



AFRICA INSIGHTS

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THE AFRICAN CONTINENTAL FREE TRADE AREA:
DEVELOPMENT ACCELERATOR OR MORE OF THE SAME?

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Africa Insights is a research collaboration between Bowmans and the University of Stellenbosch's Centre for Complex Systems in Transition.

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Foreword



The African Continental Free Trade Area (AfCFTA) agreement is being hailed as the single most progressive step forward for the continent in advancing economic development and mitigating the fallout from the COVID-19 crisis. With the exception of Eritrea, all African nations have shown intent to participate in AfCFTA, displaying a degree of unity seldom seen.

Whether or not AfCFTA delivers on its promise – and how soon – will depend on how well we as a continent deal with the inevitable challenges that accompany a plan as visionary as the AfCFTA. This seventh edition of Africa Insights examines some of these challenges and proposes how they can be managed.

One of the biggest hindrances identified by our research partners at Stellenbosch University's Centre for Complex Systems in Transition is the extent of economic fragmentation across Africa. This diverse continent has several varieties of capitalism, differing and sometimes conflicting trade standards and certifications, and weak and fragmented regimes for resolving transnational disputes and promoting competition and investment.

Further, Africa lacks economic diversification and suffers from the so-called 'resource curse'. This is a colonial-era throwback that prevents many African nations from benefiting from their resource abundance and locks them into activities that impede political, social and economic development.

Add to this the reality that some of the (Western-inherited) laws and regulations governing finance and trade do not enable the redress of inequalities and effective wealth creation by Africans themselves.

As the research team notes, it is clear that the AfCFTA will need to facilitate more than the removal of trade barriers for regional integration. It will also need to focus on trade composition and diversification, industrialisation, infrastructure development and the close coordination of Africa's commodities.

Then there are the challenges – and possibly even losses – that individual countries, smaller regions and smaller businesses could encounter as a result of adjustment costs and higher trading costs, at least during the initial stages of implementing the agreement.

The environmental impact of AfCFTA should also not be overlooked. The research team points out that while sustainable standards are included in the agreement, the environment is not prioritised and there are concerns that the rise of intra-continental trade could result in higher CO₂ emissions.

While raising these many and varied challenges, the researchers have applied their minds to solutions. These include tweaking the AfCFTA to incentivise the promotion of green growth for industrialisation; appointing a Pan-African network of experts to generate a coherent proposal for the full harmonisation of standards and certifications; and establishing a dedicated African Commercial Court to preside over AfCFTA-related arbitration matters.

There are some good ideas in this edition of Africa Insights and much to think about, debate and discuss. The implementation of the AfCFTA – an idea whose time has come – can only benefit.

Robert Legh

Chairman and Senior Partner

Introduction

Economic growth, industrialisation, sustainable development, regional cooperation and integration in Africa are just a few of the desires and expectations riding on the African Continental Free Trade Area (AfCFTA).

At this time of COVID-19-induced economic and social woes, the AfCFTA has been hailed as a continental comeback strategy, and as a way for Africa to reposition itself on a global stage. The formation of new markets, the projections for higher employment numbers, more diverse products and the stimulation of industrialisation pathways are part of the vision for the AfCFTA as African economic integration is realised.

The COVID-19 pandemic has induced a crisis in the 'real economy' of production and not merely within the financial sphere (as was the case in the 2007-2009 global financial crisis). This makes it even more important that the AfCFTA reinforces counter-cyclical interventions that reposition African economies within a global economy faced with the threat of a long-term deflationary period.

The agreement has come a long way since 2012 when heads of state in the African Union decided on its establishment. Since its adoption in 2018 in Rwanda, 54 countries have signed the AfCFTA agreement, meaning all African countries except Eritrea have shown intent to participate.

Removing tariffs on 90% of traded goods and allowing services, commodities, products and people free movement are among some of the basic protocols to counter trade barriers and slow development on the continent.

The agreement aims to boost trade by 52% by harmonising a market of 1.2 billion people to become the world's biggest free trade market. The operational phase was launched in 2019 after 30 countries had ratified the agreement.

But Africa is not a country. It is a diverse and divided continent with varieties of capitalism, some tightly controlled by the state, some more liberal. A snapshot of the 54 country signatories gives an indication of the nature of the diversity.

Underpinning the economic, legal, policy and social issues is a commitment to a vision of Pan-Africanism – an idea initially championed by Ghana's first President, Kwame Nkrumah, during the 1960s.

This idea must now hold the AfCFTA together as the key instrument for addressing many African challenges, including boosting the continent's development to improve socio-economic conditions for African people, and decolonising inherited systems of governance and ways of doing business.

African Union (AU) Chairperson and South African President, Cyril Ramaphosa, was clear on this point at the February 2020 AU summit where the AfCFTA Secretary-General was elected. He is quoted as saying, 'the era of economic colonialism and imperialism, under which Africa was a pit stop in the global assembly line, has passed'.

The agreement has the potential for catalytic change but, at the same time, poses challenges and even raises the possibility of losses to individual countries, smaller regions and smaller businesses.

In assessing the potential impact of AfCFTA, it is necessary to consider the obdurate conditions that persist through a particular understanding of an economy and the rules of that game.

