

DE-FRAGMENTING AFRICA

Deepening Regional Trade Integration
in Goods and Services



THE WORLD BANK

Edited by Paul Brenton and Gözde Isik

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List of Abbreviations

| | |
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| ADDO | Accredited Drug Dispensing Outlets |
| AGOA | African Growth and Opportunity Act |
| AGRA | Alliance for a Green Revolution in <i>Africa</i> |
| AIO | African Insurance Association |
| ANAFLUKIS | Association des Navigateurs Fluviaux de Kisangani |
| APEC | Asia-Pacific Economic Cooperation |
| ASEAN | Association of Southeast Asian Nations |
| ASYCUDA | Automated System for Customs Data |
| ATS | Automated Trading System |
| BCEAO | Central Bank of West African States |
| CA | Chartered Accountant |
| CACM | Central American Common Market |
| CARIFORUM | The Caribbean Forum |
| CDD | Customer Due Diligence |
| CEPGL | The Economic Community of the Great Lakes Countries |
| CES | Central Equatoria State |
| CNTF | Coordination Nationale des Transports Fluviaux |
| ONATRA | Office National des Transports |
| COMESA | Common Market for East and Southern Africa |
| CPA | Comprehensive Peace Agreement |
| CSD | Central Securities Depository |
| DOT | Department of Transportation |
| DRC | Democratic Republic of Congo |
| DSE | Dar-Es-Salaam Stock Exchange |
| EAC | East African Community |
| ECCAS | Economic Community of Central African States |
| ECOWAS | Economic Community Of West African States |
| EFTPOS | Electronic Funds Transfer at Point of Sale |
| EPA | Economic Partnership Agreement |
| EU | European Union |

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| FAO | Food and Agriculture Organization |
| FDI | Foreign Direct Investment |
| FSDRPI | Financial Sector Development and Regionalization Project |
| FTA | Free Trade Area |
| GATS | General Agreement on trade in Services |
| GDP | Gross Domestic Product |
| GIM | Groupement Interbancaire Monétique |
| GoNU | Government of National Unity |
| GoSS | Government of South Sudan |
| HLL | Hindustan Lever Limited |
| ICEA | Insurance Company of East Africa |
| IFRS | International Financial Reporting Standards |
| IOSCO | International Organization of Securities Commissions |
| IP | Intellectual Property |
| KACITA | Kampala City Traders Association |
| KCB | Kenya Commercial Bank |
| LRA | Lord's Resistance Army |
| MCI | Ministry of Commerce and Industry |
| MERCOSUR | Common Southern Market |
| MFI | Microfinance Institution |
| MFN | Most Favored Nation |
| MOU | Memorandum of Understanding |
| MRA | Mutual Recognition Agreement |
| MTO | Money Transfer Operators |
| NAFTA | North American Free Trade Agreement |
| NBFI | Non-Bank Financial Institution |
| NMC | National Monitoring Committees |
| NSE | Nairobi Stock Exchange |
| OECD | Organization for Economic Cooperation and Development |
| OSBP | One-Stop Border Post |
| REC | Regional Economic Community |
| RIA | Regulatory Impact Assessment |
| ROO | Rules of Origin |
| RTA | Regional Trade Agreement |
| RTGS | Real Time Gross Settlement Systems |
| SACU | Southern Africa Customs Union |
| SADC | Southern Africa Development Community |
| SAICA | South African Institute of Chartered Accountants |
| SICA | Système Interbancaire de Compensation Automatisé |
| SME | Small and Medium Sized Enterprise |
| SPLA | Sudan People's Liberation Army |
| SPS | Sanitary and PhytoSanitary |
| SSA | Sub-Saharan Africa |
| STAR | Système de Transfert Automatisé et de Réglemen |
| TMCM | Trade Monitoring and Compliance Mechanism |
| UEMOA | West African Economic and Monetary Union |

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| USE | Uganda Stock Exchange |
| VAT | Value Added Tax |
| WAICA | West African Insurance Companies Association |
| WAMZ | West African Monetary Zone |
| WHO | World Health Organization |
| WTO | World Trade Organization |

Preface

This book is the result of an extensive agenda of analytical work on regional trade integration in Africa involving staff from various units of the Africa region of the World Bank. The aim of this volume is to provide the main messages from this work to a wide audience—the private sector, civil society, key ministries, relevant agencies—that is necessary to provide the consensus and broad base for successful implementation of reforms. In addition, opportunities to transfer and spread lessons and findings from analytical work across countries and regions within Africa tend to go unexploited. The objective of this volume is to bring policy relevant analysis and recommendations from one country or region to the attention of policy makers and stakeholders in other countries or regions in Africa.

We are very grateful to the authors of the chapters in this volume for making their work available for a wider audience. We would also like to thank the following for providing peer review comments on the volume: Mariem Malouche, Jean-Christophe Maur and Andrew Roberts. Thanks for comments and advice is also due to Philip Schuler, Rick Scobey and Ravi Yatawara. The projects underlying the chapters in this volume were funded by the Multi-Donor Trust for Trade supported by the governments of Finland, Norway, Sweden and the United Kingdom. The views expressed in this collection reflect solely those of the authors and not necessarily the views of the funders, the World Bank Group or its Executive Directors.

Additional material relating to this collection can be found on the trade page of the website of the Africa region of the World Bank (www.worldbank.org/afr/trade). For example, there are videos (one on conditions for cross-border traders in the east of the DRC and one on distributions services in east Africa) and presentations from studies on regional integration in southern Africa and professional services. There are also a number of blogs relating to chapters in the book. Most important the website gives an opportunity for feedback from those dealing with the issues covered here in their daily lives. We would be delighted if this volume encourages a more open and inclusive discussion and dialogue between all stakeholders on how regional integration can be designed and implemented in Africa to deliver tangible benefits to ordinary people.

Paul Brenton
Gozde Isik
November 2011

Foreword

Regional trade integration has long been a strategic objective for Africa. However, the African market remains highly fragmented. While there has been some success in removing import duties within regional communities, a range of non-tariff and regulatory barriers still raise transaction costs and limit the movement of goods, services, people and capital across borders. The end-result is that Africa has integrated with the rest of the world faster than with itself.

Effective regional integration is of particular pertinence now. While uncertainty surrounds the global economy and stagnation is likely to continue in traditional markets in Europe and North America, enormous opportunities for cross-border trade within Africa in food products, basic manufactures and services remain unexploited. The cross-border production networks that have been a salient feature of development in other regions, especially east Asia, have yet to materialise in Africa. This is a self-inflicted wound, for integration could provide a much-needed source of export diversification away from minerals and hydrocarbons—not to mention of job creation.

Of course, intra-Africa fragmentation is not just bad for efficiency—it is also bad for equity. The incidence of barriers to regional trade fall most heavily, and disproportionately, on the poor and on women, and is preventing them from earning a living in activities where they have a comparative advantage—catering for smaller, local markets across the border.

This book brings together a collection of papers that look at the nature and impact of barriers to trade within Africa. The varied contributions draw attention to a wide range of constraints, distortions and abuses, and unveil the complexity of the reform agenda that is necessary to address them. The chapters have been written in a non-technical language, with the explicit intention of promoting dialogue about integration amongst policy makers, regulators, entrepreneurs, consumers, academia, and the broad international development community. Behind each chapter lie more detailed technical reports that are available on the trade website of the World Bank's Africa Region.

What are the key messages? There are five:

1. Effective regional integration is more than simply removing tariffs—it is about addressing on-the-ground constraints that paralyze the daily operations of ordinary producers and traders.

2. This calls for regulatory reform and, equally important, for capacity building among the institutions that are charged with enforcing the regulations.
3. The integration agenda must cover services as well as goods. Why? Because services are critical, job-creating inputs into the competitive edge of almost all other activities—think of the role that transport plays in manufacturing.
4. Simultaneous action is required at both the supra-national and national levels. Regional communities can provide the framework for reform, for example, by bringing together regulators to define harmonised standards or to agree on mutual recognition of the qualification of professionals—imagine the benefits of allowing African doctors, nurses, teachers, engineers and lawyers to practice anywhere in the continent, regardless of the African country they come from. But responsibility for implementation lies with each member country.
5. The international donors should refocus their efforts toward helping countries understand the political economy behind resistance to integrative reforms. How come leaders publicly and, by and large, genuinely pledge support for integration, but actual barriers to trade remain in place?

Needless to say, the World Bank is committed to helping Africa integrate with itself. This volume is part of a larger analytical and financing menu of support meant to facilitate that integration. Our work is driven by partnerships—with subregional secretariats, the African Development Bank, the African Union, the United Nations Economic Commission for Africa, among others. It is enriched by multi-sectoral approaches (conceptual integration, if you will). It focuses on delivering just-in-time technical advice for capacity building—the “knowledge platform” on professional services that the Bank is implementing together with the COMESA Secretariat is a great example of that. And it will be underpinned by resources: a new instrument, called “Regional Development Policy Operation”, has been designed to provide untied, fast-disbursing financial support to countries that decide to jointly implement policies leading to mutual trade integration. The final prize is clear: helping Africans trade with each other. Few contributions carry more development power than that.

Marcelo M. Giugale
Director of Economic Policy and Poverty Reduction Program for Africa
The World Bank
Fall 2011

1. Introduction

Linking African Markets: Removing Barriers to Intra-Africa Trade

Paul Brenton and Gözde Isik¹

Introduction

Regional integration in Africa has long been recognized as essential to address the issues of the small economic size of many countries and the often arbitrarily drawn borders that pay little heed to the distribution of natural endowments. But, as is often noted, Africa trades little with itself, at least to the extent that is recorded in official customs statistics. For example, the share of intra-regional goods trade in total goods imports is only around five percent in COMESA, 10 percent in ECOWAS and eight percent in UEMOA. This compares with over 20 percent in ASEAN, around 35 percent in NAFTA and more than 60 percent in the EU. On the other hand, intra-regional trade in MERCOSUR is about 15 percent of total imports and less than eight percent in CACM (see Acharya et al. 2011).

Africa is not achieving its potential in regional trade. The contributions to this volume highlight the enormous scope for increased cross-border trade in Africa and the reasons why such opportunities are not being exploited. Regional trade can bring staple foods from areas of surplus production across borders to growing urban markets and food deficit rural areas. With rising incomes in Africa there are emerging opportunities for cross-border trade in basic manufactures such as metal and plastic products that are costly to import from the global market. The potential for regional production chains to drive global exports of manufactures, such as those in East Asia, has yet to be exploited, and cross-border trade in services offers untapped opportunities for exports and better access for consumers and firms to services that are cheaper and provide a wider variety than those currently available.

This unrealized potential is evidenced by the fact that a significant amount of cross-border trade does take place between African countries, but it is constricted to informal channels and is not measured in official statistics. Such trade is essential for welfare and poverty reduction, since poor people, and especially women, are intensively engaged in the informal production and trading of the goods and services that are actually crossing African borders. Allowing these traders to flourish and gradually integrate into the formal economy would boost trade and the private sector base for future growth and development.

¹ Paul Brenton is the Trade Practice Leader for the Africa Region and Gözde Isik is a Consultant in the Africa Poverty Reduction and Economic Management Department of the World Bank.

The main objective of this introductory chapter is to draw attention to the key reason why Africa's potential for regional trade remains unexploited: the high transaction costs that face those who trade across borders in Africa. The contributions to the volume discuss a wide range of policy related barriers that drive up costs and limit trade. The volume is organized around the following three related policy issues:

1. Facilitating cross-border trade, especially by small poor traders, many of whom are women, by simplifying border procedures, limiting the number of agencies at the border and increasing the professionalism of officials, supporting traders associations, improving the flow of information on market opportunities, and assisting in the spread of new technologies such as cross-border mobile banking that improve access to finance.
2. Removing a range of non-tariff barriers to trade, such as restrictive rules of origin, import and export bans, and onerous and costly import and export licensing procedures
3. Reforming regulations and immigration procedures that limit the substantial potential for cross-border trade and investment in services.

The main message of this work is that to deliver integrated regional markets that will attract investment in agro-processing, manufacturing and new services activities, policy makers have to move beyond simply signing agreements that reduce tariffs to drive a more holistic process to deeper regional integration. An approach is needed that: reforms policies that create non-tariff barriers; puts in place appropriate regulations that allow cross-border movement of services suppliers; delivers competitive regionally integrated services markets; and builds the institutions that are necessary to allow small producers and traders to access open regional markets. The appropriate metric for successful integration is not the extent of tariff preferences but rather reductions in the level of transaction costs that limit the capacity of Africans to move, invest in, and trade goods and services across their borders.

This is a different approach to one that proceeds within the straightjacket of specific sequential steps to integration: free trade area, customs union, common market, and economic and monetary union. For example, there are enormous opportunities from trade in services in Africa that are not dependent on a common external tariff being in place. Countries can work to improve trade facilitation at the border and to remove non-tariff barriers with neighbors while free trade agreements are being designed and implemented. Countries that are not members of the same free trade agreements can work to disseminate information on market prices to producers and traders.

The chapter starts with a review of recent export performance in Africa, noting the strong growth rates in many countries. However, the impact of such growth on employment and poverty has been very muted and important challenges remain, especially with regard to greater diversification of exports, and it is here that effective regional integration that reduces transaction costs can play a key role. The paper then discusses the key barriers that raise costs for traders and continue to fragment the African market. Finally, the paper ends with some specific recommendations for action that policy makers can take at the regional level to support integrated markets in Africa and discusses how the World Bank and other donors can support those wishing to implement the necessary reforms.

Regional Integration Can Play a Key Role in Export Diversification

Until the onset of the financial crisis, most sub-Saharan African (SSA) countries grew rapidly and often at much higher rates than the world average. Economic growth in these countries was robust and driven by the boom in commodity prices, which led to very high growth in export values, especially for minerals, to new fast-growing markets such as India and China. All SSA countries experienced steep export declines in 2009, but have since recovered sharply on the back of increased exports to China. SSA exports to the OECD markets fell in 2009 as a result of the financial crisis as did their exports to China, except for EAC, which grew in that year. Since then SSA exports to OECD markets have only shown slow growth from their 2009 trough. But exports to China have grown much more rapidly. For example, EAC exports to the OECD countries were over 20 times the value of those to China in the first half of 2008 (US\$1.9 billion versus US\$88 million) but two years later were only six times higher (US\$1.7 billion versus US\$259 million). However, most of this new trade with China is in primary commodities, particularly precious metals, which are low value-added and/or capital intensive.

While exports have grown strongly over the last decade, and the region's trade has recovered well from the global crisis, the impact on unemployment and poverty has been disappointing in many countries. Unemployment remains around 24 percent in South Africa. In Tanzania, extreme income-poverty appears to have remained broadly constant at around 55 percent of the population. In Burkina Faso, income-poverty has been stagnant since 1997. This reflects that export growth has typically been fueled by a small number of mineral and primary products with limited impacts on the wider economy and that formal sectors remain small in many countries.

Hence, key objectives in Africa remain to diversify the export base away from dependence on commodities and implement policies that allow more people to participate in trade. This requires measures that will improve the conditions of firms and individuals in informal sectors, increasing their opportunities to interact with formal sector firms and providing a coherent route towards formality. Informal sector actors must be seen as providing an enormous opportunity for growth and poverty reduction rather than simply as a source of revenue loss that must be removed. Growing and more youthful populations increase the need for more inclusive and employment intensive trade and growth and at the same time offer a real opportunity for Africa to harness an enormous potential advantage that can drive productivity and growth over a sustained period as happened in east Asia in the 1980s and 1990s and more recently in China.

Regional integration and the boosting of intra-regional trade can play a critical role in achieving these objectives in Africa. Deeper integration of regional markets can lower trade and operating costs and relax the constraints faced by many firms in accessing the essential services and skills that are needed to boost productivity and diversify into higher value-added production and trade. Goods traded across borders in Africa will tend to be more employment intensive than minerals and the facilitation of such trade is likely to have a more direct impact on poverty in terms of the poor who both produce and trade the basic foodstuffs that dominate such trade. (See, for example, Chapter 2 by Brenton et al., which draws attention to the participation of poor women in cross-border trade in the east of the Democratic Republic of the Congo (DRC) and the bad conditions they often face in crossing the border, which are briefly summarized in Box 1.1.)

One imperative is to address the long-standing problem of overlapping trade agreements that have different commitments. Many countries are party to multiple agreements. Since each regional community has tended to develop its own trade regime (for example SADC has a very different set of rules of origin governing the granting of trade preferences to that of COMESA), the membership in multiple agreements often entails applying differing trade rules to different regional partners. This hampers trade flows by raising the costs involved for traders in meeting multiple sets of trade rules and gives rise to inconsistencies in the rules and procedures applied by the different trade agreements, distorting regional markets and causing severe problems of effective implementation. Indeed, important steps are being made to rectify this problem such as in eastern and southern Africa where a new initiative is being pursued to bring together COMESA, EAC and SADC under a single tripartite arrangement.

Box 1.1. Risky Business: Poor Women Cross-Border Traders in the East of the DRC

Cross-border trade between the DRC and neighbors in the Great Lakes region is dominated by women and provides an essential source of income to many households in the region. A recent survey of traders at four border posts in the region identified the following key features of cross-border trade: the majority of traders are women (85 percent of the respondents); most of the officials who regulate the border are men (82 percent); for almost two-thirds of the respondents, income from cross-border trade is the main source of income, and most (77 percent) report that household income is heavily dependent on their trading activity.

Cross-border traders regularly have to pay bribes and suffer harassment. The responses from the survey paint a dark picture of the conditions experienced by poor women cross border traders. It is striking that payments of bribes is a regular occurrence for the majority of traders. Respondents at all four border posts repeated a catch phrase used by officials: "sans argent, on ne passe pas" (no money, no passing). An important feature of border crossings between the DRC and neighboring countries in the Great Lakes region is the large number and range of officials at the border. This exacerbates the problem of poor governance with negative consequences for cross-border traders. A lack of transparency and awareness by both traders and officials of the rules and regulations that are supposed to govern cross-border movements of goods and people compound this situation. A typical account of every day conditions is provided by an egg and sugar trader from Goma: "I buy my eggs in Rwanda; as soon as I cross to Congo I give one egg to every official who asks me. Some days I give away more than 30 eggs!"

A large number of traders report being subject to acts of violence, threats, and sexual harassment. Traders are exposed to beatings, verbal insults, stripping, sexual harassment, and even rape. Much of this abuse is unreported.

Cross-border traders face regular losses in the form of the almost mandatory payment of bribes and are regularly subject to harassment and physical abuse. This lack of economic and physical security and safety undermines the livelihoods of these traders and compounds their lack of access to finance, information, and business knowledge.

Nevertheless, there are critical policy issues to be addressed beyond ensuring consistency between different regional communities. A key theme of this collection of papers on trade in Africa is that the recipe and toolkit for successful regional integration in the 21st century is quite different from that pursued in the 20th century. Old regionalism focused on the mutual exchange of tariff preferences and trade in goods. The new regionalism concerns a wide range of regulatory issues and is about the "trade-investment-services nexus" (Baldwin 2011). The exchange of tariff preferences has not stimulated regional trade and economic development and the potential for regional integration to drive diversification into a wider range of higher value added goods and services has not been exploited. Regional integration in Africa has not provided a springboard for new exports to the global economy, as happened in East Asia, and cross-border trade remains primarily informal because the costs of trading across borders in Africa remain very high.

There has been considerable success in removing tariffs on intra-regional trade, especially in Eastern and Southern Africa where, for example, the EAC has implemented a Customs Union and 85 percent of intra-regional trade in SADC is duty free, but less so in Central and Western Africa where only very

limited amounts of trade cross borders with a regional tariff preference. Nevertheless, the importance of tariff preferences has diminished. In the modern world economy the scope for tariff preferences to drive economic integration and economic development has been very much neutered. This reflects, first, that all countries in Africa reduced their external tariffs during the final 20 years of the last century. This has reduced the scope for significant trade preferences in all but a few sectors. Second, and more important, as tariffs have come down the need to address a range of non-tariff barriers that severely limit cross-border trade has become apparent. At the same time, the declines in communications costs and the splitting up of production chains to allow different tasks to be completed in different locations have transformed the nature of global trade. This has put a high premium of on low transaction costs for shifting goods, services, people, and capital across borders.

There is Substantial Scope for Trade Across Borders in Africa

It has been commonly argued that regional integration can only play a limited role in Africa because of the similarity of endowments between countries. However, this does not reflect the enormous opportunities for cross-border trade in agricultural products from areas with a food surplus to food deficit areas that result from differing seasons and production patterns. For example, Southern Malawi is not well endowed with agricultural potential and is a persistent food deficit area. Nearby Northern Mozambique is a productive area for growing maize, the main staple of the region, but it is distant from the main area of national consumption in the south of the country. Differences in weather patterns entail low correlations in production between countries and that regional production is less variable than production at the country level. Hence, regional trade integration can have a substantial impact by better linking farmers to consumers across borders and in ameliorating the effects of periodic national food shortages and increasing global food prices.

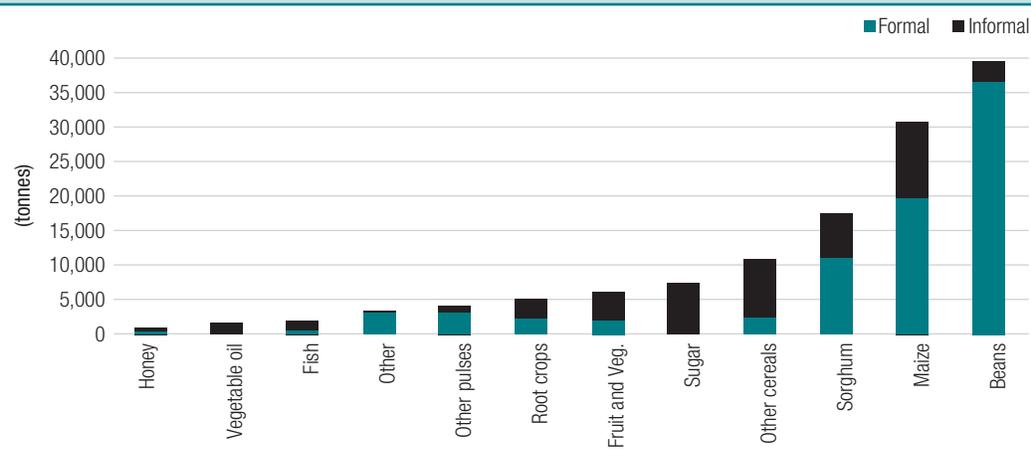
Indeed, the production of food staples for growing urban markets and food deficit rural areas represents the largest growth opportunity for Africa's farmers. The market value of Africa's food staple production is a least US\$50 billion per year, equivalent to three-quarters of all agricultural output (World Bank 2008). Given population growth and increased urbanization, Africa's demand for food staples will grow dramatically in the coming decade. Linking rural food surplus production zones in Africa to major deficit urban consumption centers requires a well-functioning regional market for these products. However, African small holder farmers who sell surplus harvest typically receive less than 20 percent of the market price of their products with the rest being eaten away by various transaction costs and post harvest losses (AGRA 2009). This clearly limits the incentive to produce for the market.

There is, however, a significant amount of cross-border trade that takes place between African countries that is not measured and therefore official statistics considerably understate the amount of intra-regional trade.² Due to the lack of consistent measurement

² In Chapter 4, Yoshino et al. explain that there can be complementarity between formal and informal trade, which underlines the similarity in products traded formally and informally. Informal trade activities can take place as stand-alone cross-border transactions such as crossing borders outside of the areas covered by border posts. But in many cases, informal trade takes place next to formal trade at border posts. The same goods can cross the border formally or informally—by foot, bicycle, motorbike, passenger car, bus, carried in small quantities. A number of the chapters in the volume demonstrate that informal trade is not characterized by avoidance of official border crossings but rather by the lack of organization of the traders undertaking the trade.

Figure 1.1 >

Formal and Informal Trade by Food Commodity in East Africa January–June 2011



Source: FEWS NET.

tools and reliable data, it is difficult to get an accurate overview of the actual scope of informal cross-border trade that takes place in sub-Saharan Africa, however, a number of studies and surveys reveal that unrecorded trade flows represent a significant share of cross-border trade in the region. Surveys indicate that in some African countries, informal regional trade flows represent up to 90 per cent of official flows. In Uganda, for instance, informal trade grew by 300 percent from 2007 to 2009, where informal exports to neighbors is estimated to account for around 86 percent of official export flows to these countries.⁵

The vast majority of informal cross-border trade in Africa involves staple food commodities, livestock, and low quality consumer goods, and often consists of small, irregular consignments in border areas. However, these small consignments, when added up, constitute significant aggregate volumes representing up to over half of official flows (Figure 1.1). In West Africa, informal cross-border trade has extended to the entire territory of countries. Cross-border flows of gasoline, grain and fertilizer from Nigeria have, for instance, moved beyond border areas in Niger and penetrated Mali, Burkina Faso, and Ghana (Lesser and Moisé-Leeman 2009).

In addition, as countries in Africa grow and develop, opportunities for cross-border trade are arising in basic manufactures such as plastics, simple chemicals, paints and cosmetics, construction materials, and pharmaceuticals.⁴ Significant amounts of plastic containers produced in Kampala are taken across borders and sold in South Sudan and the DRC. Basic manufactures are shipped from Nigeria across the border into Cameroon. Typically, these products are very expensive to transport long distances in finished forms and the processing of basic materials usually takes place closer to consumers.

There is also the potential for regional production chains. In Asia, advanced production networks have deepened regionally and underpinned its spectacular global export growth

⁵ Uganda Bureau of Statistics.

⁴ Panapress reports that the Cape Verdean pharmaceutical company, Inpharma, is exporting products to Guinea-Bissau as well as Sao Tome and Principe and is considering markets in other neighboring countries, such as Guinea Conakry. The pharmaceutical company produces 73 drugs in Cape Verde.

from a poor, underdeveloped agricultural backwater to becoming the global factory over a 50-year period. In the 1960s, developing Asian economies lacked natural resources and had high levels of poverty. There seemed to be little prospect of economic advancement. However, Asian economies had ample supplies of inexpensive, productive manpower, not unlike many African countries today. They were also close to an expanding high-income Japan, with firms seeking to expand to lower cost destinations. Subsequently, intra-regional trade in Asia increased significantly, particularly in the production of parts and components with each process relocating to the most cost-effective destination in the region.

This trade in parts, components, and accessories encouraged specialization of different economies, leading to “trade in tasks” that adds value along the production chain. Specialization is no longer based on the overall balance of comparative advantage of countries in producing a final good, but on the relative efficiencies in providing different “tasks” at specific steps along the global value chain (WTO 2011). This in turn implies concern that production similarities in Africa limit the scope for intra-regional trade is less pertinent, and that efforts to develop production capacities prior to removing barriers to trade may be fruitless and will likely deny opportunities to develop specialization in particular tasks and the emergence of cross-border production networks.

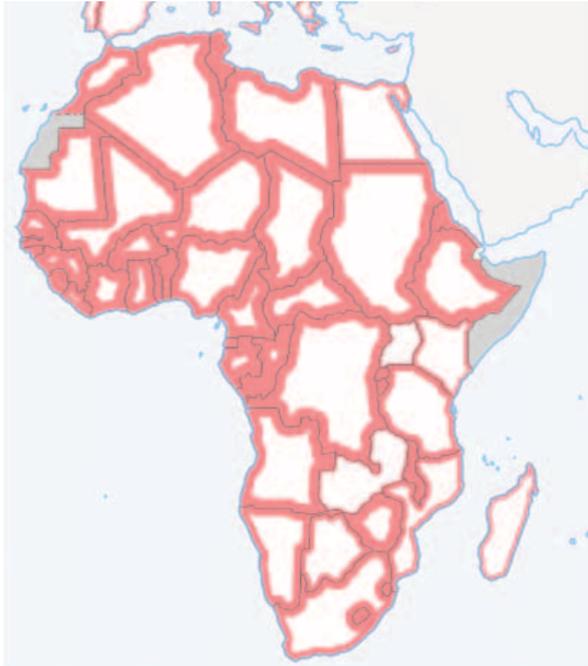
Factory Southern Africa has yet to materialize, despite the fact that South Africa has the logistics, expertise, and the capital to compete globally but these factors need to be combined with cost-effective endowments of labor and natural resources located in the smaller countries (World Bank 2011a). Production processes have not been broken down into smaller processes due to the persistence of trade barriers that raise trade costs and create uncertainty. And in those few cases where integrated production networks have appeared, they have been stifled by restrictive policies. If all countries were to open up to the region, exploiting these advantages collectively would encourage vertical specialization and the emergence of regional value chains thereby creating employment and promoting export diversification. Similar production chains could emerge around Nigeria and Kenya, the regional powerhouses of West and East Africa.

Finally, there is the potential for cross-border trade in services. Services trade between African countries is also poorly measured but examples of the opportunities that are available are becoming increasingly apparent. For example, Uganda has become a successful exporter of education services to countries in East Africa. In West Africa, Nigerian financial institutions have expanded branch networks throughout the region making available the benefits of scale to consumers in very small countries. African supermarket chains are spreading throughout the continent. Cross-border mobile banking can transform payment mechanisms for small informal traders and facilitate the spread of financial services in poor communities (see Chapter 6 by Maimbo and Saranga).

Cross-border Trade in Africa is Limited by Thick Borders

As indicated, there are numerous opportunities for firms and individual traders to increase trade across Africa’s borders and at the same time reduce dependence on a few resource based exports to the global market, contributing to food security, increasing employment, and reducing poverty. But what is preventing these opportunities from being exploited? In Asia, reductions in trade costs across the region drove increasing integration and cross-border trade and supported strong export growth to the global market. However, in Africa

Figure 1.2 >

Borders in Africa Remain Very Thick^a

Source: World Bank (2009).

^aThe wider the border, the more the country limits trade, travel and the flow of factors of production. The measure uses information on average tariffs, capital openness, proportion of countries that need a visa to visit that country, and a press freedom index that includes information such as internet filtering. For more details see World Bank 2009.

borders remain very thick relative to other parts of the world, fragmenting the African market see Figure 1.2.

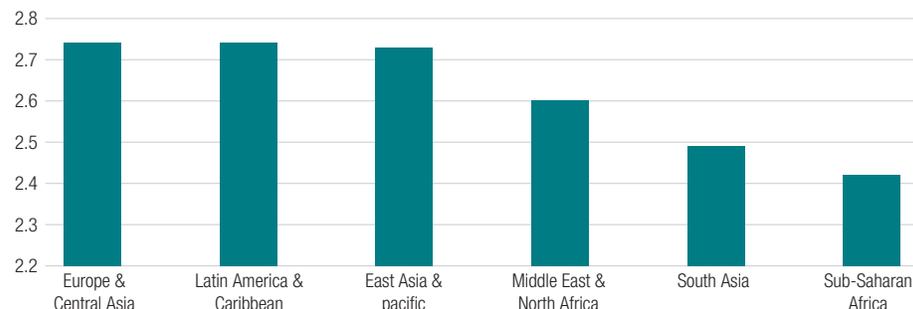
The World Bank's Logistics Performance Index, based on a worldwide survey of global freight forwarders and express carriers, demonstrates that African countries lag significantly behind other regions in key areas such as customs, infrastructure, competence in logistics, and timeliness of exports and imports (World Bank, 2010a). Figure 1.3 shows that sub-Saharan Africa performs relatively poorly relative to other regions in the quality and performance of trade related logistics.⁵

This is reinforced by the results of the latest Doing Business report. This shows that in sub-Saharan Africa it takes, on average, 38 days to import and 52 days to export goods across borders, whereas the number of days required is significantly lower in other regions. Similarly, the cost of trading across borders is the highest in the sub-Saharan Africa region, over twice as high compared to East Asia and OECD countries.

World Bank (2011b) compares the prices of agricultural products in a wide range of markets in Burundi, the DRC and Rwanda. The analysis finds that the effect of crossing

the Burundi-Rwanda border on relative prices is equivalent on average to pushing the two markets an additional 174 km or 4.6 hours further apart. However, crossing the

Figure 1.3 >

Logistics Performance Index 2010 – Regional Averages

Source: World Bank 2010

⁵ Higher numbers represent better performance.

Table 1.1 > Trading across Borders in SSA is Costly and Time Consuming

| | Days to export | US\$ per container cost to export | Days to import | US\$ per container cost to import |
|------|----------------|-----------------------------------|----------------|-----------------------------------|
| EAP | 22.7 | 890 | 24.1 | 935 |
| ECA | 26.7 | 1,652 | 28.1 | 1,845 |
| LAC | 18.0 | 1,228 | 20.1 | 1,488 |
| MENA | 20.4 | 1,049 | 24.2 | 1,229 |
| OECD | 10.9 | 1,059 | 11.4 | 1,106 |
| SAR | 32.3 | 1,512 | 32.5 | 1,744 |
| SSA | 32.3 | 1,960 | 38.2 | 2,492 |

Source: Doing Business (2011)

Burundi-DRC border is equivalent on average to pushing markets in each country 1824 km or 41 hours further apart whereas crossing the DRC-Rwanda border is equivalent to adding an extra 1549 km and an additional 35 hours. This reflects the very high financial and physical costs in crossing the DRC border that are summarized in Chapter 2 by Brenton et al. (also see Box 1.1).

Kinshasa-Brazzaville, currently the third largest urban agglomeration in Africa, and predicted to become Africa's largest city by 2025, has an international border running right through it. This regional hub of economic activity is the obvious focal point for cross-border exchanges between the two Congos. Chapter 3 by Brulhart and Hoppe "Economic Integration in the Lower Congo Region: Opening the Kinshasa-Brazzaville Bottleneck" shows that despite their size, proximity and status as regional trade hubs, both formal trade and passenger traffic between the two cities is pitifully small. Only 1.12 percent of all imports recorded by the Republic of Congo (RC) come from the Democratic Republic of Congo (DRC). Passenger traffic is around five times smaller than that between East and West Berlin in 1988—well before the dismantling of the Wall! The volume of passenger traffic, scaled to city sizes, is also just a half of one percent of the size of river-crossing passenger traffic in Kisangani, another conurbation straddling the Congo River, but not crossed by a national border.

The cost of crossing the Congo River at the Malebo Pool jumps out as the main culprit. The average cost of a return trip is estimated at US\$40, equivalent to between 40 and 80 percent of the average monthly income earned by Kinshasa residents. If residents travelling between San Francisco and Oakland (which are separated by a similar distance) had to pay pro rata the same level of fees as people crossing from Kinshasa to Brazzaville they would pay between \$1200 and \$2400 for a return trip! The costs of formally shipping goods across the pool are also exorbitant. These absurdly high prices largely result from lack of competition in river crossing services in the form of the duopoly granted to the two national operators, ONATRA (in the DRC) and CNTF (in the RC) and their lack of investment that has limited transport capacity. Cumbersome customs procedures are also costly and cause long delays for both passengers and the transportation of goods. For example, only four agencies are mandated to be present at the Kinshasa border crossing, yet up to 17 agencies operate there, raising fees from traders and travelers without offering any corresponding services.

Yoshino et al. in Chapter 4 also find high trading costs leading to large disparities in food prices between Juba in South Sudan and Ugandan cities. Maize in Juba is about three times more expensive than in Ugandan cities, while beans in Juba are about twice as expensive as in Uganda cities. With beans, for example, trading costs build up as a ton of beans is transported from a market in Kampala to a market in Juba. Transport and logistics costs (\$145 per ton; with \$93 inside Uganda and \$52 inside South Sudan) as well as duty and other official charges (\$218.33 per ton) are the categories in which a substantial portion of the total trading cost is accrued. For other products covered by the study, which are similarly regionally produced and traded, such as maize, water, beer, and cement, the size of trading costs is similarly significant.

These examples capture what is a common feature in Africa that the cost of moving goods between countries is high, transit times uncertain and delays exceptionally long. Unless all the factors leading to these symptoms are addressed, SSA's trade competitiveness will remain compromised. The costs are high partly due to the large infrastructure deficit on the continent. The Africa Infrastructure Country Diagnostic study (World Bank (2010b)) found there is a deficit across all the key core infrastructure, transport, telecommunications and energy. Clearly there is a need to scale up the levels of investment in trade related infrastructure. Though road infrastructure along the major international trade corridors is increasingly in fair to good condition, the same is not the case on the intra-regional links which require much greater attention in discussions about filling the infrastructure gap in Africa.

However, infrastructure improvements alone, though important, will neither significantly reduce trade transaction costs nor improve reliability. Empirical evidence suggests that only about a quarter of delays along major transport corridors are as a result of poor infrastructure, the rest being due to non-tariff barriers and poor trade facilitation. Improvements in infrastructure can help reduce travel time and vehicle operating costs while other measures are needed to reduce operational and bureaucratic delays and to reduce regulatory burdens. The benefits of shorter travel times will be diminished if long waiting times at the border and multiple roadblocks continue along the transport network.⁶

What is needed therefore is to ensure that upgrading of hard infrastructure is coordinated with improvements to the "soft" infrastructure, such as institutional and regulatory reforms that deliver the competitive provision of high quality transport and logistics services. Research clearly shows that regional corridors with limited competition in road transport services face higher prices (e.g., West Africa) than those where there is more competition (e.g., Southern Africa) (Teravaninthorn and Raballand 2009). It is therefore important to invest in regulatory reform in the logistics services sector including trucking, warehousing, customs clearing, and freight forwarding that ensures competitive and efficiently provided services along trade networks and lower trade costs.

It is important, therefore, to address policy constraints as an integral part of programs for improving infrastructure that link regional markets together. The appropriate metric for development then is not the length of roads built, for example, but the reduction in the cost of transport services and the improvement in the access to such services. Indeed, failure to coordinate investments with policy reform can increase the difficulties in implementing subsequent reforms. For example, road improvements in situations with regulatory

⁶ Cudmore and Whalley (2005) show that measures that increase trade (in their case trade liberalization but could equally be infrastructure improvements) can have negative impacts if inefficient customs or roadblocks cause resource-using queuing at the border or along the main networks.

restrictions on entry by providers of transport services will reduce the costs of incumbent producers and raise the rents they earn—increasing the political economy resistance to reforms that increase competition and reduce prices in the trucking sector.

For example, there is a major investment in road infrastructure to improve connectivity between Cameroon and Nigeria along the Bamenda to Enugu corridor. However, trade along this route is also constrained by numerous roadblocks,⁷ lack of investment in trade facilitation at the border, and a wide range of administrative barriers and cost raising behavior by officials. Removing these barriers should be an integral part of a policy approach to reduce transaction costs and improve trade between these two countries but little attention has been given to addressing these policy related constraints. Indeed, at present there are no mechanisms to support the coordination of transport infrastructure investments and the policy reform agenda that is essential to ensure that improvements in transportation deliver development benefits.

The cost of cross-border payments and money transfers is another important element of the total cost of trading across borders. Where financial instruments and institutions are absent poor traders have to incur the often-high costs of exchanging currencies at the border; carrying cash exposes traders to the risk of theft and predatory behavior by officials. For more formal traders reducing the cost and raising the quality and range of financial products can support larger and more diversified trade flows. Thus policies that encourage more efficient provision and greater access to formal financial services are an essential part of a program to facilitate cross-border trade in Africa. Integrating regional financial markets can be an important mechanism to allow greater scale in the provision of financial services (which is generally acknowledged as being important in promoting financial sector development), to lower the cost of financial services, increase competition and innovation, and increase access to finance.

In Chapter 5, Musuku et al describe the current landscape of payments systems in UEMOA and discuss ways to lower the cost of payments and money transfers. They find that the cost of using electronic payment services is still very high and thus out of reach of the majority of the population, even though some of the new services (such as mobile payment services) are available at appreciably lower cost than the more well-established services.

A number of private sector players have introduced or are in the process of introducing new products and services based on innovative uses of modern technology. This demonstrates significant dynamism in the market. However, the introduction of new products and services is having a limited impact in driving overall transaction costs lower or encouraging greater financial access. One important reason for this is the lack of interoperability of new products and services leading to market fragmentation. Combined with the difficulty of establishing cross-border extension of payment services, this reduces the scope for reaping economies of scale and thereby the growth of the overall payments market. Steps that need to be taken to reduce cost of payments include developing a UEMOA payments system strategy, strengthening oversight capability, and removing legal and regulatory barriers to interoperability.

Chapter 6 by Maimbo and Saranga shows the great potential of cross-border mobile banking for facilitating trade in both goods and services in Africa. The chapter stresses

⁷ For instance, there are around 15 road blocks along the 60km linking Mamfé in Cameroon with the Nigerian border.

the need for regulatory reform to put in place robust and efficient regulatory frameworks that are necessary to allow branchless and mobile to flourish. Of particular importance are clear guidelines to encourage expansion of branchless banking to informal traders and migrant workers. There are important lessons from other parts of the world, such as the Philippines and Brazil, which regulators in Africa could learn from and build upon in designing and implementing appropriate regulatory frameworks. Regional institutions can play an important role by providing a forum for cross-country discussion and sharing of experiences, by defining regulatory best practices and guiding future policy action. Regionally accepted regulatory frameworks would greatly help to facilitate cross-border mobile banking.

Chapter 7 by Rippel provides an overview of the modern trade facilitation agenda and provides a link between the first and the subsequent sections of the volume. The chapter discusses how the classical trade facilitation agenda that focuses on border management—which as we have seen remains a critical agenda at many of the borders between African countries and is especially important for small, poor and often informal traders—needs to be complemented by an approach that looks at constraints to trade along the value chain of exports and imports. Trade facilitation thus is more than “fixing borders” and requires a focus on reducing trade costs wherever they arise along the value chain of traded goods, including critical services inputs and behind the border barriers to trade.

Removing Non-tariffs Barriers is Essential to Free-up Regional Trade in Goods

While there is still much to be done to put in place effective free trade agreements, especially in Western and Central Africa, attention is turning to two issues that policy makers are increasingly recognizing as being critical to successful regional and global integration: competitive services markets and removing non-tariff barriers. Both of these issues revolve around the nature and quality of regulation, its impact on trade, and the need for improved regulatory practices in integrated markets to ensure effective regulation with minimal disruption to trade.

Non-tariff barriers are pervasive throughout all African regional groupings. Box 1.2 summarizes the information in Chapter 8 on “Deepening Regional Integration to Eliminate the Fragmented Goods Market in Southern Africa” by Gillson regarding examples of NTBs from Southern Africa and indications of the costs they give rise to. These are likely to be representative of the barriers that firms and individuals face in crossing borders throughout the continent. These NTBs impose unnecessary costs on producers that limit trade and raise prices for consumers, undermine the predictability of the trade regime, and reduce investment in the region. Finally, the heavy bureaucratic burden imposed on all regional trade flows ties up regulatory and customs resources, limiting their attention on achieving the most pressing public policy objectives such as effective border management to ensure security. For example, instead of scrutinizing all consignments, border checks should be focused on those for which the risks are greatest.

There has been progress in establishing reporting mechanisms and monitoring committees for non-tariff barriers. Raising awareness and improving transparency are necessary steps but it is becoming increasingly apparent that they are not sufficient due to the lack of progress in removing these barriers. For example, Chapter 9 on “Addressing

Trade Restrictive Non-Tariff Measures on Goods Trade in the East African Community” by Kirk shows that most of the 25 barriers identified by the EAC for immediate removal in 2008 remain in place.

It is important that there are procedures to ensure that regulations are designed and implemented to support trade by limiting their burden on producers, but without compromising legitimate public policy objectives. The answer, therefore, is not simply a matter

Box 1.2. Examples of Non-tariff Barriers in Southern Africa and their Costs.

Delays at the border raise trade costs: in order for RTAs to be effective, it is critical that intra-regional trade be able to move without hindrance. However, high transactions costs are incurred from slow and costly customs procedures and delays caused by other agencies, such as standards, operating at the border. For example, Shoprite reports that each day one of its trucks is delayed at a border costs US\$500.

Restrictive rules of origin limit preferential trade: Onerous local content requirements in rules of origin (ROOs) reduce the incentive to trade regionally. For products where ROOs have been so contentious (e.g., wheat flour) or simply not agreed upon (e.g. certain electrical products for which rules were only finalized in April 2010), preferential trade within the region has been effectively prohibited. Further costs arise from the administrative requirements for certificates of origin, which can account for nearly half the value of the duty preference. Woolworths does not use SADC preferences at all in sending regionally produced consignments of food and clothing to its franchise stores in SADC markets. Instead it simply pays full tariffs because the process of administering ROO documentation is too costly.

Poorly designed technical regulations and standards limit consumer choice and hamper trade: Standards regimes in Southern Africa are often characterized by an over-reliance on mandatory inspections and certifications, unique national (rather than regional or international) standards and testing, overlapping responsibilities for regulation, and occasional heavy government involvement in all dimensions of the standards system. These factors create unnecessary barriers to trade, especially when technical regulations and standards are applied in a discriminatory fashion against imports. One example is shoes in Mauritius: the Chamber of Commerce has proposed the development of a regulation to govern their quality to prevent the entry of low-cost Chinese sandals that are perceived to have a tendency to wear more quickly than domestically produced ones. However, these are often the only shoes that the poorest people in Mauritius can afford to buy.

Other non-tariff barriers restrict opportunities for regional sourcing: Other barriers such as trade permits, export taxes, import licenses, and bans also persist. Shoprite, for example, spends US\$20,000 per week on securing import permits to distribute meat, milk, and plant-based goods to its stores in Zambia alone. For all countries it operates in, approximately 100 (single entry) import permits are applied for every week; this can rise up to 300 per week in peak periods. As a result of these and other documentary requirements (e.g. ROOs) there can be up to 1,600 documents accompanying each truck Shoprite sends with a load that crosses a SADC border. Lack of coordination across government ministries and regulatory authorities also causes significant delays, particularly in authorizing trade for new products. Another South African retailer took three years to get permission to export processed beef and pork from South Africa to Zambia.

In SACU, national protection for infant industries has often been used to justify import bans. Namibia has used the provision to protect a pasta manufacturer and broilers, and maintains protection on UHT milk even though its eight-year limit to do this recently expired. Botswana has recently limited imports of specific varieties of tomatoes and UHT milk. Seasonal import restrictions on maize, wheat, and flour also ensure that domestic production is consumed first. For example, Swaziland’s imports of wheat flour were effectively prohibited for half of 2009 since no import permits were issued since June of that year.

Export taxes also impose costs and inhibit the development of regional supply chains. A case in point is small stock exports from Namibia. Since 2004 the Namibian Government has limited exports to encourage local slaughtering. Quantity restrictions were originally used but have recently been replaced by a flexible levy of between 15–30 percent, effectively closing the border for the export of live sheep to South Africa. The impact of this restriction is affecting the small stock industry in both Namibia and South Africa. In the former, farmers have switched to alternative activities like cattle and game farming. For those sheep farmers that remain, they have become almost entirely dependent on the four Namibian export abattoirs while they were previously able to sell more sheep to the South African market where they received higher prices. In South Africa, jobs are at risk because of the scheme, especially in the bigger abattoirs in the Northern and Western Cape that focus on slaughtering Namibian sheep during the low season to better utilize their capacity.

Source: World Bank 2011a.

of liberalization and deregulation but rather one of better regulation and more effective regulatory agencies that, while not compromising health and safety objectives defined by national legislation, leads to specification and implementation of regulations in a way that promotes regional competitiveness and growth.

This requires an inclusive and transparent approach to the design and implementation of regulations, consulting with the private sector and other stakeholders regularly and systematically as well as developing a framework for providing information to them. There should also be channels to allow firms and individuals to dispute the decisions made by officials in implementing regulations, especially for small producers who do not have access to the mechanisms that are available to large firms to influence decisions.

Building on the experiences of other countries will be important but, as is clearly shown in Chapter 10 on “Non-Tariff Barriers and Regional Standards in the EAC Dairy Sector” by Jensen and Keyser, regulations must be tailored to local demand and supply conditions in Africa: simply importing harmonized regulations from developed countries will often not be appropriate. This requires an inclusive process for defining standards that includes all major stakeholders, not just the big firms in the industry. In the case of dairy, international standards are based on the nature of consumption in Western European and North American markets where most demand is for fresh cold pasteurized milk. This requires very specific procedures, processes, and equipment to limit the growth of bacteria that could cause harm to humans. In East Africa and throughout Africa, the majority of people consume raw milk but boil it before consumption, which kills the bacteria. Requiring that all producers in East Africa satisfy the international standards would compromise the supply of milk from a vast number of small producers.

