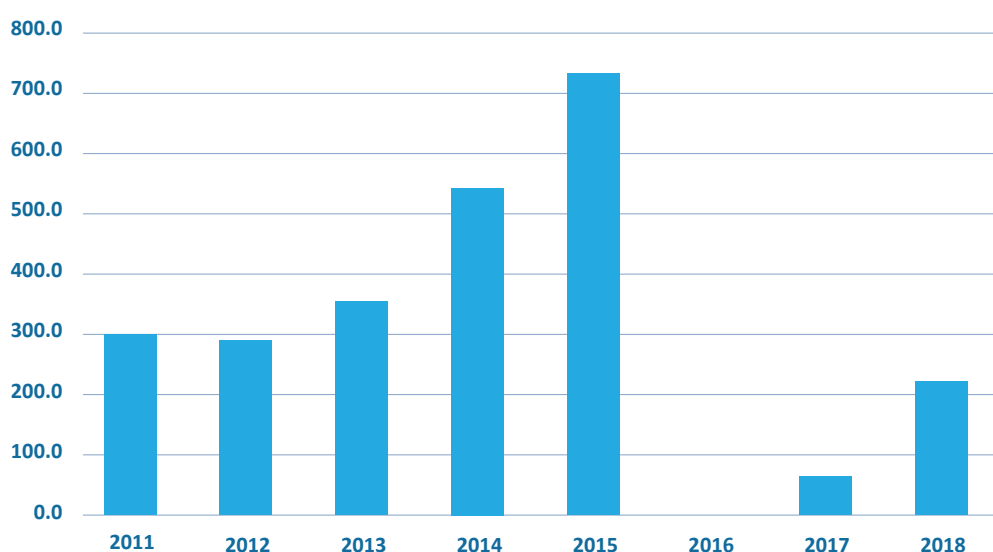
Table 2.11: Intra- and extra-regional FDI in selected regional blocs, 2009-2011

Region ³⁷	(BILLIONS OF DOLLARS)			(% SHARE IN TOTAL)	
	Total	Intra- regional	Extra- regional	Intra- regional	Extra- regional
COMESA	34	2.6	31.4	8	92
EAC	9.9	1.4	8.5	14	86
SADC	32	3.2	28.8	10	90
ASEAN	117.4	14.4	103	12	88
SAARC	71.6	2	69.6	3	97
MERCOSUR	71.3	1.5	69.8	2	98
APEC	596.4	344.2	252.2	58	42
EU	310.5	129.2	181.3	42	58

Note: Data refer to the sum of the value of cross-border mergers and acquisitions and greenfield FDI projects. Data for the value of greenfield FDI projects refer to estimated amounts of capital investment.

Source: UNCTAD (2013a).

Figure 2.12: Cross-border greenfield investment flows within East Africa, 2011-2018 in USD millions



Source: ECA computed from FDI Markets (2019) data.

Multinational firms are, by nature, integrators of cross-border trade in goods and services... they account for more than two thirds of global trade.

Theoretically, low intra-regional flows are to be expected to some extent. Dunning’s framework (1988) attempts to provide a theoretical framework for cross-border direct investment flows. Within this framework, low productivity does not translate into strong

37 COMESA is the Common Market for Eastern and Southern Africa, EAC is the East African Community, SADC is the Southern African Development Community, ASEAN is the Association of Southeast Asian Nations, SAARC is South Asian Association for Regional Cooperation, MERCOSUR is the Mercado Común del Sur (Southern Common Market), APEC is the Asia-Pacific Economic Cooperation.

ownership advantages, which is a necessary precondition for any FDI to take place. Put simply, prevailing productivity levels in East Africa, as reflected in low per capita incomes, do not lend themselves to the emergence of ownership advantages. Hence the capacity for East African firms to undertake FDI is limited. Nevertheless, the scale of the decline should be cause for concern.

Multinational firms are, by nature, integrators of cross-border trade in goods and services. It is estimated globally that more than two thirds of global trade relates to transactions by multinational firms, and of these totals, half are intra-firm transactions (i.e. within affiliates and the parent of the same company) (Shaxson, 2019; UNCTAD, 2013b). Greater intra-regional FDI would thus greatly increase the chance of the emergence of intra-regional value-chains. Higher levels of intra-regional FDI would also be beneficial from a number of other perspectives:

- **Better Knowledge of Regional Markets** – Investors from within the EAC and the wider African region have a more intimate knowledge of regional markets and are more capable of navigating the cultural factors that can sometimes impede foreign investment from further afield – there is, in other words, a greater cultural affinity facilitates cross-border business within the same region (Blonigen and Piger, 2014).
- **Greater Employment Creating Potential** – There is evidence that intra-African FDI creates both more employment opportunities and greater technological transfer than extra-African FDI (Gold et al., 2017).³⁸
- **A Spur to Economic Diversification** – The sectoral spread of intra-African FDI could contribute very positively to the sectoral diversification of regional economies. Much of the FDI received by the region has been in the natural-resource sector. Intra-regional FDI, by contrast, has a more diverse portfolio (Figure 2.13 and Figure 2.14).

Figure 2.13: Sectoral share of extra-African FDI projects to the EAC, 2013-2017

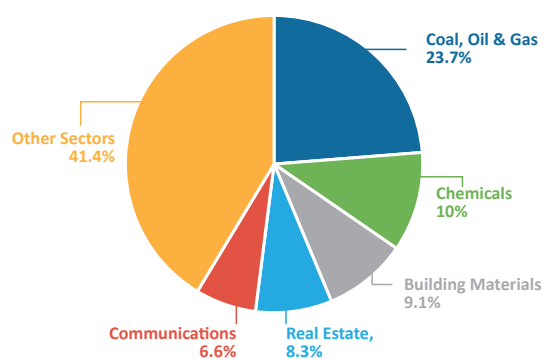
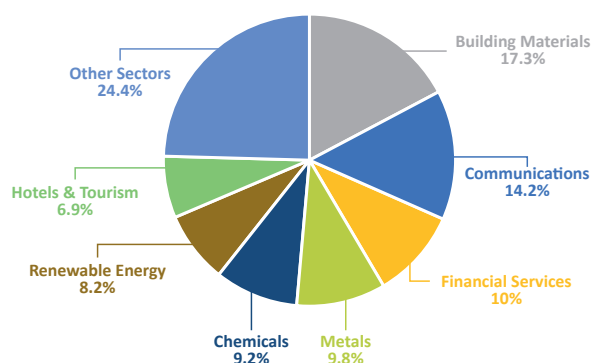


Figure 2.14: Sectoral share of intra-African FDI projects to the EAC, 2013-2017



Source: ECA calculations from FDI Markets (2019) data.

³⁸ In a data set using firm-level data for 19 sub-Saharan countries (seven of which are from East Africa: Burundi, Ethiopia, Kenya, Madagascar, Rwanda, Tanzania and Uganda), Gold et al. (2017) find that not only is employment growth generally higher for firms receiving FDI from other African investors compared to those receiving from Northern investors, but that they also receive more technology transfer from their parent company abroad.

The sectoral spread of intra-African FDI could contribute very positively to the sectoral diversification of regional economies.

for foreign investors can be fully addressed. If it is effectively implemented, the AfCFTA could give a significant boost to regional FDI in manufacturing and services sectors, such as tourism, finance and insurance (Box 3).

This is potentially where the implementation of the African Continental Free Trade Area could have a decisive impact by encouraging greater intra-African investment. The agreement includes a protocol on investment where issues around market access

Box 3: Saham – An example of pan-African expansion in the service sector

An example of the dynamism of intra-African FDI in the services sector is the Moroccan-based company Saham Assurance's rapid growth – from a small local firm into a leading African insurance company operating in 23 countries across the continent. Between 2005 and 2015, it increased its sales nearly tenfold to over USD 1 billion. The company had embarked on a bold strategy and buying stakes in existing insurance firms, overhauling the management and rapidly growing their sales. In East Africa the company has already invested in Kenya, Rwanda and Madagascar (Leke et al., 2018).

3. THEORETICAL AND EMPIRICAL PERSPECTIVES ON REGIONAL INTEGRATION AND THEIR RELEVANCE TO EAST AFRICA



Arguments about the benefits springing from trade liberalization in general and, more specifically, from regional integration, are well rehearsed.³⁹ In making the case for a rapid implementation of the AfCFTA for East Africa, however, it is important to highlight some main points stemming from the existing literature, both theoretical and empirical. Some of conclusions and lessons learned are common knowledge, but others may be more surprising – and may have a very specific bearing on AfCFTA implementation going forward.

3.1 What Theory Tells Us About the Consequences of Regional Integration

Regional integration is often seen as a form of selective trade liberalization- in the sense that it involves a process of liberalization with regional partners but does not necessarily imply any changes in trading relations with third parties. In essence, all processes of trade liberalization involve removing barriers on imports, such as tariffs and quotas. This lowers import prices and, thus, consumer prices. In countries with low per capita incomes, such gains should not be underestimated – they are an important way of raising the welfare of the population. Consumer goods and services become cheaper and, hence, more accessible to the general population. At the same time, consumers have access to a greater variety of products on the domestic market. These two effects mean that trade liberalisation may lead to substantial welfare gains in the form of consumer surpluses in importing countries.⁴⁰

However, it is not just a matter of priming the interests of consumers – regional integration can provide a major boost to the competitiveness of domestic firms and producers by lowering the cost of regionally produced inputs and services. Lower import prices can reduce the costs of imported raw materials and intermediate inputs for firms, helping to make them more competitive and facilitating their integration into regional and global value chains. This represents a major boon for a region like East Africa, which has been struggling to maintain its position in a highly competitive global economy (Mold, 2015).

Trade liberalization allows domestic firms to gain access to larger regional markets and benefit from scale economies.

In addition to cost advantages, regional trade liberalization allows domestic firms to gain access to larger markets and benefit from scale economies. One resounding feature of East Africa is the small size of national markets (especially so for the small island states), which acts as a major constraint on investment because, in many sectors, production on a small scale is often simply not economic (Collier and Venables, 2008: 19-20).⁴¹ Once the small market constraint is lifted, trade may not only allow firms to grow faster but also to get better access to finance and technology (Saygili et al., 2018). Thus, by enabling greater scale, the AfCFTA could provide a significant and much-needed boost to productivity.

A seminal theoretical contribution to the debate on the benefits from regional integration came from Viner (1950). He postulated that the gains from regional integration can be seen in terms of two fundamental

39 See Viner, 1950; Baldwin, 1995; Schiff and Winters, 2003; ECA, 2004; Sapir, 2011.

40 For instance, DeRosa et al. (2002) estimated that the formation of the EAC Customs Union would increase welfare within the region by between 1 and 2 percent of GDP.

41 Some scholars argue that, with new production technologies and the 'fourth industrial revolution', the lack of scale economies is no longer a limiting factor: i.e. small-scale production can be equally efficient. However, these arguments are not generally grounded in real-life examples. Empirical evidence still shows that scale economies are crucial for the competitiveness of industries. Most African economies are too small to launch viable steel projects, for example, yet this industry's pivotal role for developing countries to industrialize is widely recognised (ECA, AUC and AfDB, 2012: 30).

concepts – trade creation and trade diversion. The general idea is that regional integration should lead to a net trade creation effect, whereby the trade created between trading partners within the regional block outweighs the value of the displaced trade with third-party countries. As tariffs are removed on intra-regional trade, the volume of intra-regional trade should increase. However, part of that newly-created intra-regional trade may be at the expense of imports from other trading partners outside the regional block who, all things being equal, will still be trading on the same terms (i.e. have not benefited from the reduction in tariffs). If a higher-cost, less efficient, intra-regional trading partner replaces a more efficient, lower-cost provider from outside the regional block, then this is ‘trade diversion’.

Although the calculation of the net impact can be problematic,⁴² Viner’s insights were invaluable. However, they suffer a major constraint in the sense that they provide a purely ‘static’ view of the benefits of regional integration (Rodrik, 2018). In an important theoretical caveat, Cooper and Massel (1965) posit that, for developing countries, a situation whereby the creation of a regional block may lead to net trade diversion could still be considered desirable, from the perspective of priming intra-regional trade in industrial goods. From a *dynamic* perspective, then, the immediate cost of trade diversion, in a static sense, may be a price worth paying in terms of spurring the diversification of the regional economy over the longer-term.

It is wrong to conflate the AfCFTA with arguments for free trade, despite the comprehensible misunderstanding owing to its name. The essence of the agreement is about creating a unified continental market. It goes beyond traditional arguments in favour of static gains through trade creation – it is about achieving gains from ‘deep integration’. Deep integration not only deals with border measures such as tariffs and non-tariff barriers, but also entails attempts to eliminate all barriers to the movement of goods, services, people and capital. It thus involves the harmonization of all rules and regulations that impinge on cross-border flows (Schiff and Winters, 2003). As we will see in the empirical literature review, it is commonly believed that the gains from ‘deep integration’ are much larger than those from simple trade liberalization – in the case of the European Single Market Programme of 1993, one assessment (Mayer et al., 2018) finds that the gains from this form of ‘deep regional integration’ were three times larger than those typically produced by free trade alone.

The essence of the AfCFTA is about creating a unified continental market. It goes beyond traditional arguments in favour of static gains through trade creation.

Summarising, we can highlight several areas where dynamic gains from deep regional integration are likely to be forthcoming under the AfCFTA (according to UNCTAD, 2019a and ECA et al., 2012):

1. **Incentives for greater volumes of both FDI and national investment** – An enlarged regional market will provide incentives for greater volumes of both FDI and national investment, which were formerly held back by the small size of individual national markets. The combination of a stable investment climate, the development of transport and communications infrastructure, and sound regional economic policies would provide the incentives for investments in manufacturing and service projects that require economies of scale.
2. **Improvements in efficiency** – Regional integration is likely to improve efficiency as a result of increased competitive pressures among rival firms. Monopolies and oligopolistic market structures are often major impediments to efficient production across the continent. Inefficient national enterprises (including government monopolies) may reap abnormal profits, either because

42 See the discussion in Feenstra, 2004:192-199.

national laws protect them, or because there are no credible rivals. Adopting and enforcing *regional* competition rules through the AfCFTA is likely to enhance the degree of competition needed for a more efficient industrial structure.

3. **Higher returns in tradeable goods sectors** – The liberalization of intra-African trade, through terms-of-trade effects, could increase the relative returns in tradeable goods, stimulating investment further and thus raising output and employment in the impacted sectors.
4. **Faster growth and income convergence** – Research by Santos-Paulino et al., (2019) shows that participation in regional trade agreements increases GDP per capita growth. They also find evidence that regional integration confers additional benefits in terms of declines in within-country inequality and poverty levels.⁴³ The mechanisms through which this occurs are varied, but one way is through the emergence of regional growth poles capable of generating sufficient externalities to boost growth and development in the poorer Member States.
5. **Reduction in dependence on imported manufactured goods** – As production structures diversify away from primary products, Africa’s long-standing dependence on imports of manufactured goods should weaken. The existing structure of commodity specialization has placed the continent at a long-term disadvantage, not only seen in terms-of-trade losses, but also in lower technological progress and growth. One of the potential dynamic effects of the AfCFTA is the way it can provide a better environment for industrial diversification and regional complementarity than when each country develops its own industrial policies (Odijie, 2018).
6. **Greater regional cooperation** – It has been argued (De Melo, Panagariya and Rodrik, 1993) that the most important economic gains may stem from the cheaper unit costs induced by greater economic cooperation and coordination of policies, including those for region-wide transport and communications. The consolidation of the AfCFTA will also provide a platform whereby Africa can engage collectively with partners outside the continent, on a more equal footing.

The gains from the AfCFTA are not automatic... their realisation will require a series of complementary policies... investment in the necessary productive capacities.

It should be stressed that none of these gains are automatic and that their realization will require a series of complementary policies. UNCTAD (2013a) argues that for African countries to reap the expected gains from regional integration, they must also invest in the necessary *productive capacities*.⁴⁴ It also needs to be recognized that regional integration can lead to significant *transition* costs while it is being implemented: tariff revenues may fall; increased competition may pose threats to less-competitive sectors and firms; the mobility of labour and capital between firms and sectors will have to increase, and total employment may even initially decrease (Saygili et al., 2018).

Ultimately, the question of the balance of benefits from regional integration becomes an empirical question. What follows in the rest of this section is a review of the empirical evidence on existing processes of regional integration, to see what light that can shed on the potential impact of the AfCFTA.

43 This is in line with findings from prior studies. For instance, Balistreri et al. (2016) assess the impact of the EAC and the Tripartite Agreement on poverty using a Computable General Equilibrium (CGE) model based on the GTAP database, together with micro-simulation that provides detailed poverty effects. Their results indicate that greater integration leads to reduction in the poverty headcount and the percentage of the population living in poverty in all the six regions in their model (Kenya, Uganda, Rwanda, Tanzania, COMESA, and SADC). They conclude that closer EAC integration could take up to 5.3 million people out of poverty in the region, with the incomes of the poorest 40 percent rising by up between 7.5 percent and 10 percent for the EAC countries.

44 UNCTAD defines ‘productive capacities’ as the “productive resources, entrepreneurial capabilities and production linkages which together determine the capacity of a country to produce goods and services and enable it to grow and develop”.

3.2. How Does Trade Grow in Practice? Multilateral vs. Regional Processes

Since the global financial crisis of 2008-09, patterns of global trade have been undergoing a marked transition. The growth of global trade was far in excess of world GDP growth in the decades preceding 2008. It was a period that popularly became known as ‘globalisation’. World trade as a share of GDP had increased by a factor of three from 1960 to 2008. However, that process came to abrupt halt following the global financial crisis. In the seven years immediately following the crisis, trade growth failed to keep pace with even the slow rate of economic growth during the recovery period (2010-2016). The phenomenon shows little signs of abating. The average growth in the volume of world exports and imports slowed to 2.8 percent growth in 2018, down from 4.5 percent in 2017 (UNCTAD, 2019b). At a time when the global trade regime is increasingly being challenged, and Africa is proposing to move in the opposite direction with an ambitious process of regional trade liberalization under the umbrella of the AfCFTA, it is important to be cogent on what the literature tells us about the likely consequences.

The literature has seen much discussion about the manner in which trade liberalization leads to faster growth of trade, and whether the objective of trade liberalization is best served through unilateral, multilateral or regional processes. Many trade economists believe that unilateral liberalization by a country is theoretically the first-best policy option, leading to the largest net benefits. However, there is a recognition in the literature that it is unrealistic to expect individual countries to embark on such processes, for fear of putting national firms and producers at a disadvantage, should liberalization be not reciprocated by trading partners. There is also a body of literature which questions the wisdom of unilateral liberalisation for poor developing countries, because of their presumed inability to compete on a ‘level playing field’ with countries with much larger capital endowments, higher productivity, and managerial and organisational capacities (e.g. Rodrik, 2001; Chang, 2003; Pacheco-López and Thirlwall, 2007, etc.).

At a time when the global trade regime is increasingly being challenged... Africa is proposing to move in the opposite direction with an ambitious process of regional trade liberalization under the umbrella of the AfCFTA.

In the current global trading environment, this is an especially valid point – there is little appetite for unilateral liberalization anywhere, let alone on the African continent.⁴⁵ It is for this reason that orthodox opinion is generally supportive of multilateral processes under the aegis of organizations like the World Trade Organisation (WTO). However, the empirical validity of the proposition that multilateral liberalisation is to be preferred has also been questioned. For instance, a study by Rose (2004) estimated the effect of multilateral agreements on international trade: membership of the WTO, and its predecessor the Generalized Agreement on Tariffs and Trade (GATT).⁴⁶ Contrary to orthodox opinion, which generally supports multilateralism over regionalism,⁴⁷ Rose found that multilateral liberalization under the GATT/WTO had no significant impact on trade patterns.

45 An example of unilateral liberalisation is Uganda. Uganda was among the first countries in the region to liberalize its trading regime. In the early 1990s it embarked on a programme of tariff reductions, to such an extent that when it joined the revitalised East African Community (EAC), the country ended up actually increasing some of its tariffs.

46 Rose’s study used a standard gravity model of bilateral merchandise trade and a large panel data set, covering over 50 years and 175 countries.

47 For instance, Bhagwati (1993) claims regionalism is mostly welfare reducing (as the trade diversion effects nearly always outweigh trade creation) and that regionalism would limit global trade liberalization. Schiff and Winters (2003) argue that regional blocs do not necessarily lead to global liberalization. Regional blocs may well find it just as difficult to achieve internal agreement, and their combined size will make it easier for them to resist global pressures to liberalize. This was the case for the EU, which refused to open up its agricultural markets. See also Panagariya (1998).

Increased global trade has been principally driven by regional processes... Although globalization outpaced regionalism in the 1990s, the growth of regional trade has been more resilient since the 2000s.

Like Rose, other authors have also challenged the idea that the increase in trade flows seen globally has been driven predominantly by multilateral liberalization. Chortareas and Pelagidis (2004) examined the drivers of globalization by focusing on trade flows. They found that the degree of trade 'openness' converges faster

across countries of a given region and concluded that increased global trade has been principally driven by regional processes. Arestis et al. (2011) also analyse the impact of both globalization and regionalism on the growth of trade. They found that, although globalization outpaced regionalism in the 1990s, the growth of regional trade has been more resilient since the 2000s. If correct,⁴⁸ studies like these have a lot of practical implications for arguments in favour of regional integration, suggesting that the growth of trade globally has been driven more through regional integration than through multilateral or unilateral processes.

3.3. Ex-post Econometric versus Ex-ante Simulation Models

There are a number of methodologies for measuring the impact of forming a regional bloc, including ex-post econometric estimation (e.g. the gravity model) and *ex-ante* simulation models (either partial or general equilibrium approaches). Ex-post approaches use econometrics and historical data to conduct an analysis of the effects of past trade policy, while ex-ante simulation involves simulating the effects of a trade policy change onto a set of economic variables of interest.

Gravity econometric estimation models are widely used for ex-post assessment of trade policy and are useful for understanding the drivers of trade, as well as for assessing the trade effects of certain trade policies, such as membership of a regional bloc. They do so by 'explaining trade' as a function of some key variables, such as distance between markets, income per capita and the size of the respective economies. Unlike computable general equilibrium (CGE) models, they are not usually used to predict directly the impact of forming a regional bloc, but they can provide useful evidence to gauge the potential trade effects.