Which countries have ratified the AfCFTA Agreement?

Source: Tralac, 2020

Country	Date*
Kenya	10 May 2018
Ghana	10 May 2018
Rwanda	26 May 2018
Niger	08 June 2018
Chad	01 July 2018
eSwatini	01 July 2018
Guinea	01 July 2018
Uganda	28 November 2018
Côte d'Ivoire	16 December 2018
South Africa	10 February 2019
Sierra Leone	29 April 2019
Mali	February 2019
Senegal	April 2019
Namibia	February 2019
Congo, Republic	10 February 2019
Togo	April 2019
Mauritania	11 February 2019
Djibouti	February 2019
Egypt	08 April 2019
Ethiopia	10 April 2019
The Gambia	16 April 2019
Saharawi Republic	29 April 2019
Zimbabwe	24 May 2019
Burkina Faso	29 May 2019
São Tomé and Príncipe	27 June 2019
Gabon	07 July 2019
Equatorial Guinea	07 July 2019
Mauritius	08 October 2019
Cameroon	31 October 2019**
Angola	28 April 2020 **



- Instrument of ratification deposited
- AfCFTA agreement signed
- AfCFTA agreement not signed

*Date on which the AfCFTA instrument of ratification was deposited with the AUC chairperson

**Date on which ratification was approved

A long-term vision for Africa

Africa's economies have been described as relatively small, fragmented and isolated, not having developed robustly since gaining independence in the 1960s and 1970s.

Their limited scale has been the explanation for relatively non-transformative investments and the lack of competition in markets.

Most economies have grown in terms of GDP, some substantially such as Nigeria, South Africa, Egypt and Equatorial Guinea, but this has not always translated into development.

The continent, along with many Latin American countries, lags behind other emerging economies in South East Asia in areas such as education outcomes, infrastructure, good governance and technology absorption.

To a large extent, Africa has remained a resource pool for Western developing nations, mirroring the kind of exploitative exchange that occurred during colonial times. Many African nations have not benefited from their natural endowments and have been locked into activities that retard political, social and economic development.

This has come to be known as the 'resource curse' - a term coined by Richard Auty, professor of economics at Lancaster University. He links resource abundance to corrupt, violent and slow development dominated by authoritarian regimes, the likes of which have been seen in oil-endowed Nigeria, diamond-rich Sierra Leone and the Central African Republic, to name a few.

It is clear, then, that the AfCFTA will need to facilitate much more than the removal of trade barriers for regional integration. It will also need to focus on trade composition and diversification, industrialisation, infrastructure development and the tight coordination of Africa's commodities to dispel the resource curse.

The drive for intra-continental cooperation has a history going back to 1963 with the formation of the

Organisation for African Unity (OAU), which was an effort to bring peace and unity. The OAU was initially supported by a Pan-African vision to eradicate the vestiges of colonialism, apartheid and racism but turned its attention to matters of economic growth and enduring peace in the 90s after the end of apartheid in South Africa.

In 2002 the OAU became the African Union (AU) in pursuit of regional cooperation and integration, evolving into a supranational governance entity for member countries and its institutions.

This process of integration is a highly complex affair, requiring the reorientation of narrow national interests to a now shared set of rules, governance mechanisms and policy to reflect a continent-wide concern.

Political scientist Ernest Haas has described this regional integration as 'the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities towards a new center, whose institutions possess or demand jurisdiction over the pre-existing national states'.

Agenda 2063 is the AU's coherent plan for Africa to realise the objectives of inclusive social and economic development, democratic governance, security and acknowledgement of a proud cultural heritage. It builds on many years of multiple frameworks, including the Lagos Plan of Action in the 1980s and the Abuja Treaty of the 1990s, which saw the formation of NEPAD along with a host of industrial and agricultural development initiatives.

Regional integration has been a long-cherished ambition towards overcoming the disadvantages of small and fragmented national economies. The AfCFTA is but one part of Agenda 2063's ambitious programmes, other elements being the formation of an African commodity strategy, an African passport, a transition to cleaner energy and an African outer space strategy.