Countries in Africa could usefully review current regulations impacting on trade and assess their usefulness and viability. A useful first step would be to review regulations to ensure that they are consistent with their policy objectives, such as public health and with market realities, especially with regards to the economic viability of small-scale producers. Regulations that are not viable for economic or technological reasons, and that cannot be addressed by government or donor group assistance, should be jettisoned. As part of this review, countries could look for opportunities to explore regulatory cooperation with regional partners and to design and implement measures such as mutual recognition of quality marks and testing and conformity results.

Further, in many countries the policy process that defines and implements regulations needs to be improved to more carefully identify the costs and benefits of regulation supported through the increasing use of Regulatory Impact Analysis (RIA). RIA considers economic and social factors that need to be explicitly considered when designing policy initiatives. While RIA is a relatively new concept in developing countries, donors and international organizations with analytical expertise, like the World Bank, can support the development of a type of RIA suitable for African countries.⁸

There have been recent successes in Southern Africa where RIA has prevented some technical regulations considered unnecessarily burdensome to trade from being introduced. One example of a proposal that was blocked is one that would have mandated the use of (more costly) DOT 4 brake fluids in vehicles in South Africa instead of DOT 3, which is

⁸ For example, the World Bank is implementing a donor-funded project for the EAC to implement good regulatory practices.

used in most cars in other countries, including the U.S., without any problems. This compulsory specification for brake fluid was to apply at the point of sale (i.e. not of use) and to have enforced it would not have had any effect on the existing brake fluid used in South African cars. However it would have unfairly discriminated against a major manufacturer and exporter of brake fluid in Durban, which at the time was producing and exporting DOT 5 fluid, mainly to India. Since exports are deemed as sales under South African law, this specification would have unfairly affected the business; the withdrawal of the compulsory specification prevented this discrimination.

Regional integration can play an important role in providing a framework in which countries can take actions to remove the negative impact on trade of differing regulations and multiple requirements to test products for conformity with national regulations. In principle, it should be possible for African countries to agree to common standards regarding issues such as health, safety and the environment since countries are at similar levels of income and face similar risks and hence are likely to have similar demands regarding protection of health and safety. Most regional communities do have programs for harmonizing standards at the regional level (often around international standards) but application is often lacking. Where agreement on harmonized standards cannot be reached, mutual recognition can be explored so that member states accept as equivalent the technical regulations of others, even if they differ, provided that they adequately fulfill the same policy objectives. However mutual recognition is not accepted in many regional communities.

Kirk in Chapter 9 concludes that further progress will require effective commitments among countries to transparency and non-discrimination in designing and implementing regulations that affect trade as well as ensuring that regulations are not more trade and investment restrictive than is necessary to fulfill legitimate objectives. Beyond that countries must agree upon mechanisms that will enforce compliance with commitments to remove trade-restricting barriers.

In Chapter 11, the final chapter in this section, Mengistae draws attention to the need to diversify exports into labor-intensive manufactures and services to address the high unemployment and widespread poverty that characterizes most countries in Southern Africa. But trade in manufactures and services are more sensitive to trade barriers and trade transaction costs than trade in the resource products that currently dominate exports. The study finds that the more successful exporting countries in the region are those that have gone furthest in reforming their business climate and removing barriers to trade. Indicators suggest that the reforming countries are much better in allocating resources to more productive sectors and the more productive firms within sectors. Greater financial integration, reform of regulations to encourage more competitive labor and product markets, and measures to reduce trade costs and remove non-tariff barriers are key elements of the policy agenda necessary to improve the business environment and support effective export diversification.

Coordinated regulatory and trade reforms are needed to integrate regional markets in services.

Regional trade can play a crucial role in the development of services sectors in Africa. Services offer new dynamic opportunities for exports while opening up to imports of services and foreign direct investment is a key mechanism to increase competition and drive greater efficiency in the provision of services in the domestic economy. Lower prices, higher

quality, and wider access to services raises productivity improves competitiveness and is critical for poverty reduction (see Box 1.5 for the example of professional services in East Africa based on Chapter 12 by Dihel et al. on Reform and Regional Integration of Professional Services in Eastern and Southern Africa). Services reform is critical for improved competitiveness across all sectors in Africa, including agriculture and manufacturing.

Too often services are overlooked as a source of export diversification and discussions and trade policies are inappropriately focused on manufactures. Exports of services appear to be of particular importance for land-locked countries for whom opportunities to diversify into the export of manufactures are more limited by the high costs of transporting goods. Indeed, over the past 10 years exports of services from non-oil exporting land-locked countries in Africa have increased at a rate more than three times faster than their exports of goods.

Opening to trade can be an effective mechanism for increasing competition in services sectors. Competition is essential in order to increase efficiency in services sectors and lead to the achievement of lower priced and better quality services. Competition pushes service suppliers to reduce waste, improve management, and reduce operating costs. Competition then forces suppliers to pass on these cost savings to consumers in the form of lower prices. Competition also forces firms to innovate and to look for new and better products that are more closely aligned with the needs and demands of their consumers. Thus competition increases the range, variety, and quality of services in the market. Finally, competition undermines costly rent-seeking activities whereby incumbent firms spend resources on lobbying officials for policies that will protect them rather than concentrating on increasing efficiency and quality.

While the benefits of liberalizing trade in services are compelling, it can bring risks and potential costs that may require appropriate government intervention. This arises because of the need to regulate many services sectors to overcome market failures giving rise to concerns about both efficiency and equity. For example, when imports of services through commercial presence are liberalized, it is important that foreign entry leads to more competition and improved service, not merely to a transfer of ownership from a state monopoly to a private one or from a national monopoly to a foreign one. Reforms to establish an appropriate regulatory framework may need to precede the opening up of a particular sector so as to set the rules of the game for new investors by establishing appropriate competition and pricing rules for foreign investors in services, service and access requirements when relevant, and adequate oversight and conflict resolution mechanisms. Hence trade opening may need to be carefully coordinated with regulatory reform.

While in principle the scope for gains is greatest when opening up to all suppliers, regional approaches to services reform can bring particular benefits from exploitation of economies of scale, appropriate management of cross-border public goods, cooperation and coordination that leads to better regulations and pooling of technical skills to overcome capacity constraints that afflict regulation at the national level. Regional agreements can provide for deeper integration than agreements with rich countries or at the WTO through regulatory cooperation with neighbors who have markets with comparable demand and supply conditions and similar regulatory preferences and capacities. For example, in professional services, the mutual recognition of qualifications that is often necessary to make effective openness to temporary movement of workers can be more easily pursued with neighboring countries than with countries at higher levels of income. Harmonizing standards with neighbors for such services will tend to be more appropriate than harmonizing with the standards of rich countries.

Box 1.3. Regional Integration and Services: The Example of Professional Services in East Africa

Professional services matter for development. Business services are key inputs for other sectors, and greater use of professional services is associated with higher labor productivity. Business skills and services, such as accounting and legal services, play a critical role in reducing transaction costs, which are a significant impediment to economic growth in Africa. Professional services could also become an important avenue for export diversification by some African countries. But there is a large gap between the potential contribution these services could make and the meager contribution they make today. National markets for professionals and professional services in many African countries remain underdeveloped, while regional markets are fragmented by restrictive policies and regulations.

A detailed analysis of the situation in East Africa for three professional services—accounting, engineering and legal—shows that the heterogeneity of endowments of professionals and the earnings differentials across countries for each profession provide substantial scope for trade in professional services. Foreign professionals and foreign professional firms could help address the underdevelopment of the sectors and the unmet demands in East Africa.* However, very few foreign professionals are present in Kenya, Tanzania, and Uganda, although in Rwanda, in contrast, foreign professionals account for more than 60 percent of the total number of professionals. Similarly, in terms of commercial presence, there is only a limited presence of foreign engineering firms and there is an almost complete absence of foreign legal services firms. Evidence from World Bank-supported civil works procurement contracts since 1994 reflects the lack of integration of the East African market for engineering services. Domestic companies generally win most of the contracts, except in energy and mining and transportation where non-African companies have the lion's share. There is virtually no intra-East African foreign firm participation in these contracts.

Domestic regulation on the entry and on the operations of professional services firms often undermines competition and constrains the growth of strong professional services sectors in East Africa. Each country grants exclusive rights to certain professions over certain activities. Licensing and educational requirements and quantitative constraints also inhibit competition. Regulation affecting operations of legal and engineering providers (conduct regulation) include restrictions on prices and fees, advertising, form of business, and inter-professional cooperation, are particularly heavy when compared to those in emerging economies and in OECD countries. Firm-level surveys of private providers of professional services in East Africa reveal that restrictions on multidisciplinary activities are an important constraint in the accounting sector, while regulations on fees and prices are the major constraints in the engineering and legal sectors. Non-transparent procurement procedures also hurt accounting and engineering services providers while inappropriate standards hurt accounting services providers.

Trade in professional services through the movement of natural persons (mode 4 in GATS) across national borders is restricted in East Africa by explicit trade barriers, regulatory requirements, and immigration policies. Chief among them are discretionary limits through labor market tests on the entry of any type of foreign professionals in Kenya, Tanzania, and Uganda, de jure or de facto nationality requirements to practice domestic law in Kenya and Tanzania, limited recognition of foreign-licensed professionals, and work permit issues in most East African countries.

Different types of restrictions across countries in East Africa also limit trade in professional services through the establishment of foreign commercial presence (mode 3 in GATS). The entry of foreign law firms is not permitted in Kenya or Tanzania. Local members of international law networks face restrictions in Kenya, Tanzania, and Uganda on using the network's brand name. The restrictions imposed on accounting firms are even more stringent, with branches of foreign firms being prohibited in Kenya, Uganda, and even the more liberal Rwanda. Kenya and Tanzania also prohibit ownership or control of foreign accounting and auditing firms by non-locally licensed professionals. Foreign firms providing engineering services face fewer restrictions in East Africa. All East African countries restrict cross-border trade (mode 1 in GATS) in certain types of professional services, such as advice on matters relating to domestic law, audits, as well as tax representation and tax advice.

Source: World Bank (2010).

* Another example is that in Tanzania there is a shortage of teachers while in Kenya a substantial number of qualified teachers are unemployed.

Policymakers in Africa, especially in Eastern and Southern African countries, are recognizing that weaknesses in their services sectors impede growth and also that without addressing the liberalization of services deeper regional integration cannot be achieved. All three regional groups in Eastern and Southern Africa have committed themselves to pursue integrated regional markets for services. The EAC Common Market Protocol has initiated the integration process in services in Eastern Africa and all five

members have scheduled commitments in several services sectors, and have adopted the annexes on removing restrictions on the free movement of workers and on the right of establishment, and the annex on mutual recognition of academic and professional qualifications. Both COMESA and SADC are defining and seeking to implement services liberalization programs.

As with integrating goods markets where health and safety issues are important, the process by which regional integration is achieved can be just as important as the outcome, requiring an inclusive and informed process involving all key stakeholders. The work on professional services in east and southern Africa summarized in Chapter 12 by Dihel et al. provides a good indication of the challenges faced by the African countries with services liberalization and reform: (1) lack of communication and cooperation between sectoral specialists/regulators and negotiators; (2) lack of coordination between regulatory reform and services liberalization (for example, the accounting associations in East Africa developed a draft Mutual Recognition Agreement (MRA) of Professional Qualifications without any coordination with the governments and without taking into account the commitments negotiated in the context of the EAC Common Market Protocol); (3) the need to achieve some degree of regulatory harmonization in order to integrate different markets through credible MRAs and allow professionals to move freely and; (4) the need for technical assistance to diffuse knowledge on good regulatory practices in the specific sector to all stakeholders, and analysis of potential impacts of proposed reforms including experiences of reform from elsewhere.

In this regard, the COMESA secretariat and the World Bank are implementing together a knowledge platform to support integrated markets for professional services in Eastern and Southern Africa which will provide:

- Information and analysis of the current situation regarding the performance of the particular sector and its impact on other sectors and the wider economy. This may require surveys of both users and providers of the service.
- An assessment of barriers to trade and foreign investment and current regulatory policies in the form of a trade and regulatory audit together with an assessment of their impact on entry and conduct in the market.
- A review of the necessary steps to remove explicit barriers to trade and the regulatory options for an integrated services market, including measures that can be pursued at the national level and those that are likely to be more effective in collaboration with partner countries at the regional level. This will be informed by a careful analysis of the experience of other countries that have implemented reform programs in the specific sector, drawing on inputs and interactions with officials and experts from these countries.
- An assessment of capacity building that will be necessary for effective implementation and monitoring of outcomes in the sector and the impact of current regulation.

In pursuing these outputs the platform aims to support a process that ensures regular consultation between private and public stakeholders; effective communication between the regulator, sector specialists, and the relevant government ministries; extensive dissemination of information and analysis at the national and then regional levels for increased awareness and deeper understanding of the policy issues affecting each sector.

Regional integration in financial services in sub-Saharan Africa has taken two different, though not mutually exclusive, paths. In West and Central Africa, institutional initiatives

including, a common currency, an overarching regulatory authority, and supranational financial markets, are the building blocks of regionalization in financial markets. In East and Southern Africa, integration is a more market driven process, following the movement of people, businesses, and goods across fluid borders. South African and Kenyan banks have led this model of integration in the southern and eastern parts of SSA.

In Chapter 13, Wagh et al. explain the steps taken to deepen regional financial integration in the EAC and what remains to be done. The signing of the Common Market Protocol and the initiatives of the private sector banks together create a favorable climate for further integration, especially between the three original members of the EAC. However, several factors still constrain the growth and integration of the regional market. Further work needs to be done to align regulatory and supervisory frameworks and reporting requirements to address this issue. Other steps include: adopting a single licensing regime, mutual recognition among regulators, building-up a regionally compatible financial infrastructure, strengthening cross-border supervisory practices, and strengthening data gathering. Finally, a strategy needs to be developed for integrating Rwanda and Burundi into the EAC financial system.

In the West African Monetary Zone, as discussed in Chapter 14 by Musuku et al., the regional financial market remains fragmented by the lack of an official cross-border payments system, by differences in the regulatory framework for financial institutions between countries in the region and the absence of sharing of credit information across borders. For both banking and insurance, regulations and supervisory practices are far from uniform across the region which increases the costs of operating regionally and undermines the ability of the supervisory bodies to assess the risks posed by the cross-border activities of the institutions that they supervise. There is a need to focus on reducing the cost of cross-border payments through the banking system and developing mechanisms that cater for the needs of small cross-border traders.

In Chapter 15 Nora Dihel discusses the distribution services sector, which plays a critical role both in linking producers to consumers and reducing poverty. Modern distribution systems can increase the access of small farmers to high value markets and accelerate the transition from subsistence farming to market participation, while for consumers organized markets can attract better quality products at affordable prices. Many consumers and producers in Africa, however, have yet to see the benefits of a modern distribution sector. Small-scale farmers have found themselves marginalized by the distribution sector and its new practices, and very poor households (e.g., slum dwellers) are often paying more per unit for basic products than wealthier households. The chapter argues that opening up to trade in the sector and to inward investment needs to be complemented by regulatory reform that supports a modern and competitive distribution sector while addressing the interests of the poorest consumers and smallholder farmers.

Finally, in Chapter 16 on “Africa’s Trade in Services and the Opportunities and Risks from Economic Partnership Agreements”, Brenton et al. discuss how negotiations on a trade agreement in services with a third party, in this case the EU, can be designed to reinforce regional efforts towards creating integrated services markets. Negotiations at the WTO level using the GATS framework have given insufficient attention and resources to essential regulatory issues. This has also been a feature of the negotiations with the EU on Economic Partnership Agreements. Involving regulators, sector specialists and other stakeholders in the negotiations is crucial but for the most part they have been absent from the negotiating table.

The chapter recommends that countries in Africa, should draw upon available sources of financial support and technical assistance to define a strategy for trade in services that

is integrated into the national development plan. This should be based upon a dialogue among various stakeholders about the potential impact of services trade liberalization and regulatory reform and which identifies priority sectors where greater competition, foreign investment, and new technology can drive efficiency and growth. Then in the priority domestic services sectors, implement a trade and regulatory audit to identify the main constraints to competition and investment and assess the need for improvements in the regulatory regime to support competitiveness. Finally, identify how trade agreements at the regional, EPA, and multilateral level can be used to alleviate the constraints that are identified for the priority sectors and support the process of trade and regulatory reform.

This then requires that the EU and African countries consider a more flexible approach to the EPAs that reflects the diversity of capacities and priorities across African countries. African countries and the EU adopt a sector-by-sector approach to coordinated trade and regulatory reform rather than a broad but shallow GATS type agreement. The EU then works with other donors and international institutions to make adequate technical assistance available to all reforming countries in Africa from a fund that is independently managed and delink the provision of such funding from negotiations and agreement on an EPA. Such a fund could organize financial resources and expertise around key services sectors for Africa. Suggestions would include telecommunications, tourism, transport, finance, and business services.

Conclusions

The papers in this volume show that current thinking on regional integration in Africa has moved beyond removing tariffs to regulatory issues that raise trade costs and prevent goods, services, people, and capital from moving freely across borders within Africa and undermine competitiveness in the global market. Key issues include:

- Improving the quality of regulation to remove non-tariff barriers to goods trade and deliver competitive markets while achieving essential public policy objectives relating to issues such as health and safety, protection of agriculture from pests and disease, and effective control of borders.
- Coordinating infrastructure improvements more systematically with the policy and regulatory reforms that are required to deliver competitively provided services along infrastructure networks, and therefore lower prices and make services more widely available.
- Opening up to trade in services as well as goods to enable new opportunities for export diversification to be exploited and to ensure the efficient provision of essential services inputs that are necessary for increased trade and especially to allow cross-border production networks to flourish. This agenda is of particular importance to small and landlocked countries and is essential to bring more balanced gains in regional agreements containing large coastal countries that have a significant potential to increase production and trade in manufactures.

This is a much more complex agenda than reducing tariffs. It requires regulatory reform and building the capacity of the institutions that design and implement regulations. A successful regulatory reform program will include effectively dialogue among

government officials, regulators, academics and researchers and private sector stakeholders. Increasing the use of regulatory impact analysis and stipulating adherence to basic principles of good regulatory practice, such as transparency, non-discrimination and proportionality, should be at the forefront of the reform program. The challenge is one of integrating markets and expanding trade while achieving regulatory objectives efficiently. Given that knowledge on regulation is sector specific and that countries in Africa have limited capacity and resources, this will entail focusing on priority issues and sectors.

Analysis suggests that the returns to a regulatory reform agenda for trade will be substantial while the direct financial costs are small relative to other aid for trade interventions and investments in infrastructure. In an era that will require greater budget austerity, reforms to the regulations governing trade appear to be good investment. However, there is a large information gathering and knowledge building agenda to support regulatory reform. Better information on non-tariff barriers and their impact is required in many countries to identify priorities for reform. Effective regulation typically requires sector specific knowledge. The knowledge required to regulate open markets for accountancy services is quite different from that to define standards for milk. This knowledge agenda can be enhanced by learning from other countries and regions of what has and has not worked elsewhere. Nevertheless, in addition to being sector specific, regulation must also take into account local demand and supply conditions and simply importing standards from outside may not be appropriate. Finally, the regulatory reform process must be open and inclusive to ensure that all stakeholders are involved and that the regulatory outcomes are not unduly influenced by particular stakeholders, such as incumbent firms.

A successful program of policy reform that seeks to address these constraints to intra-regional trade in Africa will likely have to confront powerful interests that may be adversely affected. While measures to open up African markets to regional trade will increase the opportunities for businessmen and women and especially poor traders to earn higher returns from their activities and at the same time reduce prices for consumers, some often politically well-connected individuals will lose the high profits they are currently able to earn from the relative lack of competition. In some cases there may be important distributional impacts that will need to be addressed if poor people are employed in the activities that were previously protected. At present there are very limited mechanisms to address these political economy issues and few provisions in existing agreements for supportive policies, such as retraining schemes for affected workers.

Finally, the process of reform would be aided by setting context specific and measurable objectives. Setting priorities for reform needs to be supported by defining outcomes that can be regularly monitored to ensure progress. Establishing scoreboards in regional secretariats, in a manner similar to that in the EU that is used to monitor implementation of the Single Market, could be a useful way to allow a broader audience to assess implementation of regional commitments to remove barriers to trade. Examples of measurable objectives could include removing all road blocks, implementing harmonised vehicle axle weights requirements, providing trade partners with, say 2 months, advance notice before new policies affecting regional trade are introduced or existing policies are changed, recognition of certificates relating to conformity with standards where mutual recognition has been agreed, recognizing partners quality stamps, real-time sharing of customs information and so on.

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PART I

FACILITATING CROSS BORDER TRADE IN GOODS AND SERVICES

2. Risky Business

Poor Women Cross-border Traders in the Great Lakes Region of Africa

Paul Brenton, Celestin Bashinge Bucekuderhwa, Caroline Hossein, Shiho Nagaki and Jean Baptiste Ntagoma⁹

Introduction

There is enormous potential for international trade to drive economic growth and poverty reduction in the Great Lakes region of Africa. Much of the attention on eastern DRC has been focused on the minerals sector, yet there is substantial scope to expand output of other sectors, especially agriculture,¹⁰ but also services. While an improvement in the security situation is necessary for agricultural output to recover, greater economic opportunities and rising living standards will contribute to greater stability. For example, increasing returns to agricultural activities can provide a genuine alternative occupation and source of income to artisanal mining and thus facilitate the shift to a more organized and less disruptive mining sector.

Harnessing the opportunities of regional and international markets will play a key role in delivering higher returns to farmers and contributing to food security by making food products more widely available at lower prices to consumers throughout the region. Cross-border trade will become increasingly important in linking food surplus areas to food deficit areas, especially as development is accompanied and driven by the increasing concentration of people and activities in towns and cities. Rising incomes will lead to increasing demands for a wider range of goods and services and enhance the scope for mutually beneficial cross-border exchanges between the DRC and the other countries of the Great Lakes region in agriculture, manufactures and services.

Currently it is informal cross-border trade that plays the main role in linking producers to markets in the Great Lakes region of Africa.¹¹ Cross-border exchange provides the

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¹⁰ It is estimated that current agricultural output in the DRC may be less than 50 percent of the level in 1997 (IPC2009). Thus there would be a large increase in output just in achieving previous levels of output in addition to the scope to increase productivity and output way beyond this level.

¹¹ A crude comparison of data on formal trade from COMESA's COMSTAT and estimates of informal trade by the Uganda Bureau of Statistics suggests that informal trade in agricultural products may be as much as five times higher than recorded trade for the DRCs trade with neighbors in the Great Lakes region. For Rwanda informal trade with the region is estimated to be in the region of 25 percent of formal trade while it is 55 percent for Uganda.

main source of income for a large number of informal traders who are predominantly poor women carrying agricultural products and as a result there is an important gender dimension to this issue. There is however, very little information on these traders and the conditions that they experience.¹² This note summarizes the results of a study that has looked at cross border trade between the DRC and Burundi, Rwanda, and Uganda. The conclusions are stark: high levels of harassment and physical violence at the border and the prevalence of unofficial payments and bribes are currently undermining the livelihoods and activities of these women traders. As such, cross-border trade is nothing more than a mode of survival for these women rather than an opportunity for growth and development.

Evidence from other regions suggests that informal cross-border trade is highly sensitive to the way that traders are treated and the conditions that they face in crossing the border (World Bank 2010). The success of such trade depends upon the ability of individuals to routinely cross the border without being subject to violence or harassment and without having to pay large unofficial payments or prohibitive tariffs or charges. Supporting these entrepreneurs in growing their business and moving to more organized and then formal modes of exchange will be crucial if the potential for cross-border trade in the region is to be realized. The first step must be to improve conditions at the border.

The Characteristics of Cross-border Traders in the Great Lakes Region

Cross-border traders in the Great Lakes region play a vital role in bringing goods to consumers that would otherwise be unavailable and providing them at lower prices. If these poor entrepreneurs were not to ply their trade prices would be higher. Their activities also mean that farmers receive higher returns for their products than they would otherwise. Nevertheless, substantial differences in the prices of basic food products remain between markets on opposite sides of borders, reflecting that there are significant impediments to the movements of goods and people across borders in the Great Lakes region. Removing these constraints and supporting cross-border traders will support poverty reduction and higher incomes for farmers.

To investigate the constraints and conditions that cross-border traders face we implemented a survey in mid-2010 at four key border crossings in the Great Lakes region: at Uvira-Bujumbura (between DRC and Burundi); Bukavu-Cyangugu (between DRC and Rwanda); Goma-Gisenyi (DRC and Rwanda) and Kasindi-Mpondwe (DRC and Uganda), see Figure 2.1.

The survey obtained information from 181 traders through in depth interviews (100) and focus groups (81). This was supplemented by 58 interviews with stakeholders at the border. The key features of cross-border trade that emerge from this investigation are:

¹² International Alert (2010) provides information on the border crossing between Goma and Gisenyi and is one of a few studies that have looked at cross-border trade with the DRC. The Government of Rwanda has recently supported a study of informal cross-border trade while the Uganda Bureau of Statistics has for a number of years been surveying informal cross-border exchange.

Figure 2.1 >

Key Border Crossings in the Great Lakes Region

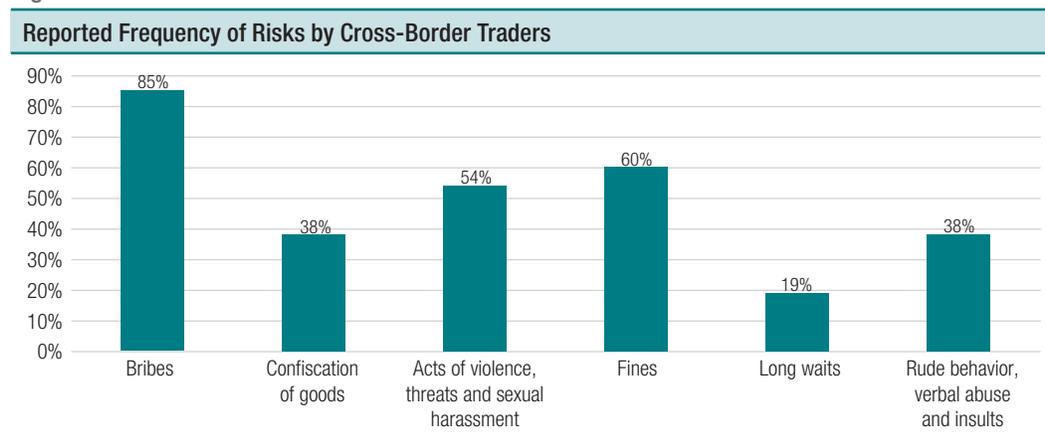


Source: World Bank Survey, 2011.

- The majority of traders are young women (85 percent of respondents were female and the average age of a trader is 32) and experienced traders, with 44 percent having been traders for more than five years.
- Most of the officials who regulate the border are men (82 percent).
- Most traders sell foodstuffs, particularly cereals, pulses, vegetables and fruits. The quantities involved are small and are typically carried by head.
- Start-up capital is very small (less than \$50) and is typically obtained from within the family. Very few traders have received loans from a financial institution. The vast majority (95 percent) wishes to invest and grow their business but is constrained from doing so by the current environment at the border and lack of access to finance.
- For almost two-thirds of the respondents, income from cross-border trade is the main source of income and most (77 percent) report that household income is heavily dependent on their trading activity.
- Few are members of a traders association.

A crucial fact is that these poor women cross-border traders are undertaking informal activities, in the sense of not being part of a formal organized economic activity, but *not* illegal activities. The majority of them cross at formal border crossing points and report that they are willing to pay appropriate duties and wish to be treated as business people. A range of officials is present, in principle, to regulate the borders that these traders cross. However, many officials hold very negative views of poor traders based on their social class and often see them as mere “smugglers.”

Figure 2.2 >



Source: World Bank Survey, 2011.

Conditions at the Border

The responses from the detailed interviews and focus groups paint a dark picture of the conditions experienced by poor women cross-border traders in the Great Lakes region. They face serious risks and losses each time they cross the border. Figure 2.2 summarizes the main findings.

It is striking that payments of bribes is a regular occurrence for the majority of traders. Respondents at all four border posts repeated a catch phrase used by officials: “sans argent, on ne passe pas” (no money, no passing). At the Goma-Gisenyi border 100 percent of respondents reported that they had to pay bribes to cross the border. A large number of traders also report having their goods confiscated and having to pay fines. An important feature of border crossings between the DRC and neighboring countries in the Great Lakes region is the large number and range of officials at the border; which exacerbates the problem of poor governance with negative consequences for cross-border traders. Not only are there officials from customs at the border but also immigration officials, the police, the army, and officials implementing health controls. A lack of transparency and awareness by both traders and officials of the rules and regulations that are supposed to govern cross-border movements of goods and people compound this situation. A typical account of every day conditions is provided by an egg and sugar trader from Goma: “I buy my eggs in Rwanda, as soon as I cross to Congo I give one egg to every official who asks me. Some days I give away more than 50 eggs!” Reducing the number of agencies and officials at the border and increasing the transparency and predictability of the policy regime is crucial to providing an environment in which traders flourish and expand their business.

A large number of traders report being subject to acts of violence, threats, and sexual harassment. Traders are exposed to beatings, verbal insults, stripping, sexual harassment, and even rape. Much of this abuse is unreported. While some borders are better organized, this gender-based violence, although more prevalent in the DRC, is being perpetrated on both sides of the border in Burundi, Rwanda, and Uganda. Not only do officials harass traders but young men, called “les viseurs” (watchers) are hired by state officials and given carte blanche to apply force as needed to extract money and goods from traders, particularly

those that move by foot with goods strapped on their backs or carried by head. A typical occurrence is that women traders are often encircled by a group of men after they cross the border. Vulnerability to theft and physical abuse is rampant in these borderlands.

Thus, cross-border traders face regular losses in the form of the almost mandatory payment of bribes and are regularly subject to harassment and physical abuse. This lack of economic and physical security and safety undermines the livelihoods of these traders and compounds their lack of access to finance, information, and business knowledge. But it is clear that most traders perceive that there is no alternative—they are stuck in a survival economy. Addressing these issues by providing security at the border and implementing a transparent and predictable regime for those crossing the border would facilitate trade, improve incomes, contribute to regional food security and, in turn, provide for greater stability in the region.

Informal traders, especially poor women food traders, often lack representation and organization. As a result, they are vulnerable to powerful officials who control the borders. At each border crossing many officials appear to have entrenched negative perceptions of these traders. Rude and hostile behavior towards traders is justified and money extorted because the traders are not formalized. But the very poor quality of the infrastructure of the border crossing used by informal traders is also at the root of allowing some of the worst types of harassment and violence. Most of the attention of the government and donors has been on improving conditions for formal trade and better infrastructure for trucks at the main border crossings. Informal cross-border traders have not been high on the agenda. The border crossings in Goma are a good example. Two crossings are regulated by customs: the “petite barrière” for small informal traders, and the “grande barrière” for more formal traders. The differences between the two crossings are striking, as is the stark contrast between the DRC side and the well-organized Rwandan side of the border. At the “grande barrière” the road is paved and buildings are in reasonable state and cross-border movements appear orderly. At the “petite barrière” (Goma side) it is chaos. Roads are very poor, and congested with vendors, and a number of storefronts tumble onto the busy roadside.¹⁵

Steps to Facilitate Cross-border Trade in the Great Lakes Region

The immediate priority must be to improve the conditions at the border and the treatment of cross-border traders. This will have a significant impact on the livelihoods of a substantial number of women and the households who depend on their income from trading. It will also lead to more cross-border trade and more widely available and cheaper food products. The second imperative is to provide and implement a policy framework by which these traders can become increasingly organized and backed up by support services that improve access to information, facilitate access to credit, and ensure better representation of traders’ interests. This will provide a route by which these activities can gradually become more formalized and distribution channels become more efficient. This will require:

1. *Officials at all levels recognize the important role played by poor cross-border traders.*

Policy makers currently view poor women cross-border traders negatively, reflecting

¹⁵ The situation has been transformed on the Rwandan side of the border where significant construction has delivered new customs and immigration buildings, and improved roads and street lighting.

the misconception that they are an important source of revenue loss. This in turn means that there has been little effort to improve the condition of the infrastructure at the border crossings such traders use and a lack of effort to bring discipline and order to the officials who regulate these borders. The vast majority of these traders are entrepreneurs who would like to invest and grow their business and emerge from their current survival mode if stability and security could be provided and policies at the border were transparent and applied in a predictable and fair manner. These traders therefore offer an opportunity rather than a constraint for growth and poverty reduction.

2. *A reduction in the number of agencies at the border and an increase in transparency and predictability of the policy regime.* There is clearly a high degree of uncertainty and ambiguity about the legal rules that apply to cross-border trade and how they are applied in practice. Lack of transparency and consistency in the application of trade rules constrain trade across the borders. The application of simple and fair procedures and reasonable fees would support greater activity and a transition to more organized and formal modes of exchange. The results of the survey suggest a number of practical steps that could immediately be made: all payments made to an official should be recorded and an official receipt provided; payments should be made only at a single, clearly designated building; agencies at the border that can legally charge fees for services that they provide, (e.g., the agencies responsible for quality and hygiene) should not be able to levy a charge unless a service is provided. In most cases the services of these agencies are not relevant for small-scale traders carrying fruits and vegetables. This should be supported by a dialogue at the provincial and national level on simplification of custom procedures between DRC and neighboring countries to facilitate trade. The benefits of joining the COMESA free trade agreement and enhancing cooperation through the CEPGL should be given careful consideration as a means of promoting further integration and simplifying the taxation of imports from neighboring countries.

The government of the DRC has taken steps to address this situation, passing a law stating that only four agencies should be present at the border (customs, immigration, health and hygiene, quality control of goods). However, while there has been some success in implementation, at many borders more than 10 different agencies remain. The customs agency is also developing simplified procedures for the border but again implementation will need to be carefully monitored.

3. *Increased professionalism of officials and greater gender awareness.* Women are under-represented in official bodies at the border and so increasing the number of female border officials is an important step. Nevertheless, lessons show that what is needed are gender-aware officials who appreciate the issues confronting traders, poor women and men alike. More women at the borders may reduce sexual crimes, but that is not guaranteed if they do not have power. Lower-level female officials cannot stop higher placed males and their associates from carrying out gender-based violence. Obvious policies such as only female officers should be allowed to body search women traders should be made mandatory and widely publicized.

There is therefore a need for enhanced training of officials, including workshops to raise awareness of gender issues, not only at the main formal border crossings but especially at the border crossings used by informal traders. This could provide a base for the introduction of performance assessments of officials in which treatment

of cross-border traders is a key indicator. It is important to educate and not to shame the officials to change behavior, to define a clear code of practice, and reward those officials who behave in manner consistent with higher standards. Experience from elsewhere, such as customs reform in Senegal, suggests that non-financial rewards, such as widespread recognition within the institution and the wider community through employee of the month schemes, with such awards being kept on the employees file and being a factor in promotion decisions and eligibility for enhanced training, can be as effective as direct financial rewards. This would need to be supported but an independent office of complaints that can record and act upon complaints when violations occur.

More generally, as in all post-conflict countries there is a need to address the fundamental issues of governance in public administration and implement effective security sector reform (police, justice, and military). The conditions that traders face at the border are in part a consequence of poor wages—and often lack of payment—and a culture of impunity due to the lack of functioning legal and justice systems.

4. *Improve infrastructure at the border crossings used by informal traders.* Both the transport infrastructure and the (lack of) buildings used by officials need to be rehabilitated, including the provision of basic facilities for officials such as electricity and water. Work is required to minimize the risks to safety and security that arise from the dilapidated infrastructure and to provide an open and transparent area for officials and traders.
5. *A strategy for integrating poor entrepreneurs into the formal economy.* First and foremost is the need to increase the representation of these traders through traders associations to ensure that their interests are properly represented in public policy. It is also necessary to address key concerns of these traders regarding their lack of access to finance, lack of information on prices, and business opportunities and training in basic business practices. It would also be interesting to further investigate the potential beneficial impact of providing warehousing facilities close to the border and the development of cross-border markets building on the knowledge of the success of bazaars, for example, in central Asia (World Bank 2010).

There would be very large economic pay-offs from interventions that facilitate freer movement of goods and people across the border. In the short-term this pay-off would be in the form of greater security and increased incomes for poor women traders whose trading activities are crucial to the welfare of their households and hence to poverty reduction in communities along the border. In addition, interventions to remove the major barriers to cross-border trade between the DRC and Burundi and Rwanda would allow for trade to play a greater role in integrating food markets in the region. This would increase the returns to farmers and provide genuine alternative sources of income to those currently linked to activities that destabilize the region.

There has been some recent progress on this issue at both the regional and the national level. Seminars have recently taken place in Goma and Bukavu that have brought together representatives of the regional government, officials from border agencies and traders. The Governor of South Kivu has visited the border at Bukavu. In recent interviews, traders at Bukavu attest that this heightened interest from policy makers has been reflected in less harassment. In Kinshasa, the issues of cross-border trade and the conditions facing poor women traders were discussed at a workshop in April 2011. At this meeting agencies agreed

a detailed and sequenced roadmap towards improving border procedures at two pilot crossings in the east (Goma and Bukvu). Implementation of the roadmap will streamline processes and achieve clear agreement between the different agencies as to who should do what, with the preparation of clear job descriptions.

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3. Economic Integration in the Lower Congo Region

Opening the Kinshasa –Brazzaville Bottleneck

Marius Brühlhart and Mombert Hoppe¹⁴

Introduction

Kinshasa-Brazzaville, currently the third largest urban agglomeration in Africa, is predicted to become Africa's largest, and the world's 11th largest, city by 2025. With an international border running right through it, this regional hub of economic activity is the obvious focal point for cross-border exchanges between the two Congos. Using satellite images of night lights, Figure 3.1 illustrates how, in spatial terms, the two capitals form a seamless urban unit, which has grown considerably over the last two decades. According to UN statistics, Kinshasa currently counts 8.8 million and Brazzaville 1.3 million inhabitants; up from 3.6 million and 0.7 million, respectively, in 1990. The United Nations (2010) expects the Kinshasa population to grow faster over the next 15 years than that of any other world metropolis, predicting a 2025 city size of 15.0 million. The population of Brazzaville is forecast to swell to 1.9 million.

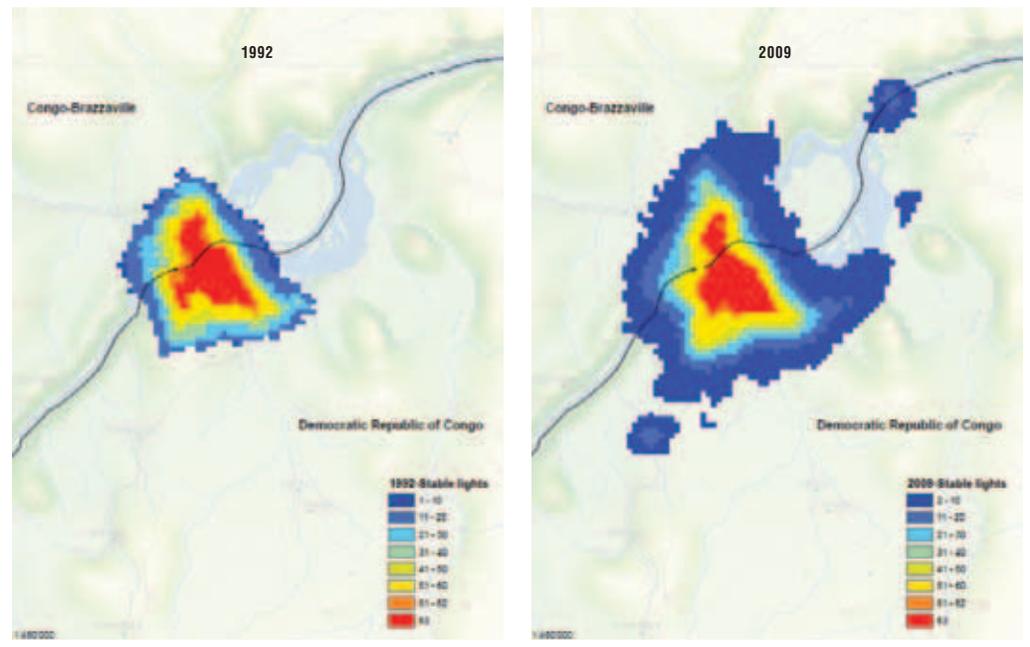
Despite their size, proximity and status as regional trade hubs, formal bilateral trade between the two cities as well as between their two countries is derisorily small. The province of Kinshasa accounts for over 21 percent of the Democratic Republic of Congo's (DRC) GDP but for a mere 0.8 percent of its exports. Officially recorded imports from the Republic of Congo (RC) represent a fraction of a percent of Western DRC imports. Recorded volumes of transit trade are somewhat larger, but also account for well under one percent of Western DRC imports. Recorded RC imports from the DRC are only slightly more important, amounting to some 1.12 percent of total RC imports in value terms. There can be no doubt that these statistics largely understate the true volume of (formal and informal) trade, but they point toward considerable potential for an expansion of formal trade.

Officially recorded trade flows between the DRC and the RC are largely limited to transit trade flows, which seem to be increasing. Recorded transit imports from DRC were about three times larger in 2007 than in the two preceding years, and transit trade seems to have increased further since. Formal transit flows predominantly run from Kinshasa to

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Figure 3.1 >

Night Lights in Kinshasa-Brazzaville, 1992 and 2009



Source: World Bank, 2011.

Brazzaville. Hence, Brazzaville is partially supplied through the DRC's ocean port of Matadi via Kinshasa, due to the poor condition of the transport corridor linking Brazzaville to the RC's ocean port at Pointe Noire. Official data also certainly under report the importance of transit trade. Large informal flows of clothing and textiles from Brazzaville to Kinshasa, for instance, mostly originate in West Africa and reach Brazzaville through Pointe Noire or Douala. These flows do not appear in any statistics.

Passenger traffic between Brazzaville and Kinshasa is smaller in relative terms than traffic between East and West Berlin in the times of the Berlin Wall. We estimate the overall number of passenger crossings at around 700,000 annually. This volume of traffic, scaled to city sizes, is some 175 times smaller than the river-crossing passenger traffic in Kisangani—another conurbation straddling the Congo River but one that is not crossed by a national border. It is also around five times smaller than the volume of passenger traffic between East and West Berlin in 1988—well before the dismantling of the Wall.¹⁵

Estimating the Effects of Removing the Bottleneck

The sheer demographic and economic size of the Kinshasa-Brazzaville agglomeration, as well as its role as a gateway for large economic hinterlands, should make economic

¹⁵ In 1988, there were some 1.9 million passenger crossings between East and West Berlin—about one crossing per three inhabitants of the Berlin metropolitan area. The 700,000 estimated crossings between Kinshasa and Brazzaville represent about one crossing per 15 inhabitants of the two cities combined.

integration between the two capitals a matter of central policy interest in the region. Recent academic research in economic geography furthermore suggests that urbanization is a key engine of growth in developing countries, and that constraints on the formation of urban agglomerations can constitute a severe obstacle to economic development of the concerned countries as a whole.¹⁶ Hence, easing the Kinshasa-Brazzaville bottleneck could yield medium-term growth effects that extend to the wider economies of both Congos. As our empirical analyses, which we discuss below, were restricted to potential short-run effects in the Kinshasa-Brazzaville region itself, our findings should be viewed as lower-bound estimates of the potential aggregate effects of trade facilitation across the Congo River.

Analysis of Price Differentials

We compared retail prices in both cities, as systematic price differences for identical goods in two markets represent the probably most reliable indicator of barriers to trade between those markets. Absent physical and regulatory barriers to trade, price differences will be arbitrated away. We therefore compared prices of 57 goods chosen so as to offer a representative sample of Congolese consumption baskets. Prices were collected using a consistent methodology in four large retail markets in each city, two in the respective city centers and two in the suburbs, between August 26 and September 3, 2010.

We find significant price differences, suggesting that trade facilitation between Kinshasa and Brazzaville would lead to lower prices in both cities. Using panel data regression methods, we find that imports from across Malebo Pool—the 3.5 kilometers-wide stretch of the river Congo that separates the two cities—are consistently more expensive than corresponding local products. Our best estimate of this price differential is 20 percent. Thus, shipping local goods across Malebo Pool is found to increase the retail price of these goods by one fifth. Our econometric analysis furthermore suggests that price differences cannot be attributed to differences in local producer and distribution costs, implying that the underlying economic structures in Kinshasa and Brazzaville are very similar. Considerable price differentials are also found for goods imported from overseas. Our observed price differentials imply significant trade barriers between the two cities but not within them. Given the proximity of the two markets, this implies considerable potential for intensified arbitrage through cross-border trade.

Structured Interviews

In order to estimate the potential for trade expansion, we conducted a series of structured interviews with firms in Kinshasa and Brazzaville in April-June 2010. The interviewed firms had to satisfy a sole criterion: that they were, or had been, engaged in cross-border economic activities, either by trading goods or by transporting passengers. Conditional on this criterion, we sought to cover as representative a sample of firms as possible. We obtained interview answers from 57 firms, 17 of which are manufacturers, 19 are based in Brazzaville, and 12 are informal. Sample firms were presented with an identical 72-item questionnaire, containing questions on the existing structure of the business as well as hypothetical assessments of the impact on their activities of trade liberalizing measures.

¹⁶ See, e.g., Deichmann *et al.* 2008, and Brühlhart and Sbergami 2009.

Brazzaville is currently considered a negligible market for most firms in Kinshasa, but responses point towards large untapped trade potential. Of the 58 Kinshasa-based firms, only 17 declared significant sales in Brazzaville. The average share of such sales is estimated at around five percent. Given that the population of Brazzaville corresponds to some 15 percent of the population of Kinshasa, and that average income is higher in Brazzaville, this implies large unexploited trade potential between the two cities.

As a result of excessive administrative costs, most cross-river trade is partly or fully informal. Only two of the 17 Kinshasa firms who have significant client bases in Brazzaville export through official channels. The remaining 15 firms get their clients to ship the goods across Malebo Pool themselves. Six Kinshasa-based firms declared that they had either exported formally to Brazzaville in the past or seriously considered doing so, but abandoned all such activity, citing excessive administrative costs including duties, paperwork, and bribes. Informally traded goods are smuggled across the river via well-established systems involving under-the-counter payments to various customs and security officials.

Trade facilitation across Malebo Pool appears to hold particular promise for promoting local manufacturing and small-scale trading activity, much of which is currently informal. Regression analysis of the survey responses suggests that smaller firms and manufacturing firms anticipate expanding their activities proportionally more than larger firms and pure trading companies, perhaps because larger firms and pure traders are already better able to circumvent trade barriers.

The estimated trade-cost elasticity of trade between Kinshasa and Brazzaville is 0.8. Our sample firms predict that halving of the trade costs would trigger a 40-percent increase in the volume of trade. The corresponding estimated elasticity for total external trade by DRC and RC firms equals 0.5. Hence, a reduction in trade barriers between the two capital cities would trigger a considerably stronger relative increase in trade flows than trade liberalization measures aimed at other partner countries and trade routes. As our approach implies a certain status-quo bias and must therefore be considered as yielding lower-bound estimates, our estimated elasticities may well be compatible with true elasticities of one, meaning that any cut in trade costs might be offset by a fully equi-proportional increase in the volume of trade.

