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The AfCFTA as a Framework for Africa's Industrialisation: Rules of Origin outcomes and value chains

Value chains describe the range of activities involved in the production and final disposal of a good – and include aspects such as design, production, marketing, consumption and disposal, and many related and complementary activities within each stage of the life cycle.

In analysing value chains, focus is often concentrated on the embedded power structures within the various activities along a particular value chain, which may be dispersed across countries or continents. Within each value chain are often dominant players that influence or even control different aspects of a value chain, including the location of production activities, and the sourcing of inputs.

Value chains can, in general terms, also be described as buyer-driven (an often used example involves the textiles-apparel sector, and where much of the 'power' resides in the distributors, brand owners and final retailers), or producer-driven (where, using the example of the automotive sector, the large OEM firms have a strong grip over many aspects of production configurations, location and pricing).

Advances in technology, logistics and generally declining trade barriers have resulted in increasingly fragmented production, where individual producers (countries) are no longer required to hold a competitive advantage over large segments of the value chain but can also play an important role with much smaller individual contributions. This means that more countries can potentially benefit from economic activities in a larger number of sectors.

Of course, many issues impact on how value chains are configured and to what extent shared contributions to a chain of production activities are really possible. A country's endowments (resources, human capital, competitiveness etc.) all play an important role as does the environment within which shared (cross-border) production can potentially thrive. Trade facilitation aspects – the simplification, modernisation and harmonisation of export and import processes – play a critical role and the more costly it is to engage in the cross-border movement of goods and services, and persons, the less likely a country will be able to integrate into these regional or international production networks.

The decision to engage in production activities in particular countries is also often determined by market access considerations, in other words: what regional access does a producer in one country have to markets outside of the country's national borders, and under what terms and conditions.

Preferential market access is framed by the rules of origin (RoO) applicable to trade in goods between two countries that are party to a trade agreement or other preferential arrangement, and complying with these usually means duty-free or duty-reduced trade transactions for buyers and sellers.

RoO are the laws and criteria and administrative requirements used to determine the nationality of a (traded) product and their design has an impact on how value chains can function in the African context. The more rigid the RoO requirements, in other words, the greater amount of local or regional content and processing that is required to fulfil the origin criteria (the processing that confers local origin status on a product), the greater the need for a range of components and activities along a value chain to be available to producers within a preferential trade regime, in commercial quantities and at an internationally competitive price. The less rigid (i.e. more flexible, or liberal) the origin criteria, the easier it is for producers to produce originating products, but essentially, also to forgo local or regional sourcing if desired. The value chain linkages are thus with international rather than regional networks.

The purpose of RoO is to define the criteria that confer origin, ensuring that the working and processing goes beyond a set minimum and arguably represents a substantial economic transformation of any non-originating inputs, into distinctly different and new products.

RoO are intended to prevent trade deflection, involving preference-shopping by routing trade flows through countries that have better market access (lower tariffs) to the final destination. They are not intended to be a trade policy instrument to steer individual countries' development paths, or to achieve outcomes that are inconsistent with a country or region's existing competitive advantage or wish list of development outcomes.

RoO in African regional economic communities (RECs) are a negotiated outcome amongst the respective Member States that are party to the agreement. The AfCFTA RoO do not replace these preferential arrangements and explicitly recognise them as building blocks towards African economic integration whose intra-regional trade preferences continue. In fact, the continental AfCFTA RoO apply only to the trade in goods between countries not already in a preferential trade arrangement; for example, between South Africa (SADC) and Ethiopia (COMESA) or Ghana (ECOWAS) and Kenya (EAC). The end-result is that all AfCFTA Member States can trade with every other African country on a preferential basis, albeit not under a harmonised set of RoO criteria and tariffs regime.

The AfCFTA RoO are still being finalised – although much progress has been made and the bulk of provisions are agreed. The process has been challenging and has taken longer than expected. Difficulties naturally present themselves when countries defend their national interests which may not be aligned with that of their REC or those of other Member States. RECs also had to manage the co-existence of REC RoO with new AfCFTA RoO, and the limited 'policy space' to agree to rules that might differ fundamentally from pre-existing regional outcomes, although such scenarios may also frequently present themselves as important new opportunities to embrace.