Pointedly, gravity models tend to give larger effects of regional trade agreements compared to general equilibrium models. A meta-analysis by Head and Mayer (2014) on 159 papers using the gravity model found that regional trade agreements boost trade by a median average of 47 percent. Afesorgbor's (2013) review of 139 previous studies using the gravity model found that regional trade agreements in Africa increased trade by an impressive 136 percent. A study of the potential benefits stemming from the AfCFTA finds that intra-African trade would increase by about 16 percent (or USD 16 billion) with the elimination of tariffs on 90 percent of existing intra-regional trade flows. The study, by the International Monetary Fund (IMF, 2019b), was based on a gravity model with bilateral goods trade data at the 1-digit industry level at five-year intervals (2000, 2005, 2010, and 2015). Despite the relatively modest trade impact, the authors argue that improving trade logistics and addressing poor infrastructure could be up to four times more effective at boosting trade than tariff reductions alone. They also stress the importance of complementary policies to address non-tariff bottlenecks.⁴⁹

48 Subsequent studies did challenge Rose's results. For example, Subramanian and Wei (2005) found that membership of the WTO increased world trade by as much as 120 percent. They did however concede that the impact was uneven, with industrial countries benefiting more from multilateral liberalization than developing countries. See also Kim (2010).

49 Gravity models have also been used to assess the level at which countries and RECs are under-trading. For instance, a study by ECA, AUC and AfDB (2010) indicated that on average Eastern and Southern Africa countries were found to be trading at about 75 percent (40 percent, using the trade-weighted average) of their potential.

Partial equilibrium (PE) models and Computable General Equilibrium (CGE) models are widely used in ex-ante assessments of the future impact of trade policies. They involve computer-based experiments, which compute how the economy could look in the future as a consequence of a specified policy change. The choice between these two approaches depends on several factors. The results of PE models are largely driven by the data that they are based on, and depend on only a relatively limited number of equations (ECA, AUC and AfDB, 2017). The PE models give the magnitude of the direct effects of the trade policy change, but without taking into account the sectoral interactions. An example of this would be the price of an import reduction on a particular good having a positive impact on another sector that uses that good as an intermediary input.

By contrast, CGE models take into account second-round effects – such as inter-industry effects and macroeconomic adjustments. Despite the wealth of results that they provide, CGE models do rely on a much larger number of theoretical assumptions compared to the PE models. In practical terms, the data requirements for PE are also less demanding than for the CGE, allowing for greater precision in identifying key products and trading partners affected by particular trade policy scenarios (Laird and Yeats, 1986; WITS, 2011; WTO and UN, 2012).

Arguably, the solution is to opt, whenever possible, for a combination of both models (ECA, AUC and AfDB, 2017). In any case, the results of both methodologies should only be used to give a sense of the order of magnitude that a change in policy can mean for economic welfare or trade, rather than pretend that they provide precise estimates (Piermartini and Teh, 2005).

With regard to past applications of these different approaches, PE models have been extensively used in studies assessing the impact of economic partnership agreements (EPAs) on various RECs and countries in Africa (e.g. Milner et al., 2005; Karingi et al., 2005 and 2006). They are also commonly used in evaluating the formation of Regional Trade Areas (RTAs) on particular sectors of the economy (though few of these studies focus on Africa). Kohl (2014) offers a comprehensive overview of studies in which the gravity equation has been used to study the effect of economic integration agreements.

While several studies have been carried out on trade liberalization in Africa using CGE models, most of them have been undertaken at the sub-regional level. Table 3.1 provides a summary of some of the CGE studies at the continental level.

Table 3.1: Summary of CGE studies on regional integration in Africa

AUTHOR	EMPIRICAL MODEL	KEY FINDINGS
Mevel, S. and Karingi, S. (2012)	MIRAGE multi-country and multi-sector CGE dynamic model, with the GTAP database 7, which provided data for 53 sectors and 113 countries/regions for the year 2004.	With the removal of all tariffs on trade between African countries, intra-African trade would increase by 52.3 percent (or USD 34.6 billion) compared with a baseline scenario without the AfCFTA in 2022.

AUTHOR	EMPIRICAL MODEL	KEY FINDINGS
Mevel, S. and Karingi, S. (2013)	MIRAGE multi-country and multi-sector CGE model in its recursive dynamic version, with the GTAP database 7, which provided information for 53 sectors and 113 countries/regions for the year 2004.	Intra-African exports would increase mostly in the industrial sector (53.3 percent or USD 27.9 billion), followed by the agricultural sector (53.1 percent or USD 5.7 billion) and the services (31.9 percent or USD 1.0 billion).
Jensen, H.G. and Sandrey, R. (2015)	GTAP CGE Static model, with the GTAP database 9.2. The base year was 2011 and the aggregation of 24 sub-regions in Africa and 20 sectors was used.	The results for tariff elimination on intra-African trade are promising, with a welfare enhancing effect of USD 7.3 billion. More impressive results were forecast by simulating a reduction of non-tariff barrier and cost in transit, indicating the importance of non-tariff barrier reductions and trade facilitation.
Chauvin et al. (2016)	MIRAGE-e model calibrated using the Global Social Account Matrix from GTAP 8.1 with 2007 as the base year. Aggregation of 21 sectors and 20 African countries and regions was considered.	The effects on trade, growth and welfare gains for each African country as a consequence of the implementation of AfCFTA would depend on the modalities of trade liberalization. Additionally, the CFTA would lead to asymmetric changes in trade patterns among African countries and within countries across sectors.
Saygili, M., Peters, R., and Knebel, C. (2018)	GTAP CGE Static model, together with the GTAP database. The GTAP model used in this study can distinguish 27 individual countries and five sub-regions in Africa.	The full elimination of tariffs among African countries creates an overall welfare gain of about USD 16.1 billion in the long run and USD 4.6 billion in the short run. The results show that the gains are not distributed equally among Member States. In the short-run, countries are likely to bear some tariff revenue losses and adjustment costs, which may not be distributed uniformly across the African continent. Both costs and benefits are reduced if sensitive products are exempt from liberalization.

AUTHOR	EMPIRICAL MODEL	KEY FINDINGS
Vanzetti et al. (2018)	GTAP CGE Static model together with the GTAP database 10. The base year was 2014.	Complete elimination of existing tariffs among African countries creates an overall welfare gain of about USD 3.6 billion in the long run. The gains are not evenly distributed. The welfare gain reduces by more than half to USD 1.8 billion when tariff elimination with the exemption for sensitive products is considered. The welfare gains from reducing non-tariff measures amounts to USD 21 billion.
AfDB (2019)	Extended version of the GTAP model using new data.	The removal of bilateral tariffs on intra-African trade, would boost the regional trade by 14.6 percent (a gain of USD 10.1 billion).
ECA (2018c)	MIRAGE multi-country and multi-sector CGE model in its recursive dynamic version, with the GTAP database 9.2 (base year 2011) and the Market Access Map database with tariff information at the harmonized system six-digit level of products (MAcMap-HS6).	The AfCFTA is projected to increase the value of intra-African trade by between 15 percent (or USD 50 billion) and 25 percent (or USD 70 billion), depending on liberalization efforts, in 2040, compared to a situation with no AfCFTA in place. The increase in intra-African trade is most pronounced in industrial sectors, thereby offering invaluable opportunities to industrialize through trade.

The variance in the results of the different studies in Table 3.1 can ultimately be explained in terms of the choice of model, its closure and underlying data. Fosu and Mold (2008) noted a gradual secular decline in the magnitudes of welfare estimates produced by CGE models from trade, partly due to: i) more comprehensive models and databases; ii) the inclusion of existing preferential market access schemes within the modelling framework; and iii) preference erosion.

The European Single Market Programme increased trade between EU members by 109 percent on average for goods and 58 percent for tradable services.

It is worth stressing that discrepancies from different modelling methodologies are also to be expected. For instance, early CGE studies on the impact of the European Single Market Programme and the North American Free Trade Agreement (NAFTA) showed large

variations in the estimated impact of regional integration. The Cecchini Report (1988) estimated total benefits of the European single market from removing barriers to trade, technical barriers, economies of scale and competition ranging from 5.8 to 6.4 percent of GDP. Yet other early studies by Gasiorek et al. (1992), Haaland and Norman (1992) and Baldwin (1992) estimated that the European Single Market Programme would improve welfare by only 1.2 percent, 0.5 percent, and 0.3 percent respectively. Landau (1995) examined the impact of the European Common Market on the economic growth of its member countries using an econometric approach, finding no statistically significant difference between the growth of member and non-member economies.

A recent extensive (and presumably much more reliable) ex-ante study by Mayer et al. (2018) studied the impact of the establishment of the European Single Market over the period from 1950 to 2012, finding that it had increased trade between EU members by 109 percent on average for goods, and 58 percent for tradable services. The associated GDP gains were estimated to reach 4.4 percent, with many poorer peripheral countries gaining proportionately more than core countries. This is clearly at odds with the aforementioned early studies, and more in line with the initial Cecchini Report's estimates. Moreover, Mayer et al.'s findings endorsed the 'deep integration' of the SMP, finding that the trade impact was more than three times larger than the effect of tariff removal alone. With hindsight, then, and from a longer-term perspective, we can say that the impact of deeper European integration may have been significantly larger than had been previously anticipated by some of the published research.

By contrast, NAFTA was quite a different proposition as it focused exclusively on trade liberalization and did not have a 'deep integration' agenda. As a consequence, it is no surprise that studies generally reported much more modest trade and welfare effects. An early CGE study on NAFTA by Brown (1992) estimated welfare effects that varied from 0.1 percent and 0.7 percent for the USA and Canada. Mexico, the poorest country in the block, was actually estimated to be the biggest beneficiary, with a 1.6 percent improvement in welfare. This certainly tallies with the subsequent trade impact of NAFTA, which led to a dramatic increase in the country's exports to the US and Canada, particularly from the Maquila industries.⁵⁰ Bachrach and Mizrahi (1992) estimated welfare effects of 0.32 percent and 0.02 percent for Mexico and the USA, respectively. The anticipated welfare gains from these studies were clearly small.⁵¹ As Krugman (1993) pointed out at the time, any benefits from NAFTA were likely to be marginal, particularly in terms of job creation. Few studies indicate that NAFTA added much more than 0.1 percent to U.S. real income.⁵²

Yet despite the evidence, some authors (e.g. Schiff and Winters, 2003) have insisted that 'North-South' agreements like NAFTA are fundamentally preferable for poorer economies than 'South-South' agreements. This argument is based on the premise that a North-South Agreement allows the low-income economy to specialize more in sectors where it has a comparative advantage, along Heckscher-Ohlin lines, in primary commodities, agriculture and low-tech manufacturing. This then allows the

50 Caliendo and Parro (2015) estimate that tariff reductions under NAFTA increased Mexico's intra-bloc trade by 118 percent, compared to 41 percent for the U.S. and 11 percent for Canada.

51 These CGE studies were extensively cited in the early 1990s to support the case for NAFTA but the results were very wide of the mark in terms of underestimating the rate of export growth between Mexico and the United States (Kehoe, 2003).

52 For an explanation on why the gains were so small, see Krugman (1993).

higher-income partner to specialize on more technologically advanced sectors in manufacturing and services. Schiff and Winters (2003: 70) claim that *“the same basic forces therefore mean that regional integration between rich countries causes their incomes to converge, whereas integration between poor ones causes divergence.”*

Such arguments – which are the products of a static, rather than a dynamic, approach to comparative advantage (Lin and Chang, 2009) – are not necessarily borne out by the facts. The end results of NAFTA for Mexico were deeply disappointing. Although the export structure diversified very significantly, the aggregate impact on welfare and employment fell well below expectations, with almost stagnant per capita income growth in the decade following the signing of the agreement. Contrary to the arguments of Schiff and Winters (2003), NAFTA also ended up undermining Mexican industry, because it locked the country into buying high-cost intermediate products from the United States, rather than sourcing those products from lower cost suppliers in Asia and elsewhere (Mold and Rozo, 2005).

Many national markets in East Africa do not have the critical mass – with small populations and low average per capita incomes – to ensure a healthy degree of competition.

To sum up, the results of all trade policy analysis crucially depend on the choice of model, the assumptions made and the quality of the data. The results of CGEs, in particular, depend on the initial calibration and base-year data used for modelling (IMF, 2019b:57). To the lay person or someone without a background in this kind of modelling approach, the recognition of these constraints could result in scepticism towards the whole exercise. In fact, however, for a host of reasons, the modelling techniques adopted in this report may actually systematically underestimate the potential gains from deep regional integration, for various reasons:

1. **Inability to foresee the emergence of new activities or trade** – Both partial and general equilibrium models are incapable of predicting the emergence of new sectors or trade in products where there was none previously. This is because product categories for which there are initially no bilateral trade flows cannot be projected to become non-zero after the introduction of zero tariffs (IMF, 2019b: 57).
2. **Neglect of the benefits from services trade** – Services trade liberalization cannot be estimated because of the lack of data on both bilateral service trade and tariffs. Yet the reviewed evidence suggests that the services sectors are often a principal source of gains from deeper regional integration (e.g. Mayer et al., 2018).
3. **Failure to model benefits derived from scale economies** – Most CGE global models assume constant returns to scale. Yet, by expanding the size of the market, scale economies are one of the principal sources of gains from regional integration. Introducing increasing returns to scale into this kind of modelling approach is perfectly possible but can make the model much less tractable and is usually avoided.
4. **The long-term impact on productivity and incomes** – The positive impact of the AfCFTA through greater competition and the reduction of ‘x-inefficiencies’⁵³ is not captured through these models. Competition is the spur of faster productivity growth and technological acquisition. Yet many national markets in East Africa do not have the critical mass – with small populations and low average per capita incomes – to ensure a healthy degree of competition. The regional market is much more likely to be conducive to a competitive market.

53 Leibenstein (1966) introduced the concept of ‘x-inefficiencies’ to capture the underutilization of resources under conditions of imperfect competition.

5. **Lack of sufficient data** – Input-output tables form the empirical backbone of CGE models. Only 26 African countries currently have input-output tables in the GTAP 10 data base. This limits the degree of disaggregation that is possible using this kind of modelling. In addition, informal cross-border trade, which represents a significant portion of intra-African trade, is not captured in the trade data used in the simulations. Surveys of informal trade are undertaken sporadically and provide figures that are often not mutually compatible with the estimates provided by neighbouring countries.

A group of young African children are gathered around a laptop, looking at the screen with interest. One child in a red shirt is pointing at the screen, while others in pink and yellow shirts look on. The scene is brightly lit, suggesting an educational or community setting.

4. THE AfCFTA ON EAST AFRICA – RESULTS OF OUR SIMULATION WORK

In the light of the previous discussion, this section summarizes the key results of our own simulation work to estimate the potential impact of the AfCFTA for East Africa. The first methodology used is the partial equilibrium analysis; it is complemented by a CGE model. The latter is a static model using the Global Trade Analysis Project (GTAP) 10.0 database, which refers to a 2014 base year. Lastly, for the sake of comparison, we contrast those results with those of earlier ECA simulations, based on the dynamic MIRAGE CGE model.

4.1. Partial Equilibrium Results

The partial equilibrium simulations use the WITS-SMART model,⁵⁴ assuming full liberalization of the tariffs on trade in goods. This may appear to be an extreme simulation – 100 percent liberalization will not occur under the AfCFTA – but is arguably the best option in the absence of prior knowledge about which products will be excluded under the sensitive item list. The model produces estimates of the changes in trade, trade creation, the trade diversion and the welfare effect. Data on trade flows and tariffs used in the model is extracted from the COMTRADE and UNCTAD TRAINS database with the underlying data referring to a 2014 baseline so as to be comparable with the CGE estimates. The elasticities incorporated in the simulation are for *import demand*, and infinite *export supply* elasticities are assumed (under the reasonable assumption that the small regional economies are ‘price-takers’ in the global market).⁵⁵ The standard Armington substitution elasticity between products of different countries is also utilized in the model, to avoid unrealistically large responses to price changes.⁵⁶

Partial Equilibrium results show that East Africa’s intra-African trade would rise by around USD 737 million upon full implementation of the AfCFTA... translating into a 13 percent increase in exports.

These Partial Equilibrium results show that East Africa’s intra-African trade would increase by around USD 737 million upon full implementation of the AfCFTA. This translates into a 13 percent increase when compared to the exports of the base year. This is not far short of the amount predicted by the IMF (2019b), cited earlier, which found that intra-African trade would

increase by about 16 percent. Although all countries in the region stand to benefit from the expansion of trade following the removal of the tariff barriers, the extent of the gains depends on the particular characteristics of the countries – namely, the compatibility of their trade profiles, pre-existing tariff structures and geographical proximity (ECA, AUC and AfDB, 2017). The largest increases (in absolute amounts) in the value of exports will accrue to Uganda, Kenya and Tanzania (Table 4.2). In contrast, for some countries in the region, the changes in exports may seem quite trivial; however, this partially reflects low levels of existing intra-African trade and, for the smaller countries, low absolute values.

It should also be remembered that both methodologies only apply to merchandise trade – not services. They are therefore unable to provide estimates of trade in new sectors or industries into which the economies may move when confronted by the opportunities that AfCFTA opens up. The estimates are, as clarified in the previous section, limited to formal-sector trade.

54 For more details on the model, see Laird and Yeats (1986) and WTO and UN (2012).

55 The import demand elasticity values used in SMART by default have been empirically estimated for each country and every HS 6-digit product. 1.5 is the default Armington import substitution elasticity value, while 99 is the infinite export supply elasticity, i.e. assuming that countries in the region are ‘price-takers’ on the world market – a realistic assumption given the very small share of East African countries in global trade, even in their principal commodity exports, such as coffee and tea, and minerals, such as gold.

56 See Armington (1969) for an explanation of why this is such an important modelling tool.

Encouragingly, the increase in intra-African trade will be most pronounced in the manufacturing sector, which accounts for almost 40 percent (USD 235 million) of the total increase in the intra-African exports, followed by the agricultural sector (food and live animals) at 28 percent (USD 176 million).⁵⁷ Nevertheless, country-level analysis reveals the beneficiary sectors are highly heterogeneous. For instance, in Burundi and Madagascar, the main beneficiary sector is the manufacturing sector; meanwhile the food and beverages sector dominates Djibouti's and Rwanda's projected increase in intra-African exports.⁵⁸ In some cases, the export response is likely to be very large indeed. For instance, exports of leather products from Ethiopia and Kenya are projected to increase by more than 1000 percent.

Table 4.1: Increase in top exports, by sector after AfCFTA reforms

SECTOR	EXPORT CHANGE (USD '000)	PERCENTAGE CHANGE
Manufactured goods	234,859	14
Food and live animals	176,223	13
Mineral fuels, lubricants	148,034	26
Beverages and tobacco	53,506	26

Source: ECA calculations based on WITS/SMART partial equilibrium model.

Table 4.2: Increase in exports after AfCFTA reforms

	ABSOLUTE AMOUNT (USD '000)	PERCENTAGE CHANGE, COMPARED TO BASE YEAR
East Africa	736,501	13
Uganda	198,546	21
Kenya	188,227	10
Tanzania	171,780	17
Madagascar	93,186	47
Rwanda	56,010	22
Ethiopia	10,718	10
D.R. Congo	9,843	1
Seychelles	3,963	7
Somalia	2,988	31
Djibouti	716	5
South Sudan	401	8
Eritrea	55	1
Burundi	39	0.4
Comoros	28	1

Note: Since the WITS-SMART simulations focus on one importing market and its exporting partners in assessing the impact of a tariff change, the estimates for Uganda, Kenya and Ethiopia may be underestimated as they do not take into account exports from these countries to South Sudan and Somalia.

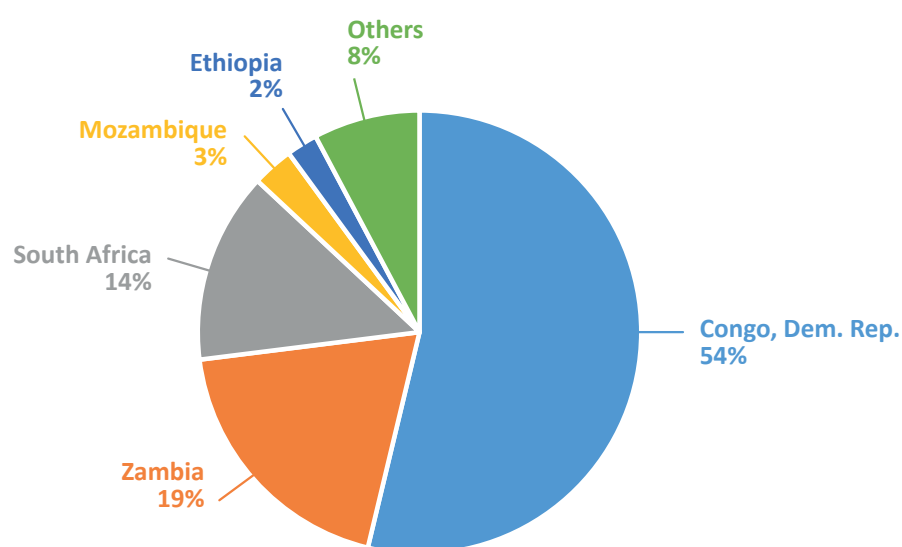
Source: ECA calculations based on WITS/SMART partial equilibrium model.

⁵⁷ Since these results are based on SITC 3 aggregation, trade between South Africa and Madagascar is not captured as WITS-SMART database does not report the SITC 3 data for South Africa.

⁵⁸ Results on the sectors (based on HS6 classification) that are likely to gain the most from tariff liberalization for individual various countries is available from the authors on request.

How will these changes impact regional trading patterns? Figure 4.1 shows the share of African countries in the additional exports from within the region after the AfCFTA reforms. More than half of the additional exports from the whole region will go to D.R. Congo, reflecting the size of the market as well as proximity, as it borders five other East African countries. Zambia is the destination of 19 percent of the additional exports, followed by South Africa at 14 percent.

Figure 4.1: Geographical distribution of increased intra-African exports from East Africa after tariff liberalization



Source: ECA calculations based on WITS/SMART partial equilibrium simulations.

It is worth remembering that integration is a two-way street and regional *imports* will also increase under the AfCFTA (Table 4.3). D.R. Congo and Ethiopia alone account for around 80 percent of the increase in intra-regional imports, indicative of their large market size and high average tariffs. Although D.R. Congo belongs to three of the eight RECs recognized by the AU (ECCAS, COMESA and SADC), its official trade with other African countries (apart from South Africa and Zambia) is currently very low because those regional agreements are yet to be fully implemented (WTO, 2016:6). This is again illustrative of where the AfCFTA can make a difference and be a potential ‘game-changer’ in terms of boosting intra-regional and intra-African trade.

Table 4.3: Increase in imports after AfCFTA liberalization

	ABSOLUTE AMOUNT (USD '000)	PERCENTAGE CHANGE, COMPARED TO BASE YEAR
East Africa	1,490,406	16
D.R.Congo	1,079,372	32
Ethiopia	166,680	21
Madagascar	77,119	25
Kenya	68,159	5
Uganda	31,318	3
Djibouti	18,144	35
Rwanda	16,361	2
Tanzania	14,053	1
Eritrea	8,947	6
Comoros	4,302	8
Seychelles	3,065	3
Burundi	2,885	2

Source: ECA calculations based on WITS/SMART partial equilibrium simulations.