Barriers to Cross-border Integration

We estimate the average cost of a return trip across Malebo Pool at some US\$40, equivalent to between 40 and 80 percent of the average monthly income earned by Kinshasa residents. All interviewed firms complained about excessive fares and taxes for crossing Malebo Pool. Accounting for the full range of fees, the cost of a return trip on an official ferry is estimated at US\$68.80 (see Table 3.1). However, effective costs stated by interviewees vary widely, due largely to unpredictable and arbitrarily applied schedules, to a multitude of fee-charging “services” with inconsistent presence and enforcement, and to widespread evasion and corruption. 20,000 CFA francs (~US\$40) is the standard all-inclusive price stated to us by several regular travelers. Crossing by pirogue represents a slower and more hazardous alternative, which, according to the costs summarized in Table 3.1, still costs about half of a ferry crossing, mainly because of payments claimed by police and military officers. To put these figures in perspective: San Francisco and Oakland are separated by a similar distance to that between Kinshasa and Brazzaville. If, relative to local average

Table 3.1 > Estimated Cost of Passenger Crossing between Kinshasa and Brazzaville (in USD)

| | From Kinshasa to Brazzaville | | | From Brazzaville to Kinshasa | | |
|---|------------------------------|------------------------|-----------------|------------------------------|------------------------|-----------------|
| | Ferry | Fast boat ("canot") | Dugout canoe | Ferry | Fast boat ("canot") | Dugout canoe |
| One-way fare | 12.10 | 25.00 | 2.80 | 10.80 | 21.60 | 2.80 |
| Travel document ("laissez-passer") at origin | 5.00 | 5.00 | | 5.90 | 5.90 | |
| Search ("jeton fouille") at origin | 2.00 | 2.00 | | 2.00 | 4.70 | |
| Port fee ("redevance portuaire") at origin | 2.70 | | | 2.40 | | |
| Vaccination card at origin | 1.60 | | | | | |
| Various fees and taxes at destination | 12.50 | 15.00 | | 11.80 | 16.00 | |
| Police/military at origin ("droit de passage", "commisse" etc.) | | | 4.70 | | | 9.80 |
| Police/military at destination ("droit de passage", "commisse" etc.) | | | 5.00 | | | 7.60 |
| Total | 35.90 | 47.00 | 12.50 | 32.90 | 48.20 | 20.20 |

Source: Confidential survey of 57 trading firms in Kinshasa and Brazzaville.

Note: Prices converted using exchange rates of 910 Congolese francs per USD and 510 CFA francs per USD.

income, the same costs applied to crossing the Bay Bridge as those that currently have to be paid to cross Malebo Pool, San Francisco residents would pay between 1,200 and 2,400 dollars for a return trip to Oakland.

In addition, traders are frustrated by tight timetables and poor organization of the ferry ports. Officially, passenger traffic is allowed only between 8 AM and 4 PM on weekdays and Saturdays and between 8 AM and 12 noon on Sundays. Customs clearance of goods is done in open spaces and is badly organized. Traders and simple travelers are not systematically treated separately, which complicates customs procedures and increases opportunities for rent extraction by officials, who are often described not only as corrupt but as aggressive and downright violent. Discrimination by nationality and ethnicity is also reported. The intensity of official harassment ("tracasseries") also seems to vary across different types of merchandise, with some goods, such as sugar, less subject to extortionary pressures than others.

Shipping goods across Malebo Pool in bulk is very costly as well. Costs reported by traders range from three to 30 percent of FOB values. Recent World Bank estimates are of US\$15 per ton for barge transport and US\$26 for border delay costs. While port infrastructure is in a general state of disrepair, administrative hurdles appear to represent the main cost factor. Transit procedures also generate considerable administrative costs, and the system allows substantial leakage.

Customs procedures at Kinshasa and Brazzaville border posts are reported to be cumbersome. There is no effective preferential trade agreement between the two Congos even though both are members of the Economic Community of Central African States (ECCAS). This means that in principle all goods transported across the river have to pay the full customs duties. While a simplified regime for small-scale traders existed in the past, this regime has been suspended, and treatment of petty traders remains arbitrary and often abusive. A DRC presidential decree of 2002 grants the right to operate at customs

Box 3.1 ONATRA and CNTF

Despite its dominant position, ONATRA claims not to be able to finance any investment projects out of its river-crossing operations. It can be estimated that ONATRA's daily operating profit from the Malebo-Pool ferry service alone exceeds US\$5,000, thus probably earning the firm some 2 million dollars annually. The port at Matadi, which is also run by ONATRA, is believed to generate even larger operating margins. The problem, according to the firm's management, is a top-heavy and bloated payroll of some 12,500 employees plus a similar number of pensioners for all of its operations. Some of this is undoubtedly a legacy of busier pre-war times, but it does not appear that the firm has proper control over its entire payroll. What is clear, however, is that this overblown personnel budget as well as various forms of government interference prevent ONATRA not only from offering the best customer service (an unlikely outcome anyway, given its monopoly status) but even from maximizing its own profits. It would appear very likely that investing some of its revenues in upgrading its transport and loading capacity would benefit its own profits in the medium term, as the firm seems to operate well below the capacity at which its marginal cost equals its marginal revenue.

The situation at ONATRA's Brazzaville-based equivalent CNTF seems to be very similar. Despite high operating margins, the firm's management claims that no re-investable profits can be generated. Discussions are said to be under way for the privatization of CNTF, but real progress does not look imminent.

posts to only four agencies. Yet, up to 17 agencies are reported to operate at the passenger port in Kinshasa, often raising fees from traders and travelers without offering any corresponding services.

The observed high prices and low capacity largely result from the duopoly granted to the two national operators, ONATRA (in the DRC) and CNTF (in the RC). A convention signed by the two governments in 2005 attributes exclusive rights over the Brazzaville-Kinshasa route for passenger traffic to the two state-owned transport companies. Yet, despite their officially sanctioned privileges, the two operators appear to be unable to finance maintenance and infrastructure investment out of their revenues from river-crossing traffic (see Box 3.1). The main reason behind high prices and inadequate infrastructure therefore appears to lie in uncompetitive market structure coupled with poor management by the dominant operators.

Cross-river passenger traffic in Kisangani is 175 times larger in per capita terms than in Kinshasa-Brazzaville. Being located on either side of the Congo River but not divided by a national border, Kisangani offers a useful point of comparison to Malebo Pool. Kisangani has an estimated population of somewhat over 800,000, making it around a twelfth the size of Kinshasa-Brazzaville. In Kisangani, it is common for traders, school children, students, and workers to commute across the river on a daily basis—something that has been unheard of between Kinshasa and Brazzaville for decades. The estimated number of passenger river crossings for 2009 is 10.2 million, while our estimate of the number of trips across Malebo Pool is 0.7 million.

Crossing the river Congo in Kisangani is about 300 times less expensive than crossing it in Kinshasa-Brazzaville, and the river in Kisangani is open for legal crossing twice as long every day as on Malebo Pool. All official operators in Kisangani apply a flat fare of CDF 100 (US\$0.1) per person and crossing. No additional charges apply, and bureaucratic obstacles seem to be minimal both at embarkation and at disembarkation. Yet, the river is only about six times wider in Kinshasa than in Kisangani. While disabled travelers, who generally pay no or reduced fares and duties between Kinshasa and Brazzaville, account for two-thirds of passengers in Kinshasa-Brazzaville according to some estimates, their share in Kisangani is estimated at just ten percent. This is an evident outcome of river crossings being significantly more affordable to the general population in Kisangani than on Malebo Pool. For details on the organization of river-crossing traffic in Kisangani, see Box 3.2.

Policy Recommendations

What can policy makers do? While large foreign-funded infrastructure projects exist on the drawing board, considerable uncertainty remains over their realization and future viability. Hence, we explore options for regulatory measures and small-scale donor interventions aimed at unleashing “bottom-up” local entrepreneurial activity.

First and foremost, our analysis points to the importance of customs reform. A central element of such a reform is the systematic implementation of single clearing and payment points for traders (“guichet unique”). A corollary of this is a significant reduction in the number of public or semi-public agencies (or even private agents) active at border posts and allowed (or at least tolerated) to collect fees from traders. Existing law in fact only allows four such agencies to operate at the border. An area for reform of particular interest to the Kinshasa-Brazzaville region, as well as to their hinterlands, is the organization of transit trade. Leakage and fraud in transit trade should be minimized. Transit could be further facilitated by more intensive collaboration between DRC and RC customs offices, and the modalities of charging (and reimbursing) indirect taxes should be improved.

In addition, travel and transport across Malebo Pool could be facilitated through a range of mainly regulatory measures, with immediate impact. Given the large cost and uncertain prospects associated with the long-standing project of building a bridge across Malebo Pool, less costly and more rapidly implementable solutions to unblocking the Kinshasa-Brazzaville bottleneck need to be identified. Such measures could prepare the ground for later infrastructure investment, by demonstrating the effects of lower trade costs. While dilapidated infrastructure may be the visible face of high trade costs in Africa, uncompetitive transport markets often pose even more severe obstacles to the free movement of goods and people.¹⁷ High administrative costs and constraints

Box 3.2 Crossing the Congo at Kisangani

More than 96 percent of crossings are made by motorized dugout canoe, with less than four percent of passengers crossing by ferry. In November 2010, some 60 canoes were in operation on any single day. Dugouts depart on average every ten minutes, between 5.45 AM and 10 PM. Passengers pay CDF 100 for a crossing on the ferry as well, whereas vehicles are charged US\$30 for a same-day return. Some 3,000 vehicle return trips are recorded per annum. The ferry operates from 7 AM until 6 PM.

Even though river-crossing traffic is significantly cheaper, more frequent, and less cumbersome in Kisangani than in Kinshasa-Brazzaville, the river-crossing transport market in Kisangani is not free either. Both prices and quantities are controlled. The mayor’s office (“Hôtel de Ville”) and the National Economics Ministry (“Ministère de l’Économie Nationale”) set the fares. Entry is costly: every canoe operator has to be affiliated with ANAFLUKIS, the association of private operators. This costs a hefty US\$500 to join, plus a daily fee of CDF 2,600. Furthermore, ANAFLUKIS restrains the number of operators at any given time, by forcing canoes to work only every second day. This arrangement is clearly lucrative for operators. It can be estimated that daily operating profits per canoe (after fuel costs and fees) are in excess of US\$25. Furthermore, ANAFLUKIS evidently makes significant revenues, the destination of which we were not able to establish. Finally, the mayor’s office forces ANAFLUKIS members to buy most of their fuel at above-market prices. This is another source of economic rents whose final beneficiaries are unknown to us.

The ferry operator seems to earn considerable profits but fails to invest in maintenance and repairs with likely very high return on investment. Our estimates suggest that the ferries generate an annual operating profit somewhere between US\$120,000 and 390,000. Nonetheless, the operator “Office des Routes” claims to lack the means for financing maintenance, let alone investment. In fact, the car ferry, which was donated by the EU in 2008, has been broken since June 2009. Since then, it crosses the river towed to the passenger ferry, which significantly reduces carrying capacity. The cost of repairing the broken engine is estimated at less than US\$20,000. Yet, based on reported revenues when the ferry was operational, we estimate that such an investment would allow the operator to more than double its revenues. We were unable to establish what happens with Office des Routes’ profits from the ferry operation

¹⁷ See Teravaninthorn and Raballand 2009.

on competition in transport services will have to be addressed to allow the full benefits of improved infrastructure to materialize. If implemented effectively, such measures by themselves could generate benefits similar to those of a bridge, at a fraction of the cost. In fact, facilitating the activities of local transport entrepreneurs across Malebo Pool could well pay higher economic rewards than the construction of a bridge, since most of the work on a bridge would likely have to be carried out by foreign contractors, whereas water-borne transport services can well be supplied by local operators. Part of such a reform could also be the reintroduction of a transparent system for clearing customs to small traders as outlined below.

To this end, the first-best policy option would be to abolish the convention restricting passenger traffic across Malebo Pool, thus ending the stranglehold of ONATRA and CNTF on Pool-crossing passenger transport. Ideally, market liberalization would be accompanied by more transparent and simpler procedures for immigration, customs, and related border controls. Transport of goods and passengers would be more clearly separated in order to reduce opportunities for rent extraction. Concessions for additional river ports to compete with the existing set of ports could be auctioned as a complement to these reforms. As a second-best solution, the establishment of a second pair of accessibly located “beaches” with independent transport operators could go a long way toward reducing transport prices and limiting opportunities for rent extraction by port agents and shipping operators.

If such solutions were not politically feasible, initial measures to facilitate trade and passenger traffic could focus on a range of relatively simple administrative measures:

- Enforcement of full transparency of fares for passengers and goods through publicly available fare schedules;
- Enforcement of full transparency of all border and harbor fees and duties through publicly available schedules of the full range of border taxes;
- Re-introduction of simplified customs duties for small transactions;
- Conducting a pilot trial of a single-fee model for passengers and/or goods (all border fees and duties consolidated into a single rate, collected at one counter, and then shared out among the relevant government agencies);
- A clearer separation of passenger and goods traffic at existing port facilities;
- A reduction in customs controls on pure passenger traffic to infrequent random checks (made possible by the separation of passengers from goods traffic);
- Enforcement of limitations to agencies allowed to operate at border points; and
- Extension of port opening hours and hours for river crossings.

The payoff for administrative and regulatory reforms could be leveraged through infrastructure investments. Private as well as social rates of return on transport investments are estimated to be particularly high between Kinshasa and Brazzaville, where population density is high and distances are comparatively short.¹⁸ Access routes also offer significant potential. The Matadi-Kinshasa and Pointe Noire-Brazzaville corridors serve not only as the respective gateways to the world for the two capital cities but they should be seen as competing corridors that can ensure substantial reductions in trade costs. Lower access costs to world markets for local companies will increase their capacity to compete and create

¹⁸ See World Bank (2010).

additional employment. In addition, the two corridors could function as mutual “fall-back options” for the case of interruptions to one of those routes. Hence, each country’s maintenance of its access route to the ocean generates external benefits to the other country.

Infrastructure investments will have to be combined with sustainable mechanisms for maintenance. The upkeep of new and existing physical capital will have to be locally funded to be sustainable in the long term. It is therefore important that projects to facilitate trade are made compatible with the incentives of local actors to serve the interests of the many rather than those of the few. As long as foreign-financed transport capital is captured for rent extraction by local elites while being left to degrade, such investments will not yield sustainable gains—and they may even add to local distributive tensions.

Unblocking the Malebo bottleneck through a combination of regulatory changes and some infrastructure investment could yield significant economic gains for both capital cities, have symbolic value as a gesture of political good will, and represent a test case for trade reform. Since many regional integration treaties have remained a dead letter and may be seen as political vanity projects by much of the population, some well-targeted interventions in Kinshasa and Brazzaville could offer visible advantages to a large number of citizens at relatively low cost. Implementation and enforcement may also be more effective right in the heart of the capital cities, where the central government has better control than in more remote border regions. Kinshasa and Brazzaville, therefore, are ideally placed to be taken as a test case for reform of cross-border transport and customs, which, if successful, could later be replicated elsewhere.

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4. Enhancing the Recent Growth of Cross-border Trade between South Sudan and Uganda

Yutaka Yoshino, Grace Ngungi, Ephrem Asebe¹⁹

Introduction

The restoration of peace has led to a significant growth in demand in South Sudan. The signing of the Comprehensive Peace Agreement (CPA) in 2005 between the Government of Sudan and Sudan People's Liberation Army (SPLA) brought to an end of the decades-long conflict in South Sudan. The oil windfall, which was driven by the new flow of oil revenue to the Government of South Sudan (GoSS) based on the wealth sharing agreement between the North and the South under the CPA, coupled with foreign aid, allowed a large increase in public expenditure in the South. Population growth from resettlement of returnees and former refugees as well as increased business presence by foreign investors in South Sudan also contributed to the demand growth.

The demand growth in South Sudan together with lack of local production capacity then led to a sharp increase in cross-border trade between Sudan and Uganda. The Uganda Bureau of Statistics and the Bank of Uganda have undertaken a series of surveys of informal cross-border trade between Uganda and its neighboring countries. Informal trade here means trade that is not recorded officially by customs at the border and does not necessarily mean illegal trade. Many informal trading activities are totally legal, going through customs but not officially recorded due to the small quantities traders carry. Combining their estimation results of informal trade, bilateral exports from Uganda to Sudan have experienced skyrocketing growth since 2005—from US\$60 million in 2005 to US\$635 million in 2008 (Figure 4.1). The consumption and the construction booms in the post-conflict Southern Sudan—a sharp increase in demand coupled with the lack of local production capacity—are the driving force behind this increase.

The stability of Northern Uganda in recent years is an additional factor that has contributed to the growth of cross-border trade between Sudan and Uganda. The Juba Peace Talks between the Lord's Resistance Army (LRA) and the Ugandan government through mediation by GoSS has resulted in a cease-fire in 2006, putting an end to the two-decade-long internal

¹⁹ Yutaka Yoshino is a senior economist in the Africa Poverty Reduction and Economic Management unit. Grace Ngungi, and Ephrem Asebe are independent consultants. This note is currently being slightly revised to take recent developments into account.

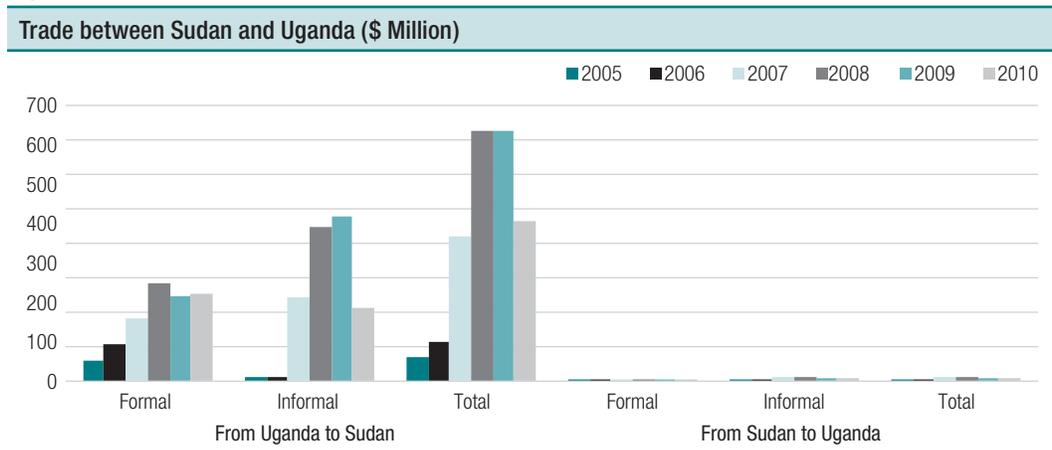
conflict that seriously affected the economy of the Northern Uganda. While the peace and stability of South Sudan and Northern Uganda has led to the skyrocketing growth of trade between the two, South Sudan's trade with other neighbors is relatively small, largely due to lack of security in the areas on the border with those countries. Direct cross-border transactions with Northeastern Democratic Republic of Congo (DRC) and Kenya are limited at the moment due to the deteriorating security condition in Northeastern DRC due to LRA activities.

The rapid growth in Ugandan trade with South Sudan stalled after 2008 and even declined in 2010 due to increased insecurity in South Sudan faced by Ugandan traders. Uganda's exports to Sudan declined in 2009 due to several reasons, including import controls imposed by the Central Bank of Sudan to lessen foreign exchange pressures and safeguard the foreign exchange reserve position of the Republic of Sudan as a whole, which led to a decline of Sudan's overall formal imports by 20 percent in 2009. Slight recovery in formal imports is recorded in 2010 in light of a normalized level of oil revenue. However, informal exports from Uganda to Sudan dropped substantially from 2009 to 2010 (Figure 4.1). A substantial number of Ugandan traders withdrew from South Sudan as they found their business environment in South Sudan at the border as well as in Juba deteriorating through increasing harassment and acts of violence against them. There were also fears of potential insecurity from the Sudanese general election in April 2010 as well as the run-up to the referendum in early 2011. While there have been signs of return of Uganda traders to South Sudan since the peaceful conclusion of the referendum in early 2011 and the drop in 2010 may be a one-year phenomenon, the magnitude of decline is nonetheless significant, implying how informal trade is sensitive to changes in local security conditions.

Even with the recent decline in informal exports from Uganda to Sudan, Sudan remains Uganda's largest trading partner, dominated by South Sudan. For both formal and informal trade combined, Sudan has been the single largest destination of Uganda's exports since 2007, larger than any other destination in the world (Figure 4.2).

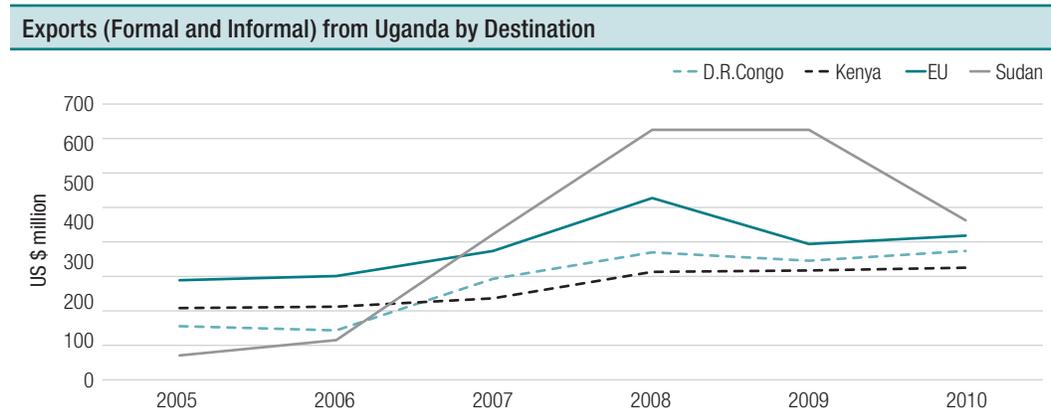
The bilateral trade between Uganda and South Sudan is highly asymmetric with the volume of exports from Uganda being disproportionately larger than the volume of exports from Sudan to Uganda and largely informal. As shown in Figure 4.1, Sudanese exports to Uganda are negligible compared to Ugandan exports to Sudan. While formal imports from

Figure 4.1 >



Source: IMF, Uganda Bureau of Statistics and Bank of Uganda.

Figure 4.2 >



Source: Uganda Bureau of Statistics.

Uganda were US\$246 million in 2008, informal imports were estimated to be as much as US\$589 million in the same year.

A range of products are exported from Uganda to Sudan with food (e.g., beer, water, food products, sugar, cooking oil) and construction materials (e.g., cement, iron sheets) being the leading exports. While South Sudan used to export a range of products such as hides and skin, honey, coffee beans, ground nuts, sesame, beans, horn and hoofs, and gum arabic, the only product currently exported is timber. Based on the survey data, the major informal unrecorded exports from Uganda to South Sudan are similar to those in recorded formal exports. For both the Oraba-Kaya and Bibia-Nimule border posts, two principal posts along the Sudan-Uganda border, agricultural crops and industrial products have significant shares in the total of informally exported products from Uganda to South Sudan.

There is some complementarity between formal trade and informal trade, which underlines the similarity in products traded formally and informally. Informal trade activities can take place as stand-alone cross-border transactions such as crossing borders outside of the areas covered by border posts. But in many cases, informal trade takes place next to formal trade at border posts and in many ways, informal trade activities are linked with formal trade activities. The same goods can cross the border formally or informally—by foot, bicycle, motorbike, passenger car, bus, carried in small quantities and thus exempted from the normal customs procedures. In some ways, informal trade is *connected with formal trade*. Trucks unload some of their consignments between Ugandan and Sudanese check points on the border and sell them to foot, bicycle, or motorbike transporters, presumably in order to reduce customs duties and tax payments when they enter Sudan.

Monitoring regional trade—trade in regionally produced and regionally consumed products—including informal trade, has become more relevant than ever as each economy in the sub-region has become more integrated. The boom in informal exports from Uganda, primarily to South Sudan, partially offset the negative impact of the global financial crisis on the Ugandan economy, acting as a crucial contribution to the current account of the balance of payments at a time when most other sources of foreign exchange earnings were under pressure. Economic interdependence through regional trade also affects food security at the regional level. Given the short-term supply capacity constraint in Uganda, the export boom to South Sudan has raised domestic prices in Uganda. The high demand for

agricultural food products in South Sudan has created supply shortages in some districts in Uganda and a rise in food prices. It has induced an expansion of agricultural production in Uganda but also attracted more imports of agricultural products from DRC.

At the same time, informal trade remains sensitive to changes in local security conditions. Even relatively small-scale security incidents, if targeted at specific groups such as Ugandan traders, could generate a substantial withdrawal of trading activities given little fixed investments associated with informal trading.

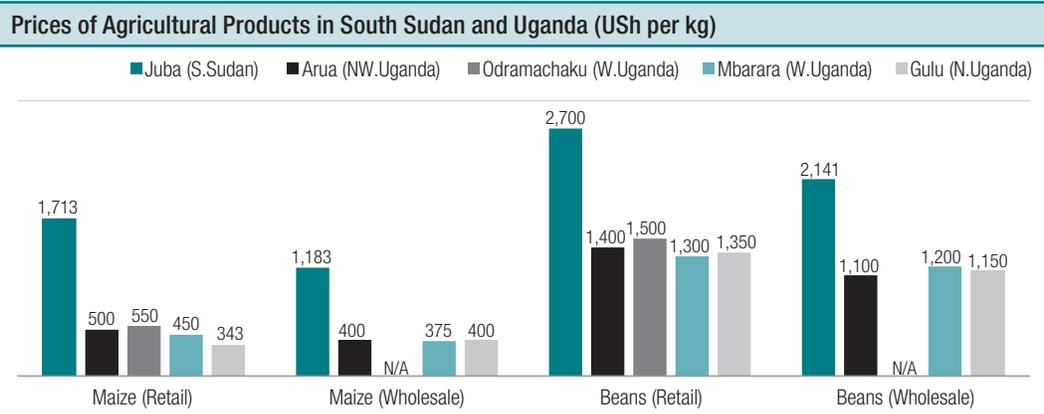
Costs and Constraints at the Border and Behind the Border

There are significant gaps in the food prices between Juba and Ugandan cities. Figure 4.3 presents the price levels of the same agricultural products (maize and beans) both at the retail level as well as wholesale level in Juba as well as four transport hub cities in Uganda—Arua (Northwestern Uganda), Odramachaku (Western Uganda), Mbarara (Western Uganda), and Gulu (Northern Uganda). Maize in Juba is about three times more expensive than in Ugandan cities both at the retail and wholesale levels, while the cost of beans in Juba is about two times more expensive than in Uganda cities for both retail and wholesale levels.

One factor behind the large gap in prices is the high total trading cost between Uganda and South Sudan. Figure 4.4 illustrates how trading costs build up as a ton of beans is transported from a market in Kampala to a market in Juba. Transport and logistics costs (\$145 per ton; with \$93 inside Uganda and \$52 inside South Sudan) as well as duty and other official charges (\$218.33 per ton) are the categories in which a substantial portion of the total trading cost is accrued. For other products covered by the study that are both regionally produced and traded, such as maize, water, beer, and cement, the size of trading costs is similarly significant.

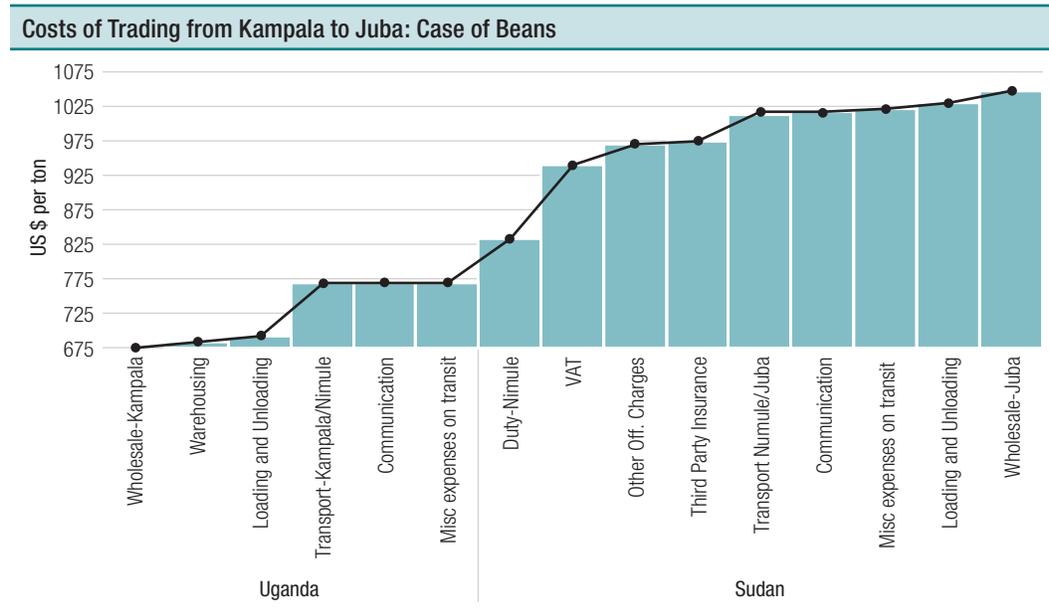
While behind-the-border trading costs are higher inside Uganda in absolute terms, the unit cost of behind-the-border trading cost inside Sudan is much higher than in Uganda. As shown in Figure 4.5, the unit cost of the behind-the-border cost—the aggregate of various costs incurred after goods pass the border post up to the final market—is roughly 40 percent

Figure 4.3 >



Source: Original data collection as in Asebe (2010).

Figure 4.4 >



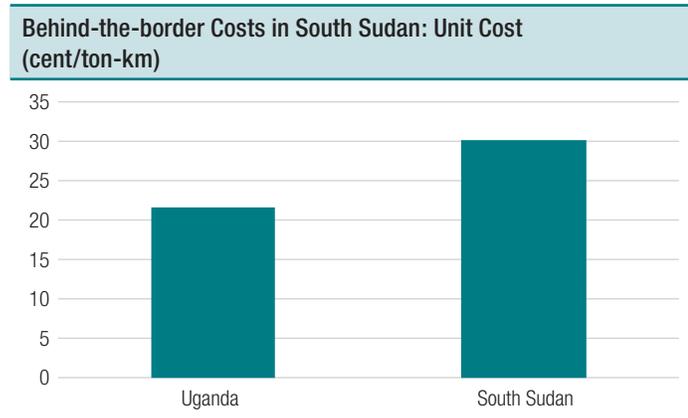
Source: Original data collection as in Asebe (2010).

higher in South Sudan than in Uganda. This is largely due to the poor condition of transport infrastructure in South Sudan such as poor road quality and limited transport routes.

Costs and Constraints at the Border

Lack of consistent implementation of trade policies by the Sudanese customs raises the cost of trading. In Sudan, there is significant confusion and lack of clarity and consistency in implementing trade policies including the tariff rates to be applied. The background to this situation is the gradual enforcement of the CPA which gives the Khartoum-based Government of National Unity (GoNU) the mandate over border controls for the entire Republic of Sudan—transition from SPLA-administered customs operation during the Civil War—as well as the existing lack of clarity in the division of labor between GoNU and GoSS in formulating the tariff policies and enforcing them. Under the current regime, GoSS has the power to intervene in the tariff rates at South Sudanese customs, reflecting the continued sense of autonomy from the SPLA time. Currently, agriculture faces zero tariffs at the South Sudanese border customs points, based on the GoSS inter-ministerial meeting’s decision in

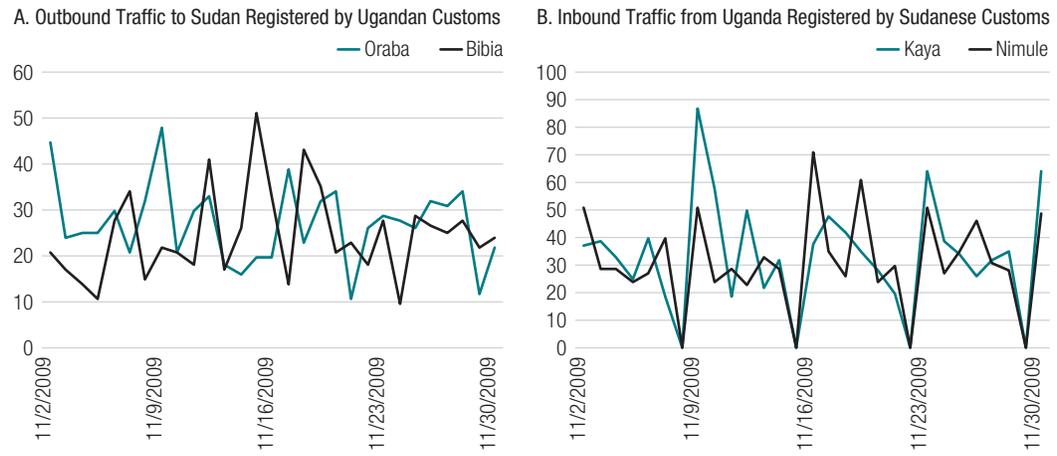
Figure 4.5 >



Source: Original data collection as in Asebe (2010).

Figure 4.6 >

Number of Vehicles Registered at Sudanese and Ugandan Customs Per Day: November 2009



Source: Customs records at Kaya, Nimule, Oraba, and Bibia customs as in Asebe (2010)

Note: The two Sudanese customs points, Kaya and Nimule, are located on the other side of the border from the two Ugandan customs points, Oraba and Bibia respectively.

September 2010. Overall, the tariff applied in the South is only about 30–40 percent of the rates set by GoNU due to the GoSS intervention based on the rationale of protecting Southern Sudanese consumers from high prices. Some anecdotal evidence leads one to suspect that actual rates applied may vary among the border points.

The limited hours of operation of Sudanese customs causes significant fluctuations in the daily volume of traffic passing through customs, and therefore in the volume of customs work, with high concentrations on Mondays. Despite manual processing, average customs clearance time at the Sudanese customs appears to be relatively short when there is no documentation problem. In reality, there are many cases with problems with documentation, which can take up to one week to clear if the problems are serious. A few trucks encounter problems with their cargo seals broken when they enter Sudan. The South Sudanese customs are closed during the weekend. The customs closure during weekends on the Sudanese side makes trade flows more volatile as goods cross the border from Uganda to Sudan (Figure 4.6). The large fluctuations of traffic recorded by the Sudanese customs imply large fluctuations in the workload on the side of customs officials, putting pressure on the staff capacity of customs. This also creates congestion at the South Sudanese customs.

Poor customs infrastructure and staff capacity are serious binding constraints at South Sudanese customs. There is a system in place for administering customs procedures within each customs point. However, the lack of modern data management and communication systems makes customs administration inefficient, particularly in terms of inter-office data verification and communication among different customs offices.²⁰ Also the lack of sheltered areas for inspections (open-air inspections) makes customs more exposed to

²⁰ For example, the customs office in Yei in South Sudan, located at a middle point between Kaya and Juba, verifies customs declaration forms with Kaya for inbound consignments from Uganda to Juba, which is now done only by telephone calls.

weather-related liability risks from rain damages to consignments during their inspections. Also, customs staff, the majority of whom were former SPLA soldiers, are poorly trained.

Security is still weak at the border area for traders particularly those from Uganda, inhibiting their business incentives in South Sudan. Harassment by the Sudanese customs officials against traders, in particular those from Uganda, is a growing concern among the private sector in Uganda. Small-scale incidents such as robbery and confiscation of goods repeatedly occur. Kampala City Traders Association (KACITA) and Joint Action Redemption of Uganda Traders in Southern Sudan report that there were approximately 320 official complaints between 2007 and 2010 including murder, rape, confiscation, and underpayment.

Costs and Constraints Behind the Border

In addition to constraints at the border, high transport costs for regional trade arise due to poor road conditions, multiple checkpoints and roadblocks, multiple taxes (state tax, VAT, county fees), as well as non-tariff barriers such as product standards and import licenses. The major impetus for high trading cost comes from high transport cost due to poor road conditions, particularly in South Sudan. The road condition between Yei and Kaya is particularly bad. The majority of vehicles that are released at Kaya Customs, for example, do not arrive at Yei Customs, which is just 90 km away from Kaya, on the same day but arrive the next day or later.

Also, the low load factor contributes to the high transport cost in South Sudan. As discussed earlier, the trade patterns between South Sudan and Uganda are highly asymmetric in the sense that the amount of goods exported from South Sudan to Uganda (or through Uganda to elsewhere) is significantly less than goods exported from Uganda to South Sudan. The implication is clear: many trucks transport goods from Uganda to South Sudan must return to Uganda empty, meaning that the cost of shipping goods from Uganda to South Sudan becomes much more expensive because it is one-way. Bringing back empty trucks back from Sudan to Uganda is associated with high opportunity cost for transport service providers. Per km cost from Mombasa to Juba and from Kampala to Juba, are more than twice as expensive as from Mombasa to Kampala. Also, limited competition in transport services in South Sudan and high risk factors also contribute to the high unit cost of transport in South Sudan.

Numerous nuisance fee payments faced by traders exacerbate behind-the-border trade costs in South Sudan on top of the already high transport cost. Among several cases collected for the study, trucks transporting goods from the two border posts, Kaya and Nimule, to Juba were stopped to pay nuisance fees every seven to 15 kilometers, five to ten times, as presented in Table 4.1. The average total amount is SDG 200, which is not very high if it is paid all at once. However, when the fee is broken down to small amounts to be paid five to ten times along the route, the time cost of the payments is substantial. Specifically, some of these include amounts to the traffic police, the army for public security, roadblocks, and waraga (travel permit) payments. Most of the payments are of an informal nature and also small in amount (e.g., SDG 10).

Additional taxes imposed by the States within South Sudan raise not only the monetary cost of trading but also the time cost from congestion at interstate borders. For example, on the Nimule-Juba route, Central Equatoria State (CES) imposes state taxes at Juba Bridge when goods cross the border between Eastern Equatoria State and CES. The analysis of data collected at Juba Bridge reveals that roughly two-fifths of tariff and VAT payments

Table 4.1> Miscellaneous Formal and Informal Payments during Transit between Border and Juba

| Case | Route | Distance (km) | Total Amount (SDG) | No. of Payments | Amount per payment |
|------|-------------|---------------|--------------------|-----------------|--------------------|
| 1 | Kaya-Juba | 233 | 285 | 11 | 25.91 |
| 2 | Kaya-Juba | 233 | 205 | 8 | 25.63 |
| 3 | Kaya-Juba | 233 | 165 | 9 | 18.33 |
| 4 | Kaya-Juba | 233 | 200 | 7 | 28.57 |
| 5 | Nimule-Juba | 193 | 145 | 8 | 18.13 |
| 6 | Nimule-Juba | 193 | 205 | 6 | 34.17 |
| 7 | Nimule-Juba | 193 | 135 | 5 | 27.00 |
| 8 | Nimule-Juba | 193 | 285 | 10 | 28.50 |

Source: Original data collection as in Asebe (2010).

paid at Nimule is being charged at Juba Bridge by CES (Atil 2010).²¹ With the imposition of multiple taxes and charges, Juba Bridge becomes a major bottleneck in transporting goods from Nimule to Juba, which therefore creates congestion at the Bridge. The import cargo spends, on average, an extra two days at the Juba Bridge (World Bank and International Finance Corporation 2011).

For formal trade, the cumbersome documentation process for importation multiplies the constraints that lie behind the border in South Sudan. The recent Doing Business report for South Sudan (World Bank and International Finance Corporation 2011) found that an entrepreneur in Juba must submit 11 documents, wait 60 days, and spend US\$9,420 to import a standardized container of cargo through the port of Mombasa. A similar story applies for regionally produced regionally traded products, which are the focus of this chapter. Better coordination of processes among Customs, Ministry of Commerce and Industry (MCI), and Sudan Standard and the Metrological Organization as well as state governments would facilitate the importation process by cutting down the time cost of importation.

Costly Trade Financing

Formal trade financing services are costly in South Sudan. Formal letters of credit (L/Cs) are available from banks located in South Sudan and Uganda, mostly branches of foreign banks, including regional banks from Kenya and Ethiopia. Kenyan Commercial Bank and Equity Bank are the two largest banks issuing L/Cs in South Sudan. However, the number of clients is very limited. L/Cs are mainly issued to clients known to the bank and backed by 100 percent cash collateral in U.S. dollars; the bulk of these are issued to traders that supply government, with the government acting as guarantor (Atil 2010). Businesses also face difficulty in terms of the high rates of daily charges associated with L/Cs.

On the other hand, many services are provided informally. Due to the high cost of L/Cs, businesses often resort to other informal ways to finance their imports. Informal trade financing is accessed through friends and personal contacts where buyers can provide

²¹ This consists of one-fifth for CES tax and another one-fifth for additional charges including cargo verification, standards verification, driver and vehicle registry, commerce check, Sudan customs policy, and parking fee.

upfront payments to traders for purchases, and/or where suppliers are willing to wait for the payments or accept partial payments. More often than not, businesses send their employees to Uganda and elsewhere to make purchases directly, thus minimizing the risk. In such a case, cash in dollars is kept outside of South Sudan for purchases abroad (Atil 2010). Other sources of trade finance include loans from family, friends, or informal moneylenders. The cash-based cross-border settlements of informal trade have attracted a significant number of informal currency exchange service providers at the border areas as well.

Women's Participation in Informal Border Trade

Women's participation in border trade is largely informal. As in most developing countries, women are prominent players in informal trading activities in South Sudan and Uganda. Trading activities play a crucial role in improving their household incomes. Among those who were interviewed by the original data collection for the study (Ngungi 2010), 77 percent of traders were from female-headed households as widows or breadwinners, depending solely on cross-border trade as a source of income. Typical age was between 35–45 years, ages that allow women to be away from family responsibilities such as childcare. Instead, they face increased needs for cash, for example, for school fees and other household needs, which drive their participation in cross-border trade.

There are largely two types of women traders engaged in informal border trade between South Sudan and Uganda: local Sudanese at the border areas and Ugandan and Kenyan traders. The first type is local Sudanese women at border towns, mostly in Kaya, where they walk to cross the border from South Sudan to Uganda (Oraba) to purchase commodities to sell during the market days in South Sudan. Most women participating in cross-border trade in this way are illiterate and lack basic education. Another type is women traders who purchase commodities in Ugandan and Kenyan markets and use regular bus services which connect Juba in South Sudan and cities in Uganda and Kenya to transport the commodities to Juba and sell them there.²² The study found that 70 to 80 percent of the bus passengers are Kenyan and Ugandan women who engage in cross-border trade (Ngungi 2010). Most of traders of this type are literate.

The vast majority of the local women participating in border trade use agents for clearing the customs. The agents do not necessarily have professional permits or licenses but are simply well known and recognized by customs officials. Agents are those who have experience of doing the work at the border posts and know how to maneuver within the system. Use of agents is not officially required; however, customs officials prefer to deal with clearing agents who understand the procedures better than the women in business. The negative perception was that the customs officers looked down on the women because they were poor and they perceived informal businesses as illegal smugglers.

Access to credit is a significant constraint for informal women traders. There seems to be a vision for carrier development among women traders engaged in cross-border trade to improve their economic livelihood by stepping up their business from retailers to wholesalers (Ngungi 2010). However, they are constrained in terms of obtaining sufficient capital to start

²² There are total of nine passenger buses that pass through the Nimule border (eight from Kampala and one from Kenya).

buying commodities in bulk and sell them to retailers at competitive prices. They have only limited access to microfinance institutions (MFIs). Among the respondents, only 10 percent have obtained services from financial institutions including MFIs to finance their start-up costs, while 90 percent have financed either from their own savings or from family members.

Lack of security at the border areas affects women more than men. A number of incidents of rape and other violence against women were reported at the border area of Bibia-Nimule. There is an ongoing effort to establish markets at the border, which will likely help reduce occurrence of those incidents.

Independent South Sudan and an Agenda for Regional Trade

South Sudan became an independent state on July 9, 2011. The independence of South Sudan will bring both opportunities and challenges. Uncertainty exists over how the border management of South Sudan, including customs, will be handled. The overwhelming majority of South Sudanese voted in favour for independence in the referendum that took place in January 2011. The immediate agenda for the independent South Sudan is to quickly set up an initial independent border management arrangement including customs. After independence, it appears that South Sudan does not even have a simple law granting the right to collect customs duties. The two countries have recently agreed on establishment of ten check points at the border between them which extends to around 2200 km as well as formation of control teams composed of Sudan Armed Forces and the Army of the State of South Sudan to investigate any violation on the ground. The two countries also agreed on establishment of customs offices and implementation of immigration procedures.

The drive for integration with East African Community (EAC) further complicates the process of creating a new customs regime in South Sudan. Prior to independence, GoSS already announced its intention to seek membership of the EAC. As South Sudan aspires to join the regional body, there will be an obvious question of how the harmonization with EAC countries in terms of trade policies and other trade-related domestic regulations will be handled in conjunction with the possibility of establishing a new regime of border control and customs. During the five years of the post-CPA customs regime, dialogue was limited between South Sudanese and Ugandan (and Kenyan) authorities, given that GoNU had been formally representing South Sudan customs. More intensified interactions between GoSS and regional counterparts (e.g., Uganda Revenue Authority) needs to take place quickly.²⁵

Maintaining security in the business environment is a critical step to sustain growth in cross-border trade. Some dialogue between GoSS and the Government of Uganda has started since the series of violent acts against Ugandan traders in South Sudan, which has led to the idea to establishment of border markets as well countering the existing antagonistic sentiment against foreign traders in South Sudan. A stepped-up effort on

²⁵ For instance, a growing issue for Uganda Revenue Authority (URA) is the loss in tax revenues for local governments by informal, unrecorded purchases and cross-border trade. Southern Sudanese traders come to buy agricultural products directly from farms, where local authority cannot capture revenues. URA held three meeting with GoSS in December 2009 and April and June 2010 to prepare common custom documents to smooth cross-border trade. Progress is slow because under current trade policy regime GoSS does not have a mandate in trade policy-making.

both sides may be helpful to sensitize their populations on the merit of trading to build stability in the region.

Improving the quantity and quality of services provided at customs through building staff capacity and extending hours of operation is of utmost importance for increasing efficiency at the border. The study found that the manual nature of the procedures at customs itself is not necessarily the most binding constraint. Weakness exists rather in the inconsistent application of policies by customs staff. The weak staff capacity is the most binding constraint against efficient customs operations, reducing staff morale and their efficiency, and lowering the transparency in their routine handlings thereby increasing risks of informal payments. Even when under the control of GoNU before the independence, customs in South Sudan were staffed by South Sudanese, mostly former SPLA soldiers. The majority of them require proper training. Also, simply providing sufficient opening hours during the weekend for customs services would help to alleviate the delay at the border crossing. Staff capacity building and ensuring sufficient amount of hours for customs operations should have a higher priority than investments in hardware infrastructure and upgraded systems (e.g., ASYCUDA) and would be simpler first steps that the new independent government can take. Regional training opportunities—cross-country learning from other Eastern African countries—may be an effective way to build staff capacity in South Sudan this regard.

Improved clarity and coordination of various taxes and charges, both at the central as well as state levels, are needed to reduce trade-related transaction costs at the border as well as behind the border. The lack of clarity in administrating duties and taxes charged by different government offices (including the state government) at the border has led to cases of multiple taxes. There is a need for more harmonization in the revenue regime of Southern Sudan. Uncoordinated issuing of exemptions from duties and taxes was also mentioned as a growing concern.

Efforts should be made to remove roadblocks and, at the same time, make investments to improve road quality. Poor infrastructure makes small loads more economical. Roads are still too bumpy for large trucks as in the case of extremely poor road condition between Kaya and Yei and the limited capacity of Juba Bridge, which can accommodate trucks only up to 5 tons. But small loads make trading more costly due to transit bottlenecks since various payments—official, unofficial or both—are made per truck not by weight. Time costs are also high. While improving road quality in South Sudan is a critical investment that must be made to reduce the costs of trading, the government needs to step up its efforts to reduce the number of roadblocks along major corridors for miscellaneous expenses during transit. If payments are collected for legitimate reasons, it is better that those are collected all together at in one place to save time.

Since alternative corridors may be developed in the medium- to long-term, improving competitiveness along the Juba-Kampala corridor is important for Uganda to keep its position as a transit hub. Once the security condition in East Equatoria improves, investments will likely be made to develop a corridor directly to Kenya to get access to Mombassa rather than going through Uganda. There is already a plan to establish a road connection from Malakal in Upper Nile State to Gambera in Western Ethiopia to develop a corridor to Djibouti. For Uganda to maintain its position as a transit hub for South Sudan, and other landlocked economies such as DRC, Rwanda, and Burundi for that matter, maintaining its cost competitiveness and efficiency of trade-related services are critical.