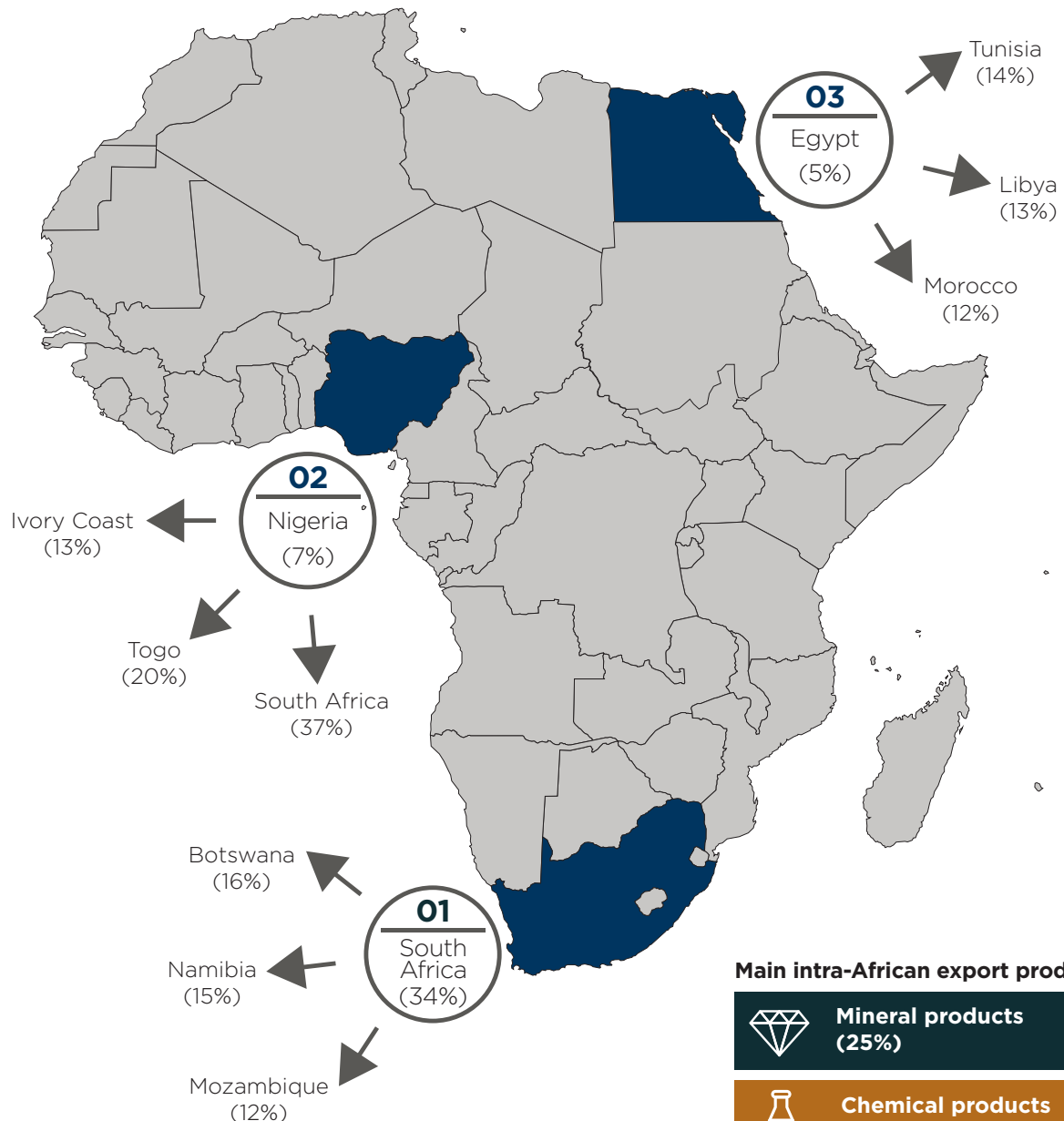
The current state of intra-continental trade

Intra-regional trade in Africa accounts for 15% of exports, which is far below that of Asia (58%), Europe (67%) and even North America (31%). While this can be attributed in part to high tariffs on the continent,

combined with colonial-era infrastructure, the complexity of multi-regional economic community membership also acts as a barrier.






Main intra-African exports






Source: Tralac calculations, ITC Trademap, 2019



Main intra-African importers and exporters, 2017

Source: Tralac calculations, ITC Trademap, 2019

Exporters			
30%	South Africa		Maize
			Food preparations
9%	Niger		Palm oil
			Rice
6%	Egypt		Sugar
			Wheat flour
5%	Uganda		Tea
			Coffee
5%	Kenya		Tea
			Cigarettes

Importers			
9%	South Africa		Cattle
			Sugar
8%	Kenya		Maize
			Sugar
7%	Namibia		Sugar
			Wine
6%	Botswana		Maize
			Beer
4%	Zimbabwe		Maize
			Soybean oil

In the period between 2000 and 2017, intra-African trade focussed on manufactured goods and food. The main intra-African exports were minerals, chemical products, food, beverages and tobacco, 60% of which consisted of raw materials and primary products. On the other hand, 70% of imports across the continent were manufactured goods, mainly comprising chemicals, machinery and transport equipment, among others.

Intra-African trade, while still low, is steadily increasing. Of particular importance is the influence of the agricultural sector in Africa. While agriculture is the largest employment sector on the continent, accounting for 19% of intra-African exports and 18% of intra-African imports, employment opportunities in the sector are steadily decreasing.

Considering the lack of economic diversification in all but a few African countries, this leaves the continent dependent on a sector that has limited job creation potential.

In addition, Africa's income generation is not proportional to its population size and labour force. This can be attributed to a lack of economic potential and not optimising the labour force at its disposal.

The creation of free trade areas in each region was seen as a mechanism to promote economic diversification, development and structural transformation.

As a result, Regional economic communities (RECs) were established. These gave rise to trade areas such as the five-nation Eastern African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA), comprising 21 countries.

The eight RECs on the African continent were intended to act as tools for unification. However, some of these overlapped, as did their membership. These dynamics began to retard rather than boost the growth in intra-African trade, mainly through the development of differing, and sometimes conflicting, standards and certifications.