The overall trade creation for the region’s producers and exporters reflect the displacement of trade by relatively inefficient producers towards more efficient ones, due to the reduction or elimination of tariffs, while trade diversion implies that, as a result of AfCFTA tariff reductions, trade with more efficient producers located outside the continent is displaced by less efficient producers within the regional block. The results show that the net impact of the AfCFTA will be trade creating, not diverting, in East Africa (Table 4.4).

Table 4.4: Trade creation and diversion effects of AfCFTA liberalization⁵⁹
in USD millions

	TRADE CREATION	TRADE DIVERSION
East Africa	1,253	219
D.R.Congo	986	93
Ethiopia	114	53
Madagascar	57	20
Kenya	40	28
Uganda	19	13
Djibouti	14	4
Tanzania	11	3
Rwanda	7	4
Burundi	2	1

⁵⁹ See Laird and Yeats (1986) for the technical derivation of the trade-creation and trade-diversion formula.

	TRADE CREATION	TRADE DIVERSION
Eritrea	2	0.5
Comoros	1	0.5
Seychelles	0.33	1

Source: ECA calculations based on WITS/SMART partial equilibrium simulations.

Ultimately, the balance of benefits is usually measured from the perspective of the consumer, who will benefit from the lower price of imported goods – the ‘welfare effect’.⁶⁰ The results indicate that, although in some cases the magnitudes are small, all countries in the region stand to gain in terms of improvement in consumer surplus – the logical consequence of removing tariffs. D.R. Congo, which is the largest single importer of merchandise goods from Africa in the region, would be the greatest beneficiary, accounting for 65 percent of the total consumer surplus in the region (Table 4.5). But other large countries such as Ethiopia, Kenya and Madagascar also stand to benefit significantly through this channel.

Table 4.5: Welfare (consumer surplus effect) of the AfCFTA

	CONSUMER SURPLUS EFFECT IN USD (‘000)
East Africa	100,869
D.R. Congo	65,917
Ethiopia	16,941
Kenya	5,725
Madagascar	5,513
Djibouti	2,156
Uganda	2,050
Tanzania	1,424
Rwanda	831
Burundi	153
Eritrea	99
Comoros	56
Seychelles	4

Source: ECA calculations based on WITS/SMART partial equilibrium simulations.

⁶⁰ The welfare effect in the partial equilibrium model estimates only the consumer surplus ascribed to the benefits for consumers in the importing country derived from lower domestic prices.

4.2. General Equilibrium Results

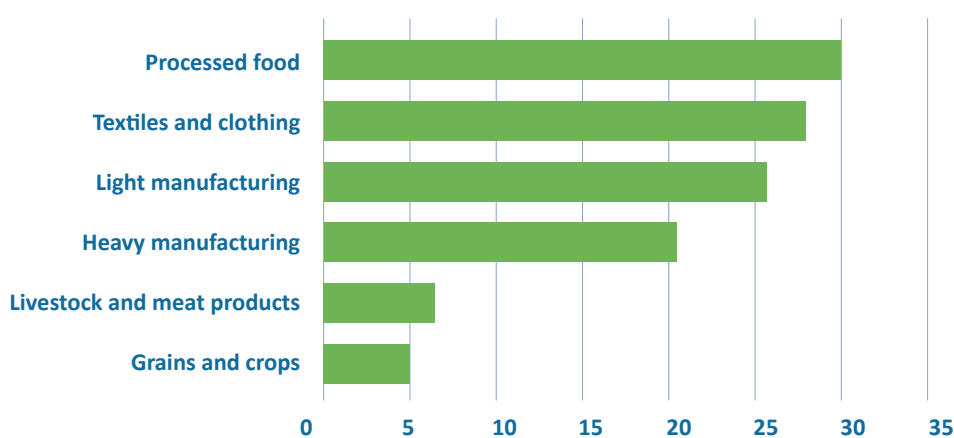
In this section, a CGE model based on GTAP data is used to study the impact of implementing the AfCFTA by assuming the removal of existing tariffs on all intra-African trade. The GTAP 10.0 database used here describes global bilateral trade patterns, production, consumption and intermediate use of commodities and services, with the underlying data referring to a 2014 baseline as in Section 4.1. Coverage of the GTAP database is not complete for the African continent, and it is only possible to carry out the simulations for six individual countries in East Africa, with the remaining countries part of a composite group called ‘Rest of East Africa’.⁶¹ The initial sectoral aggregation covers 10 sectors, although this level of analysis is subsequently complemented with a more detailed sectoral breakdown.⁶² The standard GTAP (Hertel, 1997) closure is used in the simulations, but allowing for capital mobility and fixed wages of unskilled labour in Africa (i.e. to reflect the high levels of un- and under-employment that characterize regional labour markets).

The AfCFTA would boost East African exports to the rest of the continent by around 16 percent, with sectors like processed food, textiles and clothing, and light manufacturing as the main beneficiary sectors.

The results provide compelling evidence of the positive impact of the AfCFTA on the regional economy: The AfCFTA would boost the exports of East Africa⁶³ to the rest of the continent by around 16 percent (or USD 1.1 billion), with processed food, textiles and clothing, and light manufacturing as the main beneficiary sectors (Figure 4.2). In reviewing the results, it should be

stressed that, unlike previous analysis by Mevel and Karingi (2012), our simulations do not include any allowance for accompanying measures to remove non-tariff barriers. In the latter study, it was estimated that the impact of the AfCFTA on intra-African exports could be doubled if measures were simultaneously implemented to reduce non-tariff barriers.

Figure 4.2: Change in East African exports to Africa by sector in percent



Source: GTAP simulations.

61 The six individual countries are: Ethiopia, Kenya, Madagascar, Rwanda, Uganda and Tanzania; the ‘Rest of East Africa’ group includes Burundi, Comoros, Djibouti, Eritrea, Seychelles, Somalia and Sudan.

62 The sectors are: Grains and Crops, Meat and Livestock, Extraction, Processed Food, Textiles and Clothing, Light Manufacturing, Heavy Manufacturing, Utilities and Construction, Transport and Communications, and Other Services.

63 For modelling purposes, the composite East Africa region comprises: Ethiopia, Kenya, Madagascar, Rwanda, Tanzania, Uganda, Burundi, Comoros, Djibouti, Eritrea, Seychelles, Somalia and Sudan.

One common misunderstanding about the AfCFTA is its potential to impact positively on trade balances. As we saw in Section 2.1, the region suffers from chronic trade deficits that act as a drag on economic growth and development. So, the issue is an important one. However, while the AfCFTA will boost intra-regional trade, it will not necessarily have a significant effect on the overall trade balances, for the simple reason that increased intra-regional exports will also imply higher intra-regional imports. Nevertheless, the AfCFTA will boost competition and firm efficiency across East Africa: through increased regional trade, the region will thus build stronger firms and industries that will be able to compete better in global markets.

The AfCFTA will lead to net welfare gains of over USD 1.8 billion for consumers in East Africa.

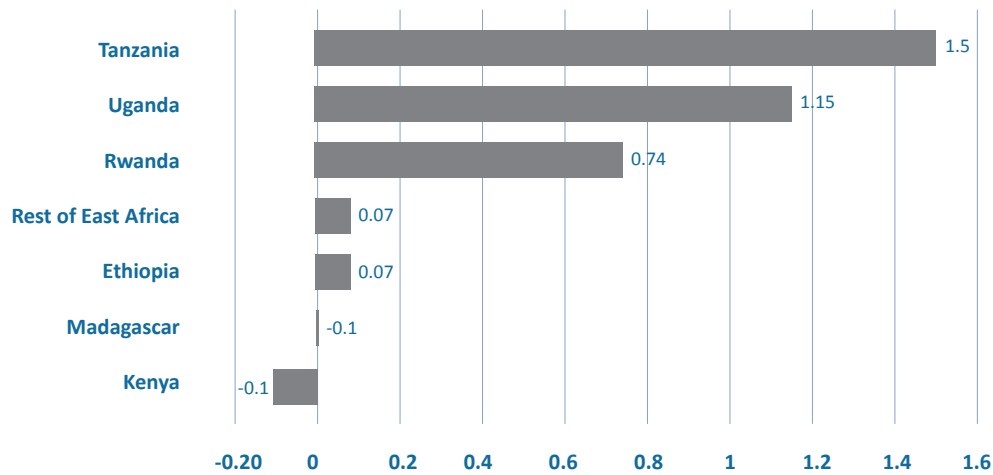
Our CGE results suggest that the AfCFTA will lead to net welfare gains of over USD 1.8 billion for consumers in East Africa, with the bulk of the gains accruing to Tanzania, Uganda and Ethiopia. The decomposition of welfare gains shows that the largest impact is due to endowment effects – changes in quantities of the factors of production (e.g. labour and capital), which, in turn, improve an economy’s productive capacity (Table 4.6). Moreover, the AfCFTA will lead to an increase in GDP in every country of the region except in Kenya and Madagascar (Figure 4.3).

Table 4.6: Welfare decomposition
in USD millions

	ALLOCATIVE EFFICIENCY	ENDOWMENT EFFECT	TERMS OF TRADE EFFECT	INVESTMENT SAVINGS	TOTAL WELFARE
Tanzania	171.2	559.0	-12.8	-18.1	699.4
Uganda	15.1	216.4	7.6	-0.1	239.0
Ethiopia	44.7	237.0	-20.3	-23.7	237.7
Rest of East Africa	38.1	131.6	-7.2	6.5	168.9
Kenya	-9.3	225.1	-36.7	-41.2	137.8
Rwanda	11.8	47.7	0.6	-0.4	59.8
Madagascar	0.5	3.2	-1.0	0.0	2.7

Source: GTAP simulations.

Figure 4.3: Percentage change in value of GDP by country in East Africa



Source: GTAP simulations.

As Figure 4.2 shows, the strongest positive effect of the AfCFTA will be on the textile industry, processed foods and miscellaneous manufacturing. These labour-intensive sectors play an essential role in the early stages of industrial development and structural change (UNIDO, 2013). However, almost all sectors in the majority of countries in East Africa will experience growth in output, with the largest average gains experienced by: ferrous metals (which are widely used in construction and industrial metal fabrication); electrical equipment; vegetable oils and fats; miscellaneous manufactures; chemical products; and rubber and plastic products (Table 4.7).

The strongest positive effect of the AfCFTA will be on the textile industry, processed foods and miscellaneous manufacturing. These labour-intensive sectors play an essential role in the early stages of industrial development and structural change.

A notable positive outcome revealed by the simulation is that the AfCFTA will boost production in the pharmaceutical sector in Kenya and Tanzania. Africa manufactures less than 2 percent of the medicines it consumes, while it imports about 70 percent of its needs from outside the continent, at an annual cost of USD 14.5 billion (ECA, AUC, AfDB and UNCTAD, 2019). The AfCFTA thus provides an opportunity for increased investment in the pharmaceutical sector in East Africa.

Table 4.7: Change in manufacturing and food-processing sector output after AfCFTA
in percent

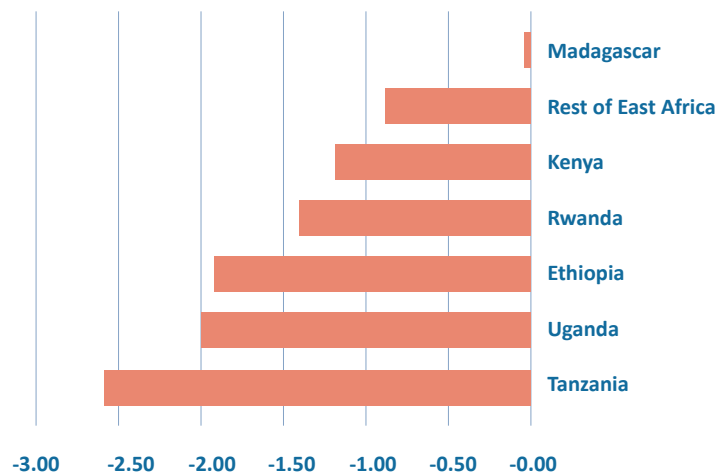
	ETHIOPIA	KENYA	MADAGASCAR	RWANDA	TANZANIA	UGANDA	REST OF EAST AFRICA	SIMPLE AVERAGE
Ferrous metals	1.72	2.87	0.14	85.26	1.59	25.71	1.65	16.99
Manufactures	-0.4	4.54	0.1	10.98	21.94	6.04	0.64	6.26
Electrical equipment	1.55	1.17	30.59	2.04	1.68	-0.09	1.14	5.44
Vegetable oils and fats	-3.69	1.59	-1.1	-0.46	24.94	4.34	0.47	3.73
Machinery and equipment	2.61	1.99	11	1.17	4.18	0.69	-0.09	3.08
Leather products	0.57	2.08	0.04	12	4.07	0.85	1.52	3.02
Rubber and plastic products	0.75	1.78	0.05	1.94	8.23	1.98	1.39	2.30
Chemical products	-1.51	0.54	0.18	1.33	9.88	2.15	0.85	1.92
Basic pharmaceutical products	1.37	4.92	0.07	0.77	3.18	0.9	0.62	1.69
Transport equipment	3.08	1.5	-3.11	1.29	3.3	5.58	-0.27	1.62
Metals	0.86	5.47	-0.02	1.23	2.29	0.6	0.85	1.61
Mineral products	1.03	0.6	0.05	1.53	3.43	2.83	-0.7	1.25
Computer, electronic and optic	0.96	1.22	1.11	1.93	2.72	0.7	-0.17	1.21
Food products	0.06	0.52	0.25	4.68	1.73	1.03	0.05	1.19
Metal products	-0.17	0.61	0.1	0.22	5.29	1.96	0.17	1.17
Petroleum, coal products	1.09	0.79	0.04	1.22	2.61	1.37	0.48	1.09
Wearing apparel	0.76	1.53	0.88	1	2.05	0.69	0.36	1.04
Beverages and tobacco products	0.41	0.39	-0.03	0.81	3.89	1.16	0.17	0.97
Textiles	-2.67	1.48	0.35	-5.5	6.92	1.66	3.43	0.81
Motor vehicles and parts	1.23	0.45	1.15	1.07	2.85	-0.45	-0.89	0.77
Wood products	0.45	0.19	0.07	-1.31	0.51	0.67	0.35	0.13
Paper products, publishing	-1.89	0.73	0.07	-0.39	-0.58	0.13	0.22	-0.24
Dairy products	0.4	-0.1	-1.02	0.29	-14.88	0.74	0.15	-2.06
Sugar	0.61	-7.2	-1.03	-10.35	-34	-20.08	0.46	-10.23

Note: Blue represents a positive change while red signifies a negative change

Source: GTAP simulations.

In all of this, consumers stand to be major beneficiaries. Not only will the AfCFTA provide a wider selection of goods and services from which to choose, but it also implies possibilities of lower prices as a result of duty- and quota-free imports (Figure 4.4). This all is good news for consumers, although it must be balanced by the impact of a potential decline in imports from other, perhaps more competitive, sources from outside the continent (the trade diversion effect).

Figure 4.4: Average change in import prices
in USD millions

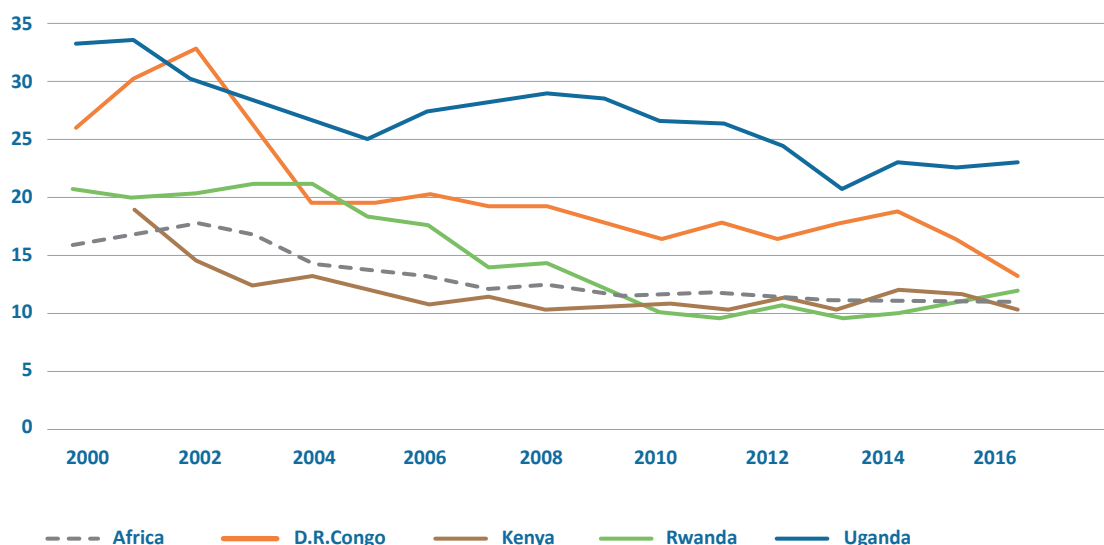


Source: GTAP simulations.

4.3. Implications for Revenue Collection

One common concern regarding the AfCFTA is the fiscal impact from the elimination of tariffs on intra-African imports. A priori reasoning would, however, suggest that the losses should be modest. This is because both the existing levels of intra-regional trade are low and the fact that African countries have been diversifying their sources of tax revenue (Moore et al., 2018). In Africa, customs and import duties represented 10.5 percent of total fiscal revenue in 2016, down significantly from 15.8 percent in 2000. For East African countries, the importance of customs and import duties has also declined notably over the years. Customs and import duties account for 10 to 13 percent of total tax revenue in D.R. Congo, Kenya and Rwanda, while the share is higher in Uganda at 23 percent (Figure 4.5).

Figure 4.5: The decline of customs and import duties as a share of total tax revenue, 2000-2016
in percent



Source: OECD Stat (2019).

Our GCE estimates foresee average revenue losses for the region amounting to less than 1 percent of total government revenues.

the simulation also indicates that it is one of the countries which will benefit most from the AfCFTA, through higher levels of trade and economic activity. The revenue losses in cases like this may well be considered by policymakers a price worth paying for the added dynamism of the domestic economy – which overtime will, in itself, lead to higher government revenues through VAT and other taxes.⁶⁴

Our GCE estimates foresee average revenue losses for the region amounting to less than 1 percent of total government revenues (Table 4.8). While Tanzania is expected to experience a larger tariff revenue loss, equivalent to 1.3 percent of total government revenue,

Table 4.8: Summary results of tariff revenue losses

	TARIFF REVENUE LOSS (USD MILLION)	AS A SHARE OF TOTAL TARIFF REVENUE (IN PERCENT)	AS A SHARE OF TOTAL GOVERNMENT REVENUE (IN PERCENT)
Ethiopia	61	6.1	0.7
Kenya	67	3.2	0.6
Madagascar	2	0.7	0.1
Rwanda	6	4.0	0.3
Tanzania	91	6.2	1.3
Uganda	23	8.4	0.6

Source: GTAP simulations.

⁶⁴ The tariff revenue losses would be less than 0.07 percent of GDP for all East African countries, except for Tanzania which is around 0.15 percent of GDP.

Coincidentally, these estimates are not out of line with estimates by the IMF (2019b) who, using a different methodology, find an average revenue loss for the continent of around 0.3 percent of GDP. The results of the CGE modelling exercise are also fairly consistent with the estimates based on an earlier partial equilibrium analysis (ECA, 2017a). The case of D.R. Congo stands out, whose high tariffs and large share of intra-African imports make it likely to suffer the largest tariff revenue losses (36 percent of its total tariff revenues) from liberalizing African imports. Other East African countries not covered in the CGE model and with relatively large revenue impacts are Comoros and Seychelles (ECA, 2017a).

In conclusion, the loss of revenues may be construed as a small price to pay for the wider economic benefits accruing from the implementation of the AfCFTA. The tariff revenue losses in the short run should thus not be understood as absolute losses; rather, they could be regarded as redistribution of income from governments to consumers and producers (i.e. lower taxes paid by domestic consumers and exporters).

Box 4: Partial vs. general equilibrium – reconciling the numbers

We have established that different modelling approaches on the impact of tariff liberalization yield different estimates. This is largely attributable to the different assumptions of the models and variations in the underlying data. Table 4.9 below provides a comparison of the different results produced by the PE and CGE modelling. Only in the cases of Madagascar and Tanzania are the differences particularly large.⁶⁵

Table 4.9: Increase in the value of intra-African exports

	PARTIAL EQUILIBRIUM		GENERAL EQUILIBRIUM (STATIC)	
	(USD MILLION)	(% CHANGE)	(USD MILLION)	(% CHANGE)
Ethiopia	148	10	160	354
Kenya	145	10	148	336
Madagascar	68	7	120	202
Rwanda	71	8	108	185
Tanzania	39	19	112	179
Uganda	43	20	55	171

Source: Calculations based on WITS/SMART partial equilibrium model and GTAP 10.0 database.

All things equal, general equilibrium models will usually give larger impacts because the impact of any tariff reduction is not limited to the sectors directly implicated – the spill-over effects on other sectors through lower import prices for a particular good may well produce positive impacts elsewhere in the economy.

Nonetheless, despite variances in the magnitudes of the gains, the key message from both models is broadly consistent: all countries in the region stand to benefit from the AfCFTA through expansion in their intra-African exports.

⁶⁵ Both methodologies use the same base year (2014), but the differences are partially explicable because of the different level of sectoral aggregation – with the PE model being done to the SITC three-digit level, while the GTAP level of aggregation is higher.