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5. Lowering the Cost of Payments and Money Transfers in UEMOA

Thilasoni Benjamin Musuku, Maria Chiara Malaguti, Andrew McEwen Mason, and Ceu Pereira²⁴

Introduction

Lowering cross-border transaction costs in any monetary block or trade corridor is an important step in encouraging greater trade and enhanced use of formal financial services. The eight UEMOA countries use a common currency, the CFA Franc (FCFA). The currency is controlled and issued by the region's central bank, BCEAO. Additionally, UEMOA has a common modern payments infrastructure, which ought to facilitate widespread access to basic transactional payment instruments and transmission circuits.

Achieving scale in financial services is generally acknowledged as being important to promoting financial sector development in Africa, to lower the cost of financial services, increase competition and innovation, and increase access. According to information provided by BCEAO, despite the region's high-quality electronic payment system infrastructure that can facilitate access to basic services less than 10 percent of the UEMOA population has a bank account.

There are new players seeking to enter the payment services market in UEMOA. This is considered a healthy indicator of the opportunities that exist for competitive (and competing) transactional products and services to overcome some of the inefficiencies and product gaps that still exist. However, given the new players, underlying money transfer costs for final users have not decreased to the extent expected.

Recent technological developments such as mobile payments provide the context for the analysis provided in this chapter. Technology opens up opportunities to increase the reach of financial services, expand the scale of operations, and reduce costs, thereby enabling usage of existing infrastructure to greater potential.

This chapter has two principal objectives: the first is to identify opportunities for and barriers to reducing the cost of money transfers between and within UEMOA member countries. The second objective is to identify means of further extending the reach of

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modern payment services and promoting access to basic transactional services to a much broader cross section of the population than the current user base.

The Current Payments Landscape

The BCEAO Regional Payment system Project produced high-quality basic infrastructure to deal with both wholesale and retail payments. With the *Système de Transfert Automatisé et de Règlement*²⁵ (STAR), *Système Interbancaire de Compensation Automatisé*²⁶ (SICA) and *Groupement Interbancaire Monétique*²⁷ (GIM), UEMOA countries have a world-class clearing and settlement infrastructure. However, the infrastructure remains markedly underused and usage costs, although lower than before, remain very high. As a result, there is room for concerted efforts by all market players to focus on both reducing costs and improving access and usage.

Overall, the payments landscape of UEMOA exhibits several distinct characteristics and trends as follows:

Shallow Penetration of Formal Channels and Services

There is a well-established formal banking sector, but it serves a very small percentage of the population. Most of the population remains “unbanked” and reliant on cash. This is well recognized by BCEAO and measures are being taken to address this issue. For example, in August 2007, BCEAO hosted a seminar to consider how to promote “bancarisation” and the use of non-cash payment instruments. The seminar was attended by a cross section of financial sector stakeholders and produced a set of action plans for BCEAO, banks, the bankers’ association, the banking commission, and the UEMOA governments.

As a result, the government of Senegal, in partnership with Ecobank, has launched a program to encourage university students to open bank accounts with associated bank-cards. The government then pays student allowances into these accounts, and students can use their cards to make payments and cash withdrawals at Ecobank branches and ATMs on university campuses. Also, GIM-UEMOA, the interbank card switching and clearing service, is actively working to widen its membership to include the broadest possible range of operators, including mobile telephone payment operators.

It is unclear to what extent these actions have resulted in measurable increases in “bancarisation.” This problem is complex and may well need to be addressed through a more holistic approach.

Cash is by Far the Dominant Payment Instrument Used in UEMOA

As previously noted, only some 10 percent of the population has bank accounts, which means that 90 percent or more of the population have no access to basic transactional instruments such as electronic credits and debits, EFTPOS or even checks. Remedies for this situation are rapidly emerging as a result of innovative electronic payment instruments and circuits that

²⁵ Automated Transfer and Settlement System.

²⁶ Automated Interbank Clearing System.

²⁷ Interbank Payment Card Group.

do not require users to have a bank account. However, these new services are still at an early stage of introduction and have as yet not achieved a critical mass. Cash therefore remains king.

Checks account for the great majority of all non-cash payments. According to data provided by BCEAO, in 2008 interbank checks accounted for 86 percent of SICA-UEMOA transactions by volume and 87 percent by value.

New Players and Services Hold Great Promise

The established “duopoly” of commercial banks and international money transfer operators (MTOs) is being increasingly challenged by a range of new entrants into the payment services market, most of them indigenous. These new entrants are seeking to exploit a variety of opportunities to offer payments and money transfer services, generally using modern technologies such as mobile phones and cards.

A common thread among these services is the goal of operators to reduce the cost of transferring money and thus enhance inclusion to those who cannot afford bank accounts. For example, although all of these service providers have contractual arrangements with licensed banks where they hold funds, as required under BCEAO regulations, they do not require the customer to have a bank account. Although there is still considerable scope for further cost reductions, their services are predicated on low fees as well as speed and convenience. Nonetheless, there is little interoperability between these newer payment systems and services, and few currently use existing BCEAO infrastructure.

While most of the new market players that participated in this study spoke enthusiastically about the number of new customers they had attracted, in terms of absolute numbers, they are barely scratching the surface. There is a lack of vision on the part both established and new service providers. They appear to see the market only in terms of their own small customer base, rather than considering the potential for growing the overall user base to encompass the entire population of UEMOA. There is an opening here for greater collaboration when it comes to provision of basic payment system services.

Important Role of Remittances

Traditionally, there have been strong inward remittance flows from diaspora communities in European countries such as France and Italy and from the United States. These have been serviced primarily by well-established international (foreign-owned) MTOs, which often have exclusive agency relationships with banks in recipient countries. The flows have therefore traditionally been from developed economies to less-developed UEMOA economies (from north to south).

In the last few years, these payment flows have been supplemented by increasing flows within the region (between east and west). These flows are driven by labor migration between UEMOA countries. To a large extent, they rely on people physically carrying cash between countries, but new entrants to the payments scene are offering intra-regional money transfer services with some success. For example, the indigenous MTO Money Express is seeing increasing volumes of transfers between UEMOA countries.²⁸ Some commercial banks are also starting to focus on intra-regional transfers.²⁹

²⁸ Source: discussion with Poste Finances, Togo, June 2010.

²⁹ Source: discussion with Financial Bank, Togo, June 2010.

Within UEMOA, all MTOs are required to operate through agency agreements with other financial institutions such as banks or Poste Finances. Most banks and other financial institutions offer money transfer services from only a few MTOs. This may be convenient for the banks, and is claimed by some banks as being less confusing for customers, but also probably has the effect of keeping the cost of transfers higher than it would be if there were more rigorous competition.

Many Different Institutions Issue Payment Cards

GIM-UEMOA members also have the option of installing and operating their own card terminal networks or participating in GIM-UEMOA's own network. Members of GIM-UEMOA issue their own debit cards, but have the option of co-branding them with the GIM-UEMOA logo. According to data provided by GIM-UEMOA, approximately one million GIM-UEMOA branded debit cards have been issued to date.

In addition to GIM-UEMOA-branded cards, many banks also issue their own cards, which can typically only be used at their own outlets. These include both debit and prepaid cards. Other non-bank financial institutions (NBFIs) are also starting to issue their own cards, based on funds held in a bank with which the NBFI in question has an agreement.

Several factors limit the growth in usage of these cards. For instance, having a GIM bank card presupposes that the cardholder has a bank account. Accordingly, the low level of “bancarisation” in UEMOA member countries is a key factor limiting the use of card products. With fewer than 1,000 ATMs and 2,000 EFTPOS terminals, there is little incentive for consumers to acquire a card. The cost of acquiring and using a GIM card is high relative to most consumers' financial resources. Not all bank-issued cards carry the GIM-UEMOA logo, so they can only be used at the issuing institution's outlets. This appears to reflect the desire of some financial institutions to carve out market share at the expense of interoperability and growing the overall market. This is a major impediment to the development of the overall UEMOA payments system.

In order to encourage as many operators as possible to join GIM-UEMOA, it may be useful to examine the procedures and costs of becoming a member, to ensure that these factors do not act as a deterrent to smaller operators. A tiered membership structure could help improve the situation, with smaller card operators connecting to GIM-UEMOA via the networks of full GIM-UEMOA members.

Mobile Payments are Becoming Popular

A recent trend in UEMOA is the emergence of non-bank players in the market that have identified a variety of opportunities to offer payments and money transfer services, typically using modern technologies such as mobile phones or cards to access services. Although those providing such services have contractual arrangements with licensed banks for holding funds (as required under BCEAO Regulations) they do not require the customer to have a bank account.

Most of the new mobile telephone-based services appear to be single country-based, at least initially. This may be due to the fact that each country has its own telecommunications licensing and regulatory regime, and also the fact that any financial service is required to be separately licensed by BCEAO for each country in which it is offered. Nevertheless, MTOs are planning to offer mobile payment services progressively across the UEMOA

region. While these will be stand-alone operations at first, in the longer term they may be interconnected.

Given the great variety, innovation, and energy of the newer entrants into the payments market, there may appear to be little need for BCEAO to take specific measures to encourage new players or services. However, most of the players are motivated to expand market share for themselves, rather than growing the overall market. Thus there is a public policy agenda here that BCEAO needs to address as part of its payment systems oversight function.

The Legal Framework Applicable to Payment Services

In recent years, new technologies have changed the landscape in the payments industry. Technology has fostered new entrants into the payments market, allowing non-financial institutions to offer new services that in some circumstances do not require opening a bank account. This in turn has highlighted the need for legal reforms designed to ensure a level playing field between established operators and new entrants.

The legal and regulatory framework applicable to payment systems and services should contribute to bringing the highest level of safety, efficiency, cost effectiveness, fairness, and convenience to the maximum number of businesses and individuals. Although new pieces of legislation, such as the e-money instruction, have been introduced in UEMOA in recent years, most provisions in the existing framework relate to the banking sector and paper-based instruments.

Directive 08/CM/2002/UEMOA introduced a number of provisions to discourage the use of cash and to promote the use of bank-based payment channels. Although these instruments also include electronic transfers and direct debits, they are not given specific preference compared to checks, the use of which far outweighs that of all other payment instruments. Indeed, the Directive does not make reference to more innovative channels or electronic instruments based on mobile telephones or prepaid cards offered by non-bank financial institutions.

Lower use of cash as a consequence of Directive 08/2002/CM/UEMOA, would actually result in a move from one inefficient and costly paper-based instrument to another. Using checks is slightly more efficient but does not signify a major adoption of “modern payment instruments and procedures” (see BEACO 2007).

Moreover, the coverage provided by the legal framework as regard new players, such as non-bank payment service providers, is still unclear. Despite the existence of the e-money instruction, most players still cannot provide services without bank intermediation. This is the result of potential inconsistencies between (i) the Banking Law, which builds regulation of payment services and systems around banking activities; (ii) Regulation No. 15, which leaves open the possibility for other entities to issue and manage payment instruments but links payment services to a bank account; and (iii) BCEAO Instruction No. 1, which regulates e-money but is meant to implement Regulation No. 15 and cannot exceed its scope of mandating only bank-based models.

One typical concern about extending operation of payment services to non-financial institutions is the risk that anti-money laundering and anti-terrorism measures would become more difficult to apply. In the case of UEMOA, Directive 07/2002/CM/UEMOA of September 19, 2002 on money laundering has been adopted and there is a harmonization

law to cover anti-money laundering. A consistent policy covering all payment service providers can be calibrated on a risk-based basis to the needs of a given type of service.

What Factors are Limiting UEMOA Money Transfers?

The payments infrastructure in UEMOA is world-class in terms of functionality and capability. It should be facilitating broad-based access to basic transactional services, whether by individuals or businesses at low cost. Below are some of the challenges to be overcome to increase usage of the system beyond a very small fraction of potential users:

Cost

The implementation and deployment of electronic services requires providers to make significant investments in networks and access points, and over the life of the system providers must be able to recoup this investment. As a result, the cost of using electronic payment services is still very high and thus out of reach of the majority of the population, even though some of the new services (such as mobile payment services) are available at appreciably lower cost than the more well-established services (such as those provided via GIM-UEMOA).

Service providers may need to consider how best they can attract a much larger user base, perhaps by forgoing a higher level of profitability in the short term in the interests of building the market overall. If non-cash payment services are to achieve critical mass, costs must come down. But to a certain degree this is a chicken-and-egg situation: fees can only come down with very high transaction volumes that can only be attained when the fees are low.

Availability of Electronic Terminals

The deployment of ATMs and EFTPOS terminals is seriously inadequate whether measured in relation to the size of the population, geographical extent of the UEMOA countries, or even the number of bank accounts. This severely limits take-up of card-based payments.

There is also no fundamental reason why the use of ATMs and EFTPOS terminals should be confined to holders of bank-issued cards. Institutions other than banks could be encouraged to issue cards usable in ATMs and EFTPOS terminals, without being tied to specific banks. This could provide an expanded role for GIM-UEOMA, particularly if it develops into the switch for all payment services, not just bank-operated systems.

Interoperability

Another key factor for rapid and widespread uptake of electronic payment circuits is interoperability. If electronic payment services are to be adopted more broadly, cards or mobile phones must be usable not only with their own systems or mobile networks but also with other systems not covered by the “parent” system.

Card-based payment services in UEMOA do exhibit a great degree of interoperability due to the existence of the GIM-UEMOA card switching and clearing system. The picture is less encouraging for emerging mobile phone-based payment services, which in general are not interoperable. Some mobile operators claim that interoperability of “mobile money” is

prohibited under the rules of the telecommunications regulators, although interoperability is clearly encouraged for voice and SMS services.⁵⁰ Mobile payment operators may be reluctant to contemplate interoperability for a variety of reasons including the need to protect their market share. The complexity of devising appropriate agreements and commercial arrangements, for example for charging and/or revenue-sharing, may also hinder the development of suitable arrangements among mobile operators and inter-bank switching services.⁵¹

The overall lack of interoperability is a significant brake on the development of emergent electronic payment services, particularly cross-border mobile payment services where UEMOA has potential given a common currency and single overseer for payment systems.

Legal and Regulatory Barriers

The assumption that the provision of payment services requires some form of intermediation by banks entails that the current legal framework does not fully foster innovation or promote a level playing field. This not only makes it difficult for new players to compete with banks, but also lessens pressures to reduce costs. With regard to MTOs, although exclusivity agreements are prohibited by BCEAO, requiring bank intermediation results in payment of commissions that are inevitably passed on to users.

It is also difficult for a payment service provider based in one UEMOA country to expand into other countries, because it must comply with local regulations and be licensed separately in each country. This represents a significant administrative burden that can make it unattractive to offer a service across the entire UEMOA sub-region. There is clearly a need—and opportunity—for the introduction of a system of mutual recognition whereby a service sanctioned by one country can be “cross-licensed” in other countries, similar to the EU passport system model for service providers.

Policy Suggestions for the Way Forward

A number of private sector players have introduced or are in the process of introducing new products and services based on innovative uses of modern technology. This demonstrates significant dynamism in the market. However, the introduction of new products and services is having a limited impact in driving overall transaction costs lower or encouraging greater financial access. One important reason for this is the lack of interoperability of new products and services leading to market fragmentation. Combined with the difficulty of establishing cross-border extension of payment services, this reduces the scope for reaping economies of scale and thereby the growth of the overall payments market. To make progress on these issues the next critical step is:

Develop a UEMOA Payments System Strategy

National payments systems in UEMOA are developing rapidly and they are much more complex today than just a few years ago. Addressing payments system complexity and

⁵⁰ Source: discussion with Sonatel 13 April 2010.

⁵¹ Source: *ibid.*

issues associated with terminal availability and interoperability requires a much greater degree of oversight of the payment system by the central bank than is currently exercised. At present, there are only three professional staff in the oversight unit at BCEAO.

BCEAO should take the lead in developing a comprehensive UEMOA-wide payment system strategy, building on the clear success of the 2000–2007 BCEAO Payment System Project. There is growing fragmentation, high cost, low usage of existing infrastructure, and foundations of the legal and regulatory framework require updating.

As the central bank of UEMOA, BCEAO is ideally placed to bring together all stakeholders throughout the Union to develop a holistic strategic plan focusing on improving financial access and ensuring broad acceptance of electronic payment products.

The successful articulation and execution of a holistic payments strategy would provide governments of UEMOA member countries, international development agencies and other partners with a strong strategic platform on which to provide further support for improving the payments landscape.

Within this strategy it will be necessary to address the following:

Develop BCEAO Oversight of Payment Systems

The UEMOA payments system is developing rapidly in a number of areas. While this is a sign of a healthy market, it reinforces the need for BCEAO to strengthen its oversight capability. This will lessen barriers to market developments and ensure that developments benefit the entire community and economy at the highest levels of safety, risk mitigation, and consumer protection. In particular, the exercise of effective oversight should:

- Encourage all players to work together towards achieving the greatest possible level of systems interoperability in the interest both of their customers and in the interest of the overall market.
- Encourage (or require) all card payment (monétique) service providers to join GIM-UEMOA.
- Ensure there are pressures on payment service providers to reduce fees on an ongoing basis.
- Make it easier for financial and payment services to be cross-licensed or recognized in multiple member states, and thereby stimulate cross-border payments.
- Encourage rapid and broad-based deployment of interoperable “end-point” merchant devices where electronic payments can be accepted. These devices should include mobile phones in addition to EFTPOS terminals.
- Ensure that services are introduced in an orderly and safe manner, observing strong consumer protection.

Interoperability of Payment Systems and Services

The interoperability between payment systems in UEMOA needs to be accompanied by agreements by private sector participants on keeping fees among networks to a minimum, otherwise the increase in volumes may not materialize. There are several measures that can be taken:

- Ensure that legal and regulatory barriers to interoperability are removed.
- Work closely with telecommunications regulators in all UEMOA countries to ensure that regulations are consistent and do not inhibit interoperability.
- Develop and implement ways of massively increasing transaction volumes through GIM-UEMOA. GIM-UEMOA is a woefully underused system, which leads to inefficiencies and high cost structures.
- Using the payments system strategy, BCEAO should engage all market players in meaningful and ongoing consultation to encourage interoperability, including taking advice on limiting factors and ways to overcome them.

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6. Facilitating Cross-border Mobile Banking in Southern Africa

Samuel Maimbo and Tania Saranga³²

Introduction

The use of mobile banking in Southern Africa is widely recognized as an increasingly important component of national and regional economic development. Mobile banking can benefit countries in two key ways. First, mobile banking can allow faster and more efficient financial transfers, increasing the volume of trade and subsequent payments to workers and their families. This dynamic is especially important with regards to informal trade, which is practiced primarily by low-income, unbanked international, regional, and domestic migrants. Second, mobile banking greatly increases access to finance for a large segment of the unbanked in developing countries. In Africa, where borders were often arbitrarily drawn, cross-border trade is an important business activity for a large subset of its population. Developing mobile banking capacity offers great potential for facilitating trade in both goods and financial services.

This note provides a description of the demand side factors influencing the development of mobile banking services—remittances and informal trade—and the financial and telecommunications landscape. On the basis of this description, it highlights the key regulatory issues facing Southern African countries, and concludes with recommendations for overcoming the constraints to the development of accessible mobile banking in Africa.

Understanding the Demand for Mobile Banking in Southern Africa

Mobile banking in this chapter refers to a range of mobile-phone-based financial transactions including payments—actual payments that are made with a mobile phone—as well as using a mobile phone to access banking services. The two key areas of migrant

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remittances and cross-border payments occasion the demand for mobile banking services for trade-related transactions.

The first, migrant remittances, is driven by the strong migration patterns that exist in Southern Africa, and migration patterns, in turn, are important for increasing the demand for mobile banking services. Although determining the exact number of migrants is difficult—available data only captures the flow of registered migrants—estimates suggest that the number is high. Significantly, the available data also indicates that a notable portion of migration flows are South-South, or between developing countries. Research has shown that, since income differentials between these countries are small, geographical proximity and networks have a greater influence on migration patterns than income levels. Other determinants of migration patterns include civil conflict, ecological disasters, and seasonal dynamics, which are factors that often affect many African countries.

A common characteristic of migrants is that they are generally of low income and unskilled or of limited formal education, which is indeed one of the causes of migration: workers tend to migrate to where there is work. For example, a recent study on migrants leaving Mozambique showed that eight percent have no education, 15 percent have secondary education, and 70 percent have basic primary education. On the other hand, there is also evidence that a significant number of migrants from other African countries are highly skilled. In these cases, political upheaval or political violence is likely the primary cause of the migration. As one scholar notes, “The pressure of uncertain economic conditions in several countries has acted as a push factor sending skilled professionals to the booming economies of Botswana, Namibia, and South Africa” (Waller 2006). In all cases, a lack of education and job prospects or political unrest and economic uncertainty help to explain why migrants are often the most financially excluded in a community. These migrants, therefore, are people that would benefit the most from the opportunities presented by mobile banking.

It is crucial that policy makers realize that migration flows will continue or even intensify in the future. Instead of a futile attempt to control these flows, policy makers are better off seeking to regulate these flows more effectively by selectively easing barriers to migration, including barriers to cross-border mobility. One key way in which cross-border mobility can be facilitated and regulated is through more effective regional integration. Although some efforts at regional integration are underway in Southern African, the closer integration of labor markets through increased cross-border mobility could bring significant efficiency gains to the region.

Remittances

In the formal financial sector, migrants generally send remittances through banks, post offices, or money transfer operators, and by carrying cash personally or through a friend or relative. As with the size of migration flows, gauging the true magnitude of remittance flows is difficult. What is certain, though, is that the true size of remittance flows is larger than the officially recorded numbers, as these figures do not take into account the unrecorded flows through both formal and informal channels. Indeed, a large proportion of remittances are believed to flow through the informal financial sector.

From a policy perspective, it will be important to know the size of migration and remittance flows, since inaccurate information or estimates could lead to policy initiatives that do not help in raising the level of formal financial sector participation. Similarly, from an efficiency perspective, large remittance flows suggest that policies should attempt to bolster competition among formal financial services providers such as banks and money transfer operators. In this case, engaging with the formal financial system could provide positive externalities due to efficiency gains from transferring money, increasing access to credit, and raising the level of savings. These gains will especially benefit those migrants that do not currently have access to the formal financial sector. For example, engagement with the formal financial sector would provide greater physical security for many workers, in that a worker would not have to always carry cash in hand.

Economically, there is limited participation in the formal financial sector simply because of the high cost compared to informal transfer methods. This is a primary reason why the informal financial sector is more popular among migrants. Indeed, a study of remittances in South Africa conducted in 2006 showed that seven percent of migrants used a post office to send money, one percent used a bank in South Africa, and six percent used a bank in the migrant's home country. The rest (86 percent) used informal means for remitting money. While other studies have shown a higher percentage of migrants using banks, a significant number still used informal methods for transferring remittances. So while current estimates of informal sector participation are imprecise—the differences between studies may be due to differences in the sampling method and survey timing—economists are in broad agreement that migrants who are engaged with the formal financial sector are a small minority.

There are several reasons why many migrants choose to use informal channels rather than the formal financial sector to remit payments:

- *Ease of use:* Migrants prefer methods with less paperwork
- *Familiarity:* Informal channels have also been used, or have been recommended, by family and friends
- *Cost:* Higher costs in the formal financial sector drive away migrants. Fees in informal networks tend to be lower than at banks or with money transfer operators. Studies have shown that the cost of formal transfers can be up to six times as great as informal transfers, with fees that can represent over 50 percent of the remittance value.
- *Risk tolerance:* There is a perception among migrants that banks are untrustworthy and can lose (or steal) migrants' money
- *Access:* It can be difficult for migrants to reach the point of delivery

Another reason why a large proportion of most migrants stay away from formal channels is that a significant number of migrants are working in South Africa without formal employment. Thus, the remittances are, by definition, the result of illegal employment. Given this context it is unsurprising that banks are generally unable to provide services to unbanked migrants.

Finally, in some countries there are regulatory restrictions that prevent the entry of financial institutions—even those that may have a greater geographical reach or are closer to migrants—into the remittance market. All of these reasons explain the disincentive facing migrants for engaging with the formal financial sector.

Trade Patterns in Southern Africa – Implications for Cross-border Payments

Besides migrants, the other key source of demand for mobile banking is informal cross-border trade, which is generally defined as an economic activity that is legal but unregulated. The unregulated nature of this cross-border trade means that most informal trade is undocumented, unregistered, and unaccounted for in countries' national accounts and official trade statistics. Still, many cross-border traders pay duties and taxes, and studies have estimated the value of informal trade within Southern Africa at \$17.6 billion per year. The payments system that typically supports these various monetary exchanges is characterized as unrecorded cash-to-cash transactions.

A 2008 study on the topic (Pailles 2008) described informal cross-border traders as including the following:

- Traders or merchants who under-declare their imported goods or wares
- Traders or merchants who do not declare anything at all (smugglers)
- Traders or merchants who do not declare through clearing agents
- Traders or merchants who sell directly to the final customer
- Agents of established wholesalers and retailers

The study also noted, interestingly, that informal traders crossing the borders tend to be predominantly female (70 percent). Informal cross-border trade is, therefore, closely linked to the feminization of migration, an emerging trend in Africa. This makes sense, as low-income women may be more likely to be unemployed, and women who are unemployed seek other opportunities for generating income such as by engaging in informal trade activities. And indeed, cross-border traders can generate relatively large amounts of revenue by African standards; estimates put the average monthly value of goods traded at US\$2,506 per trader (although profit margins may be substantially lower).

Despite the magnitude and importance of informal cross-border trade, especially with regards to income generation among the poor, governmental policies have tended to focus on formal trade activities. More recently, though, this trend has begun to change. For example, Zimbabwe signed a memorandum of understanding (MOU) with the government of Malawi to facilitate informal trade, specifically between small and medium-sized enterprises. In Southern Africa, similar negotiations are underway for the signing of similar MOUs with Zambia, South Africa, and Namibia.

The Financial and Telecommunications Landscape

In an environment characterized by international, regional and national migration, as well as significant levels of cross-border trade, the financial and telecommunications sectors play an important role in the development of the mobile banking services in the region.

Financial Sectors

Despite some recent developments in increasing competitiveness in financial markets, the number of financial operators and financial instruments remains thin in many countries. In

general, financial sectors in migrant-sending countries are characterized by: weak competitive environments (especially in the remittance market); lack of access to technology-supported payment and settlement systems; and burdensome regulatory and compliance requirements for banks. The development of a strong financial sector and efficient payment systems are essential for development and support of increased cross-border financial flows. This includes, among other factors, developing the commercial banking sector and other financial institutions, strengthening the domestic payments system, developing foreign trade financing instruments, and establishing correspondent banking relationships between countries in the region.³⁵

Countries face a number of challenges in the reform of domestic financial sectors and the creation of regional financial markets. In some countries, such as Angola, conflict has left weak institutions and governance, degraded infrastructure and public service systems, high inflation and unemployment, and a shortage of human and technical capacity. All of these factors make more difficult the already complex process of establishing a sound and efficient financial system that can support economic growth and job creation for the population. Mobile banking provides an efficient mode of financial access while the components of more traditional financial systems are built. In several countries with incomplete financial markets, several innovative initiatives for expanding access to mobile banking have been implemented, but remain nascent.

Telecommunication Sectors

As with financial sectors, the telecommunications sectors of Southern Africa are also at different levels of development. While countries such as South Africa and Namibia have relatively more developed telecommunications sectors, in countries such as Zambia, Angola, and Malawi the telecommunications sector is still characterized by the monopoly of state-owned operators and service providers. Furthermore, few countries in the region have extensive telecommunications infrastructure in place. Although Namibia and South Africa have achieved relatively significant fiber-optic deployment, in general the international bandwidth available to Southern African countries is extremely poor in comparison to Europe, North America, or Asia.

Regionally, there are several key issues facing Southern Africa. Some of the countries (Zambia and Malawi) are landlocked, meaning that they do not have the option of connecting directly to a submarine fiber-optic cable. These countries will have to rely on expensive satellite links for their international traffic and may be unable to afford or access high bandwidth links. Although there are plans to link Southern Africa with a submarine cable, progress has been slow but could be expedited if a regional solution can be found.

Policy Recommendations

Faced with migrant populations, informal markets and underdeveloped financial and telecommunications networks, policy makers must take on a broad reform agenda if they are to strengthen their mobile banking development agenda.

³⁵ Correspondent banking refers to banks that agree to perform reciprocal financial services for each other, for example, accepting deposits from or transferring funds for each other's customers. Correspondent banking allows a bank's clients to be served without having to set up a branch in another country.

The first, and perhaps most important, factor is that African countries must continue to improve the regulatory framework for domestic branchless banking. Regulation is essential for both national and international financial transactions, and a robust and efficient regulatory framework must be in place to allow branchless and mobile banking to flourish. For all Southern African countries, it is important to develop clear guidelines for implementing branchless banking that can be easily followed. Since the overarching goal is to expand financial services to the currently unbanked population, specific policies include expanding permitted points of service for low-value cross-border transactions, eliminating the requirement to prove legal residence in order to set up a bank account, and expanding the scope of Exemption 17 to cover intra-SADC money transfers.⁵⁴

Developing such regulatory frameworks, however, can be a difficult and time-consuming task. It would therefore be useful to implement “pilot programs” to test various regulations. This has been done in countries such as Kenya and the Philippines and is generally regarded as a positive step in crafting strong and efficient regulation. These pilot programs have several benefits, such as encouraging innovative regulatory solutions to difficult problems, and demonstrating for governments how regulation can yield tangible benefits for economic development. Similarly, the pilot projects can help to identify and overcome problems with proposed regulation. The final result is that regulation will be more effective at expanding access to banking services, while at the same time limiting negative externalities.

In terms of specific regulatory prescriptions, policy makers should consider permitting the use of retail agents for cash-in/cash-out, perhaps first developed through a pilot program. They should also consider developing a risk-based customer due diligence (CDD) approach with flexibility to incorporate low-value accounts and transactions. Good regulation also includes a legal basis, and policy makers should develop directives to provide legal clarity on outsourcing, branchless banking, and electronic transactions. Finally, as previously mentioned policy makers should ensure that the financial system expands permitted points of service and reduces reporting requirements for low-value cross-border transactions. Taken together, these regulations can help to expand access to financial services while creating an environment in which banks and other stakeholders can also benefit.

Recommendations for the Proposed Follow-up Action Plan

Following the policy recommendations described above, there are four key elements of a strategy for a follow-up action plan. This plan is designed to ensure that the initiatives and pilot projects outlined above are given the greatest chance to succeed.

First, provide policy support for branchless banking initiatives that target the unbanked. This chapter has discussed the variety of constraints that prevent many poor

⁵⁴ Exemption 17 allows banks and money remitters to open accounts or conduct transactions without obtaining or verifying the client’s income tax registration number or residential address. In its current form, however, Exemption 17 is of little value to low-income clients looking to transfer funds across borders. First, Exemption 17 is inapplicable for cross-border transfers from South Africa to Angola, Malawi, Mozambique, and Zambia; it is intended to be used for domestic transactions only. In addition, Exemption 17 only applies to South African citizens and residents. Therefore, banks and money remitters are expressly prohibited from using the Exemption with non-resident foreign nationals (even those who are in South Africa legally) and undocumented migrants.

and migrant workers from using formal financial services, and overcoming these constraints will require direct support for branchless banking by stakeholders. For example, providing matching grants or other financial assistance to financial service providers who would like to offer services to the unbanked but are wary of taking on excess risk could help to expand the market. In addition, the World Bank and other donors could assist pro-poor branchless banking initiatives by providing technical assistance and sharing start-up costs.

Second, African countries can learn from branchless banking leaders around the world. Although branchless banking is still a relatively new phenomenon, some countries have developed regulatory frameworks that provide space for innovation while at the same time minimizing risks. In the Philippines, for example, the Central Bank has worked with mobile operators to permit branchless banking to flourish, and Brazil has nearly a decade of experience in the branchless banking space. In Africa, regulators and financial service providers could benefit from gaining an understanding of how branchless banking operates and how it is regulated in other countries. The World Bank, in association with the Alliance for Financial Inclusion, could take a lead role in organizing and funding study tours, regional conferences, and workshops to disseminate this information.

Third, the World Bank could play an important role in facilitating and supporting opportunities for extensive stakeholder collaboration. By providing training, capacity building, and other assistance at the regional level, donors can help to create a cadre of expert stakeholders that can ultimately support the growth of the entire sector. Similarly, the World Bank could support training and the creation of formal mechanisms for collaboration among branchless banking stakeholders, including policy makers, regulators, banks, mobile network operators, payment service providers, and other interested parties. For example, regional institutions such as SADC or COMESA could provide a forum for cross-country discussion and sharing of experiences. Such a forum could also define best practice regarding regulatory frameworks and future policy action. Regionally accepted regulatory frameworks would greatly help to facilitate cross-border mobile banking.

Fourth, as previously discussed, a pilot project specifically aimed at bringing “taxi money” into the formal financial sector should be launched. This refers to funds that are transferred across borders via taxi drivers and similar informal mechanisms, and most small-value remittances from South Africa are transferred in this manner. The goal of the pilot project would be to identify the sources of the high costs of cross-border remittances from South Africa. The initial pilot project could start with a country that is an important recipient of low-value remittances from South Africa; Mozambique and Malawi would be logical choices. Mozambique, in particular, has extremely high volumes of low-value remittances from South Africa.

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7. Why Trade Facilitation is Important for Africa

*Barbara Rippel*³⁵

Introduction

Trade facilitation can provide important opportunities for Africa by increasing the benefits from open trade, and contributing to economic growth and poverty reduction. Removing trade barriers has contributed to the expansion of global trade in the decade after the conclusion of the trade negotiations of the Uruguay Round in 1994 and the subsequent establishment of the World Trade Organization (WTO). However, the quest for more open trade is not an end in of itself but driven by the experience that open trade provides more economic opportunities for people. Producers can offer their goods and services to more customers, and consumers have more choices, lower prices, and access to innovations. Open markets increase prospects of producing and selling new ideas and products locally, regionally and in global markets, which leads to more income opportunities and the improvement of living standards.

However, most African countries face considerable challenges to achieving more open trade. One reason is that the costs of trading remain stubbornly high, which prevents potential African exporters competing in global and even in regional markets. Realizing this trend, policy makers have started paying more attention to addressing trade-discouraging non-tariff barriers.

Trade facilitation measures have become a key instrument to create a better trading environment. The international community has acknowledged that for many lower income countries having better market access to industrial countries is insufficient unless the capabilities to trade are addressed as well. The resulting trade capacity building activities evolved into a broader and comprehensive Aid for Trade agenda, with trade facilitation playing a major role in these efforts.

This chapter argues for approaching trade facilitation in a comprehensive way by addressing the new challenges to trade, which no longer arise predominantly from high tariffs but from barriers behind the border. This approach highlights the need for

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cross-sector analysis, for example along the value-chain of products, to address trade bottlenecks. However, the biggest obstacle to greater trade integration is the lack of accompanying policy and regulatory reforms. Trade facilitation can provide opportunities for African exporters if hard infrastructure and technical advice are backed by equally ambitious policy reforms.

The New Approach to Trade Facilitation

“Classic View”

The term “trade facilitation” has different interpretations. Even among international organizations engaged in trade promotion, such as the World Trade Organization (WTO), the Organization for Economic Cooperation and Development (OECD), and the World Bank slightly different approaches have emerged. However, the classic approach could be described as focused predominantly on the removal of barriers to the international movement of goods and, in particular, on the procedures at and around borders (e.g., simplification of customs procedures).

The trade facilitation part of the WTO negotiations, for example, focuses on transactions at the border, such as documentary requirements, transparency of customs clearance and transit procedures, and disciplines on fees and taxes. This traditional view of trade facilitation is motivated to improve border and transit management procedures and their implementation and thereby remove obstacles to trade in goods at the border; less attention is paid to “behind and between the border” issues.

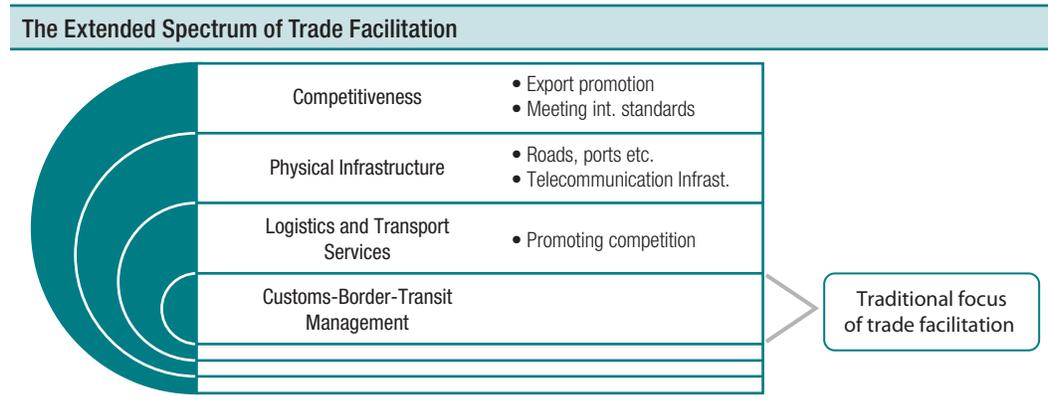
Trade Facilitation Has Grown Beyond “Fixing Borders”

The reasoning behind the efforts to address the trade challenges beyond the traditional areas is the impact on trade costs of factors along the whole trading chain. The more comprehensive approach to trade facilitation examines the costs that traders and producers face from production until the delivery of their goods and services to the overseas buyer and thereby includes all the transaction costs both directly and indirectly associated with the trading process.

Trade facilitation measures must therefore be designed to assist countries to lower trade costs and become more competitive in regional and global markets. With the removal of most quotas and a general reduction of tariffs, the search for the causes of high trading costs is shifting towards:

- *Costs of transportation and logistics:* determined by components such as availability and quality of logistics services, market structures and the degree of competition that they allow, transportation fleets, and regulatory environments;
- *Physical infrastructure:* for example, hazardous roads, lack of capacity of ports and airports, and railways hampered by decaying networks;
- *Additional market entry barriers:* mandatory or voluntary quality and safety standards which can inhibit the access to regional and overseas markets (particularly prevalent in food trade but also exist in a range of technical products); limited information about overseas markets marketing and consumer demands reduce opportunities.

Figure 7.1 >



The extended spectrum of trade facilitation, see Figure 7.1, allows for identification of constraints along the whole of the trading chain, including the factors that can adversely impact a country's overall trade performance. The challenge is to identify the most important constraints for trade in a specific country and region and to target and design trade facilitation interventions in a way most suitable to the situation. Focusing on constraints at the border may have little impact on trade and competitiveness if there are more important barriers to trade further back in the value and distribution chain.

The realization of the close linkage of an enabling environment and a country's trade performance has led to a broader agenda for research and cooperation on trade facilitation across sectors and technical fields. Most African countries face a multitude of challenges to integration into the international trading system and therefore value a more comprehensive approach to addressing these issues. Since several of the barriers are most efficiently addressed on a regional level, for example, trade infrastructure and standards, trade facilitation has become a major topic for regional economic communities and cooperation.

Trade Facilitation Contributes to Africa's Growth

Trade facilitation can help countries to reduce trade costs and increase competitiveness of the private sector. Despite the reduction in tariffs and improvement in market access many countries and regions in Africa are still lacking regional and global integration. This disconnection can have negative consequences for the economic opportunities of private sector businesses, employees, and consumers. Despite efforts, some countries have found it difficult to expand trade and take advantage of preferential market access programs, such as the Everything but Arms (EU) and the African Growth and Opportunity Act (U.S.). For example, the main exporters under AGOA still remain those that trade in oil and other natural resources.

In addition, certain provisions in preferential trading schemes might discourage the creation of regional value chains. For example, if one country loses access to AGOA (eligibility is annually reviewed) producers along the regional value chain might suffer as well. In Madagascar in 2010, the loss of duty-free access for Madagascar's apparel industry also

had negative spillover effects on its suppliers in Zambia, Lesotho, Swaziland, Mauritius, and South Africa (Page and Moyo 2011).

Economic benefits also come from the contribution that trade facilitation can provide to regional integration in Africa. Official intra-African trade is still relatively low and African companies are struggling to participate in regional and global value chains. A recent World Bank report on harnessing regional integration as an opportunity to expand trade in the Southern African region underscores that point (World Bank 2011a). Despite the existing diversity and potential for production, regional value chain production is mostly absent in the region, and as result opportunities for job and income creation are lost.

The dilemma has been widely recognized and has led to the inception of trade capacity building programs, which have evolved into the current Aid for Trade agenda. For example the new World Bank Africa Strategy specifically highlights the issue of competitiveness as one of the three pillars of the new strategy. The new World Bank Trade Strategy also points out, after assessing the lessons from earlier engagement in trade supporting activities:

“Tackling trade costs, therefore, is a core element of the Trade Strategy because they have a direct bearing on poverty reduction.” (World Bank, 2011b).

Trade Facilitation can Help Reaching Development Goals

The aim of facilitating trade is not simply to expand trade but also to focus on the broader goal of sustainable and broad-based economic growth. The expectation is that economic growth becomes a catalyst for poverty reduction by creating more and broad-based job and income opportunities. Quantifying precisely the contribution of trade and export expansion to poverty reduction might be difficult and has been the subject of academic and public debate; nevertheless numerous countries have demonstrated that a vibrant export sector and affordable access to imports can contribute to economic growth and poverty reduction.

Several African countries have been successful in expanding trade and exports, nevertheless countries lacking natural resources such as oil, natural gas, and minerals, have found it more difficult to expand exports. While the well-endowed countries have enjoyed success, partly due to high prices for many commodities, they also have struggled to diversify their export-base to avoid being too dependent on a few export products. The risk of drastic price declines might be limited, but the export earnings from the capital-intensive natural resources sector often benefit a small share of the population and do little to provide substantial new job opportunities.

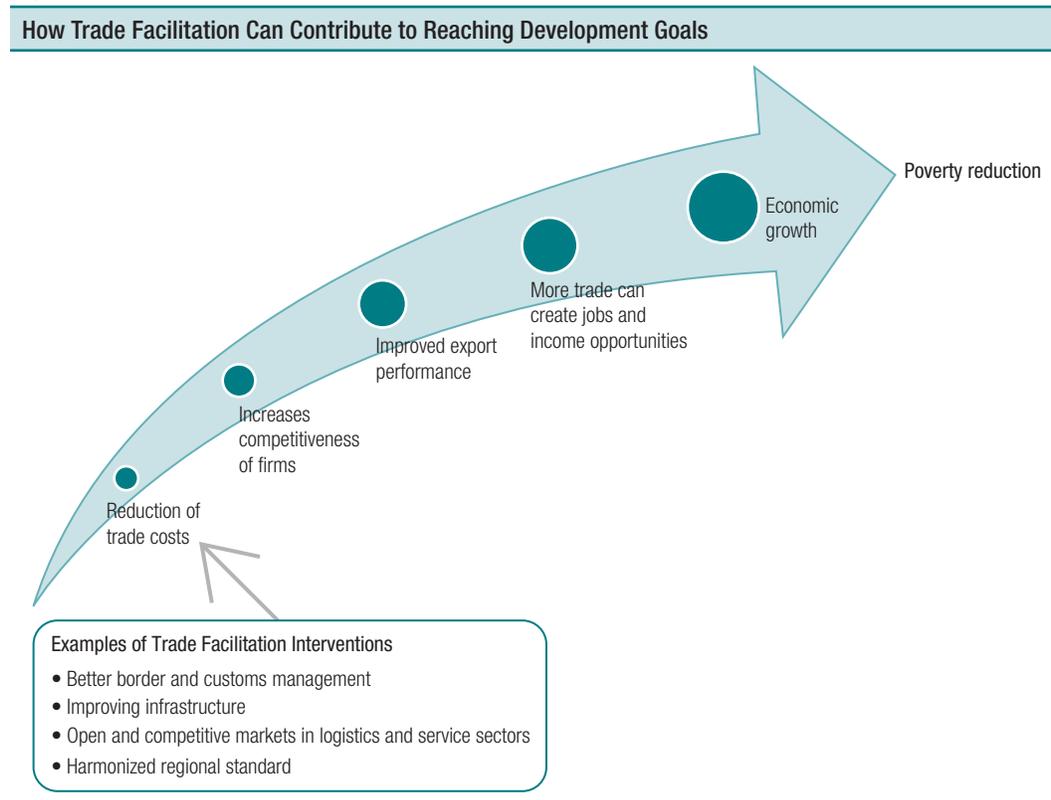
Contrary to public perceptions, smaller and mid-size companies are a key part of international trade—for example in the U.S. almost 98 percent of exporters in 2009 were small and medium-sized enterprises (companies with fewer than 500 workers) representing 33 percent of exports by value, according to the U.S. Department of Commerce. This demonstrates the essential role of SMEs in connecting to the international trading system.

However, smaller companies might depend much more than multinational companies on reliable trade-enabling environments. Large companies, for example, might be able to create private solutions to a lack of infrastructure by investing in company roads and port facilities. Also, in the policy debate the voice of large companies are often better represented than those of SMEs, which tend to be less organized and not well connected to policy-makers.

Trade facilitation efforts should therefore focus on establishing a fostering environment for SMEs by addressing the whole trade value chain. A successful example of where trade facilitation measures have been pivotal in assisting a landlocked country in reaching international markets is the export of fresh mangoes from Mali to Europe. The export program, which was supported by international donors, was able to overcome several challenges including transport and logistics problems, lack of market information and investment on the production level, as well as a less than conducive regulatory environment for exporters. By designing interventions along the whole value chain, including harvest and transport, Malian exporters were able to access the market in Europe, benefiting small-scale growers in Mali (Sangho et al. 2010).

The process of economic interaction, shown in Figure 7.2, indicates how trade facilitation interventions can contribute to the overall policy goals. Nevertheless, these results are far from inevitable after trade facilitation interventions. But, the interventions can be the impetus to start the process that otherwise might never materialize. Also trade facilitation reforms, especially soft, policy-related, trade facilitation measures, may provide added benefits. For example transparency of government procedures in one sector of the economy can provide incentives for broader reform; revenue increases for the government can provide resources to facilitate civil service reforms and performance-based remuneration; and higher safety standards might reduce accidents and causes of illness with significant social benefits.

Figure 7.2 >



Trade Facilitation Measures to Reduce Trade Costs

The trade facilitation measures can reduce the costs of trading in Africa in a variety of ways. A number of reforms can help to reduce the time needed for travel, border-crossings and administrative procedures: better border management, such as the introduction of automated customs systems and streamlining of border procedures. For example, the modernization of border-crossing facilities and streamlining procedures (see the example of the Chirundu border post between Zambia-Zimbabwe in Box 7.1) have reduced waiting times and resulted in lower costs for traders.

Better roads, especially along the main transport corridors improving the North-South connections, and more investment in railroads and ports have contributed to costs savings. Reduced travel times but also less wear-and-tear and lower fuel consumption for transport fleets can increase trading opportunities. The rehabilitation and modernization of trade infrastructure can spur investment in modern fleets with more loading capacities leading to greater efficiencies.

Other areas for reducing trade costs are harmonized technical, product, and safety standards. Producers and traders can lower their costs if products and services can be delivered to a larger number of consumers in different markets. However, adjusting to the cornucopia of official and informal technical, product and safety requirements in different local and regional markets in Africa, often adds to the costs for producers and consumers. The lack of information about requirements and different enforcement procedures reduce the reliability of delivering products and services.

Box 7.1 One Stop Border Post: Chirundu between Zambia and Zimbabwe

The Chirundu one-stop border post between Zambia and Zimbabwe was officially inaugurated in December 2009. It was hailed as the first African one-stop border post.

The goal is to address the challenges of one of the busiest border crossings in the region where transporters experienced significant delays due to clearance of consolidated loads and procedures by the revenue authorities at the border (Curtis 2009).