Parallel tariff negotiations present an inherent challenge since they relate to RoO: where tariffs are low, the RoO play less of a role than where tariff outcomes (representing the margin of preference) are high. Of course, countries also have different development aspirations and sometimes see RoO outcomes as a means to encourage these.

In a few sectors – with much riding on the outcome – RoO are still being finalised. These include the clothing sector and various textile classifications along with household textiles, certain sugar-containing products, tobacco products, and certain fish provisions (mainly around the criteria of the vessel involved in the fishing effort). In other sectors, around 20 categories, negotiations have concluded with an outcome rarely seen: agreement on rules that can be considered fairly flexible (allowing foreign inputs), with an automatic change after 3 or 5 years to a rigid rule that requires all inputs to be sourced locally or in other AfCFTA Member States. In one or two instances, the change will be subject to a review at that time.

The objective of this is clearly – apart from possibly representing negotiations compromises – to give countries a time-bound 'opportunity' to start sourcing inputs on the continent rather than from abroad (or put differently, for producers of the required African inputs to emerge). Liberal rules that allow up to 60% non-originating content in most instances change to a rule that requires all materials to be wholly obtained (i.e. African content), subject to some flexibility delivered by the value tolerance provisions (these general AfCFTA provisions allow 15% non-originating content to be used, irrespective of the AfCFTA base rule). This ostensibly forces the value chain to be an almost entirely *African* value chain where the intention is to claim origin under the AfCFTA regime. This may or may not be a successful approach, and there are past examples where this approach was followed, and failed, with the required local materials just not being or ever becoming available.

It is important to keep in mind the end-game: a producer trading a product that must comply with rigid (or flexible) local processing criteria in order to obtain origin status under a given trade regime will only do so if the product is still able to remain commercially competitive in the final destination market where it is shipped to under claim of preference. This must consider the available preference margin, against the transaction costs (and potential trade facilitation obstacles) of sourcing inputs from local or regional sources. Otherwise, traders will simply forego preferential origin status and either just pay the applicable import duties, or not trade in the first place.

The approach taken in the AfCFTA negotiations – with the rules that contain a transitional element, and many others – appears to have been steered by a desire to capture more of the value chain by linking this to preferential origin. In fact, it is evident that AfCFTA rules are often more rigid than REC rules, indicative perhaps of the value chain argument but also countries playing it 'safe', avoiding outcomes where non-REC trade is under more flexible rules than intra-regional trade.

This is often well intentioned but carries risks. A blanket approach to AfCFTA RoO that considers rigid rules a solution that is supportive of African value chains is bound to fail and undermine rather than encourage trade; instead, such an approach when it is taken must be selective, and consider the dynamics of each sector, not just in the African context but in the broader global value-chain context.

A value chain where production of important inputs is centered in certain parts of the world (for example, many of the types of textiles needed in modern clothing production) should contain sufficient flexibility to allow downstream producers access to these supply networks – not least because buyers (retailers, brand owners) demand this and play such an important role in these production networks.

Ditto products that have unique product characteristics, be it blended tobacco products (specific cigarette brands that conform to a certain international tobacco blend and taste profile), goods that require specific technology inputs available only outside of Africa, or coffee where discerning consumers might demand a flavour profile that is only possible by blending beans sourced from different international regions, and where the RoO should accommodate this.

The transitional rules that are set to graduate to more restrictive all-Africa sourcing criteria are a novel (and probably deadlock-breaking) attempt at providing some advance warning to producers and traders to encourage greater local and regional sourcing, if not now, then in the medium-term. But it may also introduce uncertainty for producers sitting on the fence about investing in production facilities with a view towards establishing new markets, especially where it is not abundantly clear that a 'wholly obtained' rule could be met down the line once it becomes applicable, or if indeed, another change is in the offing.

The design of RoO impacts on how Africa trades with itself, how producers are able to link into global production networks, and sustain or develop new regional ones. RoO can encourage greater intra-African trade if they complement the realities on the ground in terms of the current or potential availability of competitively priced and accessible inputs, or they can become a barrier, where trade – if it happens – takes place in spite of the RoO and in no way encouraged or driven by them.

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