BENEFITS FROM THE AfCFTA FOR EAST AFRICA



Simulations conducted by ECA/TMEA show major gains for East Africa when AfCFTA is implemented



Welfare gains of USD 1.8 billion for regional consumers and firms



More than 2 million jobs created, under conservative assumptions



A boost to intra-regional trade of USD 1.1 billion



Accelerated industrialisation of the region



Other benefits, as the service sector liberalises and intra-regional investment levels rise

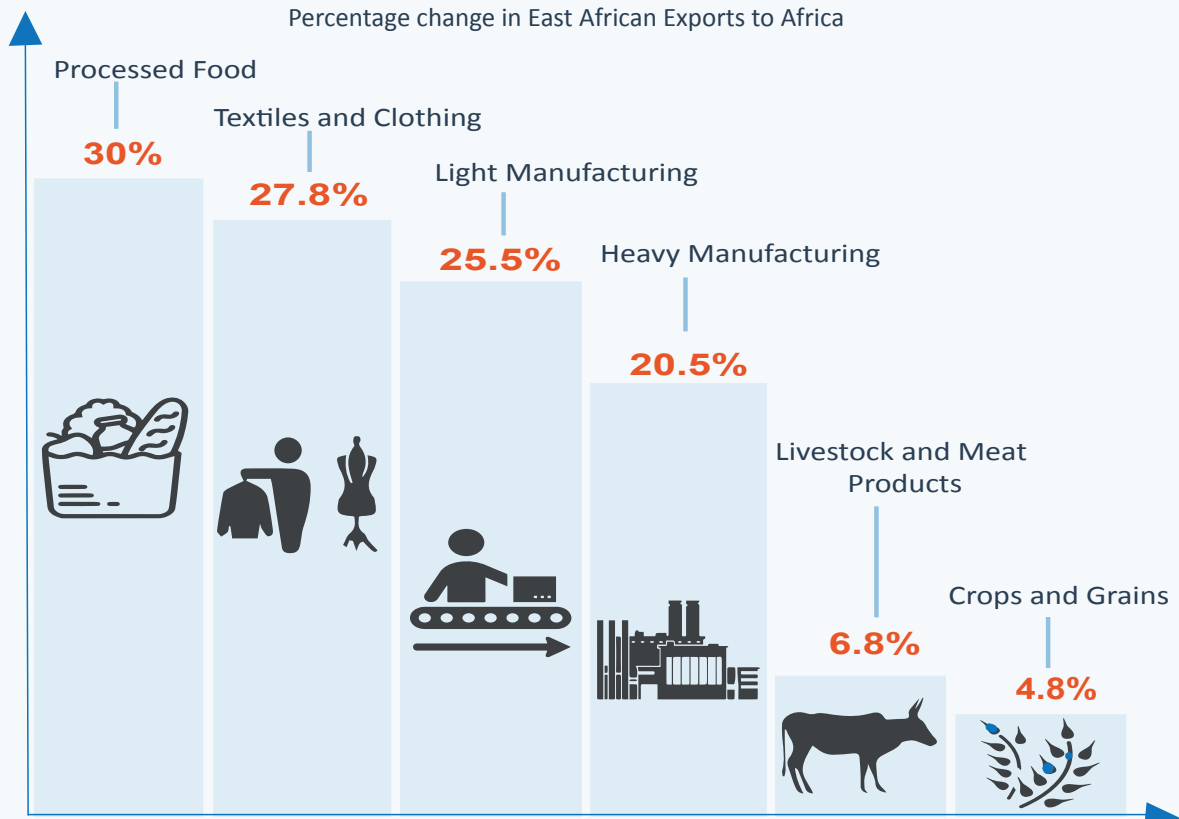
On average, this will cost less than 1 percent of the government revenues (in tariffs foregone)

A price worth paying for the added dynamism of the regional economy!



What sectors stand to benefit the most?

Percentage change in East African Exports to Africa



4.4. Dynamic CGE Simulations – Cases of Ethiopia, Kenya and Tanzania

ECA has also carried out an additional set of simulations using a different CGE model: MIRAGE, which is a dynamic (rather than static), multi-country, multi-sector model (ECA, 2018c). Dynamic models have the distinct advantage of adding a time dimension to the impact assessment, reflecting the fact that agreements, like the AfCFTA, take time to implement, and more time, still, for their impact to materialize. The added complexity of these models does, however, add another level of decision-making and complexity regarding underlying assumptions.

The MIRAGE model relies mainly on an earlier GTAP version 9.2 database (which refers to 2011 data), compared with the 2014 GTAP 10.0 database used in our static simulations, as well as the MAcMap-HS6 Market Access Map database, with tariff information at the harmonized system six-digit level of products. The modelling exercise takes the simulations a step further by making hypothetical scenarios based on the negotiated tariff reductions under the AfCFTA. Several options were considered to liberalize the trade in goods (ECA, 2018d). In brief, two main approaches are envisaged: (i) a tariff-line approach (i.e. minimum proportion of total tariff lines to be liberalized); and (ii) a double-qualification approach (i.e. minimum proportion of total tariff lines, representing not less than the same proportion of total imports, to be liberalized).

Under both approaches, 90 percent of tariffs are deemed non-sensitive and liberalized early, with the remaining 10 percent divided into a share of sensitive products to be liberalized over longer time frames, and a relatively smaller share of excluded products to be exempted from any tariff reduction. The assessment also considers a scenario where all tariff lines are fully liberalized, to assess the incidence of any possible excluded lists on key economic variables.

Summary results are presented here for the three largest economies in the region (Ethiopia, Kenya and Tanzania). The results (Table 4.10) show that full liberalization has the largest impact on exports and revenues, followed by a double-qualification approach and a tariff-line approach.

Table 4.10: Summary of dynamic simulation results for Ethiopia, Kenya and Tanzania
in percent

	ETHIOPIA	KENYA	TANZANIA
Increase in GDP	< 1	1	4
Increase in exports to Africa	23- 26	9- 14	23- 32
Decrease in tariff revenues	6.4- 14.1	2.6- 3.2	7.6- 13.8

Source: ECA (2018c).

The overall increase in GDP and total exports would be relatively modest, yet these hide much more pronounced benefits when it comes to their trading relations with their African partners. For example, the intra-African exports of Ethiopia would increase substantially – by about 23 percent (if the liberalization approach selected under the AfCFTA was to be based only on tariff lines; with no more than 1 percent of tariff lines excluded). This figure could reach around 25 percent if liberalization was to be based on a double-qualification approach; leaving no more than 3 percent of Ethiopian imports from African partners excluded from liberalization. The projected figure reaches about 26 percent under full

liberalization. For Kenya, the increase of intra-African exports would be 9 percent, 12 percent and 14 percent under the three different scenarios, whereas figures for Tanzania would be noticeably higher, at 23 percent, 29 percent and 32 percent respectively. For Ethiopia, under the double-qualification approach, industrial exports to the rest of Africa would increase by nearly 87 percent, while they would increase by about 69 percent if the liberalization was based on tariff lines only. It thus seems clear that a double-qualification approach for liberalizing trade in goods under the AfCFTA produces greater trade-related benefits than a tariff-line approach and has the most potential to promote industrialization.

Under the double-qualification approach, industrial exports to the rest of Africa would increase by nearly 87 percent, while they would increase by about 69 percent if the liberalization was based on tariff lines only.

Regarding the sectoral impact, the increase in Ethiopia's exports to its African partners would tend to be most pronounced in industrial sectors, thereby offering opportunities to accelerate the country's industrialization through trade. For Kenya and Tanzania, by contrast, the increase of exports to its African partners would be most notable in agricultural and

food sectors, closely followed by industrial sectors.



5. SOME KEY SOURCES OF BENEFITS EXPLAINED

Regardless of the methodology used, the simulation results reported in Section 4 reveal substantial benefits for East Africa from implementation of the AfCFTA. This section provides a more in-depth discussion of the nature of some of those benefits and elaborates further on other potential benefits that the modelling exercises, alone, cannot capture.

5.1. Generating New Employment Opportunities

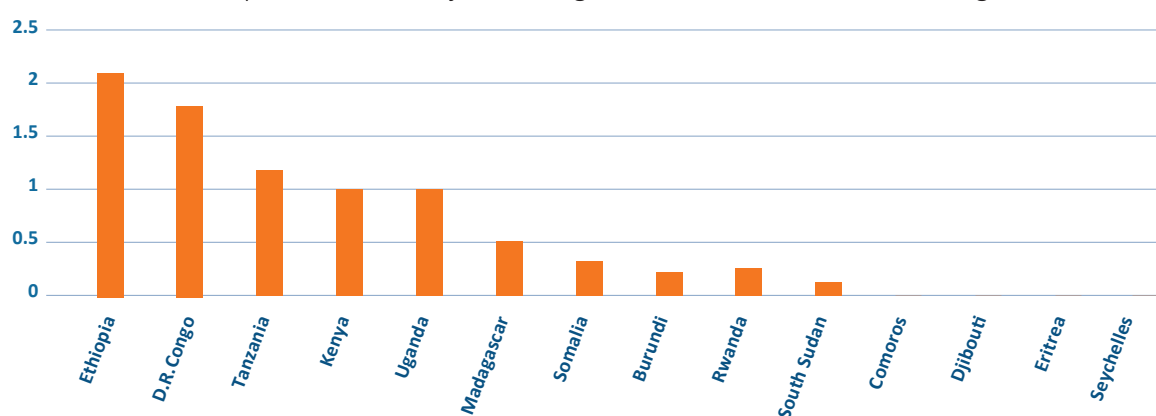
The working-age population of East Africa is expected to increase by 8.6 million individuals annually between 2015 and 2030... it is thus vital to create more job opportunities.

An important consequence of more vibrant intra-regional trade is faster employment creation. The working-age population of East Africa is expected to increase by 8.6 million individuals annually between 2015 and 2030. The largest increases are expected in Ethiopia, followed by D.R. Congo, Tanzania, Kenya and Uganda (see Figure

5.1). It is thus vital to create more job opportunities. In recent decades, employment creation has fallen far below the rate of expansion of the economy in many African countries. Between 2006 and 2011, the economy of East Africa, as a whole, expanded by some 6.2 percent annually, while employment growth in the formal sector was just 4.6 percent per year over the same period. This translates into an employment-to-GDP elasticity⁶⁶ of just 0.74. Nor was strong economic growth during 2011 and 2016 accompanied by a faster rate of employment creation, with the estimated employment-to-GDP elasticity declining to just 0.53.⁶⁷ The scale of the challenge is thus enormous. With the prevailing employment-to-GDP elasticities, we estimate that East African countries need to sustain GDP growth rates of at least 6 percent per year simply to absorb new entrants into the rapidly expanding labour force, let alone create additional job opportunities for the large number of existing un- and under-employed citizens in the region (ECA, forthcoming).

Figure 5.1: Average annual increase in working age population, 2015-2030 in millions of workers

The AfCFTA could help address this major challenge. The boost to the manufacturing sector could drive



Source: Computed from UNDESA (2019) data.

⁶⁶ Employment-to-GDP elasticity refers to the measure of the percentage change in employment when economic growth changes by one percentage point.

⁶⁷ The import demand elasticity values used in SMART by default have been empirically estimated for each country and every HS 6-digit product. 1.5 is the default Armington import substitution elasticity value, while 99 is the infinite export supply elasticity, i.e. assuming that countries in the region are 'price-takers' on the world market – a realistic assumption given the very small share of East African countries in global trade, even in their principal commodity exports, such as coffee and tea, and minerals, such as gold.

structural transformation and provide more decent jobs with higher productivity and wages. According to the CGE simulations results reported earlier, the regional economy will expand by 0.7 percent with the removal of intra-African tariffs. Based on this finding, the employment growth for the region resulting from implementation of the AfCFTA was computed, using average employment intensity of growth elasticities for the period 2006-2016.⁶⁸ When multiplying this rate by the size of regional labour market (162 million in 2016), it is estimated that the full implementation of the AfCFTA would lead to the creation of approximately 700,000 jobs in East Africa. Related literature, using a different methodology, suggests that employment could increase by 1.2 percent for the continent as a whole (Saygili et al., 2018); translating into the prediction of 2 million additional jobs for the East Africa region. The full impact could be much larger, as these figures do not take into account employment generated through new opportunities opening up in the service sectors nor through higher levels of investment that AfCFTA implementation will stimulate.

The implementation of the AfCFTA could lead to an additional 2 million jobs for the East African region. The full impact could be much larger, as these figures do not take into account employment generated through new opportunities opening up in the service sectors nor through higher levels of investment that AfCFTA implementation will stimulate.

One example of where there is scope for considerable employment growth is the textile sector. This sector has been subject to enormous competitive pressures over recent decades (see Dicken, 2015: Chapter 14). However, in East Africa, some countries have already made substantial efforts to facilitate the growth of the textile and clothing industry. The clothing and footwear industries may be especially appropriate for some African countries, because of their extensive use of local resources and labour (Omolo, 2006, McCormick et al., 2009). Kenya and Ethiopia are emerging as textile-manufacturing giants in the region. Kenya alone exports over USD 500 million of textile exports each year – principally to the US market at the current time. For the small island developing states (SIDS), such as Seychelles and Comoros, there is similarly scope for faster job creation in the expansion of other labour-intensive sectors such as tourism and fisheries.⁶⁹

5.2. Fostering Industrialization

Over the past decade, the region's manufacturing value-added as a share of total GDP has stagnated at below 10 percent. This means the region is lagging significantly behind rapidly-growing developing economies such as China, India, Singapore and Vietnam, where manufacturing played a much more prominent role (Figure 5.2). There is a traditional consensus that industrialization plays a key role in the process of a nation's economic development (Lall, 1999; Szirmai, 2012; ECA, 2016a). While it is often argued that the importance of manufacturing has diminished as a result of new technologies and the advent of the 'Fourth Industrial Revolution', recent research (Haraguchi et al., 2017) confirms that achieving economic development by following a path of industrialization

Over the past decade, the region's manufacturing value-added as a share of GDP has stagnated at below 10 percent... lagging significantly behind rapidly-growing developing economies such as China, India, Singapore and Vietnam.

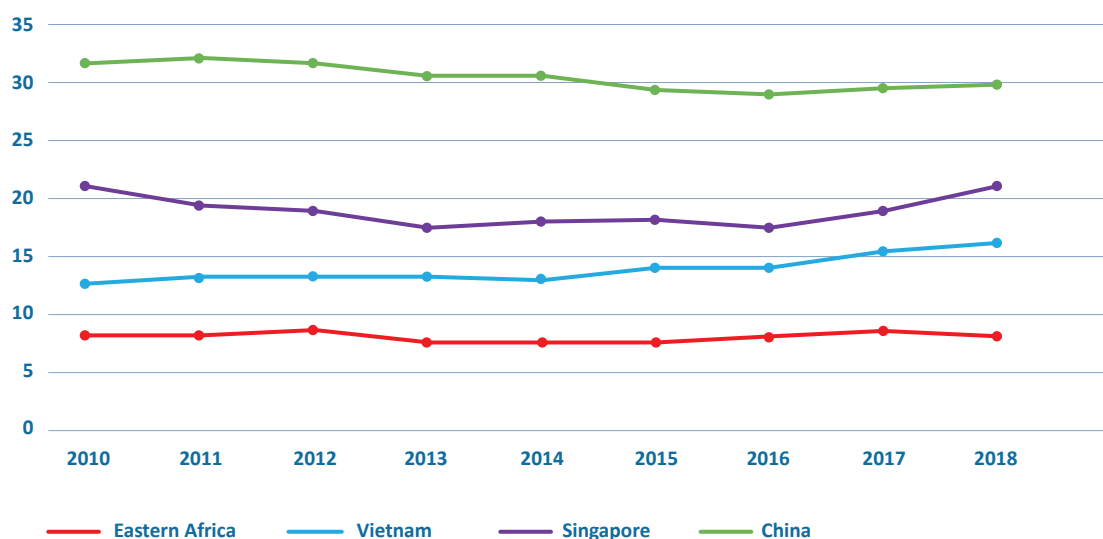
⁶⁸ The equation used to derive the elasticities follows Kapsos' (2005) value-added methodology and is specified as: $\epsilon = \Delta L / \Delta VA$ where ϵ is the employment elasticity; ΔL represents employment growth and ΔVA represents value added growth for the specified period.

⁶⁹ For instance, in 2013, the total contribution of travel and tourism to employment in Seychelles, including jobs indirectly supported by the industry, was estimated at 56.5 percent or 24,100 jobs (WTTC, 2014).

remains important for low-income countries.⁷⁰

Figure 5.2: Manufacturing value-added, 2010-2018
as percentage of GDP

Against this backdrop, the AfCFTA presents a unique opportunity to accelerate industrialization in the



Source: World Bank (2019b).

region. By lowering tariffs on both intermediate and final goods, the AfCFTA will create additional opportunities for adding value to natural resources and for diversifying into new business areas (ECA, 2015, 2018c; UNCTAD, 2019a). This is particularly important because, as established in Section 2.1, manufactured goods dominate the region's intra-African exports, in stark contrast to exports of mainly unprocessed primary commodities to the rest of the world.

The importance of value-addition to the region's traditional exports has been a recurrent theme in development policy for many decades.⁷¹ Improved access to affordable inputs, especially production equipment, is essential to increasing value addition. An empirical study into trade by a large sample of African countries by Slany (2017) suggests that lower tariffs on capital goods improves a country's position in regional value chains (RVCs). The higher demand for inputs, resulting from the implementation of the AfCFTA, could also provide economies of scale for firms and accelerate the emergence of RVCs. One example is the growing demand for leather products – a demand that is currently being met principally by imports from outside the continent. Yet a study by UNCTAD (2018a) shows that the existing intra-regional trade of leather products could be increased by six times through the elimination of tariffs and non-tariff barriers.

Another angle to this is the role of small and medium enterprises (SMEs). SMEs account for around 80 percent of the region's businesses, but usually struggle to penetrate foreign markets. The development of RVCs could provide a springboard for domestic firms in East Africa to advance up the value chain, initially targeting the closer and less standard-intensive intra-African markets. Inefficient firms will be forced

⁷⁰ Various recent publications by ECA (e.g. 2014, 2015, 2016a) and others (e.g. Page, 2016; McMillan and Rodrik, 2014) argue that the pace of industrialization must be accelerated.

⁷¹ As far back as 1965, in a Summit organised by ECA, it was noted that a sub-regional approach to industrial development was likely to result in a significantly faster rate of industrialization than would be the case if the process was undertaken on an isolated, country-by-country basis (ECA, 1965).

to improve their performance or exit the market, while efficient ones might expand. It would encourage the development of new firms, products and technologies.

The AfCFTA will make it easier for SMEs to supply inputs to larger regional companies for export.

The AfCFTA will also make it easier for SMEs to supply inputs to larger regional companies for export. An existing example of this is in South Africa, where large automobile manufacturers source inputs under the preferential Southern African Customs Union (SACU) trading regime (ECA, 2018b), such as the material for seats, including leather from Botswana and fabrics from Lesotho. The AfCFTA will allow such cross-border sourcing to flourish. Once established, RVCs can provide an opportunity for the countries of the region to link into Global Value Chains (GVCs), increasing their bargaining power with sectoral lead firms (UNCTAD, 2019a and 2018a). The potential of East Africa's automobile industry is discussed in Box 5. Effective industrial policies will lie at the heart of fostering industrialisation through the AfCFTA, and it will require adopting new approaches. In the first place, greater effectiveness in the implementation of industrial policies is needed than has hitherto been the case. The continentally-agreed programme for

Box 5: Steps Towards an East-African Automotive Industry

The evolution of the East African automotive sector mirrors the history of East Africa's industrialisation. In the 1960s to 1970s, there was a significant presence of assembly plants in East Africa, primarily in Kenya. What explains the fact that today the East African Community has become a dumping ground for used vehicles, with an automotive trade deficit of 2,8 Billion USD (Black et al., 2017). Do the reasons for the early demise of East Africa's automotive industry still hold?

The de-industrialisation witnessed in the African automotive sector had one major cause, which is about to be addressed with the African Continental Free Trade Area (AfCFTA): fragmented markets. Companies in the sector were consequently unable to reap the advantages of scale economies, which were critical in determining the efficiency and profitability of operations. In fact, the automotive industry in Africa was not able to survive in the 1970s despite import substitution rules. What hit the nail in the coffin, however, was the influx of imported used cars following the structural adjustment policies of the early 1990s. Consequently, even for a country like Kenya assembling cars, 80 percent of the car fleet is now made up of second-hand cars (Auto parts East Africa, 2019).

Around 329 000 light vehicles are sold currently in the East African Community each year of which only 23 percent are new cars. In the largest market of the region, Kenya, only 48 percent of new vehicles sold were assembled domestically with the remainder being imported. Imports, of both used and new vehicles, made up over 90 percent of new vehicle registrations in 2018 according to the Kenya National Bureau of Statistics (KNBS, 2019). The import of used cars has a double effect on air quality: old cars have higher emissions, but they also don't create an incentive to use better quality fuel. This results in high levels of air pollution. Indeed, according to the World Health Organization, the mortality rate due to air pollution in the EAC is between 21 and 48 deaths/100 000 inhabitants (EAC, 2018). Fortunately, the EAC has decided to import fuel with lower sulphuric content in January 2015 and is currently adopting higher vehicle standards. This has the potential to reduce current pollution levels by 90 percent according to the United Nations Environment Programme (UNEP, 2016).

The current fleet size in the EAC is about 2,2 Million cars, whereas the motorization rate is just 15 cars/ 1000 inhabitants against an average of 42 in Africa and 182 in the world (Black et al., 2017). Thus, there is enormous room for growth especially because the EAC has been the fastest growing region in Africa for the last decades. If things are left by themselves, to meet the growing demand, there will be more imports of used cars with adverse macro-economic implications. The foreign exchange needed to maintain the transport sector afloat will not be used to promote local industries that could in turn generate hard currencies through exports.

The AfCFTA offers a unique window of opportunity to create a large enough market for the automotive industry. Therefore, the African Association of Automotive Manufacturers has started to implement a bold Pan African Auto Pact with 3 milestones that can be achieved in the next decade.

The Pan-African Auto Pact:

Just like AfCFTA, the Pan-African Automotive Value Chain will take time to materialise. However, there are concrete milestones that can follow the implementation phases of the AfCFTA. This would start by a hub-and-spoke strategy per African region and ultimately end in a fully integrated continental value chain, once the AfCFTA is fully operational. In concrete terms, this is what the Pan-African Auto pact suggests:

- Original Equipment Manufacturers (OEM) such as Volkswagen Group South Africa are investing in countries ready to adopt an Automotive Policy. This allows for a renewal of the existing car fleet through Semi Knocked Down (SKD) kit assembly.
- There is going to be shift towards Complete Knock Down (CKD) assembly once local suppliers have been identified and volumes of new cars sales have gone up.
- There will be a regional automotive value chains supported by a regional automotive policy that ensures a win-win scenario for all countries in the region (hub-and-spoke model). The regional value chain is the precondition for a fully-fledged manufacturing plant. Ideally, there would be a specialization of vehicle type per African region.
- The AfCFTA would allow a tax-free exchange of Made in Africa cars and spare parts among regions.

With enough political will, these steps can be reached within a generation. Africa may reach even benefit from a last mover advantage, as the whole world is now learning how to manufacture the cars of the future. For example, Volkswagen is launching the first e-cars ride hailing service in Africa at the end of October 2019 in Rwanda.