The establishment of the one-stop border post has provided some significant improvements, for example, passengers and commercial traffic stop only once to complete border formalities for both countries, and waiting times for commercial traffic have been reduced from about four to five days to a maximum of two days and often to a few hours.

However, the process of transforming the border-crossing and complete integration of all procedures is a long-term project that has shown that trade facilitation is not only about bricks-and-mortar investment but requires commitment, negotiations, and harmonization of procedures and policies. The initial results also indicate that it is very important to start the discussion on reforms of rules and procedures early in the process.

Source: TradeMark Southern Africa 2011

Trade Facilitation Measures Improve Competitiveness

Trade facilitation measures contribute to improved competitiveness of private sector companies. To achieve deeper regional trade and greater integration into the global trading system, private companies have to be able to compete in price and quality. Yet their chances of success increase considerably if companies can operate in a trade-enabling environment. Competitiveness of companies is closely related to the ability to transport and provide products and services at competitive rates but also to be able to develop and produce new products and services. Local capacities and regulatory environments to create new products and produce according to consumers' demands with limited administrative burdens are key factors to success. Hence, trade facilitation interventions are an important feature of

comprehensive efforts for developing the competitiveness of the private sector in Africa. However, the critical piece of policy and regulatory reforms, which contributes to reduce overall trade costs and enhance competitiveness, has not received the necessary attention.

Setting Priorities for Trade Facilitation

Essential: Need for Policy Reforms

Countries have often invested significant amounts of money, sometimes with the help of international donors, in trade facilitation projects, but have often neglected to implement the necessary policy reforms to fully utilize these investments.

For example road improvements, especially along the main transport corridors, provide many benefits for transporters and traders, less damage to trucks, and reduced travel times; however, too often the impacts are less than they should be. Consumers and producers frequently do not benefit from the fall in costs due to uncompetitive market structures and obsolete regulatory environments. It is therefore essential that infrastructure investment is accompanied by typically less costly (in financial but not political terms), but often more intricate, policy and regulatory reforms. Successful reforms require a long and intensive commitment by countries and potential supporters, because the changes to institutions, laws, and regulations demand intensive dialogue to find compromises and the best solutions for the country or countries involved. For example, it is important to consider how negative unintended consequences, especially for vulnerable groups can be avoided or mitigated. Since this work is generally less glamorous because it lacks visibility to the public and donors, policymakers often shy away from this inherently difficult but essential part of trade facilitation. Nevertheless there is good news about such reforms: they are a cost-effective way to encourage trade.

“Soft Trade Facilitation” is an Effective Way to Assist Low-Income Countries

Hard infrastructure projects are visible signs of assistance and economic cooperation; however the less visible support of reforming the regulatory and business environment in a country is often at least as important as the roads and bridges. The so-called “soft trade facilitation” is often the hardest to implement; such work frequently faces strong vested interest in the countries and takes place without the ribbon-cutting ceremonies and other public events that make it more attractive for politicians and the donor community.

However, in times of tight budgets this should be of great interest: research by Helble, Mann, and Wilson (2009) indicates that aid for trade money spent on policy and regulatory reform might be a particular prudent investment. The research focused on the question of how aid spent on trade facilitation relates to trade flows (export and imports). Based on calculations about effectiveness of aid for trade facilitation, the trade initiating effect of one dollar spent on measures directed towards trade policy and regulation reform were estimated to be dramatically higher than the trade creation from investments in the other areas of trade support (economic infrastructure and trade development).

The main benefit according to this study comes from providing “soft” trade facilitation support. The introduction of policy reforms and improving the regulatory environment is

less costly and provides significant impacts. Of course the costs for infrastructure projects are high compared to advisory services, for example, but the important result is that relatively small amounts of money invested in the areas of regulatory and policy reform can have a large impact on trade expansion. Measuring the exact benefit of such trade assistance is difficult, but the basic message stays the same: policy and procedural reforms are very effective ways to foster an environment where traders and producers can take advantage of market opportunities.

Nevertheless policy and regulatory reforms are difficult to implement because of several complicating factors. The status quo has winners and losers. In most cases trade restrictions benefit a small group while those who bear the costs of the trade barriers are numerous. For example, outdated transport regulation in large parts of the trucking sector in West Africa is beneficial for some transporters but has prevented lower prices for consumers. However, consumers lack sufficient information on what drives the prices for everyday products and rarely organize themselves against trade restrictions. Specifically, if the additional costs are small per purchase, (for example, agricultural trade barriers might cost consumers in the U.S. and the EU a few cents every time they shop) the willingness of consumers to organize political pressure to remove such barriers is limited. The dynamics of the political economy of reform has occupied economists and political scientists for a longtime. For example Mancur Olson in 1965 *“The Logic of Collective Action: Public Goods and the Theory of Groups,”* addressed the issue of how groups can form around the benefits they can protect. Protecting these benefits can be a motivating factor in defending the status quo. If trade barriers protect certain jobs it is easy to see why the potential losers might evidence strong resistance to change if such change would mean a loss of income.

Trade Facilitation is a Multi-sectoral Approach

Trade facilitation covers activities across a wide range of sectors along the value chains important for production and trading. Any comprehensive approach to trade facilitation includes complimentary activities so that investment and progress in one area, (e.g., infrastructure investment in roads) is not stifled by the absence of reforms in another (e.g., the transportation sector) so that the investment benefits a broad range of society and encourages economic growth. To be successful, trade facilitation must address this cross-sector character at the planning phase of the measures taken to support trade.

Among the sectors profiting from trade facilitation measures are the transport and logistics sectors. Transport costs in sub-Saharan Africa have remained high despite investment in the transport infrastructure in recent years. However, transport costs depend on a range of factors, such as capital, labor, and fuel costs in addition to service costs for maintenance. The costs for transporting goods in Africa differ considerably between regions. Central and West Africa generally facing higher prices for road transport than Southern Africa, for example, due to formal or informal queuing systems in the trucking sector, which has led to uncompetitive market structures.⁵⁶ As a result traders and consumers

⁵⁶ In these queuing systems large and small firms “queue up” and loads are distributed according to next turn. The goal of these systems has been to ensure the survival of small companies but has led to less competition, higher prices, and low-quality service.

lose out on the potential benefits from improved transport infrastructure (Teravaninthorn and Raballand 2009).

Services are another important sector that can benefit from trade facilitation but have often been neglected in public debate about the benefits of trade. While trade in services is less visible the greater integration of regional markets in services has important economic potential. For example the closer integration of professional services in the Southern Africa region could provide job opportunities, address skill shortages and lower input prices for businesses (World Bank 2011a).

Business services have become an important factor for success for exporting companies. Companies trying to establish themselves in regional and global market often rely on the business service providers for essential inputs. Access to technical advice, marketing expertise, and legal and accounting services is important to be able to compete in international markets.

Services can also help to develop new export products, as well as being a major export sector themselves. These exports can include a wide range of services, for example education, legal services, and accounting and technical advice. Trade facilitation measures can address the regulatory environment in which these exports can take place, for example improving mutual recognition of educational and technical certificates.

Trade Facilitation to Improve Private Sector Capacity

Trade facilitation contributes to the expansion of private sector capacity to participate in international trade. Private sector actors, especially small and medium-sized businesses, often lack the know-how and capacity to meet the requirements of formal trading across borders. Smaller traders might be active in informal cross-border trading but find it difficult to expand due to limited financial resources and lack of information about requirements and procedures in markets abroad. Many small enterprises, which provide a large number of jobs and incomes in Africa, find it difficult to meet the prerequisites for formalization because of limited information and capacity or high costs relative to limited benefits. However, the purpose of trade facilitation is to expand trade beyond large companies and already successful trading networks. Even mid-sized companies often find access to information and financial resources difficult, which are necessary to adjust to price, quality, and safety standards in new markets. Trade facilitation measures can assist with access to information and support transparent procedures of formalization, such as licenses and standards.

How to Integrate Trade Facilitation across Sectors

The challenge for countries is to incorporate trade facilitation in overall development and poverty reduction strategies. Trade capacity building, which focused on specific technical assistance, has become broad-based Aid for Trade to address obstacles in whole value chains and sectors. Only integrated analysis of all factors can reveal major constraints to trade and economic growth. This essential analytical step needs to be conducted with substantial input from local and regional actors to obtain a realistic picture of the barriers with the biggest impact not simply those most visible. Trade facilitation support often encourages multi-sector concepts, and countries should therefore consider the benefits of

integrated reform concepts. In addition, regional solutions are often feasible and can help to reduce costs, improve efficiency, and the exchange of best practices.

Assume, for example, a country with natural resources or agricultural potential wants to improve the use of those resources. One obstacle for expansion of production and trade might be a lack of infrastructure and production capacity. Even when private investors (local or outside) are found to invest in production expansion the infrastructure needs require additional financial sources. International development banks have been active in supporting transport corridors in Africa, Central Asia and other regions. Countries benefiting for this enhanced connectivity can then use trade facilitation measures to address regulatory barriers in transport and logistics, for example, or remove persistent roadblocks along trade corridors. Cross-sector integration can be achieved through reforms of the business environment for small and medium-size enterprises along the trade corridors or as suppliers for the expanded production area. Simultaneously the removal of transit restrictions and open trade policies with neighboring countries ensures the goods can be sold across the border or easily trans-shipped to markets outside of the region.

Creating transparent mandates, along with identifying and assigning specific tasks to the cooperating agencies and donors can achieve a coordinated approach among government agencies, the private sector, and donors. Some countries have opted for creating committees or other coordinating mechanisms to promote and monitor progress. While this requires close cooperation among all actors plenty of success stories show that cooperation across sectors is an essential ingredient for encouraging trade and economic opportunities.

Trade Facilitation and the Informal Sector

Trade facilitation can play a pivotal role in supporting small-scale informal traders. This support may, in the long run also bring more participants from the informal sector into the official economy. The informal sector often faces an even more onerous trading environment. For example, in the Great Lakes region in Central Africa the majority of traders between the Democratic Republic of Congo (DRC), Uganda, Burundi and Rwanda are small-scale traders, predominantly women.

These traders face a wide range of obstacles to their daily cross-border transports of small amounts of goods. According to research and surveys the traders have to pay unofficial fees and bribes and often experience physical harassment at the border. Despite these challenges the traders and their families depend on the trade for their income but with little influence over policy-makers power to improve trading conditions (see Chapter 2).

Cross-border traders between DRC and the Republic of Congo confront prohibitive prices for official river crossings between Kinshasa and Brazzaville, according to research and surveys. Because of high administrative costs most companies have abandoned shipping across the river or use informal methods to get their goods to the other side. The average cost of a return trip for official crossings are estimated to be about US\$40, or the equivalent of between 40 and 80 percent of the average monthly income earned by Kinshasa residents (see Chapter 3).

Trade facilitation can contribute to reducing the costs of trading for those vulnerable groups that work on small margins and have a limited, if at all, financial safety net. Even low-cost trade facilitation measures, such as training of border guards or installing proper illumination at border crossings, can have almost instant impact for traders and the informal sector. In addition, improving hard and soft trade infrastructure important for small and rural traders and producers, such as feeder roads to regional markets, and

establishing market price information systems, policy and regulatory reforms often benefit the informal sector. Laborious paperwork requirements with little transparency and high fees can be an insurmountable barrier for informal traders to join the formal sector. This often deprives the trader of rights and security during their transactions and the state receives less revenue that could be used in providing government services.

Regional Integration

Trade facilitation and regional integration are joint enterprises. Trade facilitation is a key instrument in advancing regional integration by fostering intra-African trade that enhances economic opportunities and competitiveness. In addition, closer political and economic cooperation on the regional level, for example through the regional economic communities, contributes to the creation of the necessary environment for the private sector development essential for intra-regional trade.

Regional integration is necessary for African companies to be able to grow and ultimately become part of regional and global value chains. Other emerging economies, for instance in East Asia, are already further integrated with clear economic benefits. Despite existing agreements on closer integration, most regions in Africa are still trying to implement many of the basic provisions of these agreements. Nevertheless, this is an essential step if African countries are to become and stay competitive in the more closely integrated global economy. In contrast developing countries in Asia such as Vietnam have become an integral part of regional and global production chains. Asia has become the second biggest trader, behind Europe, of intermediate goods an indicator of greater regional integration, with Vietnam being among the most active importers in the last 15 years (WTO-IDE 2011).

Trade facilitation measures support closer regional integration through regional trade infrastructure, such as trade corridors, but also by supporting bilateral cooperation at the border. For example, the goal of one-stop border posts is to reduce paperwork and waiting times; this requires not only physical infrastructure but also detailed agreement on mutual recognition of process and procedures.

Regional agreements often include additional trade facilitation measures, such as harmonization of safety and quality standards for regional products. Mutual recognition of services such as truckers insurance and educational degrees are important for developing integrated economic areas that benefit from synergies and reduced transaction costs.

An important factor for trade and economic development in general is the availability of cross-border financial services. Trade facilitation and regional integration agreements assist with creating regional financial transfer systems that reduce transaction costs and can help to make financial services more accessible. Particularly, small and medium-sized enterprises and traders, often working in the informal sector, have limited access to credit, banking, and other financial services. Those services might encourage trade expansion for those producers and traders not already well connected to cross-border trading networks.

Future Opportunities for Africa

Trade facilitation is an integrated part of development strategies in most African countries because it is a catalyst for further progress in areas beyond trade and export expansion. Trade facilitation can provide these important opportunities:

- More open trade connections, in food staples for example, can encourage regional trade and reduce vulnerability from food insecurity;
- Regional cooperation on trade facilitation can contribute to closer integration beyond trade. For example, addressing regional standards on products, services and procedures encourages trade but also intellectual exchange and collaboration on safety and social concerns affecting often a whole region beyond national boundaries;
- Closer regional integration will provide opportunities for developing regional value chains that increase competitiveness and provide access to the increasingly globalized value chain production;
- Finding common positions on trade-related issues and so enhancing the ability to represent these interests in the international arena.
- Since the main goal of trade facilitation is to reduce trade costs the following (measurable) objectives for trade facilitation could be used to set benchmarks to assess progress. However, this will require coordinated efforts in the areas of data collection and defining benchmarks, and will require consistent monitoring by all partners. Objectives could include:
 - Trade costs
 - Export expansion (amounts, value and diversification of exports)
 - Cross-border trade with neighboring countries
 - Transport delays are reduced (focus on the relevant bottlenecks in each country)

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PART II

REMOVING NON-TARIFF BARRIERS TO TRADE

8. Deepening Regional Integration to Eliminate the Fragmented Goods Market in Southern Africa

*Ian Gillson*³⁷

Introduction

This note summarizes new studies that identify the most restrictive barriers to regional goods trade in Southern Africa. It also illustrates the costs associated with these barriers using information gathered from some of the largest firms engaged in cross-border trade. The note concludes by providing practical policy recommendations to deepen regional integration in the goods market and increase competitiveness.

A recent and important trend in global trade has been the proliferation of regional trade agreements (RTAs), and Southern Africa is no exception. Regional integration efforts in Southern Africa, such as COMESA, SADC and SACU, have all sought to liberalize trade between countries so as to increase bilateral trade flows, diversify exports by overcoming the limits of small markets, and deepen specialization through achieving economies of scale. Harnessing regional integration more effectively, for both goods and services, would help all countries lower their cost base thereby enhancing global competitiveness. For the smaller Southern African countries, regional integration also offers the prospect of improved access to neighboring markets as well as the potential to attract greater SADC-orientated FDI. In some of these countries (e.g. Lesotho) greater exploitation of the regional market is critical to reduce reliance on exports of a single product to a single market (e.g. clothing to the United States under AGOA). For the larger countries, especially South Africa, regional integration offers opportunities to enhance the sustainability of existing exports (e.g. light manufacturing) on world markets by lowering costs through specialization within the context of integrated regional value chains.

However, while Southern African countries have largely succeeded in increasing their trade with the rest of the world (more than tripling in value between 2000 and 2008 from US\$50 billion to US\$153 billion), increased regional trade has only played a relatively small role. Opportunities for export growth and diversification therefore remain unexploited at the regional level. While efforts to reduce tariffs have largely

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been met with success, other forms of trade restriction remain widespread. These barriers affect *considerably more* than one-fifth of regional goods trade, and are hindering the competitiveness of domestic firms and their ability to export to regional and global markets, and so must now be urgently addressed.

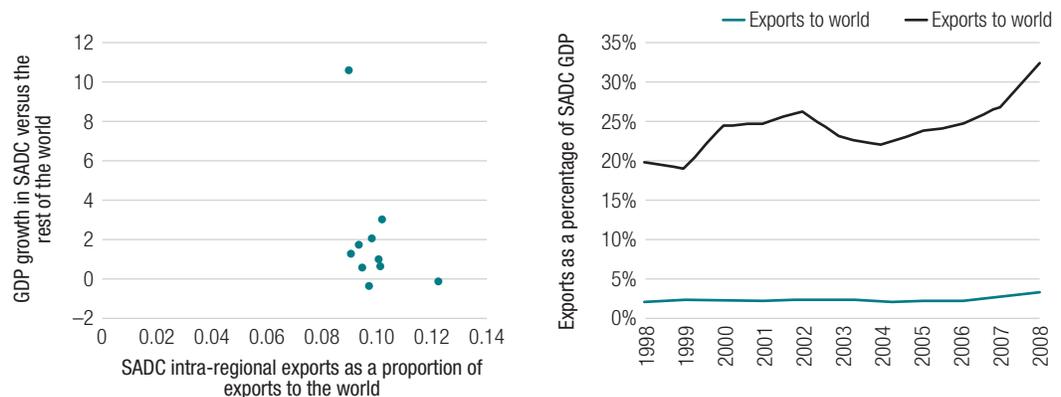
Despite Southern African Economies often Growing Faster than the World Average, Regional Trade has Remained Relatively Constant

The share of intra-regional exports in SADC has remained relatively steady at around 10 percent of total exports over the last decade despite Southern African countries often achieving higher annual GDP growth rates than the world average over this period (particularly 2003–2007). In contrast, the most successful RTAs in Asia and Latin America (e.g. ASEAN; MERCOSUR) have reached and maintained relatively higher degrees of regional trade (typically over 20 percent of their total trade), often through intensified intra-industry linkages. While SADC's merchandise exports to the world as a proportion of its GDP have increased dramatically, the share of exports to the region have grown more slowly and account for just three percent of GDP (see Figure 8.1). Furthermore, traditional exports of agricultural raw materials and minerals continue to dominate regional trade in Southern Africa. Cases of diversification into higher value-added manufacturing exports to the region remain limited (e.g. Mauritian clothing to South Africa) and strong trade imbalances persist between South Africa and the smaller countries. Regional production chains for exports to the world market remain virtually non-existent.

The key policy issue for regional integration in the Southern African goods market is why these trade outcomes have been so limited and what can be done to consolidate the various RTAs to increase regional trade?

Figure 8.1 >

Regional Trade has Lagged behind SADC Income Growth while Exports to the Rest of the World have Boomed (1998–2008, annual values)



Sources: IMF Direction of Trade Statistics and IMF.

While Efforts to Reduce Tariffs Have Largely Been Met with Success, other Barriers Are Critically Hindering Regional Trade

Regional integration efforts in Southern Africa have made significant progress in lowering tariff barriers to regional trade. For example, SADC has been trading on preferential terms since 2000 and, based on the implementation of tariff phase down commitments under the SADC Trade Protocol, formally launched a free trade area⁵⁸ (FTA) in August 2008. Under this, 85 percent of intra-SADC merchandise trade flows are now duty-free with most of the remaining 15 percent comprising sensitive products⁵⁹ scheduled to be liberalized by 2012 (2015 for Mozambique). A sub-set of five SADC members have already established a customs union under SACU. COMESA has also had an FTA since 2000. Trade between FTA⁴⁰ and non-FTA⁴¹ COMESA countries is conducted on reciprocal terms under the Preferential Trade Agreement.

The next step in COMESA's regional integration agenda is the formation of a customs union, which was formally launched in June 2009.⁴² There are also a number of bilateral trade agreements between Southern African countries, most of which were signed and implemented long before the SADC and COMESA FTAs came into effect.

The lesson from successful regional integration experiences elsewhere in the world is that tackling tariff barriers is not enough to enhance trade. Countries must also aim to facilitate regional trade by addressing non-tariff barriers (NTBs), such as restrictive product standards or complex rules of origin. In the Southern African context, borders remain thick as major obstacles to regional trade remain. A mapping of the various NTBs reported by firms in SADC countries to trade flows in the affected sectors shows that these barriers impacted US\$3.3 billion of regional trade in 2008, or one-fifth of regional exports (see Table 1). In other words, even those barriers which have been reported (and many others may yet be identified) are affecting products in which there is already significant regional trade. This is also a least cost estimate of the impact of NTBs on trade in the region since some barriers are so restrictive that preferential trade is effectively prohibited (e.g. wheat flour) and, of course, others which affect all trade and not just individual products (e.g. customs delays, transport costs) which are not captured here. So NTBs are widespread in their effect on regional trade, even more so than these figures suggest.

The remaining barriers are also costly. On average the tariff equivalent of NTBs is 40 percent, which for most products is much higher than the MFN tariff applied by most countries (Carrere and De Melo 2009a, b). Assuming 40 percent ad valorem equivalence on those NTBs cited above, which affect US\$5.3 billion of Southern African regional trade,

⁵⁸ The FTA is being implemented by Botswana, Lesotho, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.

⁵⁹ The remaining sensitive products mostly comprise textiles and clothing, cotton, cereals, dairy, and motor vehicles.

⁴⁰ Burundi (since 2005), Comoros, Djibouti, Egypt, Kenya, Libya (since 2006), Madagascar, Malawi, Mauritius, Rwanda (since 2005), Sudan, Zambia, Zimbabwe.

⁴¹ DR Congo, Eritrea, Ethiopia, Seychelles, Swaziland, Uganda.

⁴² After five years of negotiation, COMESA member states agreed to a common external tariff in May 2007 with four bands for raw materials (0 percent), capital goods (0 percent), intermediate goods (10 percent) and final goods (25 percent) although, for some products, discussions continue on which category they will be classified under. All tariff lines carrying a rate above or below its common external tariff have been placed on sensitive product lists, which should be adjusted to the CET in a period of no more than five years.

Table 8.1> NTBs that have been Notified to SADC Affect at Least one-fifth of Regional Trade

| Barrier | Examples of products affected | Volume of intra-SADC trade potentially affected (percentage of total) |
|------------------------------|---|---|
| Import bans, quotas & levies | Wheat, beer, poultry, flour, meat, maize, UHT milk, cement, sugar, eggs, pasta, sorghum, pork, fruit & vegetables | 6.1 |
| Preferences denied | Salt, fishmeal, pasta | 0.4 |
| Import permits & levies | UHT milk, bread, eggs, sugar, fruit & vegetables, livestock, liquor, cooking oils, maize, oysters | 5.4 |
| Single marketing channels | Wheat, meat, dairy, maize, tea & tobacco, sugar | 5.3 |
| Rules of origin | Textiles & clothing, semi-trailers; palm oil; soap; cake decorations; rice; curry powder; wheat flour | 3.0 |
| Export taxes | Dried beans, live animals, hides, skins, sugar, tobacco, maize, meat, wood, coffee | 4.8 |
| Standards/SPS/TBT | Milk, meat, canned tuna, beer, honey, maize bran, cotton cake, poultry, batteries, sugar, coffee, ostriches | 2.5 |
| Customs-related | Wine, electronic equipment, copper concentrate, salt, cosmetics, medicines | 5.2 |

Source: Authors calculations based on NTBs reported to the SADC-EAC-COMESA Non-Tariff Barrier Monitoring Mechanism

would imply a crude cost estimate of US\$1.3 billion per year. Consequently, NTBs significantly increase costs both for firms that source intermediate inputs from the region as well as for consumers. For example, in SADC, Woolworths reports that prices in its franchise outlets in non-SACU SADC countries are 1.8 times higher than those within SACU because of higher expenditures associated with sending goods to these markets as well as the higher costs of doing business in them.

What Are the Main Types of Barrier that Remain and How Much Do They Cost?

There are, therefore, opportunities for Southern African firms to trade across regional borders which currently remain unexploited due to policy constraints that serve to raise trade costs. Five main types of barrier can be broadly identified as follows:

Inefficiencies in transport, customs, and logistics raise trade costs: In order for RTAs to be effective, it is critical that intra-regional trade be able to move without hindrance. Many Southern African countries are landlocked, making road and rail networks very important in linking these countries to both regional and global markets. However, high transactions costs are being incurred from inadequate transport infrastructure, inefficiencies in customs procedures (including delays at road checks, borders, and ports) as well as poor quality and costly logistics due to weak competition among service providers. For example, Shoprite reports that each day one of its trucks is delayed at a border costs US\$500 (Charalambides 2010). And at Durban, the Citrus Growers' Association in South Africa estimates

that delays there cost its growers US\$10.5 million per season (on approximately US\$400 million of exports). A related source of delay within the region concerns work permit regimes for foreign truck drivers. In South Africa, visitor visas used to be accepted for this purpose but foreign drivers will soon be required to obtain work permits. This necessitates companies proving that the skills being sought outside of South Africa are not available domestically and involves each post being advertised locally. There are between 1,600 and 2,000 foreign drivers in South Africa who will require these permits, affecting 6,000–8,000 deliveries per month. While ostensibly designed to protect employment opportunities, the new approach does not take into account prospects for South African drivers operating in regional markets and may hamper regional integration. In particular, it risks South Africa's neighbors reciprocating with similar measures that will force South African drivers working in these countries to also apply for work permits. For example, Angola has already signaled its intention to put in place a similar requirement for South African drivers crossing its border. Such restrictions could significantly impede the movement of trucks in and out of countries and make trade even more difficult for regional exporters than it is now.

Cumbersome fiscal arrangements necessitate borders: Fiscal borders between Southern African countries are unnecessarily complicated and inefficient and contribute to higher trade costs. The three main reasons SACU retains internal border posts, even though it is a customs union, are to capture data on intra-SACU trade for revenue sharing purposes; administer NTBs e.g. infant industry protection; and, because domestic sales taxes have not yet been harmonized, requiring refunds and payments. The costs and delays associated with these procedures reduce trade flows between Southern African countries. Those costs attributable to the differences in VAT alone have been estimated to be up to two percent of the value of each transaction on intra-SACU trade (Jitsing and Stern 2008).

Restrictive rules of origin limit preferential trade: Onerous local content requirements in rules of origin (ROOs), particularly in labor intensive sectors (e.g. clothing) that use capital intensive inputs not produced competitively in the region (e.g. fabrics), and high compliance costs with administering certificates of origin reduce the utilization of tariff preferences offered by RTAs and therefore the incentive for Southern African firms to trade regionally. A recent example of the costs associated with meeting ROOs involves SACU moving to more restrictive rules (double transformation) on selected clothing imports from Malawi, Mozambique, Tanzania, and Zambia following the expiration of the MMTZ-SACU Market Access Arrangement at the beginning of 2010. This has resulted in some clothing producers in these countries (e.g. Bidserv in Malawi) being no longer able to compete in the regional market. It has also further distorted investment decisions as some of these firms have relocated to the BLNS countries as a result of the change to avoid the loss of preferences in supplying the South African clothing market. For other products where ROOs have been so contentious (e.g. wheat flour) or simply not agreed upon (e.g. certain electrical products for which rules were only finalized in April 2010), preferential trade within the region has been effectively prohibited (Naumann 2008).

Further costs arise from the administrative requirements for certificates of origin, which can account for nearly half the value of the duty preference. For example, Shoprite spends US\$5.8 million per year in dealing with red tape (e.g. filing certificates; obtaining import permits) to secure US\$13.6 million in duty savings under SADC. Woolworths does not use SADC preferences at all in sending regionally produced consignments of food and clothing

to its franchise stores in non-SACU SADC markets. Instead it simply pays full tariffs because it currently deems the process of administering ROO documentation to be too costly.

Poorly designed technical regulations and standards limit consumer choice and hamper trade: Standards regimes in Southern Africa are often characterized by an over-reliance on mandatory inspections and certifications; unique national (rather than regional or international) standards and testing; overlapping responsibilities for regulation; and, occasional heavy government involvement in all dimensions of the standards system. These factors create unnecessary barriers to trade, especially when technical regulations and standards are applied in a discriminatory fashion against imports. International best practice is to use technical regulations only to ensure core public policy objectives such as maintaining safety. Voluntary standards should be used in all other cases, including indicating quality attributes. But in several Southern African countries, scarce public resources are being wasted on developing and enforcing technical regulations that go well beyond issues of purely public interest. One example is shoes in Mauritius where the Chamber of Commerce has proposed the development of a regulation to govern their quality to prevent the entry of low-cost Chinese sandals that are perceived to have a tendency to wear more quickly than domestically produced ones. However, these are often the only shoes that the poorest people in Mauritius can afford to buy.

In most Southern African countries there are also no procedures by which technical regulations are assessed in terms of their consistency with public policy objectives; whether countries and the private sector have the capacity to implement them; or, their impact on trade and competitiveness. The main objective, therefore, should be to make regulations more efficient at achieving public policy objectives while minimizing their impact on trade. In particular, no ‘Office of Regulatory Reform’ exists in any Southern African country to review the justification for both new and existing technical regulations. This absence of regulatory impact assessment causes problems and raises costs. For instance, the environmental levy on plastic bags in South Africa was introduced to reduce problems associated with litter, but the technical regulation governing it also affects unrelated issues such as the minimum thickness of the plastic to be used as well as the size of the text that could be printed on the bags. While regional efforts to harmonize standards in SADC are under way (i.e. SADCSTAN), application remains lacking. Only Namibia and Swaziland have adopted all 78 (to date) of the SADC-defined harmonized standards for the region, of which some have been developed without any real sense of prioritization and so are unlikely to bring significant increases in regional trade (e.g. frozen peas and dried apricots).

Other non-tariff barriers restrict opportunities for regional sourcing: Other barriers such as trade permits, export taxes, import licenses and bans also persist. Shoprite, for example, spends US\$20,000 per week on securing import permits to distribute meat, milk, and plant-based goods to its stores in Zambia alone. For all countries it operates in, approximately 100 (single entry) import permits are applied for every week; this can rise up to 300 per week in peak periods. As a result of these and other documentary requirements (e.g. ROOs) there can be up to 1,600 documents accompanying each truck Shoprite sends with a load that crosses a SADC border. Lack of coordination across government ministries and regulatory authorities also causes significant delays, particularly in authorizing trade for new products. Another South African retailer took three years to get permission to export processed beef and pork from South Africa to Zambia.

In SACU, national protection for infant industries has often been used to justify import bans. Namibia has used the provision to protect a pasta manufacturer and broilers and maintains protection on UHT milk even though its eight-year limit to do this recently expired. Botswana has recently limited imports of specific varieties of tomatoes and UHT milk. Seasonal import restrictions on maize, wheat, and flour also ensure that domestic production is consumed first. For example, Swaziland's imports of wheat flour were effectively prohibited for half of 2009 since no import permits were issued since June of that year. Export taxes also impose costs and inhibit the development of regional supply chains. A case in point is small stock exports from Namibia. Since 2004 the Namibian Government has limited exports to encourage local slaughtering. Quantity restrictions were originally used but have recently been replaced by a flexible levy of between 15–30 percent, effectively closing the border for the export of live sheep to South Africa. The impact of this restriction is affecting the small stock industry in *both* Namibia and South Africa. In the former, exports of live sheep declined by 84 percent between 2004 and 2008 as farmers have switched to alternative activities like cattle and game farming. For those sheep farmers that remain, they have become almost entirely dependent on the four Namibian export abattoirs while they were previously able to sell more sheep to the South African market where they received higher prices (PWC 2007). There have also been cases of livestock smuggling to avoid the tax. In South Africa, 975 full-time jobs are at risk because of the scheme, especially in the bigger abattoirs in the Northern and Western Cape that focus on slaughtering Namibian sheep during the low season to better utilize their capacity (Talijaard et al. 2009).

The implication of the current system and the barriers remaining to regional trade in Southern Africa is that it imposes unnecessary costs for producers that limit trade and raise prices for consumers. Many of these barriers are simply wasteful and do not serve any real purpose. Import bans and delays create uncertainty over market access and limit investment. Thick and fragmented borders limit possibilities for regional production chains in which countries can exploit their comparative advantage in specific tasks and intra-industry trade. Finally, the heavy bureaucratic burden imposed on all regional trade flows ties up regulatory and customs resources, limiting their attention on achieving the most pressing public policy objectives such as effective border management to ensure security. Instead of scrutinizing all consignments, border checks should be focused on those for which the risks are greatest for circumventing national trade policy measures.

Priorities for Regional Merchandise Trade Reform and Implementing Them

There are, therefore, a wide range of barriers that persist on regional merchandise trade in Southern Africa. Which among these are the most pressing in terms of their restrictive effect, or perhaps easiest to deal with, that should be prioritized and tackled early on by policymakers?

First, one of the biggest issues for regional trade integration in Southern Africa, especially for manufactures and agro-processed products, is undoubtedly ROOs. The issue has gained particular prominence in light of the planned Africa-wide Tripartite FTA where one set of rules for all countries will have to be agreed upon. This is generally accepted by all member states in SADC, COMESA and EAC. Harmonization of the different rules among the regional groups will not be possible for all products because

process requirements, employed for example under SADC, cannot be easily harmonized with the value addition criteria under, for example, COMESA. So a new set of ROOs will need to be agreed, either based on one of the existing arrangements or completely re-designed. Characteristics of ROOs that would encourage the development of new export industries would include:

- Providing exporters with a *choice* as to which rule (defined simply and transparently) they apply—e.g., either a change in tariff heading test (ideally at a disaggregated product level) *or* a reasonable value-added rule (20 percent);
- Eliminating process-specific ROOs which set out how a product is to be made for originating status to be conferred;
- Removing the requirement for certificates of origin for products with nuisance tariffs, i.e., those with preference margins below three percentage points;
- Enforcing these simplified rules more consistently and effectively at customs to mitigate any concerns over leakage or trade deflection; and,
- Greater use of risk assessment, especially for large, trusted regional traders who should not be required to provide a certificate of origin for each consignment but, instead, should be able to submit these electronically per batch.

Secondly, resolving other types of existing NTBs and curtailing the development of new ones is also vital, since these critically restrict trade in the region, particularly for primary agricultural commodities. Among these, the most serious barriers are import bans, quotas, permits, and licensing, often implemented by countries with little or no consultation with their trading partners. In dealing with these types of restrictions, the existing framework to remove NTBs in the region (the non-tariff barrier monitoring mechanism) is not used as much as it should be. The use of regulatory impact assessment should also be extended.

Thirdly, while tariffs have been reduced across the region barriers arise in those sectors where tariff peaks persist. One advantage to addressing remaining tariffs is that tariff reform can often be dealt with by “a stroke of the pen” approach, as opposed to some of the other barriers where reform will be complex, perhaps more costly, and certainly more involved. High tariffs are especially restrictive because concerns of leakage from third countries can create the need for additional barriers at the regional level (e.g. ROOs) as well as affecting regional trade in all sectors, as border checks are intensified to check for transshipments of these products. Lower, more uniform external tariffs would significantly reduce the need for many of the barriers which persist on regional trade in Southern Africa as would the development of policies that directly address the difficulties that protected sectors may be facing such as assisting labor in these industries to retrain in tasks where employment opportunities are much better.

Fourthly, reducing bureaucratic requirements, streamlining border management procedures and implementing trade facilitation measures, including one-stop border posts (OSBPs), have significant potential to lower border crossing times and reduce transport costs, at least along the main corridors in Southern Africa. There is also increasing political willingness among the member states for this type of reform to go ahead sooner rather than later. For example, the South African Government has recently identified OSBPs as one focus area it wishes to develop for regional integration in the next twelve months.

However revenue concerns among the smaller SACU countries risk impeding reform. Overcoming this challenge will require the development of better ways to capture trade flows across SACU borders than those currently employed as well as an open discussion about alternatives to the current revenue sharing arrangement that might be more effective and sustainable in the long-term.

In which areas of trade reform would regional approaches be most appropriate? One reason RTAs have become so prolific has been due to their convenience in dealing with more complex and modern trade barriers (e.g. NTBs) in a simpler setting involving fewer countries than in global trade negotiations. Another argument is that adjustment costs of trade reforms may be easier to deal with by opening up to a subset of countries initially before to all later on. In other words, regional trade reform can be used strategically to support unilateral trade reform that might otherwise be too difficult on the grounds of adjustment.

Nevertheless, not all reforms need wait for regional agreement either and much can be done both unilaterally and bilaterally to increase regional trade. For example, regional harmonization is just one way to deal with restrictive product standards. Countries retain significant scope to unilaterally improve both the quality of their technical regulations and the way these are applied. Another example is trade facilitation which can be, and is being, promoted at the regional level in SADC but countries can still push ahead with reforms bilaterally to increase cooperation and share customs facilities at their borders. Some reforms may even be best tackled outside the regional process. Cooperation on indirect taxes might be more feasible bilaterally instead of regionally. And the issue of tariff peaks must be dealt with unilaterally, particularly by South Africa, which under the current SACU arrangement is able to export a diverse range of goods to SADC but behind high and complex external barriers to trade which are costly to consumers and producers in neighboring countries alike.

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9. Addressing Trade Restrictive Non-tariff Measures on Goods Trade in the East African Community

Robert Kirk⁴⁵

Introduction

The East African Community (EAC) launched a regional common market in July 2010. This followed closely on the full implementation of the customs union, which was realized in January 2010 after a five-year transition period. While all the partners have been able to eliminate a significant proportion of tariffs on intra-EAC trade and agree on a common external tariff, there has been more limited progress in addressing trade restrictive non-tariff measures (NTMs), which are referred to as non tariff barriers (NTBs). The EAC Customs Union Protocol makes specific reference to the need to eliminate NTBs and to refrain from imposing new ones. Recognition of the importance of reducing NTBs has resulted in Partner States and the EAC Secretariat devoting considerable time and attention to identifying specific measures based on a series of surveys. Moving from identifying NTBs to their reduction and removal has proven to be more challenging.

NTMs are generally understood to refer to any measure other than a tariff that causes a trade distortion. A trade distortion exists where the price at the border diverges from the domestic price and can result from regulations or administrative procedures which are imposed to serve a specific objective such as ensuring food safety, or addressing product safety or environmental issues. The pursuit of such domestic policy objectives is quite legitimate; however, in many cases the regulatory policies, procedures, and administrative requirements are implemented in a manner that effectively discriminates against imports relative to domestically produced products. Thus a NTM has the potential to become a NTB when it serves to constrain imports. Any NTM that is not implemented in the “least trade-restrictive” manner may be classified as a NTB. This chapter focuses on NTBs.

The rise in prominence of NTBs mirrors the reduction of tariffs in progressive rounds of trade liberalization at the multilateral and regional levels. The multilateral agreements of the WTO have focused on developing core principles for addressing NTBs, including transparency, non-discrimination, and proportionality. Using these three principles, the WTO members developed taxonomies for classifying NTBs with the objective of defining

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appropriate design criteria. All countries have made progress on significantly reducing “old style” NTBs, such as quotas and restrictive import licensing requirement. However, implementing regulatory reforms to minimize the trade restrictiveness of specific NTBs has largely taken place in the major developed and developing countries.

The new multilateral rules that established the WTO in 1995 included explicit agreements relating to the management of NTBs with a specific focus on customs and transit, technical regulations, and health and safety issues. Including these regulatory issues in the trade agenda requires extensive inter-government coordination as portfolio responsibility often rests with a non-trade ministry such as Agriculture, Health, Science and Technology, or Environment.

The policy recommendations in this note draw on the experience of both the WTO and other regional organizations to identify the characteristics of a successful approach for reducing and eliminating NTBs. Over the past 15 years members of the WTO have implemented the SPS and TBT Agreements through notifications and active participation and engagement in the Committees. In addition, the binding dispute settlement process of the WTO has resulted in a number of NTBs being resolved through enforceable legal process and the consequent development of precedent and case law. At the same time regional economic agreements have also turned their focus to addressing NTBs. While the European Union has pursued a legally binding approach with sanctions to enforce compliance the majority of regional economic communities have chosen moral suasion through establishing committees and other institutional structures (such as technical expert groups) requiring dialogue and the exchange of information.

The remainder of the note discusses the approach to NTBs within the EAC before outlining the key policy recommendations for reducing and removing NTBs. The policy recommendations draw on the relevance of the WTO rules and the experience of both the EU and ASEAN in addressing NTBs.

Non-tariff Barriers in the EAC

Partner States within the EAC have made progress on addressing NTBs, and the EAC Secretariat with support from Ministers and Heads of State has entered into commitments to eliminate and reduce NTBs. All the Partners recognize that realizing the vision of the EAC to create an integrated market requires the reduction and removal of NTBs. To date, the approach has focused on developing national-level focal points and publicizing specific NTBs. Establishing formal notification requirements is an important element in monitoring NTBs and represents a necessary condition. However, it is not sufficient for moving to the next step—the reduction and removal of NTBs.

The legal framework governing the EAC provides a basis for addressing NTBs. Article 13 (1) of the EAC Protocol states that Partner States must agree to eliminate remaining NTBs and refrain from imposing new ones. The following paragraph provides that Partner States shall formulate a mechanism to identify and eliminate such NTBs. The Protocol defines NTBs as “administrative and technical requirements imposed by a Partner State in the movement of goods.” Implementing this Article remains a major challenge for all five Partner States. The working definition of NTBs within the EAC is “quantitative restrictions and specific limitations that act as obstacles to trade,” other than tariffs that may be embedded in government laws, regulations, and practices at the national and local level.

Identifying and classifying NTBs is often not straightforward as specific administrative practices and legislation has evolved over time in response to political economy developments at the national and local level. These practices inevitably pre-date the initiative to move towards a Common Market in East Africa and also pre-date the establishment of the WTO. Over the past several years Partner States and the EAC Secretariat have devoted considerable attention to addressing NTBs. A series of detailed studies has identified specific measures based on surveys undertaken by private sector advocacy organizations in the region. Further studies have made recommendations for establishing an implementation mechanism to facilitate their reduction and removal. As part of this process, Partner States have established National Monitoring Committees (NMCs).

The EAC Partner States have adopted a Time-bound Program for the Elimination of Identified Non-Tariff Barriers (2009). This classifies the listed NTBs into one of four categories (see Box 9.1) based on the level of political and economic complexity and the magnitude of the impact on EAC trade. The action agenda is prioritized according to the degree of difficulty in achieving a consensus and the quantitative impact on intra-regional trade flows. Essentially this approach seeks to identify ‘easy’ NTBs to remove in order to harness a growing consensus behind further reform.

Classifying NTBs in accordance with the dual criteria of political complexity and intra-regional trade impact is justified by arguing that it will deliver a few ‘quick wins’ that will increase trade. This in turn will result in an increased awareness of the trade benefits, which will build the support necessary for addressing the more challenging NTBs. In practice there have been very few ‘quick wins’ over the past two years since it proven very difficult to remove the Category A NTBs. Some of the specific NTBs classified as Category A are shown in Table 9.1. While a number of NTBs may be explicitly protectionist, the majority of NTBs seek to meet an agreed regulatory objective—such as food safety or product safety. While there may be a consensus that an existing NTB should be abolished this does not mean that there is agreement on how to meet legitimate regulatory objectives in a less trade restrictive manner.

The publication of *Non Tariff Barriers in EAC* (now available on the EAC Web site for download) along with the existence of a high-profile forum within the EAC for discussing NTBs represents a major step forward. EAC Partner States and the Secretariat face the challenge of moving from identifying and discussing NTBs to implementing regulatory reforms and reducing trade restrictive measures. Presently there is no mechanism for ensuring that Partner States follow a process of either justifying the NTB or agreeing to remove it once a NTB is identified and publicized. The absence of a clearly defined monitoring mechanism with time limits for action means each Partner State is responsible for voluntarily removing or reforming listed NTBs without being subject to possible sanctions for non-compliance. The “moral suasion” approach to removing

Box 9.1. EAC Categories for Non-tariff Barriers

- **Category A:** NTBs with a low political and economic complexity and a low impact on EAC trade. Immediate Action required, consensus reached at EAC Council
- **Category B:** NTBs with a low political and economic complexity and a high impact on EAC trade. Short term (1–6 months) EAC Council consensus but no agreement on implementation
- **Category C:** NTBs with a high political and economic complexity and a high impact on EAC trade. Medium term (6–12 months) No political consensus as EAC Council
- **Category D:** NTBs with a high political and economic complexity and a low impact on EAC trade. Long Term (>12 months) No political consensus at EAC Council

NTBs within the EAC has, to date, failed to yield significant progress. This may be contrasted with the more formal legally binding mechanisms with sanctions that are practiced by the European Union.

At the national level the NMC is generally coordinated by either the Ministry of East African Affairs (Kenya) or the Ministry of Commerce (Rwanda and Uganda). The Ministry of East African Affairs does not have the capacity to analyze and review the identified NTB, and while the Ministry of Commerce may have more capacity to assess specific NTBs it does not have the mandate to make decisions on their modification or removal. In the absence of a transparent process for removing and reforming specific NTBs the National Monitoring Committees risk becoming ineffective “talk shops” as the same issues are repeatedly referred back to the EAC Council of Ministers for resolution.

The five members of the EAC all belong to the World Trade Organization (WTO). As such they have already committed to organizing their multilateral trade relations in a transparent and non-discriminatory manner with least trade restrictive regulations, within a legally binding and enforceable system. Linking specific reforms, such as removing NTBs, to high-level regional and multilateral commitments that already have buy-in, can assist in building support for the reduction and removal of NTBs and provides a basis for tackling difficult regulatory and procedural issues.

In Southern Africa, the SADC Ministry of Trade has established a transparent system for monitoring and ensuring compliance with the SADC Trade Protocol, which includes procedures for addressing reported barriers to trade including NTBs. The SADC Trade Monitoring and Compliance Mechanism (TMCM) requires all members to report all trade laws and regulations, and will function as a system for notification, consultations, and negotiation among Member States as well as for implementing judgments and sanctions determined by the dispute settlement system.

Policy Recommendations

The commitment of Partner States and the EAC Secretariat to reduce and remove NTBs has, to date, focused on identifying specific NTBs and establishing NMCs. Raising awareness and improving transparency over NTBs represent necessary first steps however, it is apparent from the lack of progress in removing NTBs in East Africa and elsewhere that they are not sufficient. At the Partner State level, a commitment to implement in full their commitments under the GATT 1994 Articles V, VIII, and X and the Agreements on Technical Barriers to Trade and Sanitary and PhytoSanitary measures would go a long way in advancing the EAC moves to promote a single market. Developing an effective program for reducing NTB requires governments, the private sector, and civil society to consider the following policy issues.

Firstly, all existing identified NTBs should be subjected to a WTO Compliance review to ensure that the measure is transparent, non-discriminatory, and minimizes trade restrictiveness. EAC Ministers could consider establishing a transparent rule that when a NTB is found to be non-compliant with the WTO the Partner State is required to abolish or modify the measure to ensure compliance within 12 months. This is consistent with each of the Partner States committing to implement their commitments under GATT 1994 Articles V, VIII, and X.