Consequently, long-standing economic fragmentation across Africa was reinforced. This has been partially overcome by the merging of some of the RECs, such as through the establishment of the tripartite free trade area between the Southern African Development Community (SADC), EAC and COMESA.

Thus, the AfCFTA faces a number of legacy challenges. Chief among them are high trade barriers for sensitive sectors. These include manufacturing with products such as machinery, auto, apparel and chemicals; and agriculture with products such as prepared food and beverages, and fruits and vegetables.

Other challenges are weak and fragmented regimes for promoting competition and investment, as well as for preventing or resolving transnational disputes and conflicts.

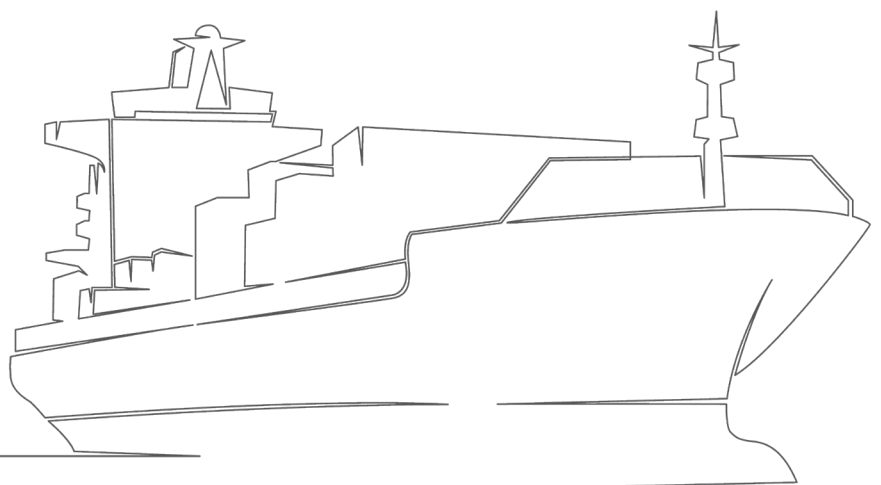
The need for a Pan-African network of experts who can generate a coherent proposal for full harmonisation of standards and certifications is clear.

Another shortcoming is inadequate customs management to facilitate trade.

The free trade areas that were established before the AfCFTA came about based their approaches for developmental integration on industrial development, market integration and infrastructure development.

This focus continues under the AfCFTA, a key goal of which is to promote investment in quality infrastructure to boost competitiveness and increase cross-border trade, particularly for historically marginalised groups.

The emphasis on infrastructure investment is crucial given that realising Africa's economic potential hinges on the availability of infrastructure in all spheres: communication, transport (roads, air and water routes, cross-border railways), energy supply, digital infrastructure (connectivity, access) and strategic facilities (trade harbours, financial hubs, special economic zones). Technical expertise to manage the infrastructure is also required.



Real-time projected impacts

African businesses operating within the continent vary in type and size, from the formal to the informal, from family businesses to micro, small and medium-sized enterprises (MSMEs) and large corporations. The success of the AfCFTA will be driven by the involvement of this highly diverse set of private commercial entities that invest and trade in goods and services across the African continent.

An often forgotten actor is the informal sector operators. Informal cross-border trade contributes between 30% and 40% of total intra-regional trade in the SADC region, and 40% in the COMESA region.

While not explicitly stated in the agreement, AfCFTA has the potential to significantly benefit informal cross-border trade by supporting its formalisation, making it more affordable for the operators, and offering protection.

MSMEs, which are responsible for more than 80% of the continent's employment and 50% of its GDP, are also likely to benefit as the AfCFTA agreement is designed to encourage MSME economic activity.

The World Bank, which estimates that approximately 415 million Africans live in extreme poverty, calculates that AfCFTA has the potential to lift 30 million people from extreme poverty and 68 million from moderate poverty.