The automotive industry has also drawn lessons from the past. For example, a frequent argument against tariff protection of local automotive industry is trade diversion, and the fear that locally produced cars can be more expensive for the customer. Today, digital solutions enable customers at the lower end of the pyramid to drive new cars without owning them. In Rwanda, Volkswagen has pioneered a Made in Rwanda mobility solution which allows people to use new cars on a pay-as-you-go basis. Furthermore, the results thus far registered in Kenya show that new cars sales of locally assembled cars have grown by 15.9 percent for Kenya between 2017 and 2018 (KNBS, 2019). The different models assembled in Kenya and Rwanda (SUV, hatchback, Saloon, Pick-Up) allow to test the African market in a view of a specialized manufacturing plant. Strategic

partnerships will also be important in addressing skills gap and consumer financing, for example Volkswagen is working with the German Cooperation Agency GIZ to train automotive professionals in Rwanda. Local banks are also realizing the reduction of risks that comes with locally assembled cars whose residual value can be preserved through professional after-sale services.

No country has ever transformed economically without a vibrant manufacturing sector. The automotive industry alone contributes 6.9 percent of South Africa's GDP, a country that does not import a single used car. This is the result of consistent policy making over the decades. There is no reason why East Africa cannot achieve rapid industrialization starting with sectors that are vital for individual productivity such as transport.

Africa's cities can become production cities and not just consumption cities of transport products. For that to happen a clear political direction is needed: discouraging importation of old used cars, adopting fuel standards allowing new vehicles to operate in a market, enabling a regional automotive car market from assembly towards manufacturing. This should be done in connection with improving logistics infrastructure to bring the costs of local manufacturing down.

Source: Serge Kamuhinda, Volkswagen Rwanda

the Accelerated Industrial Development of Africa (AIDA) could serve as a building block for the industrial pillar of AfCFTA implementation. AIDA acknowledges that Energy represents a significant portion of the costs of production (UNCTAD, 2017), and therefore that improved access to affordable and reliable energy would have an enormous impact on productive capacities and, consequently, on industrialization. With this in mind, pertinent lessons can be learned from recent experience within the region, such as that of the Ethiopian Industrial Parks.⁷²

Secondly, it will require the proper coordination of industrial policies between individual Member States in the region. It is important to avoid a situation whereby industrial policies end up promoting the same products for different countries within a regional block. This often happens because, once Member States have lobbied for exclusions from tariff liberalisation through a national or regional sensitive items list, policies are then adopted that focus on the same industries (Odiije, 2019: 9). This has already happened to some extent within the East African Community (EAC), where *'several products are produced in almost all the countries; these include cement, sugar, rice, cigarettes and tobacco products, milk and wheat'* (Shinyekwa and Katunze, 2016: 10). Hence the regional Common External Tariff (CET) has led in some cases to duplication in attempts to build capacity. Simultaneously, imports under the sensitive items list have increased, placing a substantial burden on local consumers.⁷³

Thirdly, the role of Export Processing Zones (EPZs) within the regional AfCFTA architecture will have to be carefully reconsidered. A number of East African Member States have been promoting EPZs over the last two decades, with varying degrees of success and failure. East Africa houses 45 percent of

72 ECA/UNDP (2017: Chapter 7) provides an overview of the development of Ethiopian manufacturing in the context of the industrial parks programme.

73 The import of sensitive goods from outside the region increased from USD 700 million in 2005, when the Common External Tariff (CET) was adopted, to USD 2.3 billion in 2011. Odiije (op.cit.) argues that the high rate of instability in the East African Community's CET has been due to changes in the list of sensitive products and remissions, resulting partly from the influence of interest groups on national governments.

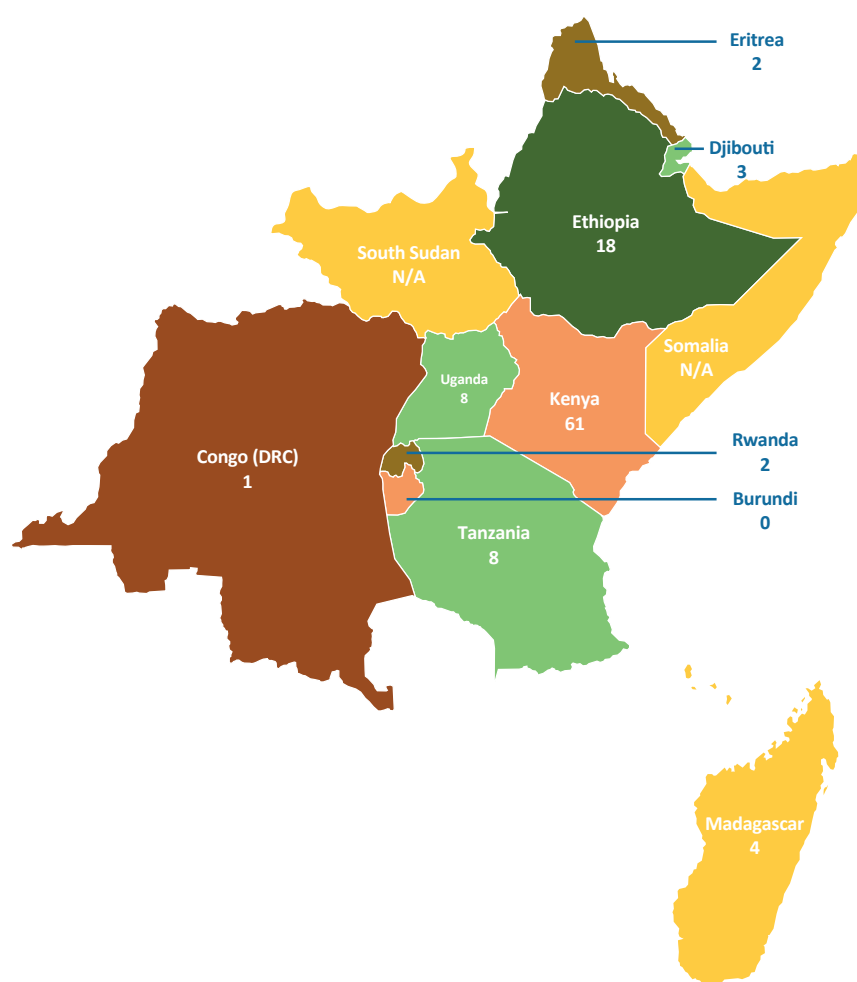
The AfCFTA will require the proper coordination of industrial policies between individual Member States in the region.

the total number of 237 SEZs legally established on the continent, with 61 of them alone in Kenya. Countries in the region have over the last two decades been promoting EPZs with varying degrees of success and failure. Ethiopia has been particularly bold in the setting up of its industrial park programme (Oqubay, 2015). In Madagascar, the apparel export industry largely benefited from the establishment of the EPZ law in 1988-1989, which offered incentives to firms exporting at least 95 percent of their production. This resulted in an increase in apparel exports from USD 118 million in 1995 to USD 368 million in 2000; although this was subsequently negatively affected by the country’s suspension from AGOA in 2008 (Morris and Staritz, 2014).

the total number of 237 SEZs legally established on the continent, with 61 of them alone in Kenya. Countries in the region have over the last two decades been promoting EPZs with varying degrees of success and failure.

Figure 5.3: Number of Special Economic Zones (SEZs) in Eastern Africa, 2018

The treatment of exports from EPZs is currently a point of contention within the AfCFTA negotiations (which is discussed further in Section 6.1).



Source: UNCTAD (2019c).

In principle, EPZs certainly do have a role to play in terms of improving the region's capacity to export outside the continent. If well-designed and integrated into the regional economy, they could also significantly increase the demand for backward supply-chain linkages across a country. Yet, in practice, these benefits have either failed to materialize, or only materialized very weakly (Farole, 2011: 40). Newman et. al (2016: 176) noted a range of common challenges in their case studies of the industrial policies of eight countries in sub-Saharan Africa (among them Kenya Tanzania and Uganda). These challenges included:

The treatment of exports from EPZs is currently a point of contention within the AfCFTA negotiations.

- An excessive heterogeneity among the kinds of firms installing themselves in the EPZs, resulting in geographical concentrations of unrelated firms with few linkages between them. The authors attribute this to the absence of strategies by FDI agencies or EPZ management to attract firms from identical or closely-related value chains into the zones.
- Excessive concern with the evasion of tariffs and other taxes by local investors has led to rules that choke off purchaser-supplier relationships between firms within the zone and domestic firms outside.
- Regulations often restrict the movement of managers and workers between EPZs and the rest of the economy to the detriment of eventual spill-overs.

To sum up, there are clearly many areas in industrial policy that require a rethink. The AfCFTA should provide an impetus to a practical and implementable review of the coherence of existing policies.

5.3. Implications for Firm Size and Economies of Scale

If the annual rankings produced by the *Africa Report* of the continent's top 500 companies by turnover are anything to go by, there are plenty of potential business opportunities across the region. The levels of profitability in some industries are particularly high, especially in some of the sectors which will be most positively impacted by the AfCFTA (Figure 5.4 and 5.5).⁷⁴

East African firms struggle in terms of the small average size of their operations. Ranked by turnover, only 34 firms from the region feature in the top 500, representing just 6.8 percent of the total.

Yet, East African firms struggle in terms of the small average size of their operations. Ranked by turnover, only 34 firms from the region feature in the top 500, representing just 6.8 percent of the total, with only three in the top 100. Bearing in mind East Africa accounts for approximately 16 percent of Africa's GDP, and 35 percent of the total population, the region's companies are clearly underrepresented at the continental level.

Figure 5.4 Net profit margin of East Africa's largest companies, 2018
in percent

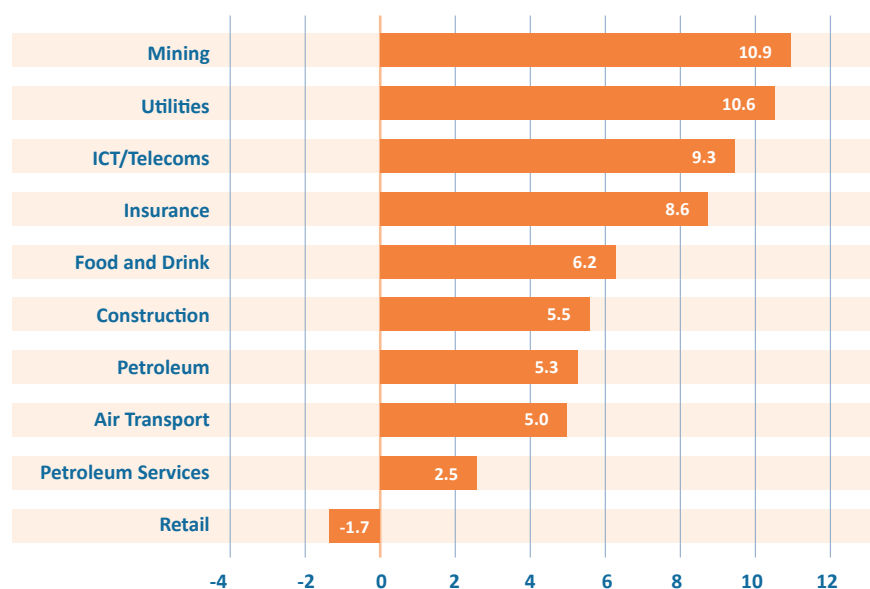
Figure 5.5: Top 10 companies in East Africa, 2018

It will be difficult for companies from the region to compete at the continental level unless there is

⁷⁴ An extreme outlier is the banking sector, which is not included in the Africa Report rankings, where levels of profits are particularly high. The return on equity for the Kenyan banking sector is typically in the order of 25-30 percent – one of the most profitable banking sectors in the world. In the African Business rankings by market capitalisation (*African Business*, 2019), banks are included and out of the top 20 firms in East Africa; and 10 are banks. As Mold and Bagiza (2016: 218) claim: "the only business that is truly regional at present is the banking sector. This must change."

SOME KEY SOURCES OF BENEFITS EXPLAINED

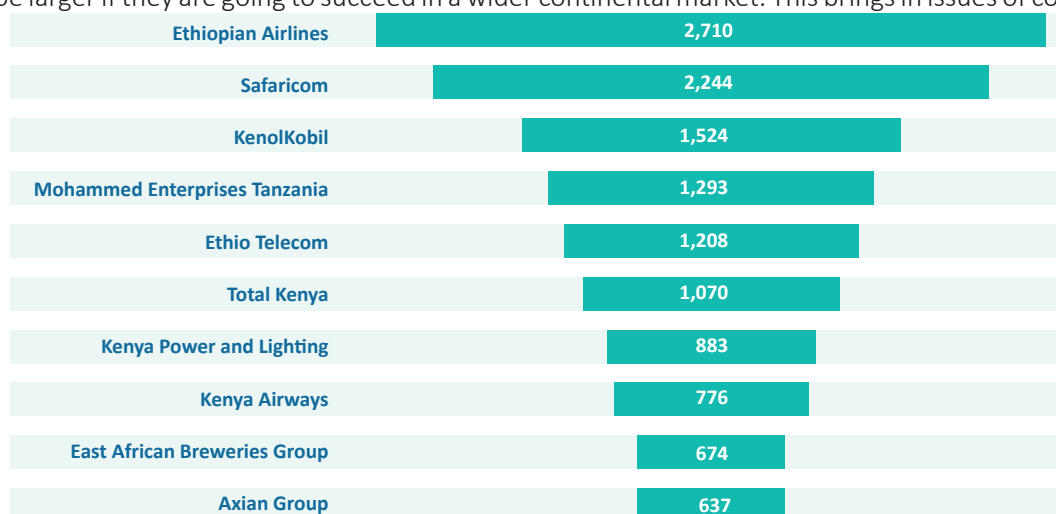
significant upscaling of economic activities. One way to achieve this could be through leveraging the AfCFTA. Scale economies and specialization are at the heart of the benefits deriving from extended



Note: Figures do not include sectors where there is only one firm represented in the top 34 companies or where turnover is below USD 1 billion.

Source: The Africa Report (2019).

African regional integration under the AfCFTA. Put simply, in many sectors, companies in East Africa need to be larger if they are going to succeed in a wider continental market. This brings in issues of competition



Source: The Africa Report (2019).

policy, too, which in the future will need to be dealt with at a regional, rather than exclusively national, level (see Section 6.3).

5.4. Enhancing Food Security

Currently, the scope for intra-African agricultural trade is underexploited,⁷⁵ largely due to high tariffs, NTBs and poor infrastructure. There are longstanding (and legitimate) complaints about the difficulty African farmers face in exporting to the markets of high-income countries. Yet average tariff rates faced

by African countries on their agricultural exports to other African destinations are actually higher, on average, than exports to destinations outside the continent (Table 5.1).

Table 5.1: Average protection (tariff rates) on agricultural imports and exports, 2015

	AVERAGE IMPOSED TARIFFS ON IMPORTS		AVERAGE TARIFFS FACED ON EXPORTS	
	AFRICA	REST OF WORLD	AFRICA	REST OF WORLD
Burundi	22	20	9	5
Comoros	10	12	10	8
Djibouti	7	15	5	10
D.R. Congo	18	15	5	11
Eritrea	5	8	6	5
Ethiopia	25	22	13	15
Kenya	22	20	16	13
Madagascar	16	15	6	9
Rwanda	22	20	6	10
Seychelles	6	5		
Somalia	-	-	3	4
Tanzania	22	20	9	11
Uganda	21	20	11	18

Source: UNCTAD Trade Analysis Information System (TRAINS) (2019).

A particular challenge for agriculture is the persistence of non-tariff barriers (NTBs). NTBs that commonly impact on agricultural trade, such as sanitary and phytosanitary measures (SPS), have become progressively more important than tariffs, and tend to be higher than in non-agricultural sectors (UNCTAD, 2016b and Kee et al., 2009). SPS measures alone have been estimated to raise domestic prices of foodstuffs by about 13 percent in sub-Saharan Africa (Cadot and Gourdon, 2012).

These disincentives to intra-regional trade in foodstuffs have to be put in the context of the delicate situation of food security in the region. Over the past decade, the continent's total food-trade deficit has averaged around USD 28 billion, driven by both supply-side and demand-side challenges.⁷⁶ Chief among the challenges is climate variability that often results in drought, floods, and can bring about conflict. Since staple crops continue to be largely rain-fed, their productivity fluctuates with the weather. This is particularly valid for East Africa, a region suffering the effects of climate change in a very visible and tangible manner.

The rapidly growing demand for foodstuffs could be met by regional production, if the barriers to trade were reduced or eliminated (Weeks, 1996).⁷⁷ The larger African market envisioned under the AfCFTA,

⁷⁵ Over the period 2015 to 2017, the share of agricultural exports (based on SITC 3 and comprising categories 0, 1, 2 and 4) from the region to the rest of Africa was merely one fifth of its total agricultural exports (UNCTADStat, 2019).

⁷⁶ The demand-side challenges include population size, structure and growth; the supply-side challenges comprise arable land availability, natural disasters and diseases, among others (Rakotoarisoa et al., 2011).

coupled with trade policies that take into account seasonal differences and varying states of food security, will allow greater flexibility in shifting food supplies from surplus regions to regions facing deficits. This was the case in 2016-17, when Kenya suffered from adverse climatic conditions but was able to supplement its food supplies partially through greater imports from neighbouring Tanzania and Uganda, *The rapidly growing demand for foodstuffs could be met by regional production, if the barriers to trade were reduced or eliminated.*

The perishable nature of many agricultural food products means that their trade could be particularly responsive to improvements in customs clearance times

and logistics, which are expected from AfCFTA implementation (ECA, AUC and AfDB, 2017). Moreover, East Africa's agricultural sector is characterized by an inadequate use of yield-enhancing practices and technologies. With the AfCFTA in place, access to agricultural inputs and intermediates (e.g. improved seed varieties and machinery) should improve, thereby raising yields and enhancing food productivity (UNCTAD, 2016b; Maur and Shepherd, 2015).

The AfCFTA should also play a role in stimulating the emergence of more agricultural Regional Value Chains (RVCs), especially in agro-processing. In Section 5.3. we saw that agro-processing generates a high rate of profitability in the region. However, as it currently stands, African agribusinesses have to compete with large international conglomerate firms (that tend to be based in developed countries) under unfavourable terms in the global agricultural markets. These firms set the 'rules of the game' – mostly due to their ability to create powerful brand names and enforce standards – and relegate the *Through boosting agro-processing, the AfCFTA will stimulate the emergence of more agricultural regional value chains.* African farmers and SMEs to the position of "standard takers" who are excluded from important value-creating processes (ECA, 2009). Tariff escalation⁷⁸ also dissuades African countries from moving up the commodity-based global value chains. These facts point to the need for African agribusinesses to compete on their own "playing field" where they are essentially the gatekeepers of the regional market. This will be facilitated under the AfCFTA.

Africa's agribusiness sector is projected to be worth USD 1 trillion in 2030. This will be augmented by a rapidly growing middle-income class and continental programmes in support of agro-industrialization, such as the African Agribusiness and Agro-industries Development Initiative (3ADI). Complementary structural reforms that boost efficiency in agricultural productivity may amplify the benefits of deeper trade integration envisioned under the AfCFTA (IMF, 2019b: 49).

Women tend to be under-represented in high productive sectors such as manufacturing.

5.5. Tackling Gender Inequality

Economies with better opportunities for women are more competitive and benefit more from economic 'openness' to global trade and investment than economies that are less 'friendly' to female involvement in the economy (IMF, 2018; ITC, 2015 and Duflo, 2012). The social benefits of economies that are inclusive to women can also be very significant; for instance, evidence shows that increased female income is disproportionately spent on the well-being and education of children (Gonzales et al., 2015).

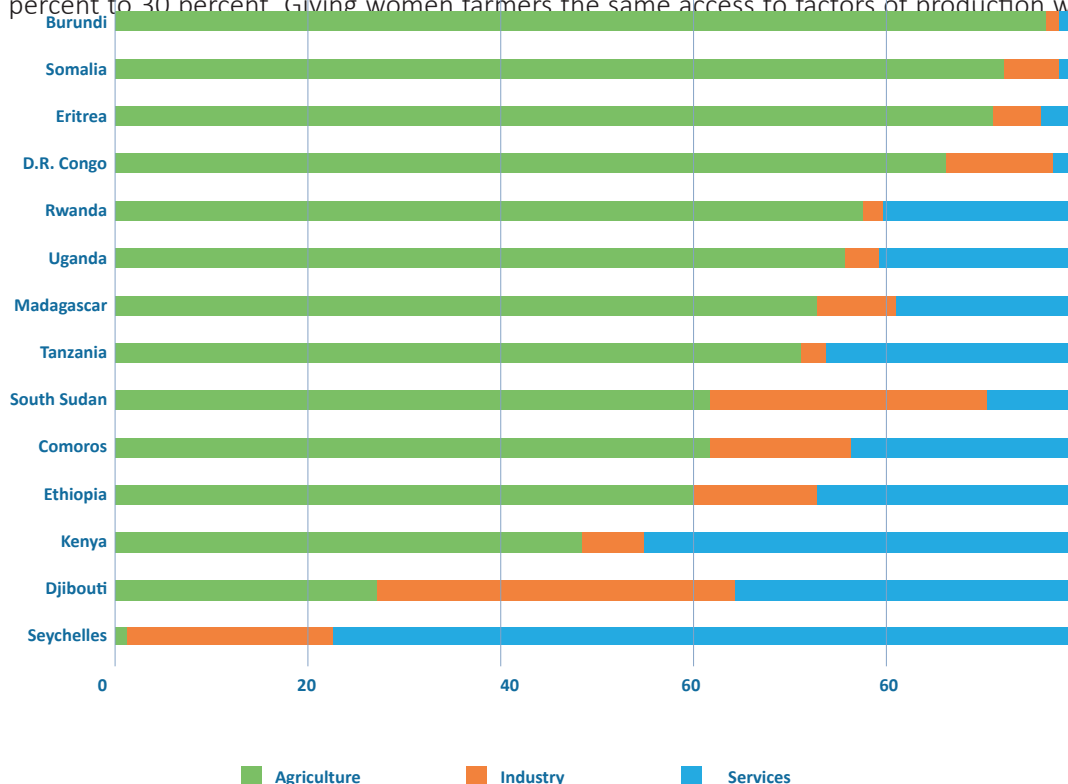
⁷⁷ One example is maize, an important staple food in Southern and East Africa. About 99 percent of intra-African trade of maize already occurs within the regional economic community where it was cultivated (UNCTAD, 2016b).

⁷⁸ Tariff escalation occurs when import tariffs increase according to the degree of processing of imported products that takes place. Raw materials tend to face lower duties, in order to provide processing companies in the importing country with cheap materials; meanwhile, processed and semi-processed products face higher duties, mainly to protect firms in the importing country from competition.