Table 9.1 > Examples of EAC Non-tariff Barriers Identified for Immediate Action

| NTB Category | Summary Description | Objective | Potential for Non-Transparent & discriminatory application | Evidence/Scientific Basis | Alternative Measure |
|--------------|--|---|--|--|--|
| B | Non-recognition of EAC Rules and Certificates of Origin | Prevent trade diversion under the EAC FTA | High | Verification Missions | Apply risk assessment |
| A | Import Bans (Milk, day old chicks, beef, poultry) | Public Health | High | Inconsistent between imports and domestic production | Mutual recognition within EAC |
| B | Multiple Road Blocks | Prevent tax evasion on transit goods | High evidence of bribes | None | Document based controls at borders |
| D | Kenya levies charges on Plant Import Permit for Ugandan tea | Protection | Yes | None | Abolish levy |
| D | Kenya requires Ugandan tea to have a SPS certificate but does not recognize it | Public Health | Yes | Lack of confidence in UNBS certificates | Recognition of SPS certificates within EAC |
| B | Multiple weighbridges along Northern Corridor | Road Safety | High | None | Use risk assessment |
| B | Requirement for import license from the Ministry of Trade and Industry and a bond prior to Tanzania issuing excise duty stamps | Protection | Yes | None | Remove requirement |
| B | Discriminatory excise duty on cigarettes that do not have 75 per cent of Tanzanian tobacco | Domestic Content protection | Yes | None | Remove requirement |
| B | Landing certificates for exports from Kenya through Namanga issued by TRA in Arusha rather than at the border | Administrative | Yes | None | Abolish Landing Certificate requirement |
| B | Extra charges levied on Kenya pharmaceutical exports by Tanzania | Protection | Yes | None | Abolish requirement |
| B | Cotecna inspection required for imports to Tanzania | Undervaluation | Yes | None | Abolish requirement |
| B | Road Consignment note required from transporters prior to packing of goods | ? | Yes | None | Abolish requirement |
| B | Corruption along Northern and Central Corridors at roadblocks, weighbridges, and borders | | Yes | None | Increase transparency |

Secondly, and with immediately effect, all proposed new regulatory measures/procedures should be required to be reported to the other Partners and the EAC Secretariat in advance to allow time (a minimum of 90 days) for consultation and review. When Partner States report new regulatory requirements or procedures to the EAC Secretariat and each other they should also notify the WTO. For simplification, the reporting requirements should be identical. The experience of the WTO, and the SPS and TBT Committees represent a relevant model for notification, reporting and discussion.

Thirdly, prior to any modifications or new technical regulations being announced, the Partner Country should undertake a regulatory impact analysis (RIA). While the RIA is widely used in developed economies it is rarely undertaken in developing countries. The RIA assesses the likely economic and social impact of a proposed regulation. Donors could potentially provide technical assistance to develop capacity for the EAC to undertake RIAs.

Fourthly, the EAC and Partner States should commit to ensuring all existing policies, regulations, administrative procedures, and any related fees and charges relating to the importation and export of goods are readily available through a publicized web site. Provision should also be made for all proposed changes to technical regulations to be posted on the web site with a facility for interested parties to submit comments.

Fifthly, EAC Partner States and the Secretariat should ensure that the dispute settlement system is in place and ready to address NTBs. It is recommended that the EAC consider adopting the SADC approach of linking the management of NTBs with a formal monitoring and compliance mechanism that allows for fast-track decision making and is linked to the formal dispute settlement mechanism with a legally binding outcome. The experience of the EU in establishing a legally binding mechanism with sanctions for non-compliance provides a relevant model.

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10. Non-tariff Barriers and Regional Standards in the EAC Dairy Sector

Michael Jensen and John Keyser⁴⁴

Introduction

The dairy industry of the East African Community (EAC) is one of the largest in Africa, and is an important part of the region's agricultural economy. Thousands of small farmers take part in the production of dairy products, and millions of consumers benefit from the health benefits brought by dairy products. In recent years, East African countries have been working to design and implement a set of regional health and production standards in order to help the dairy industry reach its full potential. Most stakeholders agree that standards should be developed by East African countries, because standards are important for health reasons and are necessary for maintaining a healthy population in the long-term. However, since almost all consumers in East Africa boil the milk before drinking it, the health risks from bacterial infection are actually quite low. Therefore, while standards are important, they need to be developed for the long run such that, in the short run, they allow small-scale producers to prosper.

Since imposing standards that small-scale producers are incapable of implementing is not useful from either a health or economic development perspective, dairy standards must be designed carefully, taking into account the technological and economic constraints in the region. This chapter examines the role that standards can play in promoting the healthy consumption of dairy products while at the same time helping the vibrant dairy industry to modernize and develop. The note begins by discussing the East African dairy industry and the current attempts to design standards, and concludes by outlining ways in which the World Bank and other stakeholders can work together in order to design and implement useful and long-lasting dairy standards that would take into account both health and economic considerations.

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The Dairy Industry in East Africa

Although the East African dairy industry is quite large, dairying is a domestically focused activity, with only 10 percent to 20 percent of milk sold and distributed through formal channels and less than one percent of the region's milk products being exported. This domestic focus is mostly due to the unique production and transportation challenges facing the sector. Raw milk is a difficult product to trade, especially given the tropical temperatures in Africa and the lack of refrigeration infrastructure. Dairy products that are more easily tradable include milk powder, UHT milk, and luxury products such as cheese and yoghurt. Although intra-regional trade is in its infancy and the highly perishable nature of dairy products makes the development of a functioning regional market difficult, dairy trade has been growing strongly over the past several years, and the potential for expanding trade in dairy products exists.

In this context, agreements on production, transportation, and health standards relating to dairy products are essential, since low-quality dairy products can have negative health consequences and can reduce demand across the emerging regional dairy market. From a production and health perspective, standards specify the quality of dairy products in terms of fat content, purified water content, and bacterial count. From a transportation perspective, cross-border trade in dairy products is limited to a large degree by the technological capacity of the industry in each country, and growth in the dairy market can even be a catalyzing factor for bringing more advanced technology to the region. For example, producers with access to refrigeration systems are more likely to be able to transport and trade dairy products across relatively long distances. In markets where producers and consumer groups can agree on appropriate health and production standards, the consumer is more likely to receive a healthy product and producers can maintain access to a growing market. The rationale for designing and implementing a regional standards regime, therefore, is strong.

At the same time, implementing poorly designed standards can come at a high cost to market efficiency and product quality, and implementing standards that will not be upheld in practice is counterproductive. For example, laboratories might test milk to try to ensure the quality of dairy products, yet the vast majority of milk is consumed locally beyond the reach of formal conformity assessment procedures—80 percent of milk producers are part of the “informal market,” which is comprised of milk vendors, milk shop owners, and mini-processors. Conforming to standards is oftentimes costly for producers, and the average East African consumer would not be able to pay higher prices for milk if these costs were passed on. The fact that implementing standards will come with a price tag is an important first step in designing standards that will be mutually beneficial across the region, and increases the importance of designing standards that will strengthen the dairy market instead of constrain it.

A further issue is that standards may be misused. Vested interests sometimes try to manipulate standards and conformity assessment procedures in order to advance the sales of their own products and block market access for their competitors. Although international trade is only a small portion of overall dairy distribution, the influence of vested interests is particularly visible in this area. Dairy quality is assessed during border crossing procedures and the imposition of standards may be used as non-tariff barriers to trade. Harmonizing standards assessment procedures across the region could therefore help to facilitate the cross-border trade of healthier dairy products given that

the standards to be harmonized are carefully calibrated to the realities of the regional dairy industry.

Despite the need to overcome the challenges facing the dairy industry, implementing standards will not, on their own, develop the dairy industry to a world-class level or expand intra-regional trade. Like many issues in development, the utility of regulatory and oversight measures for economic growth is determined by their specific details. Standards that are designed taking into account the specific situations of producers and consumers can promote efficiency and safeguard public health, but poorly designed standards can lead to inefficient markets and can be sources of rent seeking for vested interests. The effective design and implementation of standards depends on the careful calibration of the standards with the needs of the countries setting them.

Current Efforts to Harmonize Standards in East Africa

The current effort for setting and harmonize standards in the EAC has been supported by a USAID-funded regional trade integration project. The rationale given for imposing standards on dairy products is that the consumption of raw milk poses health hazards, and regulating the production and transport of dairy products can lead to positive health outcomes across the region. Specifically, milk and other dairy products may cause harm if the microbial quality is poor and if zoonoses—diseases transferred from animals to humans—are present. A study by Omore et al. (2005) illustrates the potential health risk of consuming Kenyan dairy products, in which the microbial quality is generally poor and exceeds the international health standards by a large margin. This is due almost exclusively to the hot climate, the long distance some milk is transported, and the lack of refrigeration technology. Illustrating these trends, the authors found that, in general, the bacterial count of milk in Africa increased as distance from the milking site increased.

The new EAC dairy standards are largely based on the Codex Alimentarius, which are held as the best international standards. Although the health dimension of dairy standards is important, however, basing standards on the Codex Alimentarius is problematic since the Codex assumes that consumer incomes and production infrastructure are equivalent to Western levels. In practice, this means that dairy products have to be produced, stored, transported, and labeled in specific ways that adhere to the standards. For example, in developed countries people mainly consume fresh pasteurized milk, whereas in East Africa, most milk is consumed raw. Nevertheless, eight common EAC standards now exist for raw milk, pasteurized milk, UHT milk, powdered milk, sweetened and condensed milk, butter, yoghurt, and dairy ices and ice cream. None of these standards have been implemented and, apart from a few large-scale export-oriented producers, most traders, producers, and processors will not be able to comply with the standards.

There is also the question of whether the health hazard posed by high bacteria levels in East African milk is as dangerous as some critics claim. The argument for strong health standards is based on how milk is prepared for consumption in Africa. In developed countries, milk is almost always pasteurized, a process which removes much of the bacteria content. In Africa, most milk is consumed raw. While there is no doubt that contaminated milk is dangerous to the health of people consuming it, however, this observation does not take into account differences in Western and African consumption habits and practices. Indeed, the consumption habits of EAC consumers have so far prevented the low quality

of milk to become a health risk. In Africa, nearly all milk is boiled before it is consumed, which reduces the health risk of drinking bacterial pathogens to very low levels. According to a survey conducted by Omore et al. (2005), 100 percent of urban households and 96 percent of rural households sampled boil their milk before consumption.

In addition, most dairy sector policies and project interventions in the EAC region have been guided by a view that equates dairy sector competitiveness with modern value chain development. Until recently, small-scale milk traders who account for over 80 percent of total milk trade were largely overlooked in planning project strategies and were effectively regarded as something that needed to be stamped out to make room for improved linkages with modern dairy processors. While this negative view of small-scale traders has since moderated as result of policy dialogue with donor projects and other changes that came with market liberalization, small-scale milk traders continue to be regarded by many in the EAC region as a transitional part of the dairy landscape only. Consistent with this view, dairy projects have traditionally focused their efforts on improving linkages between small farmers and formal dairy processors. Due to these efforts, there has been a significant change of policy in Kenya (and to a lesser extent in Uganda), to endorse small-scale milk traders.

Because of the preference of most consumers in East Africa for low cost raw milk, a major challenge for value chain projects has been to make formal sector dairying more attractive. Indeed, one primary reason why small-scale informal milk traders are most popular among the rural and urban poor is because of more favorable pricing compared with formal sector channels. Dairy processors throughout the EAC region have so far been unable (or unwilling) to pay price premiums that would reward a farmer's investment in quality and various kinds of project support have been needed to promote the upgrades needed for formal sector marketing instead. Among other things this has meant showing farmers the financial benefits of improved silage making and better livestock care, training of farmers in animal husbandry and milk hygiene, establishment of artificial insemination service points, and work with dairy producer groups to identify market outlets and negotiate reliable supply contracts with dairy processors.

Fieldwork conducted in East Africa during December 2009 identified several problems with the standard-setting procedure. First, the standards setting process was driven mainly by international donors and the technical agencies, and did not consider the economic environment in which the small producers that make up the vast majority of the dairy industry operate; small producers account for 80 percent of the region's dairy production. Although some of the larger dairy producers in East Africa participated in the meetings, small producers and vendors were rarely consulted—the standards setting process involved mainly dairy technologists.

Second, some East African countries participated in the standards setting process without knowing about the quality of their milk, the needs of their small producers, or the technological and capacity challenges they would face in implementing and adhering to the new standards. Similarly, no assessment of economic and wider social impacts on small-scale producers or consumers was made. Therefore, while the emphasis on health and safety has been well intentioned, the actual process has not taken into account the wider context of long term and sustainable development in the region.

Despite these problems, there have also been some positive developments which indicate that there is the potential to implement real policy changes that can better address long term development issues. For example, there has been a significant change of policy in

Kenya (and to a lesser extent in Uganda) to endorse small-scale “informal” milk traders. These informal markets are important to the rural and urban poor because of more favorable pricing compared with formal sector channels. Therefore, evidence exists showing that enabling small producers to more effectively join the formal dairy sector could affect both health and economic considerations in the short and long run.

Policy Recommendations

These issues taken together demonstrate clearly that the current effort to implement dairy standards has not been successful. To the end of formulating standards that will promote health, welfare, and economic development into the future, stakeholders should consider the following policy issues.

In the context of the problems with the current set of dairy standards, a review of the standards designed so far should be undertaken to focus their usefulness and viability. A useful first step would be a review that ensures the standards meet both public health and market demands, especially with regard to maintaining the economic viability of small-scale producers. Standards which are not viable for economic or technological reasons, and that cannot be addressed by government or donor group assistance, should be jettisoned. Future efforts to set standards should take an incremental approach, recognizing the limitations that small producers have in terms of their ability to meet such standards as well as the importance of small producers to the East African dairy industry.

Regardless of the outcome of the review, the policy process that led to the adoption of the harmonized EAC standards should be improved. East African countries and the donors that support them should avoid importing policy measures designed for OECD countries without adjusting them to the realities in East Africa. In OECD countries Regulatory Impact Analysis (RIA) is increasingly being used to improve the knowledge base of policy makers. RIA considers economic and social factors that need to be explicitly considered when designing policy initiatives. RIA is a relatively new concept in developing countries. The use of RIA to document the economic and social impact should be considered in the EAC to comprehend the full consequences of measures affecting trade. Donors and international organizations with analytical expertise, like the World Bank, would need to support the development of a type of RIA suitable for East Africa.

After this review is carried out, in the short run the EAC could first focus on implementing the already agreed principle of mutual recognition of quality marks. The licensing system should also be reviewed and discussed, with an eventual transition to a system based on annual licenses. This system could also have increased efficiency by making it electronic or internet-based. In the medium term, if public health and/or market demand is established for another set of standards, these could be developed with the assistance of donors and international organizations. The FAO and the WHO could be consulted on the development of a standard for the unique product of the region: raw milk destined to be boiled before consumption. The implementation and conformity assessment procedures should be in accordance with the realities in the EAC region. However, it should be recognized that national agencies in East Africa must want reform; once requested, the assistance of donors and technical organizations will become more important.

In the longer term, East African countries should continue to expand their fundamental capacity-building effort. This will form the basis of increased regional trade. Work on

standards quality should be a cornerstone in capacity building but the approach should be incremental rather than an attempt to radically upgrade the industry. By creating the building blocks for quality in the supply chain little by little, East African dairy industries will in the long run be able to implement standards consistent with the international best practices in the Codex Alimentarius. An incremental approach is necessary especially given the questionable utility of a “top-down” approach to standards design. East African policy makers have generally attempted to learn from the most advanced dairy industries in the world, such as the United States and the EU. Due to technological and capacity constraints, however, the value of this is doubtful. Many developing countries have dairy industries that operate more efficiently than in the EAC and under more similar conditions regarding production, trade, processing, and consumption. India, for instance, has achieved phenomenal growth in dairy while relying on smallholders. An incremental approach to quality could be based along the following principles, taken from studies of the development of the Indian dairy industry:⁴⁵

- **Recognition of the crucial role of the informal market:** An estimated 70 percent of the marketed milk in India is sold in the informal market even after decades of rapid development. Demand for higher quality and diversified products is rapidly increasing as the Indian middle class expands. Yet the informal market and small-scale producers will constitute the backbone of the dairy industry for decades to come.
- **Listen to demand:** Most demand for milk, including from middle and upper income segments, is for traditional products such as dahi, paneer, butter, ghee, and Indian sweets. Demand for Western style products and quality has remained low. The laissez-faire approach of the Indian government towards the informal sector has allowed the dairy industry to respond constructively to demand and to expand. Today, India is no longer a net importer of dairy product, but a net exporter. Indeed, in 1998, India surpassed the United States to become the world’s largest milk producer.
- **Improve quality from the bottom up:** India has chosen to work on quality improvement by investing in production and trading practices in the long and often uncoordinated supply chains rather than attempting to upgrade the industry to Western standards. The focus on quality has been on basic hygiene issues, adulteration and similar simple quality issues for which basic capacity building is more important than the implementation of advanced food safety standards.

By expanding the East African dairy industry while solving basic quality problems first and at a speed that allows consumer demand to pay for the upgrading process, the process to design and implement standards that can address health and development issues for the long run can begin.

⁴⁵ Babcock Institute for International Dairy Research and Development 2006; Candler and Kumar 1998.

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11. The Business Environment in Southern Africa: Issues in Trade and Market Integration

*Taye Mengistae*⁴⁶

Introduction

The Southern Africa Development Community (SADC) is an association of states promoting economic integration among the following countries: Angola, Botswana, the Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe. The SADC has been a free trade area since 2008 and has an ambitious regional integration agenda that includes the establishment of a customs union by 2012. The free trade area provides for the elimination of import tariffs and nontariff barriers to trade among members and aims for, among other things, the harmonization of customs procedures and technical standards, and the liberalization of trade in services within the free trade area. Since 2006, the SADC has also had a Finance and Investment Protocol (FIP) that seeks to harmonize the policies of member countries in the areas of investment promotion, labor codes, and immigration laws, with the ultimate goal of developing the region into a “SADC Investment Zone.”

This chapter⁴⁷ examines the role of differences in business environments in impeding cross-border trade flows between Southern African countries. It also considers the cross-border integration of credit and labor markets based on microeconomic data on firms and households. The aim of the assessment is to help inform the policy and business environment harmonization agenda of the Community.

Trends in Trade Integration

SADC economies are far more integrated today within the region and with the global economy than they were in the mid-1990s. Most Favored Nation (MFN) tariffs have been reduced, intraregional trade flows have increased, and trade has risen as a share of GDP. On average,

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⁴⁷ This chapter is based on a larger report by a task team led by Taye Mengistae, “The Business Environment in Southern Africa: Issues in Trade and Market Integration,” The World Bank, 2010.

SADC countries export and import as much as would be expected relative to their income and distance from international and regional markets. Further, intra-SADC trade is relatively high in relation to what intraregional incomes and distance would predict. However, much of the increase in intraregional and extra regional trade occurred in the 1990s, and all indications are that progress has halted in recent years. In addition, substantial imbalances in trade flows persist. The South African Customs Union (SACU) continues to dominate intraregional trade flows, as both a destination for other SADC member exports and a source of their imports. Trade flows among non-SACU countries in the SADC area remain low.

Another feature of the nature of integration to date, posing a major policy challenge, is that, excluding South Africa, SADC exports to the rest of the world and within the SADC are comprised mainly of primary products, although Mauritius, Malawi, Swaziland, and Lesotho also export clothing and textile products. The high concentration in commodity-based exports has limited intra-industry trade flows and the productivity gains associated with the economies of scale and the diffusion of innovation that such flows facilitate. To realize productivity gains from intra-regional trade, many member countries need to diversify into nontraditional exports, including manufactured and service exports. Trade in manufactured goods and services is more sensitive to trade barriers and other cross-border transaction costs than the current trade in resource-based products. Its development in the region would therefore require greater openness to trade of member countries and significant reforms of the business environment within the region.

Adding to the urgency of diversifying members' exports is that most SADC countries are labor-surplus economies, and many face problems of high unemployment and widespread poverty. To successfully grow out of these problems many need to diversify production and exports into labor-intensive industries in manufacturing and services. Future progress in further trade integration within the region will indeed largely depend on how far member countries succeed in this type of diversification.

Business Environment and Trade Integration

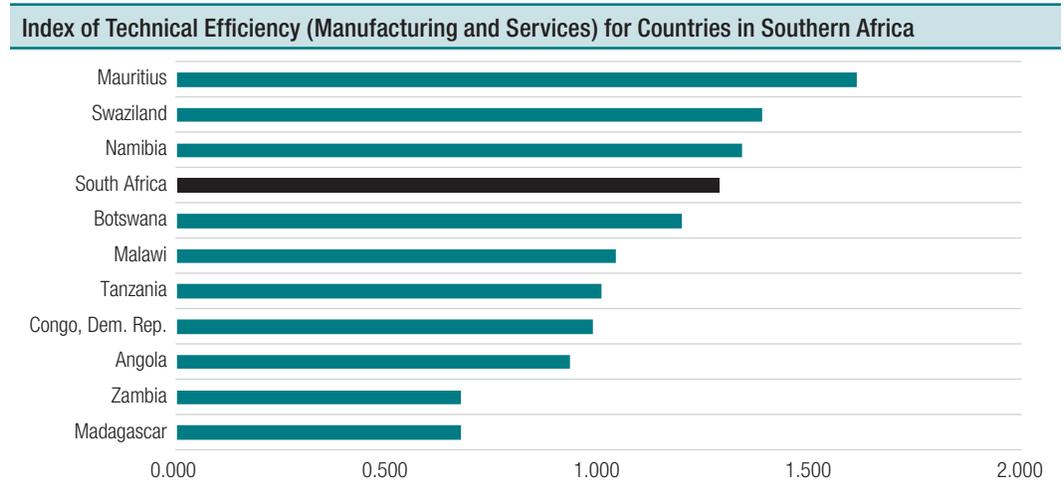
The cross-country differences in manufacturing productivity and exports that we observe today among SADC members have a great deal to do with differences in business environment. Specifically, more successful exporters of manufactures and services are, on average, more open to trade; have lower trade costs on account of more conducive geography and lower transport and regulatory costs; have lower regulatory barriers to business formation; provide better access to long-term finance; and have more reliable public utilities and better governance in the sense of having less corruption in government agencies. Above all, more successful exporters of manufactures and services suffer far less from allocative inefficiency resulting from disparities in access to long-term finance, public utilities, and to government services among sectors, business size groups, and entry cohorts, as they provide a more level playing field to everyone on those key dimensions of the business environment.

The top exporters of manufactures and services in the region currently are South Africa, Mauritius, Lesotho, Namibia, Swaziland, and Malawi. These are also among the most open to trade. All except Lesotho owe their exporting status to the higher productivity of their manufacturing sectors. On the other hand, Angola, the DRC, and Zambia have manufacturing and service sectors that are the least productive and least export-oriented in the region. One major source of the productivity gap between the two extremes of successful exporters of manufactures and services (South Africa, Mauritius, Namibia,

Swaziland, and Malawi), and non-exporters of the same (DRC, Angola, and Zambia), is differences in technical efficiency (Figure 11.1). Technical efficiency measures how efficiently an economy uses a given set of inputs; a higher score in Figure 11.1 shows higher efficiency.

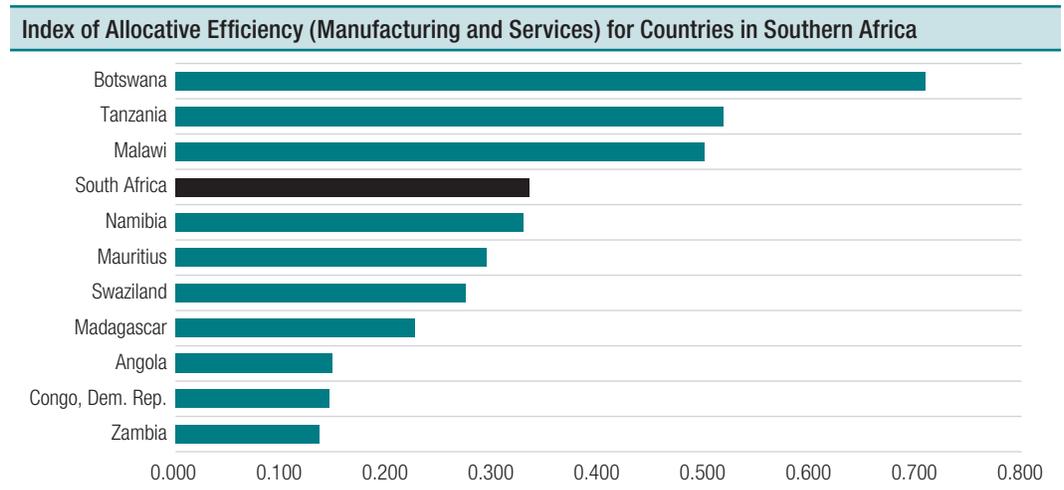
A second source of the manufacturing and services productivity gap between the two groups of countries is that, within the typical domestic industry, low productivity firms tend to have higher market shares in the non-exporting group than they would have in the group of successful exporters—a reflection of the lower allocative efficiency that characterizes industry in the non-exporting group (Figure 11.2). Allocative efficiency measures how efficiently an economy allocates available resources for production; a higher score in Figure 11.2 shows higher efficiency.

Figure 11.1 >



Source: World Bank Enterprise Surveys

Figure 11.2 >



Source: World Bank Enterprise Surveys

The relatively lower allocative efficiency of industries in the non-exporting group in turn is partly caused by the fact that there is greater in-country disparity of business environment in those countries than there is within the more successful exporters, where the playing field is more level for all firms regardless of how large they are, how long they have been in business, and where in the country and in which sector they are operating.

Business Environment Reforms and FDI

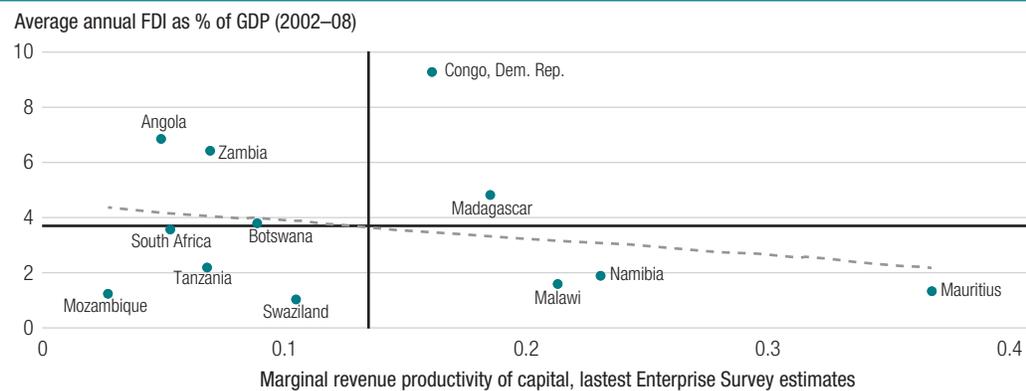
Cross-country differences in the business environment have also been a major factor in recent trends in inward foreign direct investment (FDI) in the region and in its allocation among member countries. In recent years SADC has attracted higher FDI on a per capita basis than most other developing regions (Figure 11.3). Though most of the inflow has been to mining, resource-poor countries have also attracted more than their share of FDI. In almost every case, FDI inflows have financed large shares of domestic savings and helped improve productivity, without which growth rates would have been significantly lower than they turned out to be.

However, given cross-country patterns in expected rates of return, Tanzania, Malawi, Mozambique, Swaziland, and Namibia should have attracted far more FDI than they actually did, while Angola, DRC, and Zambia are unlikely to sustain current levels of FDI as these far exceed those warranted by expected rates of return shown on the dashed line in Figure 5. Sustaining high levels of FDI in the second group and raising levels in the first group will require significant improvements in the countries' business environments. The type of improvements needed differ among countries, however. In at least one country (DRC), what is needed is reduction of investment risk through greater political stability. In almost all the others, there is an urgent need for reducing corruption and business start-up costs.

In the recent past, reforms that lowered start-up costs in Madagascar, Mauritius, and Mozambique have had drastically positive and visible impacts on FDI flows, while greater political stability in Zambia and Mauritius has had a similar effect in those countries. On the other hand, major declines in the control of corruption seem to have led to a sharp

Figure 11.3 >

FDI Inflows and the Marginal Productivity of Capital



Source: World Bank Enterprise Surveys.

fall in FDI in Namibia and Swaziland in the early 2000s. One indication of the scope for positive changes in these business environment factors is that start-up costs have steadily declined in nearly all resource-poor countries to converge with or to a lower point than the South African norm, while start-up costs are very high and have generally remained unchanged in most resource-rich countries.

DRC and Zimbabwe aside, the trend in the SADC as a whole has been one of members' convergence towards greater political stability, with steady improvements in every country's score on the stability index. Botswana, Mauritius, and Namibia are the most politically stable members; the larger countries—South Africa, Mozambique, Malawi, and Zambia—converge around something of a normal (or mean) score for the region.

On the other hand, there is not much evidence of convergence over time among SADC members in terms of control of corruption. Indeed, countries in the region fall into three distinct groups: relatively “corruption free” members, namely, Botswana, Mauritius, Namibia, Madagascar, and Lesotho; those with moderate corruption, namely, Zambia, Malawi, Mozambique, and Swaziland; and those where corruption is a serious problem—Angola, DRC, and Zimbabwe.

Issues in Financial Market Integration

Greater financial integration in the SADC should help improve the allocation of FDI and capital more generally within the region. It should also help promote trade integration. Some of the influence of business environment on investment and trade integration therefore occurs as an effect on financial integration and financial development.

At this point the level of financial integration is quite low, an indicator of which is the large variance in real interest rates among member countries: some have excessively high rates (Mozambique, Tanzania, and Zambia), while others report negative rates (DRC, Botswana, Madagascar, and Angola). Countries also vary hugely in terms availability of financial products and their accessibility to different sectors of the economy.

One major impediment to greater financial integration is that institutions of contract enforcement are weak in many member countries. The SADC scores lowest among all regions on time to enforce contracts, with Angola, Mozambique, Botswana, and Swaziland recording the longest times. Another barrier is that credit information is lacking in several countries, including DRC, Lesotho, Madagascar, Malawi, Tanzania, and Zambia. Capital controls constitute the third impediment. The SADC region has the most restrictions on capital flows, both in *de jure* measures of capital account restrictions and in *de facto* measures of actual capital flows during the past few years.

Employment Regulation and Labor Market Integration

Compared to other regions, employment contracts are not heavily regulated in the SADC. Seven countries have an overall Doing Business employment rigidity index that is well below the OECD average. The same index is below sub-Saharan Africa's average for three other members. However, there is enormous variation in the degree of employment regulation within the region itself. Angola, DRC, Zimbabwe, Botswana, and Madagascar regulate the labor market the most heavily. In Lesotho, Malawi, Mauritius, Swaziland, Namibia, and Zambia, employment contracts are the least regulated.

These differences in the intensity of labor regulation have significant implications for cross-country differences in employment and earnings, and for cross-country differences in trade integration. It is not by coincidence that the countries where employment is least regulated have attracted more FDI per capita and have more export-oriented manufacturing and service sectors than other member countries. Intraregional differences in employment regulation also generate differences in the price of labor and in labor market integration.

The reason for this linkage is that a country cannot sustain wage rates that exceed a global or regional norm unless it somehow restricts the flow of goods, services, capital, and people across its borders. Even where trade is restricted, labor market integration can be driven by the flow of capital among countries. When FDI is driven by a positive wage shock in the sending country labor market, it creates a link with the recipient country's labor markets. For example, FDI from South Africa to Zambia, motivated by a sudden rise in wages in South Africa, increases the demand for labor and, ultimately, wages in Zambia. International migration is another mechanism linking wages and labor markets across countries.

An evaluation of the extent of labor market integration involves measuring the speed with which wages in one country respond to shocks to the labor market in the rest of the region. The general rule for interpreting this measurement is that a faster adjustment indicates a more regionally integrated market. Such an evaluation shows that although South Africa has broadly integrated its labor market with others in the region, the depth of integration is still rather low. This reflects the fact that both trade and capital flows are far more restricted in the region than in places where there is greater cross-border labor market integration.

One such place is the U.S.–Mexican border, where a study showed that wages in Mexican border towns fully adjusted to wage shocks in the U.S. in around one month. This is 3.6 times shorter than the time it takes for wages in the Botswana, Namibia and Swaziland to fully adjust to wage shocks to the South African labor market. As would be expected, adjustments to the shock would take even longer as we move further away from South Africa's border. For example, it takes 5.5 months for Tanzanian wages and 11 months for wages in Mauritius to adjust to the same shock to South African wages.

Policy Recommendations

The key harmonization issues emerging from the diagnostics of the report concern import tariffs and nontariff barriers, competition policy, transport and other significant components of trade costs, provision of infrastructure, control of corruption, and access to finance.

Harmonizing Import Tariffs and Reducing Nontariff Barriers to Trade

Although average tariff rates are now quite modest in the region, the structure of MFN tariff rates vary significantly within the region, effective protection rates are quite high with a built-in anti export bias, many nontariff barriers remain in place within the FTA, and customs procedures have yet to be harmonized. As a result, the growth in regional and extra-regional trade has slowed down in recent years. There is thus an unfinished agenda for tariff reforms that should include the harmonization of MFN tariffs among SADC members and reduction of effective protection rates.

Developing and Harmonizing Competition Policies

As member countries liberalize intraregional trade and capital flows, care needs to be taken that first arrivals on the domestic scene from other parts of the region do not erect barriers to entry to domestic markets and domestic industries by design or otherwise. Combined with regionally harmonized trade policies, well crafted, effectively enforced, and regionally harmonized competition policies will help safeguard against such an outcome. At the moment South Africa is the only member country that has an internationally well-regarded competition policy regime. However, even it needs further competition policy reforms.

Reducing Trade Costs

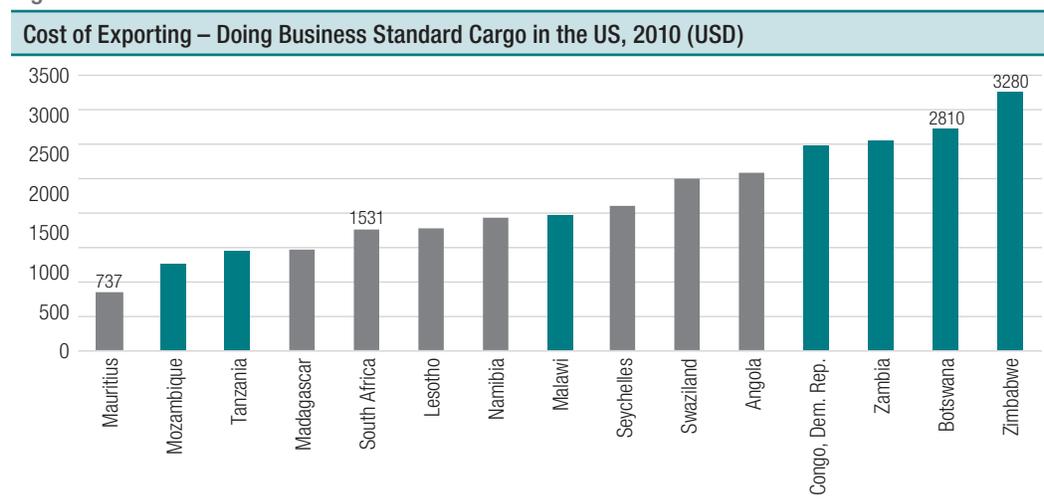
Perhaps the most prominent reason that intraregional and extra-regional trade in the SADC are not growing is that trade costs also remain high for reasons that are not necessarily related to trade policy. Trade costs are high, particularly in Angola, DRC, Zambia, Botswana, and Zimbabwe (Figure 11.4). High transport costs are often the main part of the problem, but problems with customs administration and regulatory costs of cross border transactions, and activities in general, are often major contributors.

In many countries, burdensome customs and trade regulations have added significantly to trade costs. In such countries there is a need to streamline clearance procedures as an important means of facilitating trade. Nearly everywhere there is a need to reduce transport costs by improving roads, railways and port services, although the specific means of achieving these differ from country to country.

Improving Power Supply

After freight transport and port facilities, power supply is the most important infrastructural obstacle to export diversification in many countries within the SADC. Power shortages are holding back manufacturing productivity and exports, particularly in Madagascar, Malawi, Angola, and Zambia. In each of these countries, start-ups can wait for months to

Figure 11.4 >



Source: Doing Business 2010

be connected to the public grid while established businesses report significant losses of revenue due to frequent outages. The proximate cause of the shortages in all of these cases is years of underinvestment in the power sector. As a result, governments have sought to promote large investments in maintenance and additional generating and transmission capacity.

The root causes of the shortages also include the deliberate under pricing of electricity, the failure of poorly managed state-owned operators to collect payments, and the absence of a workable legal and regulatory framework for private sector investment. Instituting cost recovery tariffs, establishing efficient billing and collection, and limiting transmission and distribution losses are also among the measures that some governments in the region are being advised to take.

Reducing Start-up Costs, Particularly in Resource-rich Countries

Although nearly all resource-poor countries have tried to lower business start-up costs, these costs as well as the time it takes to set up a company remain excessively high in all resource-rich countries. Governments should therefore carry out the administrative reforms needed to bring business start-up costs and set-up times down to international and regional norms.

Promoting Financial Development and Financial Integration

At the moment financial integration in the SADC is impeded by capital controls that are more stringent than in many other parts of the world, the lack of credit information in several member countries, and huge disparities in the quality of contract enforcement institutions among member countries. Improving availability of credit information, opening capital accounts, opening the banking industry to greater competition, and improving the quality of contract enforcement institutions are thus potentially important instruments for promoting financial development and financial integration in the region.

Monitoring Market Integration

In most SADC countries, government statistical agencies collect price data and household and labor force survey data with variable degrees of regularity and quality standards. Unfortunately, in many cases, the quality of data is so poor that they cannot be used to monitor the integration of regional goods markets or labor markets. And yet, well designed and disaggregated product price data are usually a more effective means of monitoring trade integration than are trade flows, and measures of labor market integration provide an indirect but quite powerful and indispensable indicators of barriers to trade and investment flows. Much effort has been expended by policy makers of member countries in negotiating mechanisms for achieving integration. To monitor these, sufficient investment needs to be made on collecting the price and labor market data needed to monitor integration in all member countries

PART III

INTEGRATING SERVICES MARKETS

12. Africa's Trade in Services and the Opportunities and Risks of Economic Partnership Agreements

Paul Brenton, Nora Dihel, Larry Hinkle and Nicholas Strychacz⁴⁸

Introduction

Services matter for economic growth and development. In most non-oil producing sub-Saharan African countries the services sector is now the largest part of the economy, and as countries develop the importance of the services sector tends to rise further. The provision of clean water, effective sewerage, a stable supply of energy, and access to education and health services is critical to increasing welfare and alleviating poverty. Services, such as telecommunications, energy, transport, and business services are important inputs into the production of goods and other services and hence influence productivity and competitiveness. Increasing the availability, affordability and quality of these services is crucial for economic growth and poverty reduction in all developing countries.

In this context, international trade can play a key role in the development of services sectors in Africa. Opening up to services imports and foreign direct investment can be an effective mechanism to increase competition and efficiency in the provision of services in the domestic economy. In addition, services offer dynamic new opportunities for exports, but too often services are overlooked as a source of export diversification, with trade policies focusing solely on goods. Exports of services are of particular importance for land-locked countries for which opportunities to diversify into the export of manufactures are more limited by the high costs of transporting goods.⁴⁹

However, trade opening may need to be coordinated with regulatory reforms to ensure efficient outcomes, while additional policies may be necessary to ensure that public policy objectives regarding equity are achieved. This emphasizes the importance of developing the capacity to define and implement sound regulatory policies for services sectors, capacity that is limited in many African countries.

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⁴⁹ Indeed, over the past 10 years exports of services from non-oil exporting land-locked countries in Africa have increased at a rate more than three times faster than their exports of goods.

This chapter examines the role that international trade agreements, particularly the Economic Partnership Agreements (EPAs) that are currently being negotiated with the European Union (EU), can play in supporting coordinated trade and regulatory reforms. Such reforms will enable African countries to exploit the considerable opportunities for the expansion of trade in services both within Africa as well as with the global market. The note discusses the key issues that EPAs will have to address if they are to support the development of service sectors in Africa, while recognizing that EPAs might not necessarily be the most effective way to pursue service sector reform for all African countries. The note proceeds by first reviewing the role that trade liberalization can play in the reform of services sectors.

Trade Liberalization and Regulation of Services Sectors

Trade policy plays an important role in determining the nature of competition in domestic services sectors. Countries that place restrictions on foreign service providers may limit access to the most efficient suppliers and the best technologies, and deny producers and consumers throughout the economy access to low-cost services. Empirical studies have shown that openness to trade in services is associated with greater efficiency and faster economic growth.⁵⁰ In addition, liberalization of services trade has positive impacts on trade in goods and allows developing countries to better exploit their comparative advantages in labor-intensive manufactures. The gains from services liberalization are likely to be larger than those from goods liberalization and the adjustment costs that arise from service sector reforms are likely to be lower than those arising from reducing protection of goods. This is because the dominant mode of cross-border supply in many services sectors is through commercial presence (mode 3), which means that services will likely continue to be produced locally, albeit following investment and the transfer of expertise and assistance by foreign firms.

However, liberalizing services trade can be more complex than the liberalization of goods trade and requires considerable technical capacity, which is often lacking in Africa. The complexity arises from the necessity for many services sectors to be regulated in order to ensure that they operate efficiently in the face of market failures. Opening up to services trade in the absence of appropriate regulations may not necessarily increase trade and generate greater efficiency in the provision of services.

It may also be necessary to put in place mechanisms to ensure that social objectives regarding access to key services are not compromised by trade reform. The challenge is to achieve an appropriate balance between greater competition by improving market access for foreign providers and achieving public policy objectives. A particular concern is that increasing competition and liberalizing services will lead to a deterioration in the provision of services to the poorest or less populated areas because these are the least profitable to serve. This could arise if new competitors in formerly monopolized sectors compete away monopoly profits that were previously used to cross-subsidize unprofitable provision of services to poorer regions. In response, governments can use a range of market-based mechanisms to ensure the provision of key services to poorer or under-populated areas in a competitive environment.

⁵⁰ Hoekman and Mattoo (2008) provide a full review of the empirical evidence regarding trade in services, trade liberalization, and growth.

Coordinating services trade liberalization with regulatory reform is therefore important. Although there is no strict sequencing necessary such that regulatory reform should precede trade liberalization or vice versa, in general efforts should be made to ensure competition in the market. In some cases, trade liberalization can be a driver of regulatory reform, such as when incumbent producers have captured regulatory agencies and trade liberalization leads to greater participation of consumers and new suppliers of services in the regulatory process. In other cases, regulatory reform or an improvement in the business climate may be necessary to allow investment or cross-border trade to take place.

To be able to effectively plan trade liberalization and negotiate agreements on trade in services bilaterally, regionally, or at the multilateral level it is essential for policy makers and negotiators to have extensive information on the nature of regulation and trade restrictions in all of the sectors that are subject to discussion. In many African countries as well as other developing countries, though, comprehensive data on services sectors are not available, and developing countries typically face difficulties in effectively participating in trade negotiations on services.

To address the shortage of data on applied policies governing trade in services in developing countries, the World Bank has recently carried out a survey to assess applied (actual) trade policies in five services sectors—financial services, telecommunications, retail distribution, maritime transport, and professional services—in 78 developing and transition countries and 24 developed countries in 2007 and 2008. Twenty-two African countries are considered in the analysis. The results show that, on average, African countries have relatively liberal services trade policies (Figure 12.1). For these African countries, the overall restrictiveness index of applied services policies is just above the world average and lower than the restrictiveness index in all other developing country regions except for Eastern Europe and Latin America. There is, however, considerable variation across countries in Africa. Madagascar and Mauritius have very open policies towards trade in services with a value of the restrictiveness considerably below the world average and also below the average for OECD countries. On the other hand, the value of the index

Figure 12.1 >



Source: Gootiiz and Mattoo (2009).

Note: Regional abbreviations: GCC – Gulf Cooperation Council, SAR – South Asia, EAP – East Asia and Pacific, MENA – Middle East and North Africa, AFR – Sub-Saharan Africa, LAC – Latin America and Caribbean, ECA – Europe and Central Asia, OECD – Organization for Economic Co-operation and Development.

W is average STRI of total 102 countries.

for Ethiopia is the highest score of any country in the sample. Only seven of the 22 African countries have an overall services restrictiveness index that exceeds the world average.

The Role of International Trade Agreements in Services Reform

International trade agreements can support governments that wish to implement services reforms but which are opposed by powerful vested interests. Such agreements can help break domestic deadlocks by improving market access for the country's exporters and mobilizing export groups to support the reform effort. Trade agreements can also provide a mechanism for overcoming domestic resistance to desirable reforms by locking in the commitment to reform and enhancing the credibility of the reform process. However, most African countries have been reluctant to make commitments on services at the WTO under the General Agreement on Trade in Services (GATS). Almost all of the liberalization of trade in services reflected in Figure 12.1 has been implemented unilaterally.

This caution reflects that negotiation of reciprocal commitments under the GATS has given insufficient attention and resources to enable developing countries to assess the impact of making market access concessions on domestic regulations and market outcomes. A lack of attention to concerns over regulation and the ability to regulate have constrained effective participation in negotiations. Regulators will respond to substantive arguments for reform, while GATS-style mercantilist bargaining over market access alone will be of little importance to them. This supports the need for careful analysis of the economic benefits as well as wider consequences of reform and the involvement of key stakeholders in discussions of regulatory reform.

There are several additional challenges to services trade liberalization negotiations. Developing countries often have concerns that negotiated global liberalization of services trade and negotiations over an EPA will be largely one sided, with developed country service providers likely to gain improved access to developing country service markets but with little improved access for developing-country service providers in developed country markets. The standard mercantilist bargaining over liberalization of trade in services may, therefore, not deliver improved outcomes in many of the poorest countries. In addition, many African countries face serious technical and administrative capacity constraints in designing, negotiating, and implementing liberalization of their trade in services and complementary regulatory reforms. The unwillingness of many African countries to bind existing services trade policies at the WTO/GATS level may also reflect their inability to prepare negotiating positions, and to participate meaningfully in the negotiations in a way that will positively affect the negotiation's outcome.

In general, the greatest gains from liberalizing trade in services will arise when access is provided to all suppliers on an MFN basis. By so doing a country gives its consumers and produces access to the best service-providers in the world. Sequencing preferential liberalization of trade in services before broader MFN liberalization can have adverse long-run consequences by handing a first-mover advantage to a less efficient supplier that a subsequent increase in openness cannot dislodge or force to become more efficient. Liberalization at the regional level first may be justified if there are important learning effects that local firms have not been able to exploit due to the small size of national markets or restrictive national regulatory regimes that have inhibited opportunities for growth. Preferential regional liberalization may then allow regional service providers

to emerge in Africa that are then able to compete effectively when MFN liberalization is implemented.

Liberalizing first on a regional basis may allow regulators to gain experience before full opening is implemented. Regional agreements may also make it possible to reap scale economies in regulation and supervision, particularly where national regulatory agencies face skill constraints; they could also reduce scope for the capture of national regulation by private sector interests and reduce regulatory heterogeneity. However, regional policy makers also need to avoid creating protected regional service sectors that will be difficult to liberalize and giving first mover advantages to inefficient regional suppliers against which more efficient international suppliers will not subsequently be able to compete. For this reason, it is important to carefully assess the potential costs and benefits of proceeding with preferential regional liberalization. Countries should also look for ways to make binding commitments to ensure that there is subsequent MFN liberalization.

Reform of Services in Africa and Economic Partnership Agreements

The provisions on services in the CARIFORUM EPA between a group of Caribbean countries and the EU suggest that a similar EPA with African countries could be a mechanism for locking in existing levels of openness, enhancing the credibility of reform, and providing a signal to investors of the stability of the current policy stance on services. The CARIFORUM EPA also defines frameworks for the regulation of a number of services sectors, which could provide a basis for increasing the quality and credibility of regulations in Africa. In other sectors in which Africa has export interests, such as tourism and IT related services, commitments that go beyond the GATS could provide important precedents for future regional and multilateral trade agreements. Provisions in the CARIFORUM EPA for cooperation between competition authorities, especially the specific commitments in tourism, could be useful in disciplining anti-competitive behavior by EU firms in African markets and in allowing African firms to effectively compete in vertically integrated production chains. Regional regulatory cooperation and a regional preference clause could be useful for advancing regional integration in services in Africa. Putting in place structures for dialogue on mutual recognition at the EPA level may facilitate progress at the regional level.

However, an EPA is unlikely to offer much in terms of improved access for African countries to the EU market. Although the CARIFORUM EPA contains provisions for expanding the temporary employment of skilled professionals, it does not address the issue of temporary movement of unskilled workers. Greater temporary access to the EU for unskilled workers, for example, through carefully crafted and managed sub-contracting schemes would have a significant economic impact in Africa. Without significant opening to temporary movement of unskilled workers by the EU, services reform will have to be driven by African countries seeking to reform their domestic services sectors. Further, the current GATS-style negotiation of reciprocal commitments between the EU and African countries under the EPA has given insufficient attention and resources to improving regulatory policies and strengthening regulatory institutions.