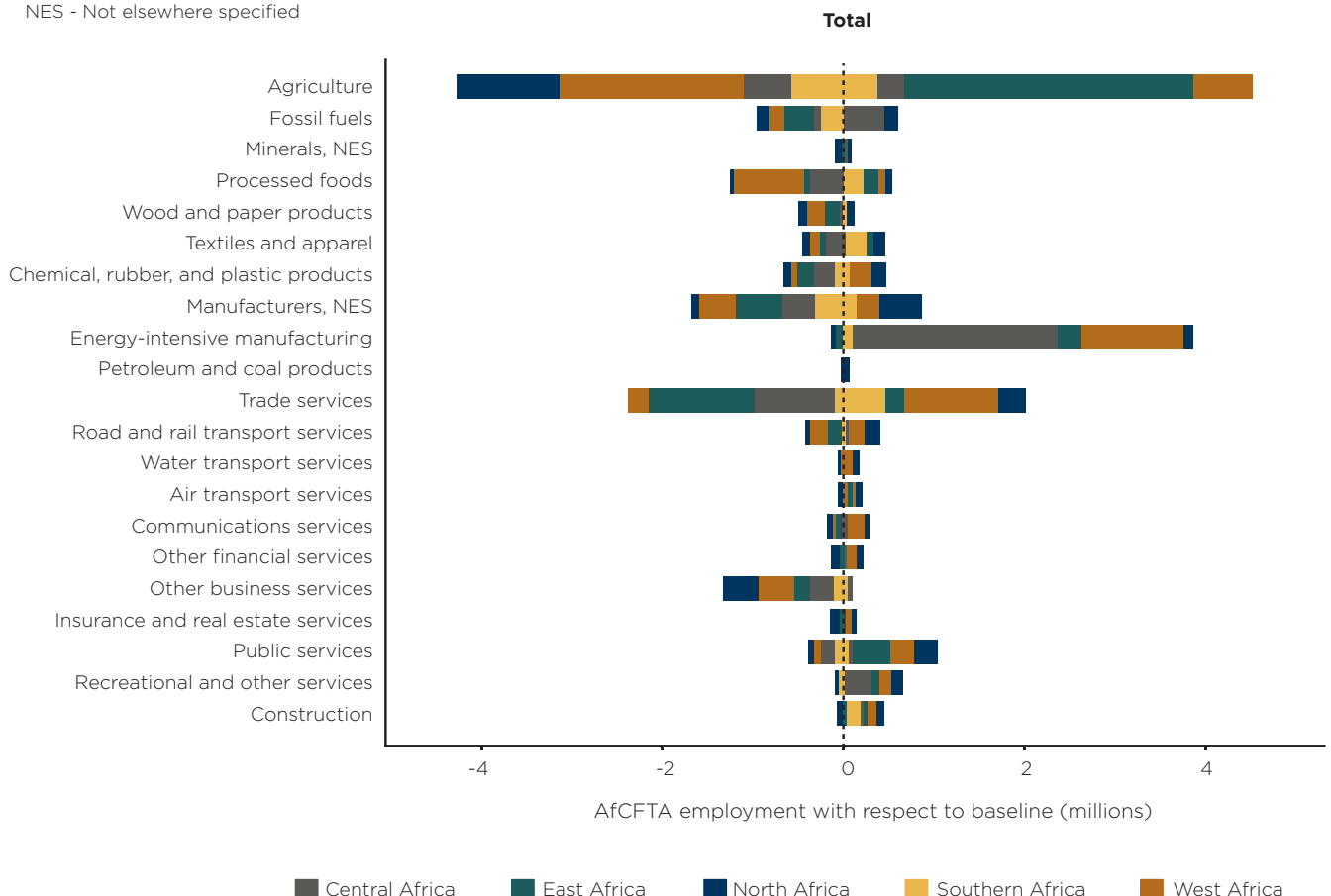
With the ratification and implementation of AfCFTA strategies, the structural transformation of employment in Africa is set to accelerate diversification. Half of employment on the continent is expected to be in the wholesale and retail sectors and, to a lesser extent, in agriculture.

The diagrams below and overleaf illustrate the changing volume of workers across several sectors and industries from a pre-AfCFTA implementation baseline.