To gauge the gender impact of the AfCFTA, it is important to understand the sectoral impacts (Zarilli, 2017). Women are often disproportionately represented in specific sectors, such as textiles, education, health, agriculture and tertiary services. Meanwhile, women tend to be under-represented in high productive sectors such as manufacturing. In Africa, women are particularly economically active as farmers: women grow most of Africa’s food (AfDB, 2015). Figure 5.6 demonstrates just how strong this effect is in many East African countries. Yet despite women’s central role in agricultural production, they are often unable to take advantage of new market opportunities such as those that will arise from the AfCFTA. For instance, research by UNCTAD (2014) reveals that women have not necessarily benefited equally from trade in Rwanda – a country with a stellar record with regards to the political empowerment of women. This is attributed to “a growing polarization in terms of employment, whereby women are increasingly segregated in the less-dynamic, contracting sectors... while men engage in the expanding sectors.”

Figure 5.6: Share of female employment in agriculture, industry and services, 2016
in percent

This takes us to a broader point: women’s and men’s participation in value chains is essentially shaped by their access to and control over factors of production (land, labour, capital, technology, market information). Women tend to have less access to (and control over) such assets. It is therefore harder for them to move from subsistence agriculture to higher value chain activities. However, if women had the same access to productive resources as men, there is compelling evidence of large economic gains. FAO (2011) findings demonstrate that, if the world’s female farmers had the same access to productive resources as their male counterparts, yields on women’s farms in developing countries would grow by 20 percent to 30 percent. Giving women farmers the same access to factors of production would also



Source: ILOStat database (2019) and National Bureau of Statistics of Seychelles.

Giving women farmers the same access to factors of production would also increase total agricultural output by up to 4 percent.

increase total agricultural output by up to 4 percent. As a result, it is estimated that the number of people suffering from hunger would fall by 12-17 percent. Additionally, it would also result in increased trade volumes – particularly in view of the fact that much of

the existing informal cross-border trade is in agricultural produce.⁷⁹

UNCTAD (2018b) recently developed a *Trade and Gender Toolbox* to evaluate the impact of trade reforms on women. This same approach could be used to ensure that AfCFTA is beneficial to women. This is part of a broader push to support women traders more actively. One such example is the International Women’s Coffee Alliance (IWCA), which supports women in the coffee value chain – growers, exporters, roasters and buyers – to achieve the best quality. As the IWCA Uganda chapter put it, the goal is to “stimulate meaningful, sustainable and women-led economic growth in Uganda’s coffee sector, as well as to derestrict participation of women throughout the coffee value chain in Uganda and beyond.”⁸⁰ The International Trade Centre (ITC) and other regional players have strengthened women’s entrepreneurship by improving skills in ways that have boosted women’s confidence and allowed them to enter markets in their countries. So too has the AfDB; to alleviate the constraints on access to finance the AfDB has crafted a pan-African initiative called the Affirmative Finance Action for Women in Africa (AFAWA). The project acknowledges the USD 42 billion financing disparity across business value chains facing women in Africa – a figure which includes a USD 15.6 billion gap in agriculture alone – and seeks to bridge the gap.

5.6. Misconceptions About the AfCFTA

With all the projected benefits of the AfCFTA there are still a few doubts and concerns circulating. As Box 6 shows, these honestly-held concerns tend to be underpinned by misconceptions – or by the very same problems that the AfCFTA itself tackles head on.

79 A field study conducted by EASSI (2012: 21), looking at the five EAC Member States, revealed that agricultural products account for 42 percent of the total informal cross-border trade carried out by women. This was followed by textiles and consumables, which meanwhile account for 21 percent and 18 percent respectively.

80 For more information on the initiative, see AfDB (2019a).

Box 6: Anticipating Potential Objections to the AfCFTA

By **Mr Andrew Mold**, *Acting Director, ECA Office for Eastern Africa*

Objections to the implementation of the African Continental Free-Trade Area (AfCFTA) reflect honestly-held concerns about the bold policy initiative. However, they tend to be underpinned by a series of misconceptions:

1. “African countries all trade the same things”

This paints an excessively simplified view of trends in regional trade. It is true that East Africa is still heavily dependent on traditional export crops and commodities, even though diversification of exports has occurred over recent decades. This does indeed constrain the scope for mutually beneficial trade. However, the situation is beginning to change rapidly. Section 2 demonstrated that the intra-regional component of trade is becoming much more diversified, with much higher shares of non-traditional exports and manufactured goods; meanwhile, the traditional commodities exports are predominantly exported outside the continent of Africa (Na, 2019). The policy conclusion is clear – if the priority is to accelerate economic diversification, the regional route is the way to go. The AfCFTA is the way to deliver on this goal.

2. “AfCFTA is a ‘neo-liberal’ project serving the interests of big corporations”

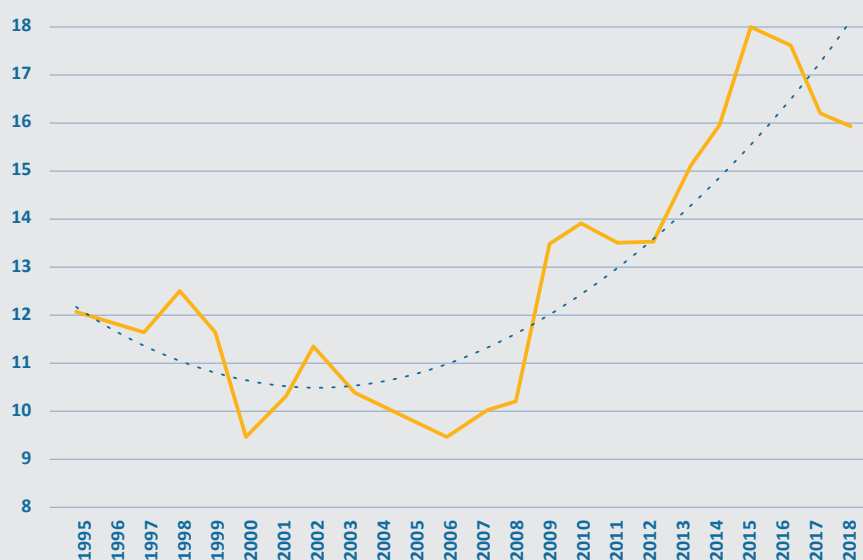
Given the history of outside interference in African countries’ affairs, this is a logical concern. The AfCFTA is indeed geared at boosting the levels of industrialization, intra-regional trade and investment. However, the framework is socially-oriented too. It seeks deeper regional integration and cooperation, with a view to making the continent economically stronger and more resilient. Precisely to prevent exploitation, it includes safeguards such as protocols on: competition policy, investment, intellectual property and the free movement of people. AfCFTA is thereby designed to create a unified continental market that works to the benefit of all its citizens.

3. “How can the AfCFTA succeed while regional trade is actually declining?”

Although intra-African trade has been progressively rising over the last decade, there is no doubt that intra-regional exports have remained at low levels for most countries on the continent, accounting for an average of around just 16 percent of total exports, compared with an average in the European Union of 64 percent and 70 percent for Asian Pacific Economic Co-operation (APEC) countries. Indeed, within some African regional blocks, intra-regional trade has recently been stagnant or actually declining in recent years (Figure 5.7).⁸¹ There are several reasons for this: persistent barriers to trade in the form of high tariffs and NTBs; a lack of complementarity between regional economies; and physical hurdles that cannot be overcome because of the lack of infrastructure. However, the AfCFTA is a tool for alleviating precisely these trade inhibitors: it is an Africa-wide effort at reducing barriers and harmonizing economies, providing the incentive and framework to improve infrastructure in doing so.

⁸¹ For instance, within the EAC, there was a significant decline in intra-regional trade 2013-2018, whereas recently released figures show a recovery in 2018, with a rise in intra-regional trade within the EAC by 10 percent (see GTDW China, 2019).

Figure 5.7: Intra-regional merchandise trade in Africa, 1995-2018
As a percentage of total trade



Source: UNCTADstat (2019)

4. “It won’t be implemented”

Admittedly, the history of non-implementation of international treaties and protocols in Africa has not been satisfactory to date. However, as mentioned above, there is a new sentiment that surrounds the AfCFTA, evidenced by the political support. The fact that 54 out of 55 African countries have signed in December 2019 shows that lessons have been learnt on this score. With almost every AU Member State committed to the AfCFTA, and the clear benefits well understood, there will be significant peer pressure to be pro-active in implementation. Even more compelling is the fact that, of these 54 signatories, more than half (28) have now ratified the agreement through their national parliamentary processes; this categorically signals the seriousness with which member states are taking the AfCFTA. Among the general public, too, there are signs that there will be an important level of popular support to the AfCFTA. A survey of two thousand African citizens from across the continent carried out by the Rockefeller Foundation in November 2018 found that 77 percent of respondents were supportive of the formation of the AfCFTA.

To conclude, the rationale for greater economic co-operation and integration among African countries has always been strong. In today’s global economy, increasingly dominated by large economies and regional blocks like the European Union, the United States, China and India – and against a backdrop of increasingly pronounced trading tensions between them – those arguments become even more convincing. The AfCFTA presents a way to achieve that goal and create a more prosperous, economically resilient, continent.

The image shows the facade of a building belonging to the Rwanda Revenue Authority. The building is light-colored with a dark roof. A blue flagpole with the Rwandan flag is visible on the left. The text on the wall reads "R.R.A CUSTOMS RWANDA REVENUE AUTHORITY" and "DOUANE-GISENYI CORNICHE". There is a logo to the left of the text.

R.R.A CUSTOMS
RWANDA REVENUE AUTHORITY
DOUANE-GISENYI CORNICHE

6. OUTSTANDING AREAS FOR NEGOTIATION AND PRIORITIES FOR EAST AFRICA



It is best to view the AfCFTA as an umbrella instrument, divided into two phases. As per Figure 2.1 back in Section 2, Phase I includes goods and services liberalization, the protocol on rules of origin and procedures on the settlement of disputes; Phase II of the negotiations will deal with protocols on investment, competition policy and intellectual property rights. These are essential components in the construction of a unified continental market. As was the case for the European Union's Single Market Programme in the early 1990s, the harmonization of rules on investment, competition and intellectual property is a necessary step for the smooth functioning of the internal market. Among other things, this section will discuss some of the associated issues with this element of Phase II.

Rules of origin can have a significant impact on trade flows and can potentially undermine the benefits of trade agreements if they are too restrictive.

6.1. Rules of Origin

"Rules of origin are a passport for goods. [They] are at the cornerstone of what it means for goods to be labelled "Made in Africa" [and] are situated at the nexus of trade and industrial policy. Make them soft and a Free Trade Zone runs the risk of not spurring the creation of local value. Make them too strong and countries risk being considered too protectionist and firms may find them too difficult to comply with"

(Mukhisa Kituyi, Secretary General of UNCTAD, 2019).

No matter how opaque, dauntingly complex or lengthy their texts may be,⁸² some form of rules of origin are inescapable when preferential trade agreements are signed. Although in the past the topic of rules of origin has been relatively ignored when dealing with regional integration, there has recently been a growing interest in the impact. The consensus among experts is that rules of origin can have quite a significant impact on trade flows and that they can potentially undermine the benefits of trade agreements if they are too restrictive (Augier et al., 2005; Estevadeordal and Suominen, 2004; Brenton and Manchin, 2003; Inama, 2003; UNCTAD, 2019a).

In principle, rules of origin are established to avoid the 'transshipment' of goods that do not originate from within a regional bloc. The transshipment of goods takes place when traders take advantage of lower tariff barriers in a neighbouring country and import goods from outside the region, potentially also flooding the markets of other countries in the regional bloc. Whenever a regional block is formed without concurrently establishing a common external tariff, this kind of transshipment is a distinct possibility, since the 'origin' of the products in question will not have been established.

This is therefore a legitimate concern when it comes to the AfCFTA, and there are well-documented precedents within Africa. Rice (2004) describes at length the case of the suspected transshipment of wheat flour products from the EU and the US to Kenya via Egypt. COMESA, to which both Kenya and Egypt belong, allows the duty-free entry of commodities from member countries if 45 percent of the product originates in the exporting country. However, in 2000, concerns arose in Kenya about the rise in the volumes of

⁸² For instance, while the main text of the typical Association Agreement between the EU and a Barcelona process country is between 20-30 pages long, the length of the annex covering the rules of origin for thousands of individually mentioned products is close to 100 pages. Similarly, the rules of origin annex in NAFTA runs up to over 200 pages. This makes difficult the task of quantifying the severity of particular rules of origin (Augier et al., 2005: 570).

cheap, duty-free wheat flour imported from Egypt undercutting local prices and having a negative impact on Kenya's wheat farmers. The high production costs of wheat in Egypt had meant that transshipments of cheap subsidized imports from the EU and the United States were being used by Egyptian producers to supply the Kenyan market.

The further dilemma is that if the rules of origin are too restrictive, companies may simply choose to trade at most favoured nation (MFN) rates and forego the benefits from the regional agreement. The negative impact of excessively strict rules of origin, and how this may ultimately lead to trade diversion, can be illustrated by the experience of Mexico with NAFTA. Early analysis of the agreement did not find any evidence of trade diversion (and, rather, found evidence of trade creation; Krueger, 1999). However, more recent empirical work uncovered high levels of trade diversion (Romalis, 2005). Related literature reached similar conclusions (e.g. Appiah, 1999; Cadot et al., 2002; Anson et al., 2005; Mold and Rozo, 2006) that suggest that rules of origin are the 'prime culprit' for the meagre impact that NAFTA has had on the Mexican economy – i.e. where trade flows were distorted, and welfare undercut.

An additional consideration is the fact that, in many African countries, the private sector consists largely of ill-equipped SMEs; and the manufacturing sector is quite weak. In these circumstances, strict rules of origin could constitute a major barrier for most African businesses, preventing them from taking advantage of the preferential access under the AfCFTA. In this context, UNCTAD (2019a) argues that the value-addition threshold should be kept low (say, 30 percent of a product must originate from the origin-claiming country), as it will safeguard the ability of Member States to trade under the AfCFTA preferences. They argue that this is especially the case during the initial stages of implementation of the AfCFTA agreement, since flexible rules of origin could help African economies with weak supply capacities take up trade preference and participate in regional value chains by building capabilities in domestic production (UNCTAD, 2019a).

Finally, an outstanding complication forming part of the negotiations on the rules of origin is the treatment of goods coming from Special Economic Zones (SEZs). As was seen in Section 5.2, given the proliferation of SEZs in the region, this is a particularly crucial issue for East African. Articles 9 and 23 of the Protocol on trade in goods specify that trade in goods benefiting from special economic arrangements or zones shall be governed by specific regulations established by the Council of Ministers (AU, 2018). However, until such regulations are developed, goods manufactured in SEZs within Member States will be subject to the conferral of origin according to the other provisions of Annex 2 of the protocol (i.e. governing the rules of origin). If not resolved satisfactorily, this issue could potentially undermine the role of the SEZs in improving the overall export performance of the region.

Despite the legitimacy of these concerns, recent research invites optimism in the case of the AfCFTA. Felbermayr et al. (2019) argue that, in a majority of cases, trade deflection or transshipment is unlikely to be profitable within regional blocks for a series of reasons:

- i) Tariffs are nowadays generally low, reducing the incentive for transshipment;
- ii) Countries within free trade agreements tend to have similar external tariff levels; and
- iii) For many goods, transportation costs again reduce the incentive for transshipment.

In their extensive analysis, Felbermayr et. al. (2019) find that, within free trade areas, transshipment is only potentially profitable in around 16 percent of cases. This is because tariffs imposed on imports of those same products in neighbouring countries are similar or higher, or they are lower but offset by high transport costs. In other words, the incentives for transshipment are, in practice, limited. Hence strict rules of origin may be unnecessary to guarantee the integrity of the AfCFTA.

To sum up, it is important for negotiators in East Africa to learn from past experience with rules of origin

Among the different types of NTBs that impede trade within the EAC, rules of origin are the most common obstacle.

and use historical insights to inform their decisions. For instance, among the different types of NTBs that impede trade within the EAC, rules of origin are the most common obstacle, representing 45 percent of

all the NTBs reported in the EAC region between 2008 and 2018 (ECA, 2019). In addition, intensive consultation with industry representatives is essential, since they are ultimately the ones who are directly affected. In particular, careful attention needs to be paid to the specificities of each sector; this is because excessively strict rules of origin could lock a country out of an industry or sector where a future dynamic comparative advantage may exist.

6.2. Harmonising Investment Regimes

The rules governing the continent’s investment landscape are currently excessively fragmented. In a bid to attract more FDI, many African countries have understandably signed bilateral investment treaties (BITs). The majority of BITs have been with countries outside the continent. However, in an effort to boost intra-African FDI, countries are gradually signing more treaties with each other. There are currently 512 BITs in force on the continent, of which 144 involve countries in East Africa (Table 6.1). But while African RECs have adopted diverse Investor–State Dispute Settlement (ISDS) approaches, countries that belong to more than one of these RECs often subscribe to different ISDS regime. This undermines the effectiveness of the BITs.

Table 6.1: Bilateral Investment Treaties (BITs) signed by East African countries

	TOTAL BITS BY COUNTRY
Ethiopia	31
Tanzania	19
D.R. Congo	18
Uganda	16
Kenya	13
Madagascar	11
Djibouti	9
Rwanda	7
Burundi	7
Comoros	5
Eritrea	4
Seychelles	4
South Sudan	0
Total	144

Source: ECA (2016a).

Greater harmonisation is therefore clearly required. Like in the case of the rules of origin, any reform

under the AfCFTA should be informed by the most recently available evidence. And with this in mind, the first thing to stress is that, despite the increasing number of the BITs, studies reveal that their impact is at best ambiguous. Some studies, like Salacuse and Sullivan (2005) and Neumayer and Spess (2005), have found a positive effect of BITs on FDI inflows to developing countries. However, others, such as Hallward-Driemaier (2003), Aisbett (2007) and Yackee (2008), found no evidence that BITs increased FDI flows at all. This in itself suggests that their effectiveness needs to be carefully examined.

The majority of BITs have been with countries outside the continent but, in an effort to boost intra-African FDI, countries are gradually signing more treaties with each other.

Secondly, a common criticism of existing BITs is that they have included provisions on ISDS that have eroded the policy space of African governments, by favouring foreign investors over the state. Existing investor-State (ISDS) dispute settlement mechanisms remain contentious, because they can be one-sided. When ISDS is one-sided, it allows a private investor to take a state to international tribunals, but not the opposite (Gallagher, 2010; ECA, AUC and AfDB, 2016). There are also concerns about the lack of transparency, high arbitration costs and inconsistent decision-taking.

Given these concerns about BITs, African countries have been urged to consider adopting more consistent regional legal frameworks for foreign investment (ECA, AUC and AfDB, 2016). This would help avoid disputes that disadvantage Member States of a common region and could raise their collective bargaining power in any dispute with third parties.

In this regard, the AfCFTA Protocol on Investment provides an opportunity for a continental-wide African agreement on investments and dispute settlement, with more transparent, consistent and predictable regulations. It is critical that the right balance is struck between protecting the investor and giving African governments sufficient policy space to pursue their respective developmental objectives. A good legal basis for the agreement is the existing Pan-African Investment Code (PAIC). This provides predictable, forward-looking and transparent rules, as well as emphasising investment promotion and dispute prevention.

The AfCFTA's Protocol on Investment provides an opportunity for a continental-wide African agreement on investments and dispute settlement, with more transparent, consistent and predictable regulations.

6.3. Creating a More Competitive Business Environment

Competition is at the heart of any market economy. It is necessary for ensuring economic efficiency, as well as to guarantee that productivity gains or reductions in costs are passed on to consumers. Given the small size of domestic markets and challenges of economic governance, the prevalence of monopolies, duopolies, and oligopolies is often assumed to be relatively widespread in African economies.⁸³ Certainly, higher price mark-ups have consistently been observed in African sectors with a high degree of market concentration (oligopolies), a low elasticity of demand (because of the lack of substitutes), and a prevalence of anti-competitive practices (cartels and collusive agreements). Some concrete examples will help make this point:

By opening up domestic markets to more competition through trade, the AfCFTA may go some way to [create a more competitive business environment].

⁸³ Bates (2015: 76), for instance, claimed that “characteristically, industries in Africa are dominated by a few large firms; sometimes they are dominated by a monopoly; and often, the major firms are government-owned. Under such sheltered conditions, inefficient firms survive. And consumers, including farmers, pay higher prices.”

- The World Bank (2016) estimated that the retail prices of 10 key consumer goods are, on average, at least 24 percent higher in African cities than in other economies around the world, even after controlling for transport costs, geographic variables and other factors.⁸⁴
- A similar more recent study, commissioned by COMESA, found that monopolistic and collusive behaviour creates artificially high prices for consumers, specifically on high-demand goods and services, such as cement, fertilizer and financial and transportation services. Staple goods such as bread, sugar, rice, potatoes, butter, milk and eggs are all susceptible to price gouging – from 20 percent to 30 percent higher in some African markets – due to abuse of firms’ market dominance (Anyanzwa, 2019).
- A single operator holds over half the market share in both the telecommunications and transport sectors in the services sectors of more than 40 percent of African countries. The result is often poor service delivery and high prices.
A single operator holds over half the market share in both the telecommunications and transport sectors in the services sectors of more than 40 percent of African countries.
- Cement prices in Africa are 183 percent higher, on average, than world cement prices. It is estimated that African cement consumers could therefore be overpaying by more than USD 2.5 billion per year due to a lack of competition. This indicates that the potential impact of boosting competition in the cement market in Africa is significant. In fact, advocacy action by the Tanzanian Competition Commission to encourage the removal of a duty on cement imports in Tanzania led to a 26 percent reduction in retail prices (World Bank, 2016).
- In the beer industry, the USD 13 billion African market is controlled by four international brewers (Fick, 2017). In this case, firms can strategically collude across national and regional markets to control both the market for the final product and the markets for agricultural inputs.

By opening up domestic markets to more competition through trade, the AfCFTA may go some way to addressing these concerns. With this being so, the benefits from AfCFTA may also be diminished in the presence of monopolies, oligopolies and cartels. It is, therefore, important that the AfCFTA Protocol on Competition is effective and ensures strong cooperation between national and regional authorities.

In doing this, the first challenge is to address the diversity of competition regimes across African countries. In the East Africa region, only a minority of countries have both competition law and an operational competition authority (e.g. Kenya and Tanzania). Other countries have enacted competition law but have not yet established a competition authority. A significant number of East African countries do not have any competition legislation at all.

Against this backdrop, the AfCFTA Protocol on Competition will provide substantive coverage of the main competition issues: including anti-competitive agreements, cartels, monopsony power, and firm mergers. The building blocks for a regional approach to competition laws are already in place. For instance, the COMESA Competition Commission has opened investigations into firms operating in the 19-member economic bloc, where there is evidence of collusive behaviour and price-rigging (Anyanzwa, 2019). The investigation will initially target various companies in the pharmaceutical, construction, banking, telecommunications, dairy, beverages and water industries. The investigation is part of the effort to make competition laws effective – their mere presence is insufficient to safeguard consumers.