For countries with limited capacity to negotiate and regulate services a focus on priority services sectors from a development perspective (in most countries these are likely to include transportation, telecommunications, electricity, finance, and business services)

is likely to be more effective than a broad but shallow preferential trade agreement that involves negotiations across all sectors and modes of supply.

Recommendations

Regulatory and trade reforms in Africa will need to be supported with technical and financial assistance. Such assistance should be targeted at those factors with the greatest impact on performance in the market and not solely at market access and national treatment considerations and the preparation of GATS-type schedules of commitments. However, this assistance should not be directly linked to the signing of an EPA. Assistance should be available to all African countries that wish to reform their services sectors, whether they sign an EPA or not.

One way to organize and coordinate such support could be through a dedicated forum, independent of specific trade negotiations, that supports the application of economic and regulatory impact analysis, discussion of good practices and effective institutional structures. The forum, which would need to be organized around the priority sectors for Africa, would allow for meaningful dialogue between regulators and trade negotiators to address concerns about the impact of trade reform on the capacity to effectively regulate. Such a forum would have to encapsulate that for services reform one size does often not fit all and that reforms and appropriate regulatory structures will often tend to be country specific. A key issue would be where to host such a forum and how to ensure access to its resources for all countries in Africa.

Countries in Africa, should draw upon available sources of financial support and technical assistance to:

- Define a strategy for trade in services that is integrated into the national development plan through the following activities: (1) improving the collection and dissemination of more and better data on service sectors and trade in services; (2) creating awareness and facilitating a dialogue among various stakeholders about the potential impact of services trade liberalization and reform; (3) identification of priority sectors where greater competition, foreign investment, and new technology can drive efficiency and growth; and (4) establishing a committee for services trade and regulatory reform to champion open and transparent approaches to regulation and trade opening and oversee the use of regulatory impact analysis.
- In the priority domestic services sectors, implement a trade and regulatory audit to identify the main constraints to competition and investment. Do they lie in insufficient openness to trade and investment, lack of credibility of existing openness, inappropriate regulations, insufficient capacity to implement a sound regulatory framework, a hostile investment climate, or some other area?
- In priority export sectors assess the need for improvements in the regulatory regime to support competitiveness and mobilize an export supporting approach in relevant line ministries and institutions such as the export promotion agency.
- Identify if, and how, unilateral reforms and trade agreements at the regional, EPA, and multilateral level can be used to alleviate the constraints that are identified for the priority sectors and support the process of trade and regulatory reform. Explore

opportunities for cooperation with the EU outside of a formal broad services agreement, for example, with regard to cooperation between competition authorities.

- Pursue more actively opportunities for regional cooperation and deeper integration of services in priority sectors of mutual interest with regional partners.

With regard to the EPAs:

- The EU and African countries consider a more flexible approach to the EPAs that reflects the diversity of capacities and priorities across African countries. The EPAs become a process in which the focus is not on a bilateral deal between the EU and regional blocks in Africa for the preferential opening of services sectors based upon a GATS type schedule but rather a country-based cooperative approach to remove the constraints that block development of the sectors identified as priorities by African countries. For example, if requested by an African country or group of countries, the EU could work with these countries to facilitate cooperation between competition authorities. This could be provided even in the absence of a formal comprehensive EPA agreement. Similarly the EU could look at opportunities for mutual recognition of qualifications that are not predicated on signing a formal EPA agreement.
- African countries and the EU adopt a sector-by-sector approach to coordinated trade and regulatory reform rather than a broad but shallow GATS type negotiation in which priority sectors for reform are defined by each country consistent with national development plans.
- The EU supports African countries in pursuing openness to trade in services primarily through MFN liberalization especially in infrastructure sectors where preferential opening may have long-term adverse implications.
- The EU works with other donors and international institutions to make adequate technical assistance available to all reforming countries in Africa from a fund that is independently managed and delink the provision of such funding from negotiations and agreement on an EPA. Such a fund could organize financial resources and expertise around key services sectors for Africa. Suggestions would include telecommunications, tourism, transport, finance, and business services.

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13. Developing Professional Services in Africa

How Regional Integration Can Help?

Nora Dihel, Ana M. Fernandes and Aaditya Mattoo⁴⁸

Introduction

Professional services play an important role in the functioning of modern economies and are among the fastest growing services sectors⁴⁹ in many developed and developing economies. Professional services contribute directly and indirectly to economic growth, including by lowering transactions costs and by creating spillovers of knowledge to other industries.

Accountancy is critical for accountability, sound financial management, and good corporate governance (Trollet and Hegarty 2003). Effective legal and justice systems and access to legal services improve the predictability of the business environment, facilitate engagement in contracts, and mitigate investment risks (Cattaneo and Walkenhorst 2010). Engineering is a knowledge-intensive sector essential to the productivity and sustainability of other economic activities. For example, civil engineering is critical for the development and maintenance of a country's physical infrastructure, while electrical engineering is important to the operation of public networks such as utilities or commercial facilities and communication systems (Cattaneo et al. 2010).

Greater usage of professional services is associated with higher labor productivity for firms—particularly small firms—across countries in Eastern and Southern Africa. For example, the average labor productivity of East African users of professional services is 10 to 45 percent higher than that of non-users of professional services. In addition, increasing trade in professional services can become an important source of export diversification in Africa and contribute to reducing reliance on the export of a small number of mineral products or cash crops. Finally, in common with services generally, professional services show greater resilience to economic downturns than do manufactures, in part because of their lower demand cyclicalities (Borchert and Mattoo 2009).

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⁵² The available data for Eastern and Southern Africa indicates that the average annual growth rates of business services outputs (of which professional services constitute an important part) were of 21 percent in Zambia, 18 percent in Uganda, 14 percent in Tanzania, 8 percent in Kenya and 7 percent in South Africa over 2000 to 2009.

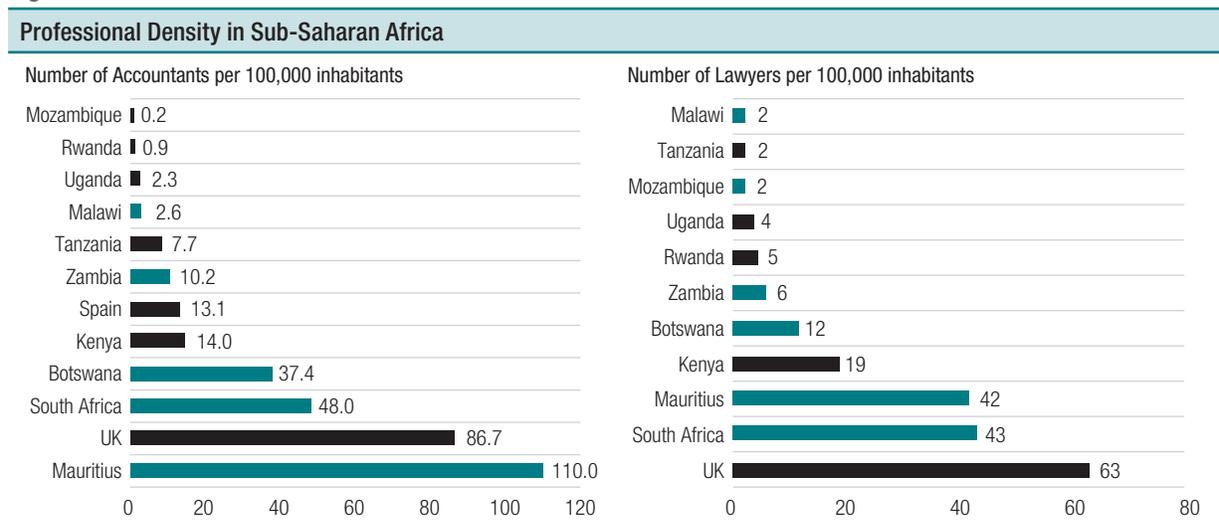
But there is a large gap between the potential contribution these services could make and the meager contribution they make today to growth and economic development in Africa. Policy makers in East and Southern Africa have recognized the critical importance of developing professional services. Along with reform of backbone services like telecommunications, banking, and transport, governments are adding professional services to their list of priorities. Improving and expanding these services will require both national reform and international cooperation, including creating a more integrated regional market.

This note presents the results of extensive information gathering and analysis of these largely unexplored segments in Eastern and Southern Africa. It shows why national markets for professionals and professional services in Eastern and Southern Africa remain underdeveloped, while regional markets are fragmented by restrictive policies and regulations. To turn this sector around, the note calls for policy action in four areas: education, regulation of professional services, trade policy, and labor mobility at both the national and international levels.

Striking Differences in the Level of Development of Professional Services in Eastern and Southern Africa

Countries in Eastern and Southern Africa exhibit striking differences in the level of development of their professional services sectors, with relative abundance of professionals in Mauritius, South Africa and Kenya and relative scarcity in Rwanda, Zambia, Malawi, Uganda and Tanzania. But per capita availability of accountants and lawyers in most Eastern and Southern African countries is only a fraction of that in the more advanced economies of Mauritius and South Africa (Figure 13.1).

Figure 13.1 >



Source: World Bank Regulatory Surveys in Eastern Africa, 2009; World Bank Regulatory Surveys in Southern Africa, 2010; Paterson et al. 2003; and CEPEJ 2008).

Although professionals in Eastern and Southern Africa receive low nominal wages relative to their counterparts in developed and other developing countries, once their wages are adjusted for purchasing power, professionals in South Africa, Botswana, Uganda, Mozambique, Kenya, and Malawi are comparatively well paid—reflecting their scarcity relative to the demand for their services. However, in legal services, the very high wages earned by professionals are not necessarily indicative of their scarcity but rather of the power of professional bodies which impose strict entry and conduct regulations that enable incumbents to capture high rents and thus limit the potential contribution of the sector to growth in the region.

A Middle-level Skills Vacuum and Significant Skills Mismatches

Middle-level professionals such as accounting and engineering technicians, or paralegals who can provide services to under-served client segments and produce large economic gains are sometimes underappreciated category of professionals. For example, accounting technicians can provide basic recordkeeping services needed by SMEs. Paralegals engage with clients on a variety of complex law-related tasks, including working with lawyers on criminal justice cases, advising clients on law-related issues, and mediating commercial disputes between parties. Indeed, there is a growing role for paralegals in the criminal justice space in Africa. The existing data suggest that—with the exception of accounting technicians in Kenya—East Africa is facing a middle-level skills vacuum. Southern Africa is somewhat better endowed with middle-level professionals but they generally account for only half the total number of professionals in a given sector.

Skills mismatches at all levels are a serious issue across professions in all African countries. For example, accounting associations in Kenya, Malawi, and Tanzania reported that there are jobless accountants despite high demand for qualified accountants. Potential explanations include the absence of links between the education system, labor market, and professional associations. Consultations with accounting sector stakeholders in Mozambique revealed that multinational auditing and accounting firms face shortages of entry-level accounting and auditing professionals as most applicants do not have the requisite training quality, and of senior-level local professionals who could monitor the quality of financial reporting. In South Africa, mismatches in accounting result from private sector firms hiring chartered accountants (CA) registered with the South African Institute of Chartered Accountants (SAICA) because of their perceived quality for work that could be performed by less highly qualified accountants.

Professional Services Remain Inaccessible for Many Small and Micro Enterprises

Evidence from recent firm-level surveys in Eastern and Southern Africa suggests that usage of professional services is highest for large firms regardless of their sector in all countries. Anecdotal evidence confirmed by observed patterns of services use by firms of different sizes in sub-Saharan Africa suggests that the prices of professional services are prohibitive for many small firms.

Limited Trade in Professional Services

The heterogeneity of professional endowments and differences in sectoral earnings suggest that there is substantive scope for increased regional trade in professional services in sub-Saharan Africa. Foreign professionals and foreign professional firms could help address the underdevelopment of the sectors and the unmet demands in the region. However, data on the presence of foreign professionals in Eastern and Southern Africa show that in Kenya, Malawi, Tanzania, Uganda, and Zambia foreign accounting professionals represent less than 10 percent of the total. That percentage is higher in Botswana, Mozambique, and Rwanda. In legal services, there are virtually no foreign professionals practicing in any of the African countries.

In terms of commercial presence, statistics from professional associations reveal some foreign participation in accounting and engineering services. In accounting/auditing services, firms with foreign affiliation (i.e., with foreign equity or with foreign partners) dominate the markets. In engineering, 25 percent of registered firms in Mauritius and 35 percent of registered firms in Tanzania have foreign participation. In Zambia however, out of 298 engineering firms only two are foreign-owned. Foreign law firms are virtually absent in most African countries. In South Africa out of 8,200 registered law practices in 2008 only three were foreign-owned. Exceptions are Botswana and Mozambique where foreign-owned law firms are among the five major law firms in each country. In Mauritius, where law firms are a recent development, the majority are actually foreign-owned.

The World Bank surveys of Users of Professional Services in Eastern and Southern Africa show that only a small proportion of firms import accounting, engineering, or legal services in Eastern and Southern African countries which may be a consequence of high trade barriers in place.

Evidence compiled on World Bank-supported civil works procurement contracts between 1994 and 2009 reflects the lack of integration of Eastern and Southern African markets for engineering services. Domestic companies generally win most contracts, except in energy, mining, and transportation, and, in some countries, industry, trade, and water and sanitation, where non-African companies have the lion's share. Surprisingly, there is virtually no intra-East African foreign firm participation in these contracts, with the limited exception of Kenyan firms in some Tanzanian and Ugandan projects and Ugandan firms in some Rwandan projects. Similarly, there is virtually no intra-Southern African foreign firm participation in these contracts with the limited exception of South African firms in several Southern African countries and some Malawian projects in Mozambique.

Explaining Skills Shortages and the Segmentation of Markets for Professional Services in Eastern and Southern Africa – Weaknesses in Education

A number of factors explain the lack of supply of appropriately qualified professionals in Eastern and Southern Africa. First, professional education is very expensive in all Eastern and Southern African countries. While skills premiums for professionals exist, and internal rates of return to education are high in the region, the average cost of acquiring a professional degree across all countries and professions is more than US\$22,000.

This makes attaining professional qualification unaffordable for the vast majority of the population in these countries, especially given the underdeveloped nature of the markets for educational loans.

Second, the weaknesses in secondary education witnessed across Eastern and Southern African countries limit the ability of students to acquire professional skills. The general erosion of mathematical skills in all countries explains the declining number of applicants in science, engineering, and technology courses, leading to shortages in the engineering sector.

Third, the capacity and quality of professional education institutions are limited. In several Eastern and Southern African countries, institutions that offer specialized post-graduate courses, as well as institutions that offer academic and professional training courses for middle-level professionals are entirely absent.

Fourth, there is an absence of links between educational systems, employers, and users of services. This dynamic leads to unmet needs and unemployed professionals, explaining the attrition of skills in several professions in Eastern and Southern Africa. Stakeholders from the private sector emphasized the severe lack of coordination between employers, professional associations, and education institutions with regards to the content of educational programs for accountants and engineers.

Fifth, opportunities for spillovers at the regional level are not being exploited due to the high trade barriers and regulatory heterogeneity affecting education services.

Explaining the Segmentation of Markets for Professional Services – Strict Domestic Regulation and Regulatory Heterogeneity

Domestic regulation on the entry and on the operations of professional services firms often undermines competition and constrains the growth of strong professional services sectors in Eastern and Southern Africa. Domestic entry regulation, such as licensing and educational requirements, quantitative restrictions on the number of suppliers of professional services, and exclusive rights granted to suppliers in certain activities, as well as regulations on the operations of firms, such as restrictions on prices and fees, advertising, form of business, and inter-professional cooperation, are particularly heavy when compared to those in emerging economies and in OECD countries.

In Eastern and Southern Africa, entry regulation is significant in all professional services sectors. The three professions (accounting, legal services, and engineering) are subject to qualitative entry requirements related to education and qualifications that do not vary significantly across African countries.

Other qualitative entry requirements are present in most African countries. Membership in the relevant professional association is mandatory in accounting and legal services in all countries. Compulsory licensing is a must in accounting in all countries but in legal services Mauritius and South Africa do not require licensing. In engineering, licensing requirements are also absent in South Africa, Botswana, and Rwanda—in the last two countries because engineering boards have not been established yet. Continuing education is an obligation for accountants in all countries except Mozambique, for lawyers only in Kenya, Tanzania, and Uganda, and for engineers only in South Africa and Zambia.

The regulation of middle-level professionals is much more heterogeneous across African countries. For example, the regulatory spectrum for engineering technicians ranges from

total absence of entry requirements in Botswana and Rwanda to requirements to pass a professional exam, undertake compulsory training, and engage in continuing professional development in South Africa and Tanzania.

Furthermore, restrictive qualitative requirements in the form of restrictions on access to the profession, mainly due to the monopoly of professional associations over training institutions, were identified in legal services in Kenya and Zambia. The higher education institutions that provide the required law degrees are controlled by the professional associations, which restrict the number of students. The Kenya School of Law, through which all legal professionals must pass, had a limited capacity of 600 students per year in 2008. The Zambia Institute of Advanced Legal Education is the only institution providing the post-graduate one-year course necessary for domestic and foreign candidates to become licensed lawyers in Zambia.

Highly skilled professionals in all sectors and countries have exclusive rights to perform certain activities, for example: auditing for accountants; representation of clients before courts and advice on legal matters for lawyers; feasibility studies, design and planning for engineers. The scope of exclusive activities is wider in accounting and legal services.

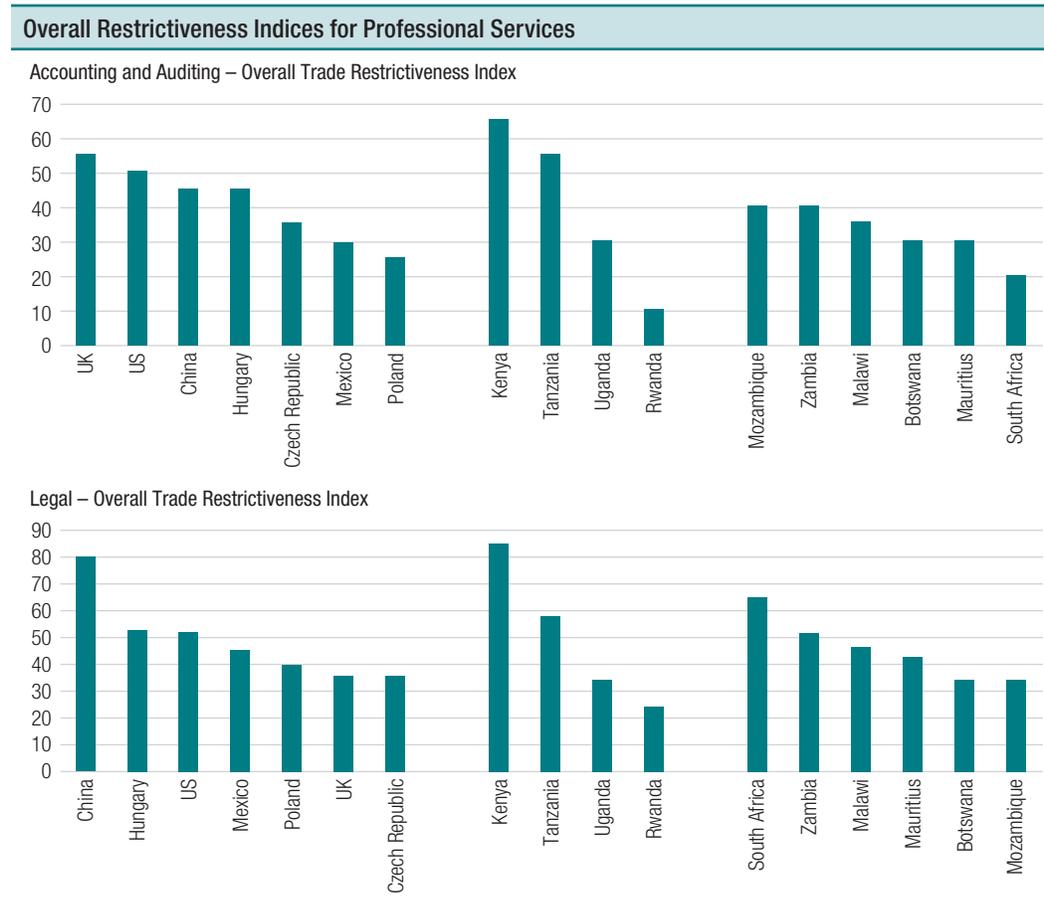
Regulation affecting the operations of legal and engineering providers in Eastern and Southern Africa is heavier than in most other countries. This evidence is explained by price regulations, advertising prohibitions, and restrictions on firms' business structure and on multidisciplinary activities. In accounting and engineering, fees for professional services tend to be negotiated freely between practitioners and clients across African countries but accountancy fees are regulated in Zambia and engineering fees are regulated in Botswana, South Africa, Tanzania, and Zambia. As opposed to most developed countries, legal services' fees are regulated in all African countries except Mozambique and Rwanda.

Several professional services in Eastern and Southern Africa are subject to advertising prohibitions: accounting in Botswana, Kenya, Tanzania and Uganda; legal in Botswana, Kenya, Malawi, Mozambique, Rwanda, Tanzania, Uganda, and Zambia; and engineering in Tanzania and Zambia. In general, African countries impose more severe regulations on advertising than most developed and developing countries. Restrictions on business structure are present in all professional services in most African countries. These regulations restrict the ownership structure of professional services companies, the scope for collaboration within the profession and with other professions, and the opening of branches, franchises, or chains. For example, these regulations might prevent lawyers and accountants from providing integrated legal and accountancy advice for tax issues.

Explaining the Segmentation of Markets for Professional Services – Trade Barriers and Restrictive Immigration Policies

Trade barriers limit competition and the efficiency of professional service providers in Eastern and Southern Africa. Trade in legal services tends to be more heavily regulated and restricted than trade in accounting/auditing services in Africa and elsewhere. Kenya, South Africa, Tanzania and Zambia are characterized by more severe restrictions on trade in legal services than most countries in the sample. In contrast, South Africa and Rwanda have some of the least restrictive trade policies in accounting/auditing services (Figure 13.2).

Figure 13.2 >



Source: Gootiiz and Mattoo (2009). Note: a larger index value indicates a more restrictive trade policy.

The establishment of foreign law firms (mode 3 of trade in services in GATS) tends to be substantially more difficult than that of foreign accounting/auditing firms in Africa, but also elsewhere in the world. Nevertheless, a few of the examined African countries—Botswana, Mozambique, Rwanda, and Uganda—exhibit the most open markets to the presence of foreign law firms across a large worldwide sample of countries. However, the entry of foreign law firms is prohibited in South Africa while ownership by non-locally-licensed professionals is prohibited in Zambia and limited in Mozambique. In Mauritius entry is allowed only if the foreign law firm sets up a joint venture with a local firm, while in Malawi branches are not allowed. Local members of international networks face restrictions on using the network's brand name or the foreign parent's name in Botswana, Kenya, Tanzania, and Uganda.

In accounting and auditing, the establishment of foreign firms is permitted in all African countries but with restrictions. Malawi, Rwanda, and Uganda have lower restrictions than those in many OECD countries. Kenya, Tanzania, Malawi, Mauritius, Mozambique, and Zambia prohibit ownership or control by non-locally licensed professionals. In Kenya, Uganda, and even the more liberal Rwanda, branches of foreign firms are prohibited. In Tanzania, ownership by foreign nationals is limited to 50 percent. Botswana and Tanzania impose restrictions on the use of the foreign parent firm name.

The movement of natural persons (mode 4 of trade in services in GATS) is substantially more restricted for legal professionals than for accounting/auditing professionals in Kenya, Tanzania, South Africa, Malawi, and Zambia. Those countries impose some of the most restrictive barriers to the practice of foreign lawyers in their jurisdictions, only equaled by the barriers imposed by China. In Kenya, Tanzania, Malawi, Mauritius, Mozambique, and South Africa, de jure or de facto nationality requirements to practice domestic law exclude participation by foreign professionals.

The entry of foreign accountants and auditors is less restricted across African countries. In fact, Mauritius and Rwanda exhibit the most liberal trade policies towards the movement of foreign accountants among all countries. Except for Mauritius, all African countries impose discretionary limits on the presence of foreign accounting professionals. Entry conditions through mode 3 and mode 4 are much more liberal for engineering. The establishment of foreign engineering firms is not prohibited in any African country and the form of entry is not restricted.

In terms of immigration policies, Eastern and Southern African countries apply stringent regulations to the movement of skilled workers into and out from their borders. In South Africa, the difficulties in obtaining work permits lead many international firms to set up partnerships with local firms instead of setting up commercial presence in the country. The immigration law of 2007 in Mozambique is very restrictive and makes hiring foreign workers extremely difficult.

Reforming Markets for Professional Services in Eastern and Southern Africa

Given all of the preceding information, the national markets for professionals and professional services in most Eastern and Southern African countries remain generally underdeveloped with performance indicators below the averages of countries at a similar level of development. Also, the regional markets for professional services and professional education in sub-Saharan Africa are fragmented by restrictive policies, such as nationality requirements and regulatory heterogeneity, relating to licensing, qualification, and educational requirements. Strict domestic regulations combined with a lack of regional coordination among countries further constrain foreign investment and hinder economic growth and development in the region. These outcomes are the result of constraints that suggest policy action in the following areas: education, regulation of professional services, trade policy, and labor mobility. While policy action at the national level will differ from country to country given diverse conditions and outcomes in the examined countries, international and regional cooperation would complement domestic policy reform. Trade liberalization and regional integration are mechanisms that can be used to reduce the scope for private-interest regulation, enhance competition, and deal with labor mobility issues that are crucial in professional services.

Reforms at the National Level

Reforms at the national level need to focus on the development of framework conditions that address skills shortages and skills mismatches and that attempt to facilitate the growth of professional services in the various African countries.

Education reforms need to focus on the following issues:

- Financial constraints prevent individuals from acquiring a professional education, so *developing new and expanded means of financing higher education* (such as student loans schemes) is a priority.
- Weaknesses in African educational systems mean that students are poorly equipped to acquire professional skills, so *enhancing the quality and capacity of schools (especially in mathematics, sciences, and technical studies)* needs to be a key item on all countries' policy agendas.
- Given the capacity constraints and quality limitations of professional education institutions, *improving existing institutions and encouraging the creation of new ones is necessary*.
- Policy action to *encourage closer collaboration and consultation between employers, professional associations, and education institutions* could help professionals acquire job-market relevant skills and crucial practical training.

Reforms need to focus on incremental, qualitative improvements in domestic regulation:

- *Disproportionate cumulative entry requirements need to be relaxed.* The argument in favor of exclusive rights is that they can lead to increased specialization of professionals and guarantee a higher quality of service. But the negative price and allocation effects of exclusive rights, which act as monopolies, can be substantial, especially if they are granted for standardized services that can be provided at a lower cost by less-regulated or non-regulated providers. For example, narrowing the scope of exclusive tasks in certain professions would contribute to this goal. Exclusive rights can lead to increased specialization of professionals and guarantee a higher quality of service, but if they create monopolies they can have adverse price and allocation effects, especially when granted for services for which adequate quality can be provided at a lower cost by less-regulated middle-level professionals.
- Disproportionate restrictions that limit competition need to be eliminated:
 - Price regulations are supported and introduced by professional associations who claim that they are useful tools to prevent adverse selection problems. But such regulatory instruments can seriously harm competition by eliminating or reducing the benefits that competitive markets deliver for consumers. Countries need to adopt less restrictive mechanisms such as better access to information on services and services providers to accomplish the same goals at lower economic cost.
 - Countries impose restrictions on the ownership structure of professional services firms; the scope of collaboration within the profession and with other professions; and, in some cases, the opening of branches, franchises, or chains. To justify these regulations, professional associations argue that professionals are more likely to give independent advice if certain forms of intra-professional partnerships are prohibited, while restrictions on multidisciplinary activities prevent potential conflicts of interests that are detrimental to consumers. But often such regulations are clearly anticompetitive and may harm consumers by preventing providers from developing new services or cost-efficient business models, and need to be eliminated. In general, restrictions on collaboration between members of the same profession seem to be less justifiable

than restrictions on collaboration between members of different professions where there is a strong need to protect the independence and liability of professionals.

- Most examined African countries impose advertising prohibitions on many of their professional services sectors. Professional associations justify advertising restrictions by the need to protect consumers. But there is no justification for prohibiting advertising that is relevant, truthful, and not misleading. Instead, advertising fosters competition by informing consumers about different products and allowing them to make better-informed buying decisions. Countries need to allow advertising of professional services that facilitates competition by informing consumers about different products and that can be used as a competitive tool for new firms entering the market.

Reforms at the International Level

The fragmentation of regional markets for professional services and professional education by restrictive policies and regulatory heterogeneity prevents countries from taking advantage of gains from trade based on comparative advantage, as well as gains from enhanced competition and economies of scale.

The potential benefits from regional integration in Eastern and Southern Africa are considerable:

- The differences in national endowments of professionals and in the capacity for professional training, reflected in differences in professionals' earnings and the costs of training across countries, suggest that there is substantive scope for trade based on comparative advantage and potentially large gains from eliminating trade impediments.
- Deeper regional integration would enhance competition between service providers, allow providers to exploit economies of scale, especially in professional education, produce a wider variety of services, and increase the prospects for attracting domestic and foreign investment.
- Regionalization may make it possible to reap scale economies in regulation and supervision, particularly where national regulatory agencies face skill constraints; it could also reduce scope for capture of national regulation by private sector interests.

Policy action is called for in the following key areas.

Steps need to be taken to relax the explicit trade barriers applied by African countries to the movement of natural persons and the commercial presence of professional services. Despite compelling benefits from liberalization, policy makers often maintain protective measures at a cost to productivity. Regulatory capture and the complexities associated with the coordination of liberalization with regulatory reform are among the main explanatory factors for the high level of protection in professional services. Examples of possible reforms in the trade policy area are: articulating the economic and social motivation for nationality and residency requirements; developing transparent criteria and procedures for applying any quantitative restrictions on the movement of professionals, such as economic needs tests; minimizing restrictions on the forms of establishment allowed; and developing a transparent and consistent framework for accepting professionals with foreign qualifications.

The reduction of explicit trade barriers needs to be complemented with the reform of immigration laws.

Trade liberalization needs to be coordinated with regulatory reform and cooperation at the regional level. Trade barriers ideally would be liberalized on a most-favored-nation or non-preferential basis because that would generate the largest welfare gains. But such liberalization may not be technically feasible or politically acceptable, especially when impediments arise from differences in regulatory requirements. Deeper regional integration through regulatory cooperation with neighboring partners who have similar regulatory preferences can usefully complement non-preferential trade liberalization.

Regulatory cooperation to overcome regulatory heterogeneity under the aegis of the Tripartite arrangement between the East African Community (EAC), the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA) would be particularly useful in the following areas:

Mutual recognition of professional qualifications and licensing: The model adopted by East Africa could be followed by Southern African countries. The five East African countries have taken the first steps towards mutual recognition in professional services in the context of the EAC Common Market negotiations. The Common Market Protocol, adopted by the Multi Sector Council in 2009, includes an annex on a framework agreement on mutual recognition (MRA) of academic and professional qualifications. The implementation of a full-fledged MRA would need to cover areas such as education, examinations, experience, conduct and ethics, professional development and re-certification, scope of practice, and local knowledge. If African countries adopted common criteria for professional qualifications or recognized the qualifications and licenses obtained in other African countries, significant efficiency gains would be obtained.⁵⁰ The EAC MRAs could be useful models to be followed by other African subregions.

Developing appropriate standards: Inappropriate standards can stifle demand for services. While uniformity of standards may improve the quality, completeness, and comparability of the reported information, and international standards remain appropriate in specific cases, applying common international standards to large firms and SMEs can prevent smaller firms from using auditing and accounting services. A single standard may be appropriate if there is little demand for service variety and there is no anticompetitive risk from having a single standard. However, if the market requires variety to satisfy different types of users, then a single standard may not be appropriate. The development of an appropriate standard may be desirable at a regional rather than national level in order to exploit economies of scale in regulatory expertise, prevent fragmentation of the market by differences in standards, and limit the scope for regulatory capture.

Removal of restrictions to free movement of labor: Regional cooperation in removing restrictions on the free movement of labor (including visa and immigration laws) is crucial for Africa. The mobility of businesspeople is a key factor in the promotion of free and open trade. While the EAC and the SADC have tried to regulate labor mobility, so far none of the

⁵⁵ Kox et al. (2004) estimate that the stock of FDI in the European Union could increase by 20–35 percent if regulatory heterogeneity across countries was reduced as a result of a common services regulation directive.

groupings has adopted a regional labor mobility agreement, mostly due to disagreements among national governments. The experience of the EU or the APEC Business Mobility Group that have made considerable progress in this area could provide practical guidance for the implementation of commitments related to the free movement of labor and harmonization of immigration policies in Africa.

Financing higher education and improving professional education institutions: Regional cooperation in terms of sharing information and experiences to increase the recovery rate of loans while increasing students' access to higher education could improve the impact of student loan schemes in Africa. The recent partnership between the Kenya Higher Education Loan Board, the Tanzania Higher Education Students Loans Board, and the Students Finance Agency for Rwanda under the aegis of the African Higher Education Financing Agencies to tackle students' loan schemes regionally is a useful example from East Africa that could be followed by Southern Africa.

The absence of institutions that offer specialized (post-graduate) courses (e.g., in legal and engineering services) was noted in many African countries, as was the absence of institutions offering academic and professional training courses for middle-level professionals. Where the market of a given country (e.g., Malawi, Mozambique, Rwanda) is too small to justify the creation of these missing institutions or courses, policies to facilitate access to foreign training are needed—including portability of course credits and scholarships. The system of credits in higher education to be implemented within SADC is a right step in this direction.

Also, specialized courses for which a need was expressed in Eastern and Southern Africa (e.g., legal courses focusing on e-commerce, technology transfer, etc.) could be designed and implemented at the regional level. In general, the fragmentation of the regional market for education by differences in regulation can prevent the emergence of regional hubs for higher education; so smoothing these regulatory differences can lead to a greater variety of higher education services becoming available at lower costs for students in sub-Saharan Africa. Regional institutions that are allowed to operate at the regional level and are accredited to deliver courses that are recognized by all countries could exploit economies of scale and recoup the large fixed costs of establishing training programs in order to produce students with the necessary specializations for the EAC and SADC regions. South Africa has the highest potential to become a regional hub for higher and professional education.

While the economic benefits from regional integration are evident, the pace of integration is largely dependent upon the members' political motivation and conviction that such liberalization is beneficial to their domestic constituencies. To improve such prospects, the promotion of more frequent and open dialogue between the key stakeholders involved in professional services—professional bodies, private sector providers and users of services, higher education institutions, trade negotiators—is essential. The Eastern and Southern African countries have committed themselves (at least on paper) to pursue regional integration in the context of the EAC, SADC and COMESA. While recognizing that there is a varying degree of political will and commitment among the Eastern and Southern African countries, the information provided in this chapter serves as a pointer towards more informed choices as countries contemplate reform and regional integration in professional services sectors. Countries wishing to reform and integrate their

professional services markets can be supported through aid for trade and knowledge platform projects.

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14. Scaling up Regional Financial Integration in the EAC

*Smita Wagh, Andrew Lovegrove, and John Kaskangaki*⁵⁴

Introduction

Regional Financial Integration (RFI) in sub-Saharan Africa (SSA) has usually taken two different, though not mutually exclusive, paths. For some regional economic communities (RECs), institutional initiatives including, a common currency, an overarching regulatory authority, and supranational financial markets, are the building blocks of regionalization in financial markets. This applies to West and Central Africa where the two CFA franc zones, regional central banks (BCEAO and BEAC), and a regional stock exchange (the BRVM in the WAEMU) are the cornerstones of regionalization. For other RECs, integration is a more market driven process, following the movement of people, businesses, and goods across fluid borders. South African and Kenyan banks have led this model of integration in the southern and eastern parts of SSA. Of course, this distinction serves only to highlight the more visible drivers of integration rather than suggesting that market forces are at standstill in the WAEMU and CEMAC regions, or that institutional arrangements are irrelevant in the SADC or EAC regions. WAEMU has a growing regional bond market and the recent signing of the Common Market Protocol in the EAC in 2009 is a significant institutional step forward in the regionalization process.

In the East African Community (EAC) commercial banks have generally been ahead of the curve in assessing the potential of the regional financial market. Several banks have to some degree adopted a regional business model motivated by a range of factors including client-demand, their own corporate structures, or by opportunities perceived along the regional trade corridors. These banks display a fair degree of operational integration not just within EAC markets but also all the way along the trade corridors to southern Sudan and the eastern Democratic Republic of Congo (DRC).

Institutional initiatives are perhaps more significant for the development of the non-banking financial sector and capital markets in the EAC. With the exception of motor insurance, insurance products in the region generally have very low penetration rates. Weak regulatory frameworks for the insurance sector and low incomes have hindered the development of markets in all EAC countries, with penetration rates being especially low for life insurance

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products. Capital markets are also widely disparate in size, investor base, infrastructure, and regulatory and supervisory capacity. Highly publicized initial public offerings (IPOs) have, in the recent past, been enthusiastically received by the public and institutions within the EAC, even where the rules on intra-EAC cross-border investment have not been clear. Despite this, cross-listings and cross-border investments are still in their infancy, and several *de facto* hurdles remain for businesses wishing to raise capital on a regional basis.

Extending the EAC to include Burundi and Rwanda in 2007 has greatly added to the diversity of the membership. The three founding members of the EAC have a long history of trade and administrative cooperation (stretching back nearly a century), and as a result of their colonial history have all inherited legal systems based on English common law. Both Rwanda and Burundi are former Belgian colonies and as a result follow the civil law tradition.

This note focuses on two aspects of scaling-up trade in financial services within the EAC:

- Documenting and building on financial integration in the EAC as it is actually taking shape on the ground; and,
- Elaborating on the challenges specific to the further integration of Burundi and Rwanda

The note concludes by discussing a new capacity building initiative that the World Bank is implementing with the EAC Secretariat to support the deepening of financial integration in east Africa.

Cross-Border Financial Linkages in the EAC

Banking Sector

Kenya-based banks are leading regional integration in the EAC banking sector. About 11 multinational and Kenyan owned banks use Kenya as a hub to expand their operations into the EAC region.

There are four indigenous Kenyan banks with branches within the region. These banks include Kenya Commercial Bank (KCB), Equity Bank, Fina Bank, and Commercial Bank of Africa. These banks have a total of 65 branches outside Kenya (16 in Tanzania, 31 in Uganda and 16 in Rwanda). Ugandan and Tanzanian banks do not have a regional presence and operate exclusively in their home markets:

- Since 2006 KCB has been expanding extensively in the EAC region. It has 164 branches in Kenya, and 56 branches in other countries in East Africa—Tanzania (10), Uganda (11), Rwanda (nine) and Southern Sudan (six). KCB's Tanzanian operation is the oldest of its regional subsidiaries having been established in 1997;
- In March 2009, Commercial Bank of Africa merged with First American Bank, the latter had a Tanzanian subsidiary, United Bank of Africa (the bank has since been renamed Commercial Bank of Africa – Tanzania);
- Fina Bank began its regional expansion into Rwanda in 2004 and has recently entered Uganda in 2009 with five branches already established. The bank now has a total of 11 branches regionally; and,
- In 2009 Equity bank completed the acquisition of Uganda Microfinance in a deal worth US\$26.9 million. The microfinance institution had over 45 field offices and branches. Equity Bank Uganda currently operates 15 branches.

A survey conducted to gauge the operational integration of banks operating in the EAC revealed that 56 percent of the banks interviewed have their operations in the East African region hubbed, mostly in Kenya. Most of the banks surveyed have yet to achieve full integration of their operations in the region, but partial integration has taken place in the areas of ICT, risk management, customer service, and treasury operations. A few banks have not significantly integrated their operations, with most of their operations carried out at the individual country level.

For the purposes of this report it is especially significant that two-thirds of the banks state that regionalization has facilitated the introduction of financial products and services that would not have been possible in the absence of scale. Establishment of a single licensing regime (which would remove barriers to entry posed by separate capitalization requirements for each subsidiary and enable cross-border branching) is favored by a majority of the banks as a measure that would promote integration.

The major impediments to attaining full integration cited by banks are: the lack of a common tax regime; resistance from bank supervisors (particularly in Tanzania and Uganda, who are averse to banks under their jurisdiction being managed by Kenyan parents); IT connectivity problems (caused by weak physical infrastructure); differing regulatory requirements; restrictions on the mobility of labor; and, the existence of differing capital movement policies within the EAC.

Non-Banking Financial Sector

There are indigenous Kenyan insurance companies with branches within the region. These include: APA Insurance, Insurance Company of East Africa, (ICEA), Jubilee Insurance, Phoenix of East Africa, Real Insurance, and UAP Insurance. The estimated number of Kenyan insurance company branches within the region is about 30. There are no Tanzanian or Ugandan insurance companies with a regional presence. Similarly, several Kenyan stock brokerage firms have subsidiaries within the EAC region. These include, Dyer and Blair Investment Bank (Uganda and Rwanda), Faida Securities (Rwanda), and Kingdom Securities (Rwanda). Each of these stockbrokers has only one branch in the regional countries they operate in.

The integration of the EAC stock exchanges is planned to take place in 2012. The first move to integrate the exchanges was to develop common automated trading and clearing platforms. This adoption is currently underway, with Uganda adopting the same automated trading system (ATS) that is used by Kenya, and Tanzania and Rwanda expected to follow suit (Burundi does not yet have a stock exchange).

Table 14.1 > Regionalized Banking Operations in the EAC

| Bank | 2009 | | | | |
|---------------------------------|---------|-------|--------|----------|--------|
| | Burundi | Kenya | Rwanda | Tanzania | Uganda |
| Barclays (UK) | | | | | |
| Bank of Africa (Mali) | | | | | |
| Citigroup (USA) | | | | | |
| Diamond Trust (Kenya) | | | | | |
| Ecobank (Togo) | | | | | |
| Equity (Kenya) | | | | | |
| Fina (Kenya) | | | | | |
| Kenya Commercial (Kenya) | | | | | |
| Standard/Stanbic (South Africa) | | | | | |

Source: Various bank websites.

Prior to implementation of a common trading platform, cross-listing of shares in the EAC is already occurring and has increased private capital flows within the region. The total market capitalization for cross listed shares in the EAC region stands at about US\$2.88 billion with 99.84 percent being taken up by the Nairobi Stock Exchange (NSE) while 0.16 percent is shared between Dar-es-Salaam Stock Exchange (DSE) and the Uganda Stock Exchange (USE). All companies that are cross-listed and traded regionally are from Kenya. To date there have been no cross-listings of companies based in other EAC countries. Kenya defines a local investor as an EAC citizen and allows foreign participation of up to 75 percent. Tanzania allows foreign participation of up to 60 percent of shares in primary or secondary issues. There are no restrictions in Uganda or Rwanda.

Unlike Kenya, Tanzania does not allow foreign participation in IPOs. Rwanda and Uganda require citizens to seek approval from their central bank to buy foreign IPOs. Sale or issue of shares by foreigners is not restricted in Kenya, Uganda, and Tanzania but Rwanda requires central bank approval. There are no restrictions for foreigners to buy debt instruments in Kenya, Uganda, Rwanda, and Burundi. Tanzania however restricts purchase of government bonds but allows foreign participation for corporate debt instruments.

Institutional investors, national pension funds, fund management firms, and insurance companies usually dominate participation in EAC stock and bond markets. Information provided by Kenyan investment banks suggest that the participation of Kenyan investors in other EAC markets is about 10 percent, whereas that of Uganda investors in other EAC markets is between two and five percent, and of Tanzania a maximum of 0.5 percent. Due to the lack of restrictions on capital flows from Kenya, a greater number of its retail investors participate in EAC markets; this contrasts to Tanzania and Uganda where mainly institutional investors participate. Indeed, in 2008 citizens from all EAC countries were able to participate in the Kenyan IPO of Safaricom with the same status as Kenyan local investors. EAC citizens were allowed to take up 40 percent allotment for local investors and pay five percent withholding tax on dividend income as opposed to the 10 percent that foreign investors are required to pay.

Path to Deeper Regional Financial Integration

Several factors have come together to propel the regionalization of financial markets in the EAC. The signing of the Common Market Protocol and the initiatives of the private sector banks together create a favorable climate for further integration, especially between the three original members of the EAC (issues pertaining to the integration of Rwanda and Burundi are dealt with separately in the following section). However, several factors still constrain the growth and integration of the regional market. At the same time there is reason to stay alert to the risks that come with increasing cross-border financial links. Thus, the path forward should involve taking steps that on the one hand facilitate the movement of funds between EAC members, and on the other ensure a more careful oversight of the volumes and consequences of these flows:

Harmonization of legal and regulatory frameworks: The banks surveyed cited differential tax regimes and other regulatory discrepancies as a major hindrance to further integration. Further work needs to be done to align regulatory and supervisory frameworks and reporting requirements to address this issue.

Adopting single licensing regime: Banks surveyed during in the preparation of this report cite single licensing as an important aid to further integration. If introduced for banks, single licensing should also be extended to other market participants such as brokers and insurance companies in order to significantly reduce cross-border transaction times and costs and barriers to entry.

Mutual recognition among regulators: Adopting single-licensing will have to be accompanied by mutual recognition among regulators and this will require that national regulators converge around some broadly defined international principles such as the Basle core principles for bank supervision, the International Organization of Securities Commissions (IOSCO), and others.

Building-up regionally compatible financial infrastructure: Kenya, Tanzania, and Uganda have already made substantial progress in integrating their real time gross settlement systems (RTGS). Rwanda and Burundi also need to align their payments systems with the regional system. Similarly, it is necessary to ensure that other parts of national financial infrastructures, including central securities depositories (CSDs) and trading platforms for national exchanges, are compatible at the regional level.

Strengthening cross-border supervisory practices: Deepening links between financial institutions warrants a similar deepening of cooperation between supervisors. As indicated by surveyed banks, instances of scrutiny by supervisors in other countries are rare. Home-host supervisory communication and consolidated supervisions are important to ensuring that weaknesses in one financial institution/market do not put the regional financial system at risk.

Strengthening data gathering: Information on current volumes of cross-border trade in financial products is generally sketchy and incomplete. This data gap is problematic, not just because policymakers are working with limited information on the issues and opportunities that lie ahead, but also since it also masks the benefits and costs of further integration by obscuring the extent of cross-border linkages. Porous borders, high volumes of unrecorded informal trade, and the widespread use of physical cash in transactions further compound these issues. There is ample scope to build additional capacity on this front both at the national level and at the EAC Secretariat.

Integrating Burundi and Rwanda

The financial sectors in both Burundi and Rwanda are at a lower level of development than those in other EAC countries—in Burundi, the financial sector consists of seven banks, of which three are commercial banks, with four very small insurance companies; in Rwanda, the 12 banks operating also dominate the financial sector, but with a more developed insurance sector compared to Burundi. Overall, the financial sector in Rwanda is larger, offers a broader range of financial services and products, and is developing faster than Burundi's. The degree of cross-border banking sector integration with the rest of the EAC is also higher in Rwanda than in Burundi, with three EAC-headquartered banks operating in Rwanda versus one in Burundi.

The integration of Burundi and Rwanda into the EAC's financial system brings the problems posed by small scale into sharp relief. Of the two countries, the awareness of the need to achieve scale to support high quality regulation and supervision, to support capital markets development, and to build physical infrastructure such as payments and settlement systems, is clearly most advanced in Rwanda. Burundi still lacks a coherent vision of how its financial system will be integrated with the EAC and as a consequence needs to do much work to formulate a strategic vision and move forward with implementing its strategy. The alternative is to see the direction and development of the financial system largely passed to institutions in other EAC countries.