AfCFTA employment change with respect to baseline, total

Source: World Bank, 2020

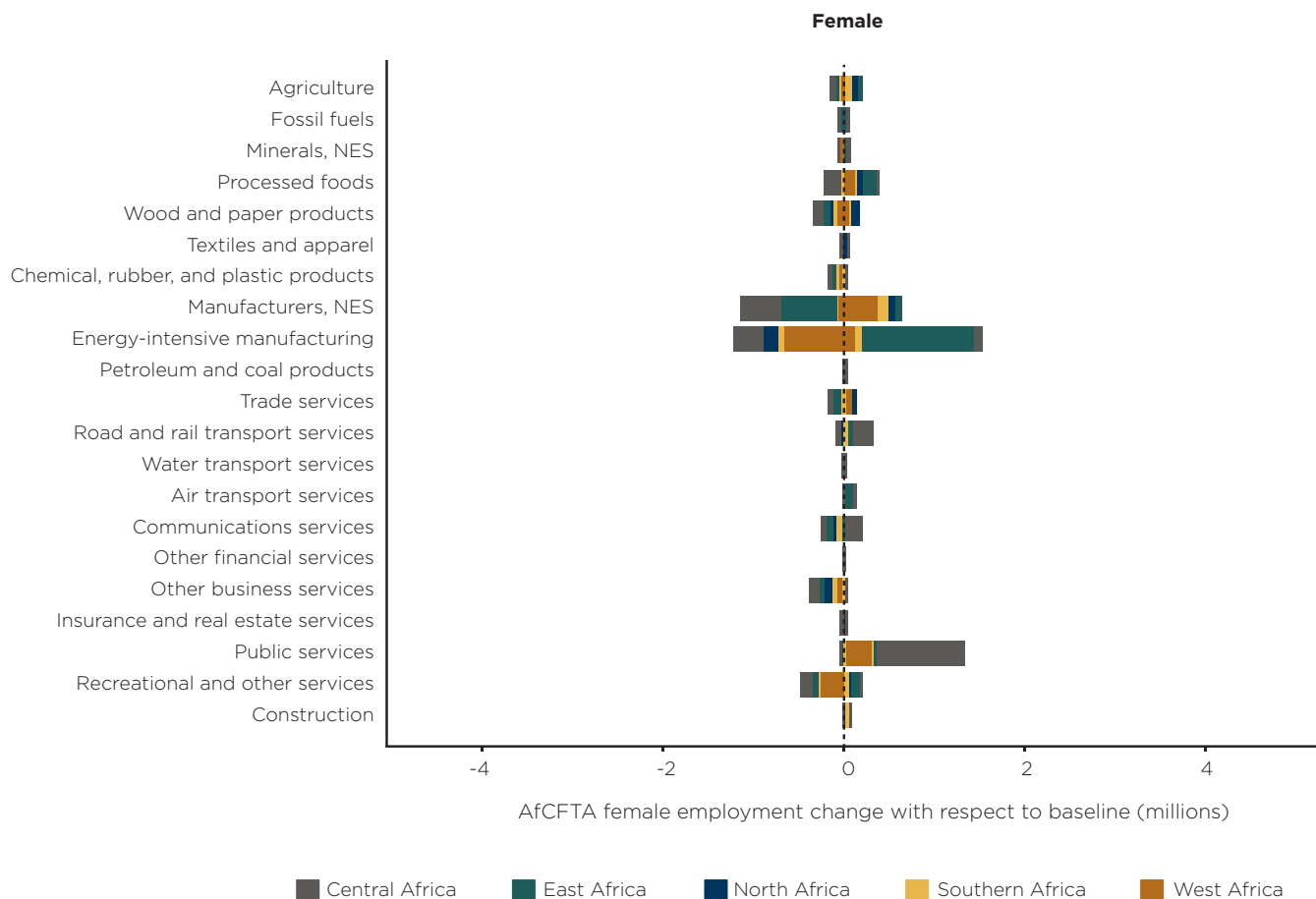
NES - Not elsewhere specified



AfCFTA employment change with respect to baseline, female

Source: World Bank, 2020

NES - Not elsewhere specified



Sectors likely to experience the greatest growth in employment are energy-intensive manufacturing (with an all-African increase of roughly 2.4 million employees), public services (4.6 million), recreational and other services (0.28 million), and trade services (0.13 million).

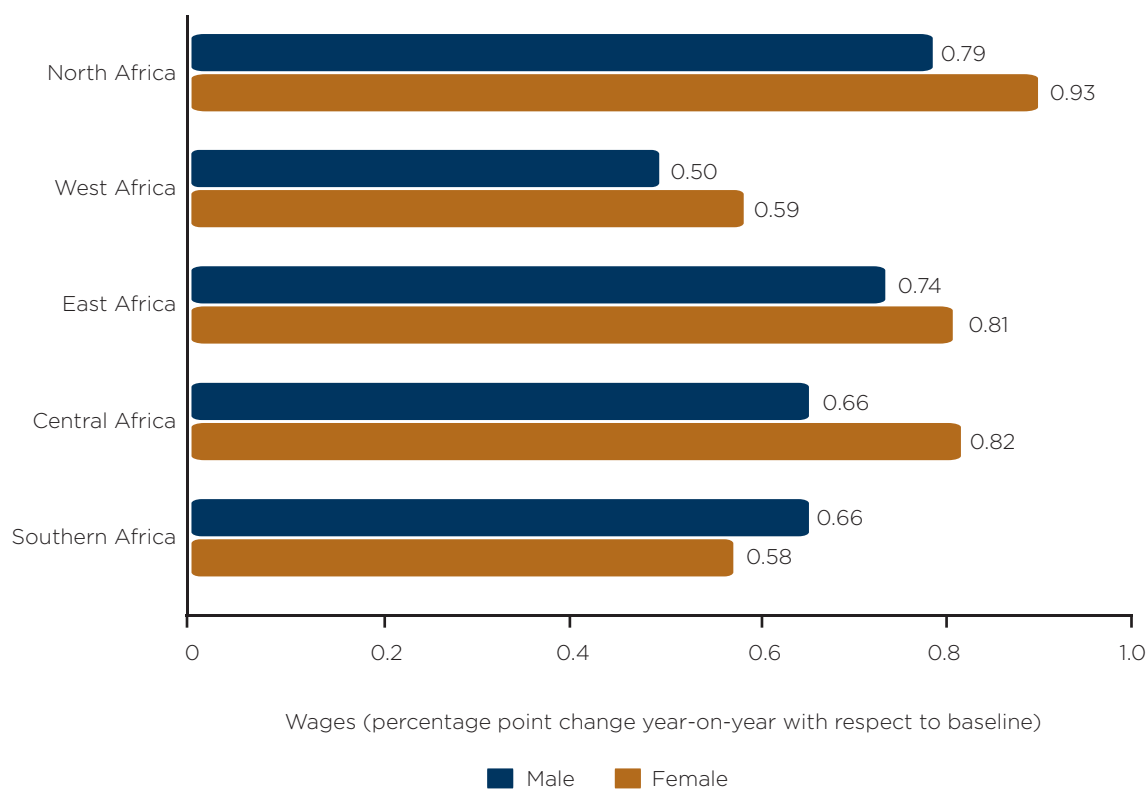
While the agreement aims to promote economic development for all, it also addresses exclusionary economic development, particularly along gender lines and in other marginalised communities.

Vera Songwe, Executive Secretary of the United Nations Economic Commission for Africa (UNECA), has said that the economic empowerment of women will be one of the effects of the AfCFTA. Total income for female labour is expected to grow faster than average income growth in all regions except Southern Africa.