6.4. Defining Development-Friendly Intellectual Property Rights (IPRs)

⁸⁴ By tackling anti-competitive behaviour, the World Bank estimated that a mere 10 percent reduction in prices of main food staples could lift 270,000 people in Kenya, alone, above the poverty line.

Intellectual property rights (IPRs) are a necessary part of investor protection and can play an important role in promoting innovation. Yet IPRs have generally been premised on the interests of developed countries and do not afford African countries the necessary safeguards.

Excessively strong Intellectual Property Rights can actually end up detracting from investment in the development of new products and services.

Studies show that African innovation occurs mainly in the informal sector and is not heavily reliant on conventional means of knowledge governance (Kraemer-Mbula and Wunsch-Vincent, 2016). By contrast, Mold (2002) argues that IPRs have often been used by industrialized countries to protect their own established companies from competition – and as part of a strategy to continue to draw rents from past innovations. In this way, quite contrary to their original intention, excessively strong IPRs can actually end up detracting from investment in the development of new products and services.

Nevertheless, in the right context IPRs have the potential to help achieve African developmental goals. For example, Kenya is a member of the WTO and is thus bound to the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). As a developing country, however, Kenya has utilized TRIPs flexibilities, such as voluntary licenses,⁸⁵ and has also domesticated TRIPs through the 2001 Industrial Property Act. This helped Kenya build one of the best-developed domestic pharmaceutical manufacturing industries in Africa, contributing to reducing the price of drugs (Konrad Adenauer Stiftung and SportsLink Limited, 2009). Similarly, the East African Community has developed a regional Pharmaceutical Manufacturing Action Plan using TRIPs flexibilities (EAC, 2018b).

However, there are also a myriad of cases of African intellectual property being ‘stolen’. For example, there are cases of tacit local knowledge being taken without paying back the communities from where the knowledge derived. There have also been attempts by companies from outside Africa trying to patent the characteristics of indigenous and unique plants and fauna of the region. For instance, considerable controversy was generated when Disney Corporation attempted to trademark “Hakuna Matata”, a Swahili word that means “no worries” (Pilling, 2018). The fact that a regional language could be ‘appropriated’ in this way caused much ire among the public. Other examples include the Kenyan Kiondo Basket that was patented by a Japanese firm, a UK-based firm that applied for the East African Kikoy patent and Louis Vuitton’s appropriation of the Masaai shuka (a form of blanket customarily worn by Masaai).

The AfCFTA provides an opportunity to bring coherence to regional intellectual property rules, as well as a common stance to negotiate with external partners and engage with the global intellectual property regime. Like in the case of BITs, Africa’s own regulatory framework on IPRs is currently fragmented. Most African countries are members of one of two separate regional intellectual property bodies: The African Regional Intellectual Property Organization (ARIPO) (mainly Anglophone countries), and the *Organisation Africaine de la Propriété Intellectuelle* (OAPI) (mostly Francophone countries). There are structural differences between the two organizations. For example, ARIPO Member States each have a different Intellectual Property (IP) framework, while OAPI Member States subscribe to a unified IP legal system. Despite efforts in recent years, cooperation between the two organizations is weak and the links with policy frameworks at national, regional and continental levels are tenuous.

⁸⁵ A voluntary licence is a licence issued by the patent-holding company that allows another company to manufacture a patented product subject to the payment of an agreed royalty fee to the patent holder. In Kenya, provisions in the Industrial Property Act 2001 enabled the government to work with the main domestic pharmaceutical company, Cosmos, to obtain two voluntary licenses in 2004 for anti-retroviral drugs (Konrad Adenauer Stiftung and SportsLink Limited, 2009).

The continental framework will need to cover copyright, patents, trademarks, traditional knowledge and competition.⁸⁶ There is also a need to include *Geographical Indicators of Origin* to provide strong protection to untapped potential in countries such as Madagascar, which has rich endemic fauna and

A viable IPR protocol in the AfCFTA could provide guiding principles for national IP laws, as well as develop norms to safeguard African interests.

flora. A viable IP rights protocol in the AfCFTA could provide guiding principles for national IP laws, as well as develop norms to safeguard African interests.

Policies related to technology transfer, compulsory licensing and indigenous knowledge are of great importance as far as IP management is concerned. Digitalisation may bring about entirely new products, as well as enable new functionalities. Meanwhile, the majority of the ‘enabling technologies’ are proprietary, which makes it difficult for developing countries to learn from and catch up with developed countries through adaptive and imitative innovations (Sikoyo, Nyukuri and Wakhungu, 2006). Given this, African economies need to consider an IP regime that leaves scope for active design-oriented innovation policy. The AfCFTA also provides a valuable opportunity for African countries to develop regional rules on IP that can support digital transformation, which will go a long way in expanding intra-regional trade (Afrieximbank, 2019: 42).

6.5. The Free Movement of Persons Protocol

Deep regional integration of the kind envisaged under the AfCFTA is not just about the free movement of goods and tradeable services, it is also about the free movement of factors of production – both capital and, crucially, labour. Economic studies show that the returns to the free movement of labour can equal or even outweigh the benefits of trade liberalisation (Walmsley and Winters, 2003; World Bank, 2006). The free movement of persons is the means to ensure availability of skills and labour where needed. This spurs investment. Economic development is further bolstered by drawing on the full breadth and diversity of professional and technical competencies, as well as labour power across the member States of RECs. As Taran (2015: 3) puts it, free movement is “*the practical means for expanding free trade and commerce throughout the region, particularly of locally-produced goods and services.*”

However, although the free movement of persons is a core objective of many existing RECs, relatively few have had much progress in implementing it. Within East Africa, the most advanced protocol is that of the EAC. Even there, there are challenges of implementation. The EAC adopted a protocol on movement and labour in 2010. But eight years after its coming into force, and despite advocacy by the East African Employers Organisation and the East African Trade Unions Confederation, the free movement of labour remains contentious within the region. COMESA and IGAD have made less progress. Only Burundi has ratified the COMESA free movement protocol, but Mauritius, Rwanda and Seychelles waive visas to all COMESA citizens (ECA, AUC, AfDB and UNCTAD, 2019: 17). Failure to liberalize labour mobility encourages the use of precarious illegal routes for migration – this puts women and girls, in particular, at risk.

Successful implementation of free movement has been hampered by a confluence of factors:

- More economically-developed Member States are concerned about being flooded with job-seekers from less developed ones;

⁸⁶ A related initiative of the AU is the establishment of a Pan-African Intellectual Property Organization.

- Less developed countries are concerned about losing talent to leading regional economies (a.k.a. suffering a “brain drain”);
- There are overlapping and contradictory rules and regulations on free movement between African RECs (ECA, AUC, AfDB and UNCTAD, 2019: 17).

This is especially odd, given that much of Africa’s migration is already intra-African. Intra-African migration is on the rise, up from 12.5 million in 2000 to 19.4 million in 2017, with 80 percent of African migration now taking place within the continent and only 20 percent outward-bound (UNCTAD, 2018c).

However, intra-African migration needs to be managed better for the benefit of Africa’s integration and sustainable development (AUC and IOM, 2018). The structural transformation of regional economies requires knowledge, skills and capabilities in higher value-adding sectors. The lack of appropriate skills and capabilities can slow structural transformation processes (Khan, 2018). Often, there are people with the right skills, but who are ‘in the wrong place at the wrong time’ and therefore instead suffering unemployment. In Tanzania and Kenya, for instance, employers in 41 percent and 30 percent of firms (respectively) identify inadequately skilled workforces as major constraints for their businesses (World Bank, 2017). To fill this gap, countries can of course improve their own educational systems. However, countries in such situations would also benefit from looking beyond their national borders to attract people with the required skills. As a ‘case in point’, one survey (Ernest and Young, 2014) indicates strong demand for expatriate skills in East Africa⁸⁷, with firms expecting to recruit more expatriate executives, managers, professional and technical skills; meanwhile, 62 percent of respondents believed that governments were making it difficult to employ expatriates.

In addition to redistributing skilled labour where it is needed, greater labour mobility could also help to develop human capital: skilled workers and students could travel in the region for work and educational purposes. This will accelerate the transfer of skills and encourage mutual recognition of professional qualifications.⁸⁸

The Free Movement of Persons Protocol thus represents a unique opportunity to align policies and liberalize the movement of people across the continent (Gwatiwa and Sam, 2018). However, it is notable that this protocol was initially only signed by half of African Member States in March 2018 – much fewer than the 44 member states signing up to the AfCFTA itself. This reveals the potential for division over this issue.⁸⁹ There are signs that things are moving in a positive direction. AfDB and AUC (2018) note that African countries are becoming more open to each other, facilitating intra-African travel.

The Protocol on Freedom of Movement was initially only signed by half of African Member States in March 2018 – much fewer than the 44 member states signing up to the AfCFTA itself. This reveals the potential for division over this issue.

The 2018 Visa Openness Index shows that East Africa hosts nine out of the 20 visa-open countries. These countries have facilitated movement of persons into their territories. For example, Seychelles is a fully open country requiring no visa for anyone wishing to visit; this relaxation of visa requirements has helped boost tourism, with a 7 percent annual growth in international tourism arrivals between 2009 and 2014. Similarly, visiting Rwanda and Uganda does not require prior obtainment of a visa for anyone, and allows entry using a dual system of no visa or

87 The survey looked at Ethiopia, Kenya, Rwanda, South Sudan, Tanzania and Uganda.

88 In 2015, the AU Assembly adopted a declaration on migration where, among other things, they sought to “establish a harmonized mechanism to ensure that higher education in Africa is compatible, comparable, with acceptability and enable recognition of credentials that will facilitate transferability of knowledge, skills and expertise.”

89 In fact, only one country has thus far ratified the Free Movement protocol: Rwanda.

Greater labour mobility could also help to develop human capital: skilled workers and students could travel in the region for work and educational purposes.

visa on arrival. In fact, Rwanda has ranked third among 138 countries surveyed in 2016 in terms of accepting migrants and welcoming and integrating them into the host society (Gallup, 2018).⁹⁰

Meanwhile, Comoros, Djibouti, Madagascar and Somalia are the only four countries in East Africa that still do not grant visas on arrival.⁹¹ Kenya and Tanzania grant visa on arrival; however, they still make concessions for citizens of some countries and require visa for others. Furthermore, EAC citizens of Kenya, Rwanda and Uganda move freely between the three countries using either ID cards or the EAC passport.⁹² This is a result of the removal of mobility restrictions enacted by Heads of State in 2013.

Unless regulated by appropriate laws and policies, migration entails high costs in violations of rights of persons, in social disruption, in reduced productivity, and in lost opportunities for development (Taran, 2015: 12). The Free Movement of Persons Protocol could provide the necessary coherence to laws and policies across the region, while making a significant contribution to addressing the skills shortages which cripple the growth of many strategic sectors.

⁹⁰ The ranking is based on the Gallup World Poll, which asked whether people think migrants living in their country, becoming their neighbours and marrying into their families are good things or bad things.

⁹¹ In June 2018, Ethiopia also allowed online applications and started a visa on arrival regime for all Africans.

⁹² The EAC passport is currently applicable in and issued by the three member countries.



7. COMPLEMENTARY INITIATIVES TO THE AfCFTA

7.1. Boosting Intra-African Trade (BIAT) Action Plan

The AfCFTA reforms are necessary but not sufficient on their own to boost the level of intra-Africa trade: complementary measures will be needed to ensure that the benefits of the AfCFTA are *fully* harnessed and shared equitably. Cognisant of this fact, the AU Heads of State and Government adopted the Boosting Intra-African Trade (BIAT) Action Plan, at the same 2012 AU Assembly meeting at which it was decided to establish the AfCFTA. The BIAT Action Plan has seven priority clusters that address the common trade constraints in the region such as, *inter alia*, poor trade-related infrastructure, limitations on productive capacity, differences in trade regimes and restrictive customs procedures (Table 7.1).

Table 7.1: Summary of the seven priority clusters of the Boosting Intra-African Trade (BIAT) Action Plan

CLUSTER	TOTAL BITS BY COUNTRY
Trade policy	<ul style="list-style-type: none"> • Mainstream intra-African trade in national strategies • Enhance participation by the private sector, women and the informal sector • Boost intra-African trade in food products • Undertake commitments to liberalize trade-related services • Commit to harmonize rules of origin and trade regimes • Promote “Buy in Africa” and “Made in Africa”.
Trade facilitation	<ul style="list-style-type: none"> • Reduce roadblocks • Harmonize and simplify customs and transit procedures and documentation • Establish one-stop border posts • Adopt integrated border-management processes.
Productive capacity	<ul style="list-style-type: none"> • Implement the programme for the Accelerated Industrial Development of Africa (AIDA), the African Productive Capacity Initiative and the Accelerated Agribusiness and Agro-industry Initiative • Establish integrated trade information systems • Encourage investment • Establish regional centres of excellence.
Trade-related infrastructure	<ul style="list-style-type: none"> • Implement the Programme for Infrastructure Development in Africa (PIDA) • Mobilize resources for multi-country projects • Pursue high-quality multi-country projects • Ensure an enabling environment for private-sector participation • Develop innovative mechanisms (legal, financial, etc.) for multi-country projects.
Trade finance	<ul style="list-style-type: none"> • Improve payment systems • Set up an enabling environment for financial services to provide export credit and guarantees • Speed up the establishment and strengthening of regional and continental financial institutions.

CLUSTER	TOTAL BITS BY COUNTRY
Trade information	<ul style="list-style-type: none"> • Create interconnected centres of trade information exchange.
Factor market integration	<ul style="list-style-type: none"> • Operationalize existing protocols and policies • Facilitate movement of businesspeople • Harmonize rules on cross-border establishment • Conclude agreements on mutual recognition of qualifications.

Source: Adapted from ECA, AUC and AfDB (2017).

In addressing the need for improved payment systems, the African Export-Import Bank (Afreximbank) has launched the Pan-African Payment and Settlement System (PAPSS). It is a continent-wide digital payment system aimed at facilitating payments in African currencies for goods and services involved in intra-African trade. With this platform, intra-regional payments will be domesticated, effectively saving the region approximately USD 5 billion in payment transaction costs annually. The system is also expected to formalize a considerable fraction of the estimated USD 50 billion of informal intra-African trade (Nelson and Adekoya, 2019).

Laudable as they are, initiatives under the BIAT will all require significant additional finance. Research suggests that African exporters rely on Bank-intermediated finance more than in other regions (German Development Institute, 2015). Yet, unlike in high income countries, banks are relatively more conservative about supporting local exporters; they lack the capacity, knowledge, enabling regulatory environment, international network and/or foreign currency to supply export-related finance. Equally, traders are largely not aware of the available products, or of how to use them efficiently. The overreliance on bank-intermediated trade finance, against a background of capacity-challenged banks with small balance sheets, represents a significant impediment for intra Africa Trade (Nyakundi, 2017).

The Pan-African Payment and Settlement System (PAPSS) is a continent-wide digital payment system aimed at facilitating payments in African currencies for goods and services involved in intra-African trade... [projected to save] the region approximately USD 5 billion in payment transaction costs annually.

That being the case, the AU needs to seek partnerships with the private sector and development partners in order to finance the BIAT action plan. For example, the financing of trade facilitation in the EAC region has been spearheaded by TradeMark East Africa (TMEA), which is an ‘aid for trade’ programme set up by the United Kingdom (UK) Department for International Development (DFID) to help countries in the EAC implement trade facilitation reforms.

TMEA’s programme in the EAC was launched in 2009 and has since invested over USD 800 million from ten donor⁹³ governments to enhance trade facilitation across the region. TMEA programmes have focused on: automation of trade systems and processes; improving infrastructure; upgrading ports and border posts; improving the trading environment through automation of single window systems; customs systems automation; harmonisation of standards; and removal of non-tariff barriers. Interventions have resulted in a significant reduction in trading time and costs across the region. For example, the Rwanda electronic single windows system reduced the days it took to clear goods through customs, from 11 days to 1.5 days. The upgrade of the port facilities in Mombasa Kenya reduced import and export times by an average 50 percent. Investment in the one-stop border posts have reduced time taken to cross

⁹³ The ten donor governments to TMEA’s programme in the EAC are: United Kingdom, Belgium, Canada, Denmark, European Union, Finland, Netherlands, Norway, Ireland, and the United States

borders by an average 70 percent. Additionally, the implementation of the simplified trading regime for small scale traders (threshold of USD 2000) at the one-stop border post has led to increased incomes and improved livelihoods for many women and youth. Support to implementing East African product standards has reduced testing costs by 85 percent in Kenya, 71 percent in Uganda, and 50 percent in Rwanda.

TradeMark East Africa’s programme in the EAC was launched in 2009 and has since invested over USD 800 million to enhance trade facilitation across the region.

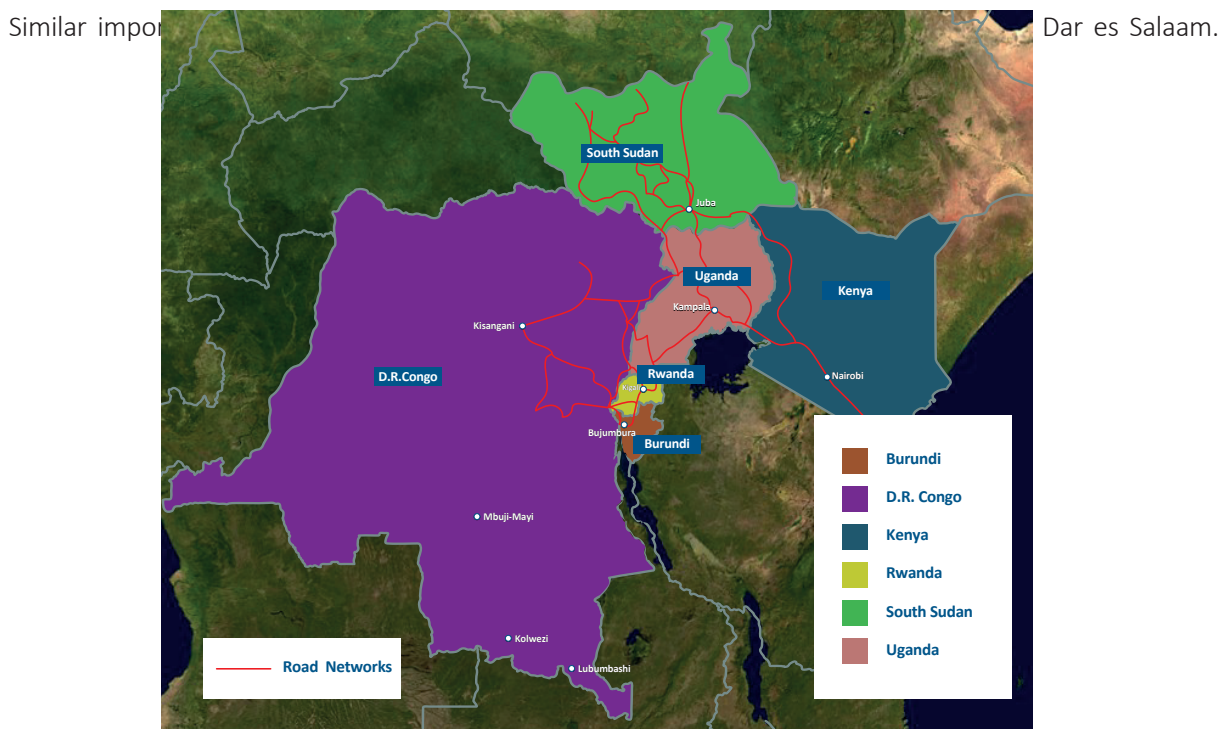
Finally, the AfCFTA Adjustment Facility, a USD 1 billion financing instrument instituted by the Afreximbank in July 2019, comes as a timely contribution to the regional trade integration process. The funds will support participating countries with any initial fiscal imbalances that may arise from implementation of the

Agreement. The funding will also help with capacity building.

7.2. The Development of the Northern and Central Corridors

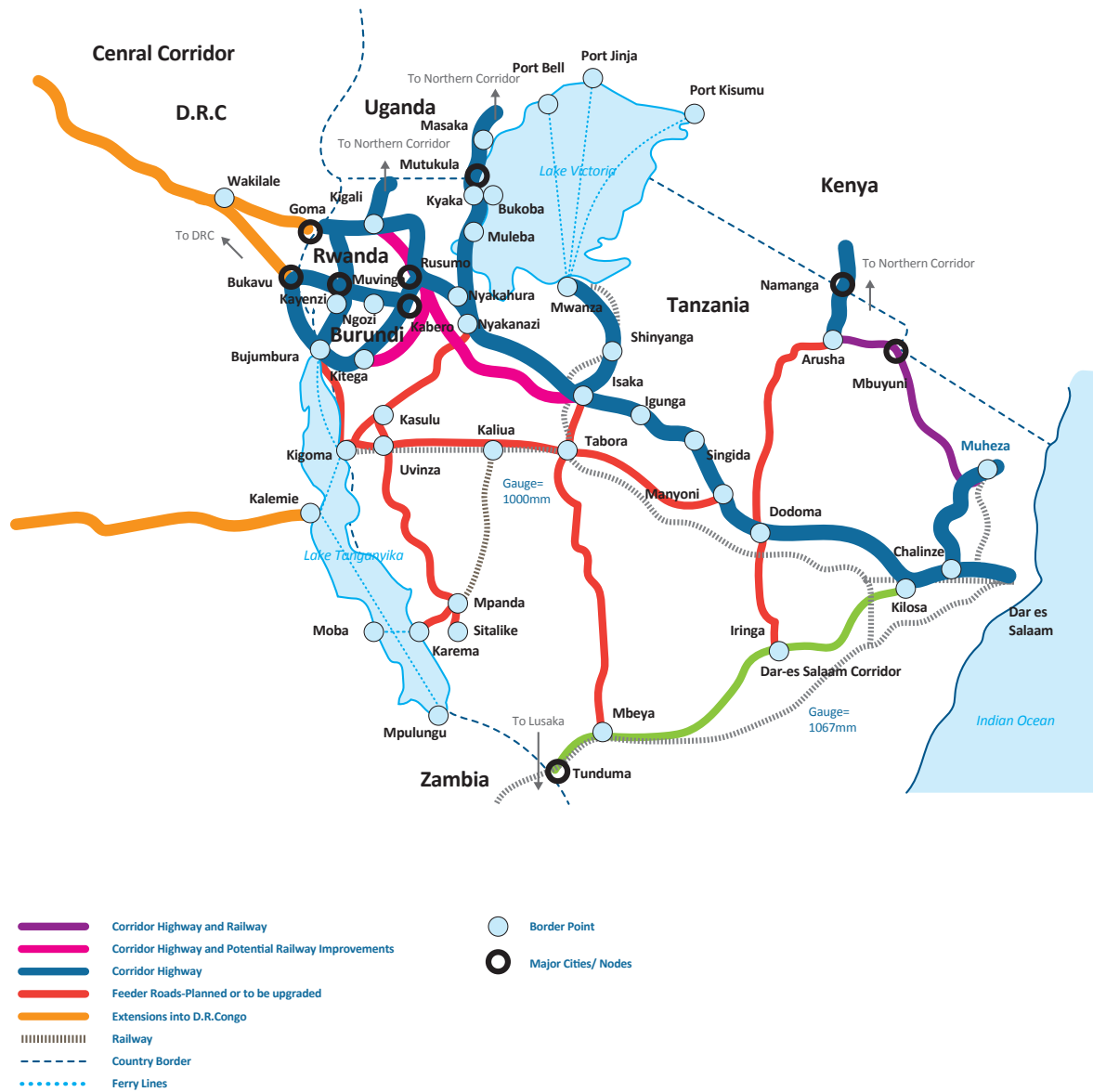
Improvements in the quality of the region’s infrastructure (international linkages and internal networks) are thus vital if countries are to capitalize fully on the potential gains from the AfCFTA. Within the region, the Northern and Central Corridors are two distinct multimodal routes connecting the seaports of Mombasa in Kenya and Dar es Salaam in Tanzania, respectively, to the landlocked countries of the Great Lakes Region – including Burundi, D.R. Congo, Rwanda, South Sudan and Uganda (Figure 7.1). They do so by road, rail and inland waterways. Both corridors form the backbone of regional transport in East Africa. These corridors also include Lakes Victoria and Tanganyika as waterways, as well as their major ports (Kisumu-Kenya, Mwanza-Tanzania, Port Bell-Uganda on Lake Victoria, Bujumbura-Burundi, Kalemie-D.R. Congo and Kigoma-Tanzania on Lake Tanganyika).