Unlike communities such as the European Union, the EAC has worked on a post-membership convergence principle, with countries joining and then seeking to harmonize their laws and regulations for the financial sector with other member states. One consequence of this approach is that parts of the financial sector may be exposed to cross-border activity and competition before the regulatory and supervisory frameworks are in place (as in the Rwanda and Burundi insurance sectors), another is that financial institutions may enter from larger markets with a degree of sophistication greater than that of the host regulator, posing a risk that supervision will be inadequate. As a result, countries—such as Burundi and Rwanda—may be called upon to build capacity on a “crash basis.” These circumstances in turn may require a greater willingness to seek capacity-building solutions which may require some willingness to surrender a degree of sovereignty in order to gain the benefits of scale: as discussed above, both Burundi and Rwanda could benefit from forming joint regulatory institutions.

Going Forward

The following are key steps towards integrating Rwanda and especially Burundi into the emerging EAC financial system:

Develop an EAC Integration Strategy for the Burundi Financial Sector. Burundi needs assistance in developing a coherent strategy for integrating the financial sector with the EAC. This assistance should focus critically on assessments of: (1) the financing needs of the real sector, including manufacturing, housing, agriculture, and trans-shipment trade, (2) the capacity of the financial sector as presently constituted to meet financing needs and identification of capital shortfalls and financial products needed, (3) government strategy towards inward investment in the financial sector and an associated licensing policy for foreign entrants from within the sub-region.

Support to Accelerate Burundi's Convergence with EAC Financial Sector Law. Given the work already done in Rwanda to prepare EAC-convergent laws and regulations for the financial sector, it would make sense—given the common legal heritage of the two countries—for Burundi to use these laws (on banking, payments, collective investment schemes, and capital markets functions) as models for its own reforms. Technical assistance could therefore be provided to draft new laws and regulations for Burundi using the Rwandan models.

Financing for Supervisory Development. For both Burundi and Rwanda flexible technical assistance credits could be created to deliver capacity building support on a flexible basis,

using a framework contract. This would allow the regulators in both countries—over a period of three to four years—to draw technical assistance and finance equipment and software on an *ad hoc* basis.

Financing for Burundi's Payments System. As discussed above, the Burundi authorities see the logic of purchasing a payments system that is fully compatible with that procured by Rwanda. The Rwandan authorities have already absorbed a substantial cost in preparing the specifications for a new system, and financial support could be given to Burundi to “piggyback” on the Rwandan procurement. This might also enable the costs of the Rwandan procurement to be reduced by increasing the total size of the hardware, software, and services contract(s) by the addition of duplicated systems for Burundi

The EAC Financial Sector Development and Regionalization Project

Drawing extensively on this analysis and in response to strong interest expressed by the EAC, the World Bank is implementing the Financial Sector Development Regionalization Project I (FSDRP I), which comprises a three-year US\$16 million regional technical assistance grant to the EAC to support the move towards a single market in financial services. The project development objective of FSDRP I is to establish the foundation for financial sector integration among EAC Partner States. FSDRP I consists of six components as follows:

Component 1: Financial Inclusion and Strengthening Market Participants will leverage the establishment of a single market and the benefits of scale associated with regionalization to make a broader range of formal financial services/products available to a more diversified client profile, including those that are currently unserved.

Component 2: Harmonization of Financial Laws and Regulations will move towards legal and regulatory harmonization in banking and accounting, securities markets, insurance, pensions, investment funds critical to achieve an effective functioning of a single market in financial services via EAC Acts.

Component 3: Mutual Recognition of Supervisory Agencies will support the establishment of a system in which a financial institution or market intermediary licensed by the supervisory authority in one Partner State will be allowed to operate in all Partner States upon simple notification to the supervisory authority of the host State.

Component 4: Integration of Financial Market Infrastructure will support the establishment of an efficient market infrastructure, compatible at the regional level.

Component 5: Development of the Regional Bond Market will support the development of the Government bond market in each Partner State, to ensure bond issuers in individual EAC Partner States having access to a deeper pool of liquidity in a single market.

Component 6: Capacity Building will strengthen capacity at both the regional and the national level to ensure that the integrated market functions effectively and that all economic

agents in the regional area aware of and able to realize the benefits from the process of integration.

FSDRP I is envisaged as part of a broader program of continued engagement with the EAC the higher-level objective of which is to support the broadening and deepening of the financial sector through the establishment of a single market in financial services among EAC Partner States, with a view to making a wide range of financial products and services available to all, at competitive prices. This higher-level objective will be achieved through two back-to-back Projects over a nine-year period. Financial Sector Development and Regionalization Project I (FSDRPI) will span 2011 to 2014, and FSDRP II will span 2014 to 2019.

15. Increasing Trade in Banking and Insurance Services in the West Africa Monetary Zone

Thilasoni Benjamin Musuku, Patrick Elat, Andrew Lovegrove, and Oliver Reichert⁵²

Introduction

The West African Monetary Zone (WAMZ) was established in 2000 with the objectives of securing monetary union between the five member states (The Gambia, Ghana, Guinea, Nigeria, and Sierra Leone); establishing a regional central bank; establishing a single financial services supervisor; and, developing a common market for goods and services. The development of a monetary union and, also, the willingness of member states to facilitate progress towards a common market in financial services by harmonizing legal and regulatory frameworks, are clearly hampered by the heterogeneous nature of WAMZ. For example, the WAMZ banking market is dominated by Ghana and Nigeria with the combined banking systems of The Gambia, Guinea, and Sierra Leone amounting to only 0.37 percent of WAMZ's total banking assets, 0.45 percent of WAMZ's total deposits and short term funding, and 0.29 percent of WAMZ's total loans.

Some progress has been made towards preparing the basic architecture for financial sector integration in West Africa: first, the West Africa Monetary Institute (WAMI) was established as the precursor to the West African central bank (WACB) and serves as a secretariat for WAMZ's governing bodies and an advocate for integration; second, WAMI has prepared common statutes covering banking and non-bank financial sector regulation; third, the statutes for WACB have been adopted; fourth, a framework for a region-wide payments system has been prepared; and, lastly, in September 2008, financing was secured (from the African Development Bank) for implementation of potentially interoperable new payments systems in Guinea, Liberia, and Sierra Leone. Nevertheless, WAMZ has made little practical progress towards integration as a result of the unwillingness or inability of its member states both to ratify and pass enabling legislation required to implement

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WAMZ decisions or to meet the convergence criteria established as the prerequisite for monetary union.

This chapter identifies a limited number of “quick wins” for integration of the banking and insurance sectors in WAMZ which could be used as confidence building successes from which to build momentum for further integration-centered reforms as well as an agenda for medium-term progress in integration of the sector. The driver for the report’s recommendations is ideas raised by private sector financial institutions in WAMZ.

Opportunities for Increasing Cross-border Trade in the Banking Sector

The transformation of the banking sector within WAMZ is being driven by three main factors: (1) liberalization of cross-border banking activities, primarily in the form of the willingness of member states to permit the establishment of subsidiaries of banks domiciled in other African states; (2) a dramatic increase in the capitalization of Nigerian banks (reinforced by increases in the minimum capital of Ghanaian banks) which has encouraged these banks to seek additional markets within West Africa; and, (3) the growth of pan-African banking groups (such as Ecobank and United Bank of Africa) which have moved quickly to establish subsidiaries in countries across West Africa and the rest of the continent.

Cross-border expansion of banks is driven by the direction of trade—for example, Ghanaian banks planning to expand into Niger (following Ghana’s trans-shipment trade from the coast to the interior)—or by the perception of market opportunities and the need to service corporate clients expanding abroad, as in the case of Nigerian banks expanding into Ghana.

The size differential among the respective banking markets suggests that either:

- The path to integration of banking systems will have to be driven very much on Nigeria’s terms, albeit mitigated by Nigeria’s desire (strongly expressed in its Financial Sector Strategy 2020) to conform to global standards for banking regulation, supervision, and financial reporting and to comply with Basle core principles. Given that all other WAMZ countries share the same objectives, eventual harmonization around these same principles should be assured; or,
- A “compromise” where the smaller countries seek to avoid a more or less complete takeover by Nigerian and other multinational banks of their banking systems by harmonizing with each other and maintaining some barriers to entry to protect domestic “champions.” Taking the second of these courses (if it is even possible, given that Nigerian and multinational banks are already established in all markets) would deprive the smaller countries—perhaps with the exception of Ghana—of access to Nigeria’s large capital resources, advanced banking technology, and the benefits that the application of scale could bring in terms of system development and increased access to finance.

Obstacles to Securing the Benefits of Regionalization of the Banking Sector

The benefits of regionalization of the banking sector come from: (a) greater competition in banking markets leading to the increased availability of banking services and lower prices; (b) increased scale allowing a reduction of risk in the banking sector as a

result of the increased ability to diversify both geographically and across sectors and; (c) increased innovation, resulting both from cross-border transfers of technology and increased competition, and from the availability of the economies scale required to support mass market banking products.

However, there are a number of specific problems which are reducing the benefits of regionalization including: (1) the lack of a functioning official cross-border payments system for WAMZ and no direct link to the UEMOA payments system; (2) continued wide disparities in the bank regulatory framework between WAMZ countries; and, (3) a lack of cross-border credit information flow and a corresponding lack of a legal framework for data protection:

Payments Systems Problems: The long term solution to the high cost of cross-border payments within WAMZ (and also between WAMZ countries and UEMOA states) lies in the creation of a single payments system for WAMZ linked to the UEMOA payments system already in place. The primary cause of delays in building the WAMZ payments system has been an inability to reach agreement on how settlements would be guaranteed in the period before the WACB is formed. Despite ongoing discussions, it seems unlikely that this obstacle can be overcome in the short term. In the absence of an official WAMZ payments system, both traditional and parallel systems continue to operate:

- Payments continue to be routed for settlement via correspondent banks in Western financial capitals.
- For small payments in cross-border trade and between individuals, cash is still extensively utilized.

Increasingly, banks with cross-border operations are operating an internal settlement system. Pending agreement between the WAMZ member states to establish a single payments system, opportunities may exist to develop an interim solution based on the intra-bank net settlement process for cross-border transactions, which has been implemented by banks where the counterparties for payments are both customers of the same bank.

Discussions with banks indicated that there is considerable confusion as to whether or not a net settlement system would be possible due to foreign exchange controls, and some banks stated that existing intra-bank net settlements are also prohibited, whereas the banks performing intra-bank net settlements insisted that the settlements are permitted. The completely open operation of cross-border ATM and debit transactions (using Ecobank's ATM network and VISA) suggests—but not conclusively—that cross-border intra-bank net settlement is allowable. Given this regulatory uncertainty, the banks strongly suggested that this idea be carried forward with participation of the regulators in a pair of pilot countries (Ghana and Nigeria).

Developing a cross-border payments system also requires work to develop uniform regulations and anti-money laundering surveillance mechanisms for cross-border payments through mobile telephone companies. An important feature of this system would be to promote competition between the mobile telephone companies by facilitating mobile payments from one mobile network operator to another.

Lack of a Harmonized Bank Regulatory Framework: The absence of uniform accounting standards, regulatory reporting requirements and minimum capital adequacy requirements

presents yet another challenge to securing regionalization of the banking sector. Progress towards the objective of harmonizing accounting standards has been uneven—countries within WAMZ all have the long-term intention to harmonize their accounting standards with International Financial Reporting Standards (IFRS).

Bank regulations and supervisory practices are not uniform across the region, thereby increasing costs and impeding the supervisor’s ability to assess the risks posed by a subsidiary or parent of a bank that they supervise. A number of initiatives could be undertaken to reduce regulatory costs and prepare for harmonized statutes such as standardization of reporting requirements. A detailed mapping of regulatory reporting requirements could be undertaken to develop a single set of reports required by WAMZ bank regulators and designed to meet the requirements of the model banking statute and compliance with Basle core principles, with additional country specific reports included only to the extent that they are required by current law.

To improve the quality of cross-border bank supervision, two measures are suggested: (a) to standardize the memorandum of understanding (MoU) used to establish information sharing arrangements between supervisors; and, (b) establish a “cross-training” program for supervisors to encourage (and in the case of weaker WAMZ supervisors, subsidize) periods spent working with the supervisors in other WAMZ countries.

The supply of credit information: Initiatives are underway in several WAMZ countries to improve the flow of credit information from credit bureaus or central bank administered credit databases (Table 15.1). However, to date, there has been no legislation permitting the cross-border sharing of credit information in any WAMZ country.

This problematic situation is made worse by the absence of uniform data protection laws across WAMZ which would prevent the abuse of customer data stored in regional data centers. These issues suggest that two recommendations need to be implemented in the medium term: (1) WAMZ, preferably working in conjunction with UEMOA under the umbrella of ECOWAS, needs to develop a legal framework for the cross-border movement of customer credit information; and, (2) both WAMZ and UEMOA need to work together to develop a uniform data protection statute which affords equal protections for bank customer information regardless of the location of the data storage or processing facility within WAMZ or UEMOA

Table 15.1 > Credit Information Sharing Activities in WAMZ States

| Activity | Gambia | Ghana | Guinea | Nigeria | Sierra Leone |
|-------------------------------------|--------|-------|--------|---------|--------------|
| Credit bureau law | X | X | | X | X |
| Private credit bureaus allowed | | X | | X | X |
| Central bank credit database exists | | X | | X | |
| Private credit bureaus exist | | | | X | |

Opportunities for Increasing Trade in the Insurance Sector

The insurance markets of the WAMZ countries are not efficient. There are far too many small insurance companies competing for premiums. Only one company within the entire WAMZ region, Nigeria’s NICON, has a gross premium base in excess of \$100 million—and NICON is presently under

judicial management. With the possible exception of Nigeria, there seems to be a relatively small base of an educated, trained, and experienced workforce for the insurance industry and the insurance regulators. The Insurance Institute based in The Gambia caters for middle management and senior staff, as do the education and training courses conducted by West African Insurance Companies Association (WAICA).

The insurance regulators are at various stages of development, with the Ghanaian and Nigerian supervisors best staffed and equipped. Consequently the degree to which the industry is supervised varies significantly across the countries. The region's regulators share little information among themselves. There are no formal MoUs whereby information could be shared. Harmonization and improvements in cross border trade could be brought about by implementing certain courses of action, such as a common approach to supervision, licensing, and claims payments.

The region's insurance laws and regulations are diverse. Most of the insurance supervisors seem to be in the process of amending their laws. There are considerable differences in the amount of minimum capital required for obtaining an insurance license in each of the countries, the extremes being in Sierra Leone, where a life license requires \$25,000 of capital, and Nigeria, where that same license requires a minimum capital of \$13,500,000.

Each of the WAMZ countries has its own set of insurance laws and regulations. The laws presently do not take risk-based capital into consideration—the emphasis is on absolute capital. The relatively high levels of capital requirements in Nigeria impose a significant barrier to entering the insurance market for insurers from other WAMZ countries. Space for regulatory arbitrage in respect of capital requirements is negated by the fact that branch operations are not permitted in any of the WAMZ countries: separate corporate structures need to be established.

Each of the WAMZ countries has an insurance regulator/supervisor. In Ghana, Nigeria, and Sierra Leone, separate quasi-independent insurance regulators have been established. In the case of The Gambia and Guinea, a department within the central bank is responsible for insurance supervision. In Liberia, the insurance regulator is situated within the ministry of transport.

The level of staffing and the quality of the insurance regulatory staff is related to its funding. The insurance regulators within the WAMZ countries recently established a forum although it is not fully operational as yet. A number of regulators do meet informally, and have done so over a period of time. There are no formal arrangements in place between the insurance regulators of the various WAMZ countries, for such purposes as information sharing. The only formal cross border agreement currently in place is the Brown Card Scheme (Box 15.1). Presently, companies operating in more than one WAMZ country have not

Box 15.1. African Insurance Forums

- National level: insurance associations and insurance brokers' associations have been established in each of the WAMZ countries. These appear to be actively supported by the insurance industry as a whole in each country.
- Continental level: there is the African Insurance Association (AIO). The Cameroon-based AIO includes all WAMZ members. The AIO involves its members at a number of levels: annual insurance conferences are held each year in a different country throughout Africa and serves as a discussion forum at the highest level of executives of insurance organizations. Seminars and workshops are held throughout the year to engender discussion on insurance related topics.
- West Africa: There is one insurance treaty signed by all ECOWAS members: the Brown Card Scheme, which provides common third-party motor insurance across the region. An anti-money laundering forum has also been established for financial institutions in West Africa.
- WAMZ: The WAMZ area itself has been active in certain areas, and has established some forums specifically catering for this geographic and geopolitical area.

yet established functions that are centralized across all countries, such as claims handling or underwriting.

Prerequisites for Increasing Cross Border Trade: Almost all of the insurance products sold in the WAMZ region are in compulsory insurance products, few people purchase insurance products voluntarily, and therefore insurance penetration rates are at world-record low levels. There is very little attention to customer satisfaction. Efforts toward creating the right conditions for healthy cross border trade, and benefitting policyholders and the entire insurance industry could be driven through improved supervision and improved insurance laws and regulations, or improved application of existing laws and regulations.

As WAMZ insurance regulators seem to be either replacing, or considering replacing their laws and/or regulations, there is an opportunity to harmonize insurance laws, regulations and supervisory approaches. Those countries that have not adopted the framework law approach (Guinea, Liberia, Nigeria, and Sierra Leone) could consider doing so in the short to medium term. The insurance regulators of all WAMZ countries could improve the environment for growing a viable and healthy long-term insurance industry by making a continuous and concerted regional effort to force insurance companies to pay claims in a timely and fair manner, as measured by a continuously increasing percentage of premiums being allocated to the payment of policyholder claims and benefits. Those countries with very low minimum capital requirements (The Gambia, Guinea, and Sierra Leone) could also consider adopting Ghana's approach of requiring a minimum capital of the equivalent of at least US\$1 million for each of their insurance companies/insurance licenses.

Consumer education and understanding also need to be addressed: throughout the WAMZ region, potential policyholders are unaware of the benefits to be derived from owning insurance products. A concerted effort to increase consumer education, drawing attention to the benefit of holding insurance policies, could be carried out throughout the WAMZ region via production and distribution of published material and advertisements.

Conclusions

In spite of the progress realized in both the banking and insurance sectors, WAMZ remains prone to numerous problems associated with banking and insurance sector integration—more specifically these impediments include difficulties in building adequate financial infrastructure such as payment system infrastructure, the lack of harmonization of a legal and regulatory frameworks governing these two sectors, the lack of credit report bureaus to access financial information of banks and assurance clients, and the high costs of transactions related to the transfer of funds through banks and the insolvency regime.

The urgency is for an immediate solution to accelerate the integration process of these sectors and facilitate trade of goods and services within WAMZ. With regard to the banking sector efforts should focus on:

- Reducing the cost of cross-border payments made through the banking system;
- Developing a mechanism for small cross-border payments for traders and individuals;
- Reducing the cost of bank regulation and supervision;
- Improving the quality of cross-border bank supervision; and
- Improving the flow of credit information.

In terms of the insurance sector, focus should be on:

- Taking action in order to make the brown card scheme a success;
- Increasing the minimum capital requirement in some of the WAMZ countries;
- Developing a program whereby insurance companies are forced to play claims fairly; and
- Harmonizing insurance laws and regulation.

16. Beyond the Nakumatt Generation

Distribution Services in East Africa⁵³

Nora Dihel⁵⁴

Introduction

Distribution services⁵⁵ are an important driver of growth in East Africa. With contributions to GDP ranging from about 11 percent in Kenya, Rwanda and Tanzania to more than 14 percent in Uganda in 2008/09 distribution services are a significant part of all East African economies. The sector also employs an important part of the population (in many East African countries over 10 percent of the active population) and includes a high proportion of informal, unskilled, female and part-time workers. Distribution services are among the most rapidly expanding sectors in East Africa. Over the period 2001–08 (2004–08 for Uganda), distribution services have grown, on average, at eight percent a year in Rwanda, 12 percent in Kenya and Tanzania and 20 percent in Uganda.

There is an emerging recognition amongst the East African countries regarding the importance of this sector. For example, distribution is a strategic sector in Kenya’s “Vision 2030”—the country’s new development blueprint. In addition, distribution services were identified as a priority sector in the context of the East African Community Common Market Protocol and the negotiations with the EU on services in European Partnership Agreements by Kenya, Rwanda and Tanzania.

Distribution services represent a crucial link between suppliers and producers. With improved efficiency and higher productivity due to the emergence of large supermarket chains and the increased internationalization of the distribution sector across East Africa,

⁵⁶ This chapter was prepared by Nora Dihel with input from Richard Gicho and Joseph Kimoto (Kenya), Joseph Butoyi (Burundi), George Gandje (Tanzania), Henry Rugamba (Rwanda). Pumela Salela and Nicholas Strychacz provided assistance with the data collection.

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⁵⁸ Providers of distribution services generally fall into four categories: retailers, wholesalers, franchisers, and commission agents. Retailers in both the formal and informal sectors sell goods for personal or household consumption; wholesalers sell merchandise to retailers or to other businesses. Franchisers sell specific rights and privileges related to operating a branded business, for example, the right to use a particular retail format or trademark. Finally, commission agents trade on behalf of others, i.e., they sell products that are supplied and usually owned by others to retailers and wholesalers. The main focus of this note is on the retail and wholesale given that they dominate the distribution sector in East Africa.

the sector has great potential to benefit both producers and consumers and contribute to increased food security and alleviation of rural poverty. Modern distribution channels and procurement systems that reduce transaction costs and facilitate market exchanges can increase the access of small farmers to high value markets and accelerate the transition from subsistence farming to market participation. For consumers, organized markets can provide substantial benefits that include better quality products at affordable prices.

So far, however, modern distribution channels have failed to capture a large portion of the retail market in East Africa. Across the region informality still prevails, small-scale farmers have found themselves marginalized by the distribution sector and its new practices, and very poor households (for example, slum dwellers) are often paying more per unit for basic products than wealthier households.

This chapter documents the current state of distribution services in East Africa, including the patterns and the determinants of the diffusion of modern distribution channels and the increased internationalization in the region. It shows why, despite major transformations during the last decade, the distribution sector remains underdeveloped and the impact of reforms is uncertain. To strengthen the contribution of the sector to poverty reduction, policy action that addresses the concerns of the households and producers at the bottom of the income pyramid, especially in the informal sector, should be a priority in all East African countries. Policy action that enables a gradual transition of informal firms to formality, as well as measures that encourage regulatory reform needs to complement the liberalization of the distribution sector in East Africa.

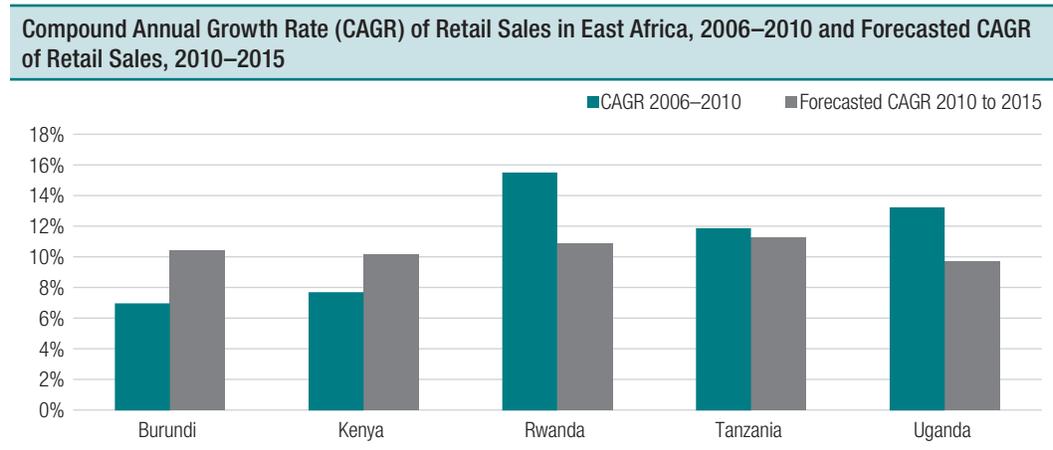
Developing the Distribution Services Sector in East Africa to Reach Poor Consumers

Informality Prevails Despite the Rapid Diffusion of Modern Retail Stores.

Increasing population, continued urbanization, higher incomes, and political stability have propelled the growth of distribution services in East Africa during the last decade. The proliferation of supermarkets and large retail stores are among the most significant developments regarding the evolution of distribution services in the region. Supermarkets in East Africa have sustained impressive growth rates over the period 2006–10: the compound annual growth rates of retail sales reached more than 15 percent in Rwanda, about 15 percent in Uganda, almost 12 percent in Tanzania and about seven percent in Kenya and Burundi; and retail sales in East Africa are expected to grow around 10 to 11 percent per annum over the next five years (Figure 16.1). Total retail sales in East Africa are expected to increase from around US\$43 million in 2010 to more than US\$70 million in 2015 (Figure 16.2).

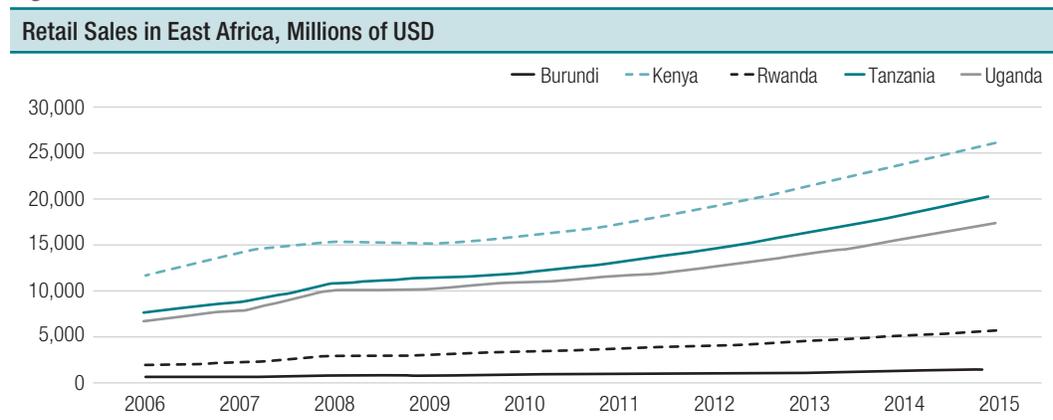
Formal distributors in East Africa tend to be large supermarkets and large to medium-size retailers and franchisees. Retail outlets, including supermarkets, tend to grow by first focusing on urban areas and large cities, then branch out to medium-size urban areas, and finally out to rural areas. In this way, although supermarkets generally begin by catering to higher income urban consumers, the growth path of retailers in East Africa has the effect of eventually bringing lower income rural consumers into the retail outlets as well, driving up retail growth rates significantly. For example, the Uchumi supermarket expanded

Figure 16.1 >



Source: Planet Retail, retail sales data, 2011.

Figure 16.2 >



Source: Planet Retail, retail sales data, USD, 2011.

in Kenya by first opening stores in Nairobi then shifted its focus by opening smaller stores located near bus stations used by lower income consumers.

Despite the growth of the higher-end supermarket segment, including those rural areas, the number of traditional small stores that sell local produce remains high in East Africa's retail market. In general, the distribution sector includes a small number of large supermarkets, a slightly greater amount of large to medium-size wholesalers and retailers, and a much larger number of independent and often informal small retail shops and street vendors. Such informal retailers can be found in both urban and rural areas and are often the primary enterprises engaging in distribution services outside larger cities. Most businesses in the East African informal sector are engaged in the retail of food and basic retail household appliances, and are single-shop sole proprietorships.

In the wholesale segment, we observe a high degree of duality between traditional and specialized wholesalers. Traditional chains are still widely prevalent in all East African

economies. Farmers and traders supply traditional wholesalers, who then sell to individual retailers and processors. But most modern retail stores have their own direct procurement systems and buying centers. Several supermarkets—for example, Nakumatt—have also developed regional distribution centers to perform the wholesale function for their outlets.

The franchising segment is small and mostly limited to foreign firms. This is partly due to the lack of intellectual property enforcement in African countries, which hampers the process of branding that is required for successful franchising. For example, the weak enforcement of Intellectual Property (IP) and lengthy resolution of IP disputes⁵⁹ in Kenya prevents the establishment of international franchises. Some Kenyan firms, however, have been successful in establishing franchises in East Africa, such as Kenchic in the poultry segment and Deacons in the apparel segment.

A common characteristic across the distribution sub-sectors of all East African countries is the large proportion of the informal sector. An estimated 70–80 percent of sales in East Africa still go through informal enterprises, with only about 20 percent of sales going through formal outlets. In Kenya, for example, an estimated 88 percent of businesses in the distribution services sector are considered informal, employing 80 percent of the total labor force in the sector. Low entry barriers and the relative ease of operations are among the factors that could explain the high level of activity in the informal distribution sector. However, informality can be also a byproduct of low productivity. World Bank (2010) shows that as Zambian firms became increasingly productive, they became more formal.

Although informal enterprises handle the large majority of sales, turnover is low for most individual informal enterprises and businesses tend to be very small. Enterprises in the informal sector are more limited in their operational capacities than businesses in the formal sector. Furthermore, the lack of access to finance, uneven cash flows, the absence of management knowledge, highly fragmented and inefficient supply chains, and poor infrastructure are key constraints faced by enterprises in the informal sector that discourage their transition to formal activities.

The prevalence of the informal market can sometimes discourage large formal business from entering this market segment. Additionally, informal retailers are also suboptimal from a governance perspective, since it is difficult or impossible to collect taxes (VAT, excise tax, import duties, etc.) from unregistered businesses without licenses.

Regulatory Barriers Limit the Benefits of Internationalization in the Distribution Sector.

Foreign direct investment (FDI) is starting to play an important role in the distribution sector of most East African economies. The largest businesses operating in the formal sector of all countries except Kenya tend to be companies with substantial foreign equity. For example, South African and Kenyan chains dominate the supermarket segments in Uganda and Tanzania. Kenyan supermarkets are also present in Rwanda, and Nakumatt is preparing its entry into Burundi in 2012. The Burundian distribution sector has already several foreign operators from Belgium, China, India, the Netherlands, and Pakistan. By contrast, the Kenyan market has been challenging to foreign investors in

⁵⁹ On average it takes about 8 to 9 years to resolve IP cases in Kenya.

distribution services. Foreign retailers such as the South African Metro Cash & Carry and Lucky 7 exited Kenya's market in 2005 after brief operations. The limited success of foreign companies in Kenya's retail segment has been attributed to strong competition, insufficient and expensive suitable locations, and inadequate market entry strategies among others.

Kenyan supermarkets began establishing foreign operations in the EAC in about 2002 and have since stepped up their efforts to penetrate the regional market. Currently, the three largest Kenyan supermarkets have a combined total of seven branches in Uganda and one in Rwanda. The main market entry strategy employed by these supermarkets is acquisition of existing supermarket chains. In 2011 Tusksys acquired the Ugandan supermarket chains Good Price and Half Price and has now four stores in Uganda.

The estimated Kenyan FDI in the East African supermarket segment amounts to US\$22–28 million (Table 16.1). Total Kenyan FDI outflow in distribution services is estimated to be around USD 26–32 million over the period 2002–2009. Expected investment in the EAC distribution services sector over the next five years is projected to be US\$30–50 million.⁵⁷ Major drivers of investment in East Africa include the adoption of the EAC Common Market Protocol and the harmonization of tax regimes and customs import regulations.

The foreign presence in the distribution sector of the East African economies has been made possible by extensive trade liberalization measures adopted by these countries. Burundi, Kenya and Rwanda are largely free of any major impediments to foreign presence in retail services. Tanzania imposes a few explicit policy restrictions: there is a 50 percent limit on foreign ownership if the foreign firm is acquiring a state-owned retailer, and the licensing criteria tend to favor and promote domestic retailers. (Borchert, Gootiiz and Mattoo 2011).

With a population of more than 140 million people, the East Africa region provides a vast retail market for formal retail traders with important benefits for consumers and producers. According to Nakumatt Holdings Research the current regional population has an opportunity to sustain at least 10 major retail stores in each town. In the next ten years, Nakumatt Holdings is forecasting that close to 25 million customers across the region will

Table 16.1 > Kenyan Supermarkets with EAC Presence

| Kenyan Supermarket | No. of Branches in EAC Countries | | Estimated FDI Investment Flows* (\$ millions) |
|--------------------|----------------------------------|----------|--|
| | Uganda | Rwanda | |
| Nakumatt | 2 | 1 | 8.25 |
| Tuskys | 4 | | 11.00 |
| Uchumi | 1 | | 2.75 |
| Total | 7 | 1 | 22.00 |

Source: Consultant Interviews 2010/11.

* Average investment required for establishing a supermarket in EAC is \$2.75 million. This figure was calculated using past investment spend of Kenyan supermarkets in EAC. Nakumatt invested about \$3 million for each of its Uganda branches, \$2.5 million of their Rwanda branch. Uchumi invested about \$2 million for its branch in Uganda, and is poised to spend \$2.5 million for their planned branch in Tanzania.

⁶⁰ Nakumatt plans to invest \$20 million in its EAC expansion over the next 5 years, Deacons \$10 million. Nakumatt is looking at opening 2 new stores in Kigali, Rwanda by the end of 2011. Uchumi is looking to commence its Tanzania operations in 2011.

have access to formal retail trade facilities with monthly sales reaching the US\$700 million mark and selling space reaching close to 40 million square feet, up from 15 million square feet today (Nakumat CBC 2011).

Several regulatory measures obstruct the entry of formal distribution firms and limit their operations in East African markets. Most East African countries have some form of regulation on market access (World Bank 2011). In Kenya, Rwanda, Tanzania, and Uganda new businesses must register with the commercial registry and must notify authorities. These countries also require that a new business obtain licenses and permits in order to engage in commercial activity, with fees depending on the type of business permit required. Multiple licenses are a significant challenge in distribution services. For example, a Kenyan distributor who covers a territory spanning several local authorities will be required to have licenses from each local authority to drop off goods at particular customers and receive payment. A similar problem occurs in the case of exporting. A distributor is required to have documentation for each product regardless of whether it is in the same product category. For instance, if the distributor is exporting yogurt in different flavors, export documentation for each flavor is required.

In Kenya and Rwanda businesses selling certain types of goods must also comply with outlet site regulations, in addition to compliance with local urban planning provisions. Large outlets have an additional set of regulations. In Uganda, foreign retailers are required to establish their outlets in the city area—establishment anywhere outside the city is prohibited. This decelerates the expansion of retailers from urban to rural areas. Rwanda has regulations on tax registration for micro-retail businesses and franchising. By contrast, Burundi has very little regulation in place with regards to distribution services. With the exception of pharmacies, which have to follow zoning and location rules, regulations or registration requirements are absent for most businesses. This lack of regulation has created a legal vacuum that actually constrains business growth and allows many opportunities for unfair competition and corruption.

The main restrictions affecting operations in the distribution sector are related to price regulation. The justification for such regulations is consumer protection, but price restrictions have a negative effect on competition. Price controls exist in most East African countries for essential goods. In Burundi gas and sugar are price controlled; in Rwanda there are price controls on gas, gasoline, and pharmaceuticals. Tanzania has price controls on a large number of goods and services, with fuel, water, electricity, transport fares, and telecommunications all being regulated. More recently, Kenya has introduced price controls on numerous food products to address food security concerns despite a strong opposition from the private sector. Across the region the cartels that control the prices and the flow of certain goods such as sugar or maize are particularly problematic.

Several countries have regulations on the quality and the standards of sourced products. But often such standards do not take into account the technological or economic constraint in the region; producers—especially small-scale producers—are unable to implement the standards and therefore remain informal (see Chapter 10 for an example in the dairy sector).

Finally, it is worth noting that regional imports by modern retail chains face a number of non-tariff barriers related to standards and rules of origin as well as delays due to bureaucracy and congestions at the ports. This has an impact on the cost of importation and stocking of appropriate inventory levels, and limits the role of foreign distribution companies as regional integrators.

The Distribution Sector in East Africa Has Undergone Major Transformations in the Last Decade but the Impact on Poverty Reduction Remains Uncertain.

The emergence of large supermarket chains across East Africa and the increased internationalization of the distribution sector have transformed the retail environment in the region. Numerous middle class consumers benefit from a greater variety of goods at affordable prices in modern retail outlets. The modern procurement systems and buying centers established by supermarkets have also improved the lives of many participating farmers. Several procurement and marketing studies focusing on fresh fruits and vegetables, dairy products, and crops in Kenya, Tanzania, and Uganda document the positive implications of the reorganization of supply chains and transformation of food systems for farmers, food security, and rural poverty (Hooton and Omore 2007 and Ngugi, Gitau, and Nyoro 2007).

However, very poor households at the bottom of the income pyramid pay higher prices for basic goods and services than do wealthier consumers—either in cash or in the effort they must spend to obtain them—and they often receive lower quality as well. Box 16.1 illustrates the price penalty for cooking fat, sugar and maize affecting poor consumers in Nairobi’s Mathare and Kibera slums.

Moreover, in all these countries where the majority of the population depends on agriculture, small-scale farmers have sometimes found themselves marginalized by the distribution sector and its new practices. Given the high fixed costs associated with participation in modern chains, many small farmers and traders are not able to participate in modern procurement systems and continue to supply traditional wholesalers, who then sell to individual retailers

Box 16.1 The Bottom of the Pyramid Penalty

Within informal settlements, retailers buy normal goods from wholesalers or retail outlets and break them down into smaller affordable quantities. For instance, consumers living in slum areas cannot afford to buy the 2kg packet of sugar that retails at about KES 200 (or US\$2.5) in most shops; however, they can afford to buy a pack of 50 grams at KES 10 (or US\$0.12). This makes goods affordable for slum dwellers many of whom live on less than US\$1 a day.

Though the smaller quantities are more affordable to consumers in slum areas, they are paying a considerably higher price for these products. The table illustrates this point where a 10 grams pack of cooking fat retails at a 300 percent premium, and a 50 gram pack of sugar at 141 percent. The poorest members of the society pay more for their essential goods than ordinary Kenyans.

Price Comparison of Selected Products in Informal Settlements

| Commodity | Kiosk: Price for Units under 250 grams (Kes/grams) | Supermarket: Price (Kes/grams) | Price Differential for Units under 250gms (%) |
|-------------|--|--------------------------------|---|
| Cooking Fat | 0.50 | 0.125 | 300% |
| Sugar | 0.20 | 0.083 | 141% |
| Maize Flour | 0.05 | 0.030 | 67% |

* Some retailers in informal settlements, such as Mathare, have weight scales. But by and large the portions are meted out without the use of weighing scale. Thus the packs found in these retail kiosks weigh sometimes more, sometimes less.

Source: Interviews in the Mathare and Kibera slums of Nairobi, 2011.

and processors. As the supermarkets in the highest tier tighten their demands in terms of consistency in volume and quality, small producers and under-capitalized brokers face tougher competition from larger producers and risk being squeezed out of the system altogether.

Talent Shortages Impede the Development of the Distribution Sector.

The availability of adequate skills remains an issue across the distribution sectors in East Africa. Despite the economic importance of the sectors, targeted training programs remain largely unavailable across East Africa. Only Kenya's Jomo Kenyatta University of Agriculture and Technology (JKUAT) offers a diploma-level retail management training course in East Africa. Consequently, most formal distribution businesses rely on training on the job. Also, there is limited influx of knowledge with regard to best or good practice in the sector. Lack of access to specialized training has led to slow growth and late adoption of modern retailing techniques. For example, many large supermarkets are only beginning to understand the value of and adopt modern retailing techniques such as merchandising, category management, and just-in-time inventory management.

Poor Infrastructure, Insecurity, Cumbersome Import Processes and Lack of Market Data Further Constrain the Development of the Distribution Sector.

Business representatives in East Africa identified the following additional issues as important constraints to the development of the sector:

- High transportation costs due to poor road networks conditions, especially in rural areas, and traffic congestion in main cities.
- Insecurity is a recurrent concern. The frequent hijacking of goods during transport leads to increased insurance, storage and transport costs. A hidden cost associated with insecurity is the growth of organized crime filtering into the distribution services sector. Criminal groups such as the “mungiki” control certain regions and extort money from formal and informal distributors on their territories.
- Cumbersome importation processes due to overly burdensome bureaucracy and congestion at the ports increase the price of imported goods and complicates stocking and inventory planning.
- The limited availability of market data particularly affects distributors at the bottom end where business is highly fragmented. It is extremely difficult to measure the value of goods that move through this channel. Even in the modern distribution segment information is difficult to obtain. Distributors are unable to gather information on their market shares or performance indicators with negative implications for the development of marketing strategies, new product development, and forecasting and strategic planning.

Policy Recommendations

Raising awareness about the importance of distribution services is an important first step in designing a comprehensive reform strategy that is linked with national development

plans. The sector urgently requires a broad development strategy and recognition as a key economic driver to facilitate its growth to the next level. The importance of the formal distribution sector that is heavily contributing to economic growth and is currently the second leading (formal) employer has been acknowledged by several East African countries. Steps must be taken to raise awareness about the importance of the sector in a consistent way on the basis of detailed economic performance analyses and benchmarking exercises, and incorporate the informal sector into the landscape of distribution services. The large size of the informal sectors in all East African countries underscores the importance of distribution strategies that can efficiently reach households at the bottom of the income pyramid and integrate small-scale farmers into the distribution system.

Addressing the concerns of the poorest households and facilitating the inclusion of small-holders in modern distribution chains should be a priority in all East African countries.

The majority of the population, who account for a significant percent of overall income, remain at the base of the pyramid and are excluded from the benefits that large distributors have brought to middle class families in terms of wider availability and lower unit prices for basic products. Possible policy actions to address the constraints that prevent informal forms from formalizing, meet the needs of the poorest households and expand their access to basic products at affordable prices include:

- Facilitate access to financial services in the informal sector. Several case studies show that increased access to credit by micro and small enterprises has contributed to the growth in the distribution sector particularly in the informal segment.
- Provide support to traditional and informal operators to acquire relevant skills. For example, training courses offered in the slums and focused on basic hygiene standards, merchandising, sampling, or promotion techniques could improve the skills of retailers in wet markets, kiosk sellers, or hawkers. There are several examples of innovative solutions to localized conditions that rely on consumer behavior and private public partnerships with commercial potential (see Box 16.2 for an example).
- Encourage firms to design and apply business models that deliver the right products at the right price point. For example, to meet the needs of consumers at the bottom of the pyramid,

Box 16.2 Pharmacy Accreditation Programs for Informal Retail Operators – Tanzania

Because they allow access to treatment in areas and conditions where no formal commercial entity could operate at a profit, distribution models that leverage existing physical infrastructures and consumer habits to distribute drugs in remote areas have an enormous development potential. An accreditation and training program and access to microfinance services enabling small rural shops (*duka la dawa baridi*) to sell essential drugs is a business model that has significant development impact that can also be financially sustainable. Given high retail margins, charging fees for a 40-day training program that allows regular shop owners to sell essential medicines is a viable business model. This has been implemented in Tanzania through the Accredited Drug Dispensing Outlets (ADDO) scheme on a pro-bono basis. However, regular retail shop owners have demonstrated a willingness to pay for this training that includes marketing support in order to enter the lucrative retail drug market. These business models dramatically increase access to drugs for remote populations by increasing the number of medical outlets available. In addition, training programs for small retailers can improve their awareness of counterfeit and substandard products, thus enlisting them as key agents in improving product quality.

Source: IFC 2007.

Box 16.3 Reaching the Bottom of the Pyramid – Innovations in Distribution in India

Business strategy enabling access. Some of the higher prices paid by consumers at the bottom of the pyramid can be ascribed to the difficulties and added costs of distribution in low-income communities. Many companies are finding innovative ways to reach poor consumers. For example, Hindustan Lever Limited (HLL) requires new managers to spend six to eight weeks in a rural area and learn from these consumers as part of their training. HLL uses non-conventional marketing to reach this consumer segment: fairs, festivals, and traveling cinemas have become part of the company's consumer outreach combining entertainment with hygiene education.

HLL has reached deeper and deeper into rural areas and has set up networks that carry its products to the most remote villages by whatever means required—motorbike, bicycle, oxcart—and has also employed direct sales agents. The approach builds brand loyalty and creates employment.

Source: World Resource Institute and IFC 2007.

companies must re-design products and use smaller pack sizes to increase trial purchases and volumes, build strong distribution partnerships and adapt marketing strategies (see Box 16.3 for an example).

Steps should be taken to ensure a gradual transition of informal firms to formality. The transformation of distribution and procurement systems may offer participants higher returns but they also introduce new risks and costs. With fewer and more powerful buyers, small farmers are confronted with reduced negotiating power in addition to important transaction costs. Policy actions to facilitate the access and participation of smallholders in modern distribution chains include:

- Encourage horizontal coordination—such as farmer associations and cooperatives—to increase the bargaining power of small farmers, allow for economies of scale and lower marketing and negotiation costs. Given the mixed experience with such associations, a case by case approach is warranted that puts emphasis on soft skills and contextualized management structures.
- Coordination between farmers that focuses on subcontracting arrangements, different forms of tenant farming (e.g., exchange of labor for a portion of harvest) or reverse tenancy (e.g., leasing of land management to a larger operator in exchange for rent) could be alternatives to associations and cooperatives.
- The widespread duality between traditional distribution chains and modern procurement systems in East Africa could be exploited to increase the participation of small farmers in modern chains. Rather than bypassing traditional wholesale systems and increase the gap between traditional domestic markets and the formal processing sector, encourage the upgrading of traditional wholesale systems to support the interaction between the modern and traditional systems. The main focus should be on improving basic safety standards, increasing the traceability of products and reducing spoilage rates in the traditional markets. This can improve the structure of wholesale markets and enable upstream linkages with producers and downstream linkages with retailers and processors.

Steps should be taken to eliminate the regulatory barriers that limit investment in the sector. Although all East African countries have made progress in removing explicit restrictions to trade, the lack of regulation in critical areas, onerous regulation elsewhere or an unequal enforcement of regulation pose serious problems to competition and affect formal (including foreign operators) in the distribution sector.

Reforms should focus on developing the necessary regulatory frameworks for modern distribution services including rules and regulations affecting the business environment. The lack of licensing and operation rules for distribution companies, inadequate codes on investment, commerce, labor, and taxation, as well as the lack of bankruptcy procedures create significant uncertainty and burden for firms that are trying to conduct business operations in the formal distribution sectors of East African countries.

Improvements to existing regulatory frameworks should eliminate disproportionate entry requirements such as lengthy registration procedures, multiple licenses, or inadequate zoning regulations. Price controls imposed across the region and the cartels in place in several East African countries represent a serious impediment to competition and should be removed.

Address skills issues in the distribution sector. A strong distribution sector will require local know-how and talent. At first, companies will need to bridge the gap by using a mix of local and international employees. In parallel, investments in developing and retaining local talent are required. Developing local training programs and putting in place apprenticeship opportunities will be critical to achieving long-term success.

Address the other constraints identified by the business community. Steps must be taken to address the infrastructure and insecurity concerns raised by the business community. The removal of non-tariff barriers that hamper the imports of distributors should be on the policy agenda of all East African governments. Finally, all governments in the region as well as business associations can play a constructive role in collecting and disseminating relevant market information for distribution operators in the formal and informal segments.

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Africa is not achieving its potential in regional trade. This is of particular importance given the uncertainty surrounding the global economy and stagnation in traditional markets in Europe and North America and the emergence of Africa as a rising growth pole. The contributions to this volume highlight the enormous scope for increased cross-border trade in Africa in both goods and services and the reasons why such opportunities are not being exploited. The varied contributions show that for effective regional integration policy makers must look beyond simply removing tariffs to address barriers on the ground that constrain the daily operations of ordinary producers and traders. This requires a reform agenda, covering both goods and services that puts in place appropriate regulations for integrated markets and builds the capacity of institutions that are essential for trade across borders.

The incidence of barriers to regional trade fall most heavily on the poor and women and prevents them from exploiting the opportunities that regional trade provides to diversify exports away from a narrow range of minerals and primary products that have been driving recent growth. Regional trade can play a key role in delivering the jobs that are needed for Africa's young populations. The chapters have been written in a non-technical way to promote dialogue on regional integration in Africa amongst a broad audience that includes policy makers, officials, academics, entrepreneurs, consumers as well as the international development community.