The graph overleaf illustrates the expected impact of the agreement on wages by gender.

Effects of the AfCFTA on wages by gender

Source: Estimates, World Bank study team



Challenges in implementing the AfCFTA

The AfCFTA has been applauded for its scope and ambition. In the short term, however, a more competitive environment could disadvantage MSMEs and small-scale farmers through higher trading costs than larger and more established companies.

Furthermore, in the transitional phase, less diversified and adaptable countries will encounter higher adjustment costs. In addition, labour mobility costs will vary from country to country, while labour mobility remains limited across economic sectors.

The development of e-commerce across the African continent is vital if the potential of AfCFTA is to be realised. The advent of the digital economy highlights the necessity for affordable information and communication technologies and enhanced connectivity in rural and remote areas. Closer attention will also have to be given to ensuring a conducive legal framework to support digital activities and trade, as well as data privacy, data protection and cyber security.

In the short to medium-term, trade liberalisation could potentially negatively impact unskilled labour, particularly if low-skill sectors were previously protected. Unless governments put social security and compensation safeguards in place, such change could precipitate social tensions or adverse working conditions and job losses.

Important to note is that trade liberalisation, decoupled from developing a financial sector, strong governance structures and a population with rising education levels, does not result in lower poverty levels, so developments in these areas are key to achieving the goals of AfCFTA.

For some member states, reduced tariffs could adversely impact government budgets, particularly if revenue decreases are sharp or sudden. Beyond inhibiting governments' capacity to invest in infrastructure, education and social programmes, revenue decreases could shift countries away from sustainable development practices and exacerbate inequality.

The European Union experience is instructive in this regard: the rules favour a dominant economy, such as Germany with a strong manufacturing-oriented export base, and can work against less industrialised

economies such as Greece, Portugal and Spain. One can only imagine how this could be exacerbated in Africa, where inequalities between middle developing and least developed countries are particularly severe.

A major potential challenge that the AfCFTA could face involves the necessary integration of heterogeneous economies (varying in levels of development) under the single agreement.

Unlike other continental free trade agreements, the AfCFTA will be implemented in a context with massive levels of income disparity – more than double that of the Association of South East Asian Nations (ASEAN) and Caribbean Community (CARICOM) economic blocs.

In addition, further integration will be required across regional economic communities. The membership of states within multiple RECs will need to be addressed, requiring convergence to ensure compatibility with the AfCFTA.

Convergence in terms of standards and certifications is certainly needed, along with trade facilitation policies to reduce excessive border bureaucracy and corruption, while encouraging businesses to develop cross-border trade.

There are concerns about the effect of the AfCFTA on climate sustainability and sustainable practices if the rise of intra-continental trade results in higher CO₂ emissions.

Greater competition could tempt smaller companies to cut costs in the areas of manufacturing and waste disposal. There is an assumption that an improvement in south-south trade would eventually result in a decreased contribution to climate change by reducing reliance on imports from the north. However, shorter term concerns remain. In addition, while sustainable standards are included in the AfCFTA agreement, the environment is not prioritised in its primary objectives.

It will also be important to ensure that trade disputes are effectively managed. The AfCFTA agreement contains the protocols of trade in goods and services, as well as processes and rules to govern how disputes, competition policy and intellectual property rights are settled.

At the same time, the agreement relies heavily on mutual trust, cooperation and harmonisation of processes and legal frameworks.

Arbitration will be the primary means to settle commercial disputes arising from the implementation of the AfCFTA, and must be a regime that makes provision for commercial entities, in addition to public or national actors to raise disputes. Currently, access to dispute resolution is limited to public actors, which is at odds with the commercial nature of trade envisaged under the agreement.