Figure 7.1: The Northern and Central Corridors



Source: Northern Corridor Transit and Transport Coordination Authority and Central Corridor-Transit Transport Facilitation Agency (2018).

Figure 7.1: The Northern and Central Corridors



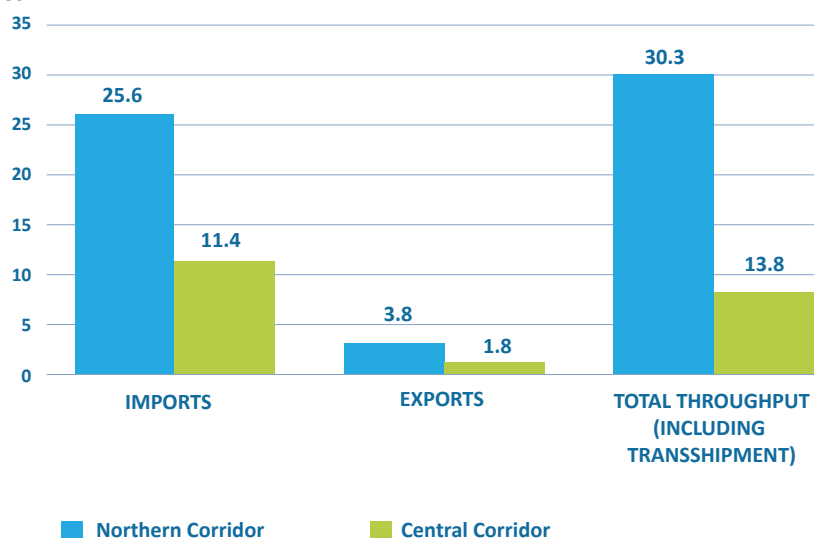
Source: Northern Corridor Transit and Transport Coordination Authority and Central Corridor-Transit Transport Facilitation Agency (2018).

Imports make up the bulk of the freight in both cases, with the Mombasa port handling around double the cargo than the Dar es Salaam port (Figure 7.2) – around 30 million metric tonnes in 2017. At the present time, some EAC member states (e.g. Burundi and Rwanda) seem to be shifting from the Northern Corridor to increased usage of the Central Corridor – in terms of the volume of goods transported. (Table 7.2). This is essentially motivated by shorter distances, reduced freight charges and other fees, improved road condition, lower number of transit nodes and less traffic congestion.

Figure 7.2: Cargo imports, exports and total throughput, 2017
million metric tonnes

Table 7.2: Imports through the Northern and Central Corridors, 2017

'000 metric tonnes



Source: Kenya Ports Authority, Tanzania Ports Authority, Northern Corridor Transport Observatory and Central Corridor Transport Observatory (2018).

	NORTHERN CORRIDOR (MOMBASA PORT)	CENTRAL CORRIDOR (DAR ES SALAAM PORT)
Burundi	22	404
D.R. Congo	317	785
Kenya	17,701	-
Rwanda	167	1,040
South Sudan	545	-
Tanzania	244	6,704
Uganda	6,590	270
Others	17	2,155
Total	25,604	11,358

Source: Kenya Ports Authority, Tanzania Ports Authority, Northern Corridor Transport Observatory and Central Corridor Transport Observatory (2018).

The trade volumes and rapidly evolving dynamics between coastal and land-locked countries in East Africa reflect infrastructure development trends. The construction of the 2,561 km Central Corridor Standard

Gauge Railway by Tanzania was launched in 2017; it will eventually link the port of Dar es Salaam with Mwanza on Lake Victoria and Kigoma on Lake Tanganyika, as well as neighbouring Rwanda and Burundi. The first phase of the Standard Gauge Railway between Dar es Salaam is to begin operations in December 2019 (East African, 2019). The rehabilitation of the Central Railway line in Tanzania is underway and the line from Dar es Salaam to Mwanza through Isaka is already operational. The Dar es Salaam- Kigoma railway line is also operational.

Not only does East Africa need better intra-regional infrastructure, the region also needs to be better connected with the rest of the continent. For the region to benefit from the AfCFTA, such cross-border infrastructure projects are crucial.

There is scope to expand cross-border infrastructure in East Africa, both within the East Africa region, as well as with its near neighbours. Not only does East Africa need better intra-regional infrastructure, the region also needs to be better connected with the rest of the continent. For the region to benefit from the AfCFTA, such cross-border infrastructure projects are crucial. Two major infrastructural projects are:

- **The Lamu Port, South Sudan, Ethiopia Transport (LAPSETT) Corridor Program** is East Africa's largest and most ambitious infrastructure project, bringing together Ethiopia, Kenya and South Sudan. This megaproject consists of seven key sub-projects: the new 32 berth port at Lamu (Kenya); inter-regional highways connecting Ethiopia, Kenya and South Sudan; a crude oil pipeline across the three countries; an oil pipeline from Kenya to Ethiopia; 1,500 km of inter-regional standard gauge railway lines; three international airports; the construction of resort cities (one in each country); and the High Grand Falls Dam along the Tana river.

The new Lamu Port will be able to handle the largest ships in the world with its 500-metre-wide and 18-metre-deep channel (ECA, AUC, AfDB and UNCTAD, 2019: 20). (In comparison, the Port of Durban has a 16-metre-deep and 220-metre-wide channel.) The LAPSETT Corridor Program is designed not only to link the main corridors within the region, but to provide a land bridge through the African Great Lakes region). According to the LAPSETT Corridor Development Authority, over 5,000 jobs have been created since construction started in 2012.

- **The AU's Programme for Infrastructure Development in Africa (PIDA) committee** has 51 projects and 16 priority initiatives – all aimed at improving the continent's infrastructure (ECA et al., 2017: 25). The Central corridor modernization is part of its third priority under the African Regional Transport Infrastructure Network (ARTIN). It aims to facilitate movement of people and goods across the borders between Tanzania, Uganda, Rwanda, Burundi and D.R. Congo. The North–South Multimodal Corridor, linking D.R. Congo, Mozambique, South Africa, Zambia and Zimbabwe, is the highest priority ARTIN corridor (ECA et al., 2019: 19).

7.3. Leveraging the Blue Economy

The Blue Economy could play a role in boosting the benefits of the AfCFTA through the resources it offers, in particular, the increased use of inland waterways for transport of goods. An AfDB (2010) report focusing on *Ports, Logistics and Trade in Africa* highlights the fact that, for landlocked countries, *The development of transport infrastructure of Lake Victoria and Lake Tanganyika, forming part of the Northern and Central Corridors, could contribute greatly to the improvement of intra-regional trade.*

median transport costs are almost 50 percent higher than the equivalent costs for coastal economies. Low port efficiency, dilapidated connected infrastructure networks, and delays at the borders all contribute to this state of affairs. Yet, the development of transport infrastructure of Lake Victoria⁹⁴ and Lake Tanganyika,⁹⁵

forming part of the Northern and Central Corridors, could contribute greatly to the improvement of intra-regional trade.

Inland waterways have always been an essential component of multimodal transport networks.⁹⁶ Lake Victoria has been of particular importance throughout East African history, offering transportation of passengers and cargo as part of the railway system – linking the rail network to the lake ports of Kisumu (Kenya), Port Bell (Uganda) and Mwanza (Tanzania). Key ports on Lake Tanganyika include Bujumbura (Burundi), Kalemie (D.R. Congo) and Kigoma (Tanzania). Both of Africa's two largest lakes share similar operational characteristics and provide a link in the Northern and Central Corridors.

Both lakes are navigable, but the navigational aids have been non-functional for a long time, leading to increased propensity for accidents.⁹⁷ The existing hydrographic survey maps are outdated, with most of

Ports in the Great Lakes region have suffered from a lack of investment... infrastructure is outdated; rail connections unreliable or broken; ferry operations erratic: and inadequate maintenance and safety measures are in place.

them dating from the beginning of the 20th century. Lake Victoria's ports are based on traditional general cargo traffic except for Port Bell, Kisumu and Mwanza, which were initially developed for rail RoRo (roll on, roll off) traffic. none of Lake Victoria's ports have container-handling equipment and most of them are in a poor state with difficult road and rail access (IMDC, 2016).

All ports in the region have suffered from lack of investment. Evidentially: infrastructure is outdated; rail connections unreliable or broken; ferry operations erratic; and inadequate maintenance and safety measures are in place. Furthermore, there is a lack of shipbuilding capabilities, which has led to the importation of vessels that are then disassembled and transported to the lakes only to then be reassembled; this adds new costs for handling activities. The situation has led to a decline in demand for lake transport, which has, in turn, been affecting the overall performance of intermodal freight in East Africa.

Promisingly though, infrastructural developments in the region are set to mark a turning point. For example, in July 2017, the governments of Tanzania and Uganda signed a Memorandum of Understanding (MoU) to cooperate in the improvement of ports, inland waterways and railway transport, with a view to

⁹⁴ EAC has identified the Lake Victoria basin as a critical economic growth zone with an estimated potential annual fish catch in excess of one million tonnes. The lake's catchment area covers parts of Burundi, Kenya, Rwanda, Tanzania and Uganda and supports a population of over 40 million people; it has a GDP estimated at USD 30 billion.

⁹⁵ Lake Tanganyika interconnects Burundi, D.R. Congo, Tanzania and Zambia; it covers a population of over 10 million people.

⁹⁶ For instance, the Industrial Revolution of the 18th and 19th century in the United Kingdom: economic historians often attribute the rapid industrialisation at least partly to the prevalence of navigable waterways; these rivers and canals made it possible to transport coal from the mines to industrial centres at relatively low cost.

⁹⁷ For example, while travelling between the island of Ukerewe and Ukara on Lake Victoria, 227 people are thought to have lost their lives in the incident that occurred on 20 September 2018.

strengthen the critical Mwanza-Port Bell-Kampala link for the Central Corridor.

7.4. Closing the Energy Infrastructure Gap

Last of all, improving the efficiency of the energy sector is also critical in boosting industrial development and the competitiveness of regional firms under the AfCFTA. Currently, the energy infrastructure gap in East Africa is notable, as evidenced by, inter alia, low electricity access levels. Member States have set themselves ambitious targets to address these challenges. For instance, Kenya set clear energy targets in its Vision 2030. Kenya's goal is to lower cost to KSH 10 from the KSH 18 from an installed capacity of over 5,000 MW by the end of 2017 (Government of Kenya, 2014), yet the installed capacity was still only 2,351 MW a year after that deadline (Otuki, 2018). Similar ambitions are expressed in Rwanda's Vision 2020 and its Energy Sector Strategic Plan 2018-2024 (MININFRA, 2018). Similarly, Ethiopia has set its targets in its Growth and Transformation Plan (GTP).

It is estimated that East Africa harbours up to 20GW in hydropower potential.

Even though some countries harbour immense energy generating potential, as it currently stands East African countries do not have sufficient installed domestic capacity. This implies that there is potential for an energy transformation in the region. This could be achieved partially through regional power pools and interconnected grids, which present clear opportunities for trade in energy services across the region. Ethiopia, which is currently in the second phase of its GTP, is on course to meeting its 2020 targets and has, as a result, revised its energy targets: seeking 35,000 MW by 2037, with the goal of becoming an energy hub in East Africa. Likewise, the Inka Dam in D.R. Congo, which will be the largest dam in the world once completed, is expected to generate 40,000 MW, up to 40 percent of the continent's electricity needs (Vidal, 2016). Overall, it is estimated that the region has up to 20GW in hydropower potential. And this is without even taking into consideration other renewable sources, such as geothermal, wind and solar (Nile Basin Initiative, 2012).

Nord Pool is a European multinational exchange for trade in electricity, with 13 countries of operation (Denmark, Estonia, Finland, Latvia, Lithuania, Norway, Sweden, Germany, the Netherlands, Belgium, Austria, Luxembourg and the United Kingdom). The success of Nord Pool – the world's first of its kind – is testament to the potentiality for regional power pools and interconnected grids in other regions such as East Africa (AfDB, 2019b). The AfCFTA and its sister initiative, the BIAT Action Plan, present an opportunity for establishing an integrated set of platforms and partnerships to drive such regional power systems, and thereby to facilitate energy trade across the region.

8. CONCLUSIONS AND RECOMMENDATIONS



8.1. Conclusions

The Organisation for African Unity (OAU) – the forerunner of the African Union- sought to establish an African Economic Community (AEC) with the signing of the Abuja Treaty of 1991, which called for the creation of a Continental Customs Union and subsequently a Continental Common Market. The AfCFTA exists to deliver on those same goals: to *“lay the foundations for the establishment of a Continental Customs Union”*.

In consonance with these objectives, this report has maintained that the AfCFTA is much more than a free trade area: it is a tool for achieving deeper regional integration on the continent. The AfCFTA agenda is ambitious and far-reaching, it is intended to reverse Africa’s premature de-industrialization and exploit a vast number of opportunities in the agricultural, manufacturing and services sectors. The elimination of tariffs and non-tariff barriers required by the Agreement will boost intra-African trade and improve developmental prospects for East Africa, allowing regional firms to tap into the rapidly growing markets both within the region and throughout Africa. In the move towards greater harmonization of economic policy in areas such as competition, investment, intellectual property and rules of origin (which constitute the ‘nuts and bolts’ of any cross-border regulation), East African governments will lose a minor amount of autonomy in their economic affairs. However, both from experience and the simulation results reported here show that the net results will be enormously positive, in terms of economic potential, economic efficiency and policy space in their dealings with third-party countries outside the continent.

Naturally, the fruits of the AfCFTA will only accrue when Signatory States ratify the Agreement, thereby ensuring its effective and continent-wide implementation. Events are unfolding quickly in this regard. In July 2019, the operational phase of the AfCFTA was launched during the 12th Extraordinary Summit of African Union (AU) Heads of State in Niamey, Niger. This phase of the Agreement is governed by the refinement of five instruments: Rules of Origin, the Online Negotiating Forum, the monitoring and elimination of non-tariff barriers, the digital payments system and the African Trade Observatory. By the last quarter of 2019, 28 of the current 54 signatories to the Agreement had ratified it. Demonstrably, the African continent is well on its way to fulfil a vision of regional integration – a vision that dates to the inaugural Summit of the Organisation of African Unity in May 1963.

Yet this report has stressed that a lot of other measures must be in place for the effective implementation of the AfCFTA. Critical parts of the Agreement need to be finalized before it can become fully operational. These negotiations need to be concluded rapidly and should be approached with a generosity of spirit in order to maximize the level of commitment and the degree of real liberalization, while avoiding defensive stances. Moreover, there are several strategic policy areas that should not be neglected in the quest for a successful outcome:

1. Complementarity:

The AfCFTA is about complementarity, strengthening the positive aspects of existing agreements. Hence, implementation of the AfCFTA depends on the coordinated participation of existing RECs and building on existing agreements. Failure to recognize complementarities and duplication could render implementation more difficult and less effective. The empowerment of existing institutions, such as the COMESA’s Competition Commission, and the implementation of pre-existing agreements, like the Tripartite Free Trade Area, will form a vital part of this new approach.

2. Financing:

The AfCFTA Adjustment Facility and the Africa50 pan-African investment platform, as part of the Programme for Infrastructure Development in Africa (PIDA), are welcome additional financial

resources for the implementation of the Agreement. East African countries need to fully leverage these opportunities for AfCFTA-related finance.

3. Private Sector involvement:

Actors from the private sector should be closely involved during the negotiation and implementation process, and beyond. When setting the scheduling priorities, the needs and concerns of the private sector must be heard in order to gain an understanding of the impact on the affected sectors. This requires an understanding of needs at all levels including large, small and medium-sized enterprises. It is important to recognize that larger enterprises might have a better grasp of the implications of liberalization and of the potential benefits that they can draw from it. Their leadership can serve as an incitement to smaller firms to scale up to meet the challenges and opportunities offered by the AfCFTA.

4. Support for smaller Member States:

Some smaller Member States in East Africa lack the capacity to engage in the negotiations in the same way as the larger countries. Their interests should not be forgotten. Governments should therefore seek assistance from the relevant institutions for capacity-building in trade negotiations, particularly in the new areas related to services, intellectual property, competition and investment regulation, etc.

5. Civil Society involvement:

African civil society must be involved and informed about the Agreement and the benefits that could be derived from it, as well as the status of the negotiations. While a 2018 opinion poll carried out by the Rockefeller Foundation shows that popular support seems to be high in principle,⁹⁸ Civil Society knowledge about what the AfCFTA really entails is very limited. Initiating information campaigns and discussion forums with the involvement of civil society across the continent would contribute to ensuring continent-wide appreciation of the AfCFTA and help to avoid a Brexit-type reaction based on a failure to understand the nature of the project. Such communication initiatives would also be useful because they will oblige involved parties to confront key questions and clarify the scope and objectives of the AfCFTA, as well as the challenges it may face.

8.2. Recommendations

Following on from the conclusions of this study, a successful approach to the AfCFTA will entail particular attention on some specific issues:

- **Recommendation #1: Standardize as much and as far as possible**

The standardization and harmonization of product standards, quality controls, phytosanitary regulations and technical specifications (etc) is crucial to making the continental market work as unified entity. This is arguably what holds back intra-regional trade more than anything else at the current time: non-tariff barriers of the discretionary kind leave traders vulnerable to arbitrary decisions by customs officials. The harmonization of regulatory standards would remove the discretionary nature of many cross-border transactions and provide clear benefits for consumers.⁹⁹

⁹⁸ Of the 2000 people from across the continent interviewed over the phone, 77 percent answered positively with regard the way they view the AfCFTA.

⁹⁹ Where standards have been harmonized, as in the EU, it has demonstrated that "...[harmonized standards] are actually crucial in facilitating trade... Standards provide individuals, businesses and all kinds of organizations with a common basis for mutual understanding. A standard represents a model specification, a technical solution against which a market can trade" (EU-CEN, 2019).

- **Recommendation #2: Move towards a Regional Concept of ‘Local Content’**

Many countries in East Africa have national campaigns to promote local content and production. For instance, Uganda embarked on a Buy Uganda¹⁰⁰ campaign in 2014, and Rwanda has had a similar “*Made in Rwanda*” policy in place since 2015. These initiatives have borne some fruits¹⁰¹. However, there are limits to the extent to which national authorities can singlehandedly promote their domestic production, especially in the context of a move towards a unified continental market that is supposed to create a level playing field for all. With the implementation of the AfCFTA, success hinges on the rapid emergence of *regional* value chains. This is unlikely to happen without a concerted effort to induce local content at the regional, rather than at the national, level.

- **Recommendation #3: Open services to intra-African competition**

Much of the discussion on the benefits from the AfCFTA have tended to focus on merchandise trade. Yet this report argues that many of the benefits will spring from the liberalisation of intra-African services trade. Services already constitute more than 50 percent of the regional economy. If services are opened up to intra-African competition, one of the major benefits from creating a unified continental market will be that it will reduce costs for both consumers and enterprises in a host of services, ranging from financial to transport. A common regulatory environment is an essential element in achieving this objective in the same way that common standards are.

- **Recommendation #4: Be especially open to FDI from other African countries**

A quick way to create regional value-chains, and more employment, is to encourage greater intra-regional investment. In Section 2, we established that the level of intra-regional FDI is currently much lower than intra-regional trade. Yet there are remarkable business opportunities on the continent. More than 60 percent of retail and consumer goods companies plan to expand into additional African countries over the five-year period 2018-2023.¹⁰² The AfCFTA will facilitate the expansion of firms seeking a greater regional or continental presence, and Member States should be especially open to FDI from other African countries.

- **Recommendation #5: Leverage the potential for cross-border digital trade**

Although from a very low base, digital trade is currently growing annually at 18 percent in Africa – which is more than double the global average. As the region that has spearheaded innovations like M-Pesa, East Africa is especially well placed to leverage the dynamism in digital trade. New continental-wide policies under the umbrella of the AfCFTA could provide a major boost to cross-border digital trade, helping to catch up with other regions of the world where it is far more prevalent. The establishment of an African Single Digital Market would be a major step forward. The AfCFTA could provide the basis for such an agreement.

100 This was extended to a ‘Buy Uganda, Build Uganda’ campaign in 2017.

101 In the case of Rwanda, for instance, Kimonyo (2019: 225) reports that the “Made in Rwanda” campaign and the associated Domestic Market Recapturing Strategy had resulted in a tripling of cement production, and a 40 percent increase in sugar and rice production between 2014-2017.

102 See Leke et al. (2018: Chapter 4). According to a McKinsey analysis, 88 large multinationals operating in Africa had built an African business with operations in more than 10 countries. Nearly a third of them are present in more than 20 countries, and on average the firms with the widest footprint are found to have the largest revenues. These strategies have typically been decades-long undertakings: most of these multinationals have been on the continent for 25 years or more..

A large map of the African continent is formed by a dense arrangement of dark brown coffee beans. The map is set against a light brown, textured burlap background. There are also smaller clusters of coffee beans scattered around the main map, including one at the top left and another at the bottom right. A dark blue horizontal band is positioned across the upper portion of the image, containing the text '9. REFERENCES' in white, bold, sans-serif font.

9. REFERENCES

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