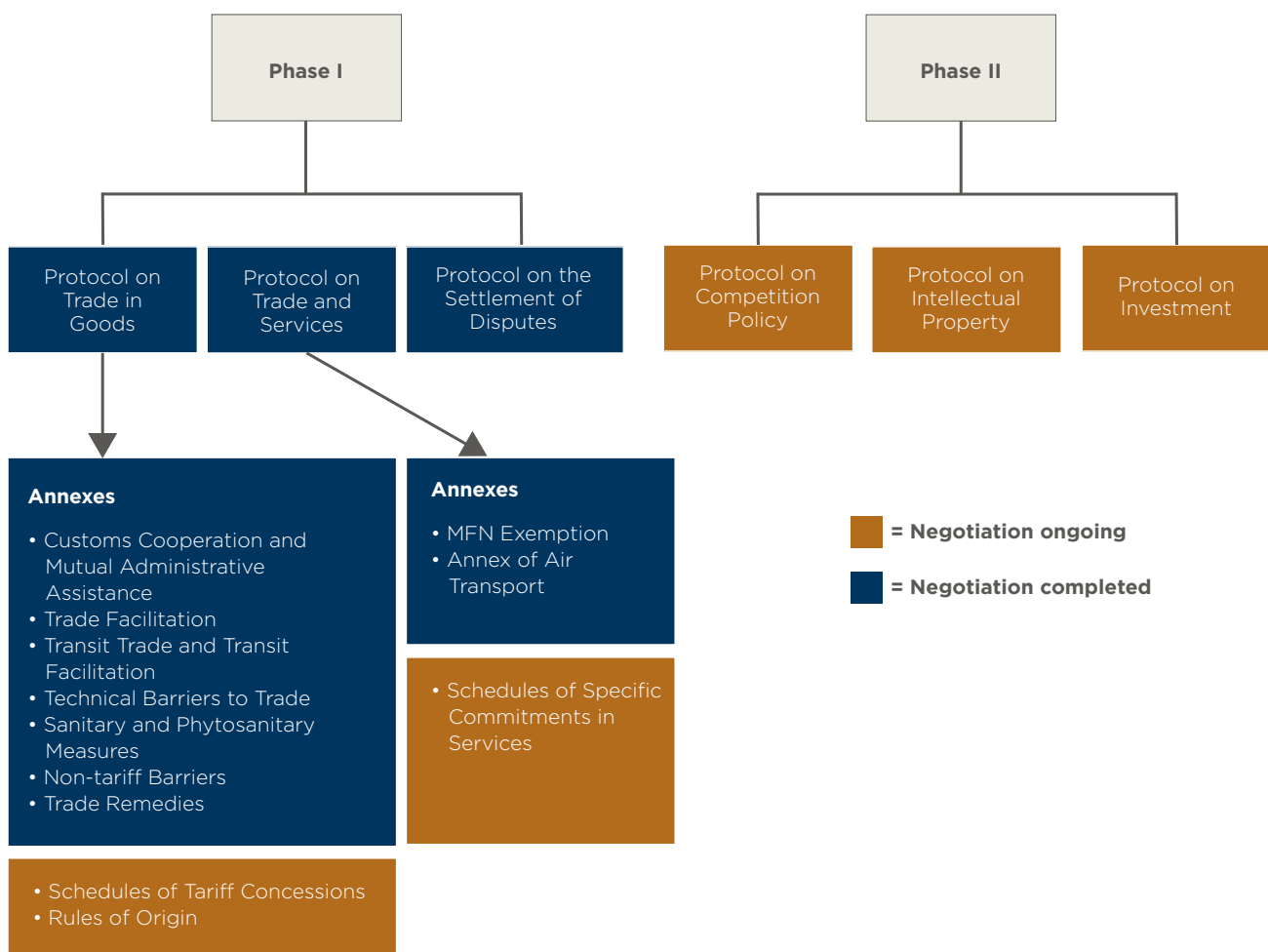
Ensuring effective continent-wide arbitration capacity is still some way off. Although many countries have modern arbitration laws, supportive courts, arbitration centres and arbitration practitioners, capacity is uneven.

A solution could be to establish a dedicated African Commercial Court which presides over arbitration matters solely related to the AfCFTA, enforceable in all AU member states.

The diagram below shows the outstanding issues that require negotiation. Critical Phase 1 issues like rules of origin and tariff concessions have not yet been decided, which will impact potential traders looking to benefit from the AfCFTA.

Status of AfCFTA protocols

Source: Signe and van der Ven, 2019



Conclusion

The AfCFTA echoes to a certain extent the World Trade Organisation (WTO) principle that economic growth is a result of free trade. The concept of free trade rests on a very particular kind of economic theory, namely one which elevates the role of the market as a solution to complex historical, political issues. The reality is that markets do not function independently but are extensions of human values, national laws and regulations, and have great impact on the environment.

Laws and regulations governing finance and trade in Africa have largely been inherited from colonial powers and Western institutions. While there are some positive features in this legacy, such as contract law, there are aspects of these approaches that do not enable the redress of inequalities and effective wealth creation by Africans themselves.

Inherited colonial frameworks remain an obstacle to development, sometimes overtly. For example, until recently, the Central African Franc (CFA) in former French colonies still controlled the finances of these economies. While colonialist legacies have left inequality, environmental degradation and regional conflicts deeply embedded on the continent, Africans are on their own when it comes to dealing with the consequences.

A strong Pan-African vision for the AfCFTA that includes full decolonisation across all institutions should not mask the reality that many economic policies that counteract this vision in practice, are still in place.

As AfCFTA evolves, greater consideration of underlying ethical norms must be included. An example is the relationships between each other as Africans and our relationships with nature in the context of the climate emergency. Given the global consensus that green infrastructure investments have the best short and long-term multiplier effects, the AfCFTA should be tweaked to incentivise the promotion of green growth for industrialisation.

Similarly, we might have to accept that asymmetrical trade liberalisation may be necessary to give smaller economies fair opportunity to prepare for a competitive regional environment. The COVID-19 pandemic has revealed just how vulnerable countries and regions have become in a hyper-globalised world, dependent on financial flows and value chains that can severely impact the real economy of a national state.

When trade and economic interdependence are more regional, better regulated and coordinated, with a strong social and environmental compact at the centre, the shocks of future pandemics and the growing impacts of climate change could be buffered.

COVID-19 has shown us how alliances, loyalties, agreements and supply chains can fail when stretched too far geographically and ideologically. AfCFTA holds much promise for developing and uplifting the continent as a force for change on a fast-changing world stage.



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