Inquiry into Africa Free Trade Initiative

Written evidence

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Key messages

- Trade facilitation promotes productivity growth, employment creation and poverty reduction by raising volume and diversification of exports, reallocating resources to more productive activities, improving access to inputs and enabling participation in value chains.
- Physical (hard) and regulatory (soft) infrastructure are both important, and are in fact complementary in order to facilitate trade.
- The indirect effects of regional infrastructure on households, firms and governments need to be considered.
- Aid for Trade has been effective in raising exports and improving the investment climate. Future Aid for Trade interventions need to aim at reducing the cost of trading; address binding constraint to growth; ensure effective coordination between donors and recipients; address the transnational and regional level constraints and; improve M&E of impacts, outcomes and outputs.
- Development finance institutions play an increasingly important role in promoting growth, especially when they focus on in power generation and on the financial sector, that can in turn catalyse investment in other sectors

This brief is a submission from Neil Balchin, Linda Calabrese and Max Mendez-Parra (Overseas Development Institute) on the Africa Free Trade Initiative (AFTi). For additional information, contact Max Mendez-Parra (m.mendez-parra@odi.org).

We have organised this brief in three sections, following the questions outlined in the terms of reference.

1. Trade Policies and trade facilitation systems in Africa and their effects on wealth creation, employment and poverty reduction

Trade facilitation can stimulate transition towards more productive activities in Africa by raising exports, supporting export diversification, reallocating resources to more productive activities, improving access to cheaper and better-quality imported inputs and enabling participation in value chains. This can promote growth, creation of higher-quality employment opportunities, and poverty reduction.

Recent ODI-SET work conducted with the African Centre for Economic Transformation analyses the links between trade facilitation and economic transformation (Amoako-Tuffour et al., 2016). The first part of the study considers the role trade facilitation – involving the simplification, harmonisation, standardisation and modernisation of trade procedures to reduce trade transaction costs – can play in assisting economic transformation in Africa. The focus is on trade facilitation related to cross border customs procedures, transit and logistics. In principle, trade facilitation measures that reduce trade costs can influence economic transformation by lowering the cost of inputs, raising competition in the domestic market, boosting the competitiveness of exports and facilitating the integration of domestic firms into modern value chains. These factors enable domestic producers to raise their productivity, improve their competitiveness in traditional products and facilitate the export of new higher-value products, thereby contributing to the movement of labour from low- to higher-productivity activities.

The second part of the study surveys trade facilitation measures that have been applied in different African Regional Trade Agreements (in East, West and Southern Africa) and how these can be conducive to trade facilitation. Digital technologies are playing an important role in trade facilitation. African regional economic communities (RECs) are using digital technologies extensively to improve processes and decrease obstacles to trade. For example, the Southern African Development Community countries harmonised their customs IT systems and set up electronic payment system to settle regional transactions among banks. Similarly, the East African Community states are working towards the harmonisation of their customs procedures to ensure faster customs clearance and border crossing.

Finally, the paper highlights that African RECs have designed good policies, but struggle in implementing them. Therefore, more attention should be paid to the policy constraints that might prevent implementation of trade facilitation policies.

Another recent ODI project (Jouanjean et al., 2016) highlighted the importance of regional infrastructure for trade facilitation (RITF). The research examined physical (hard) and regulatory (soft) infrastructure, stressing the existence of complementarities between both types of infrastructure to ensure pass-through of the benefits of the reduction in trade costs to poor producers and consumers. The pass-through of the effect of new hard infrastructure to economic actors occurs only when complementary regulations allow for efficient trade logistic services. In particular, innovative regulations and infrastructure should address coordination failures in modern value chains and tackle obstacles such as localisation barriers to reduce competition in the logistics sector.

Using a mix of research papers and case studies, the report develops and tests a new theory of change for the impact of regional infrastructure and associated trade cost reduction on the behaviour, risks and opportunities of economic actors (mainly households, firms and government). The theory of change highlights the direct impact of hard and soft infrastructure on decreasing transport and transaction costs, increasing reliability and efficiency of transport. The theory of change also identifies indirect effects of infrastructure, highlighting the fact that the impact stems from the interaction between direct and indirect effects.

The main findings of the report are the following:

1. RITF encourages economic activity across the border, including for most informal traders. The study finds the facilitation of trade across borders leads to a greater spatial spread of economic activity, suggesting trade facilitation projects are valuable not just for their growth effects but also for their spatial effects and potential reduction in urban pressures. The study suggests the need to implement complementary policies to support and sustain the effects on the reduction of spatial inequalities, such as investment in rural areas and small urban centres to support the participation and access of rural populations to the market and increase access to health and education services to address the needs of vulnerable groups.
2. RITF helps firms in African countries connect to modern value chains and in particular global value chains. The study finds a clear positive association between infrastructure for trade facilitation and connectivity to international production networks, particularly in textiles and clothing. There is a strong positive association between infrastructure and trade facilitation improvements in neighbouring countries and greater value chain connectivity at home. It is, therefore, not just what a country does that matters for its connectivity, but also what its neighbours do. Recognising this new evidence, policymakers should improve hard and soft infrastructure and also adopt a regional approach to infrastructure development.
3. RITF has long-lasting effects through productivity of firms. The study suggests firms in countries with better regional infrastructure (reflected in the quality of infrastructure in their neighbours) also have relatively higher productivity. The productivity-enhancing effects of regional infrastructure are shown to come through importing material inputs and supplies, but also through exporting. Regional exporters put greater emphasis on technology, which leads to higher productivity and better product quality. We find evidence of significant variation in transaction costs associated with the use of regional infrastructure.

2. Findings from recent work on vulnerable groups and informal cross-border trade

Jouanjean et al (2016) analysed how regional infrastructure for trade facilitation (RITF) can help trade costs reduction, growth and poverty reduction. The study addresses, in particularly, the synergies and complementarities between hard and soft infrastructure in reducing risks and creating opportunities for households and firms. As part of the RITF project, Tyson (2015) conducted a survey at the Busia border between Kenya and Uganda to investigate the effects of trade facilitation measures, and in particular the One-Stop Border Posts (OSBP) on vulnerable groups. We considered different types of vulnerable groups (small traders, casual workers) and we found differentiated effects on these groups. Overall, the case study concludes that the effect of the OSBP has been to make crossing the border easier and increased livelihood opportunities for the poor.

The OSBP has predominantly improved the economic livelihoods of informal traders operating around the border by increasing their opportunities for cross-border trade and enlarging the markets in which they are able to trade and seek employment opportunities. This includes through the presence of simpler and informal border crossing processes, which – from the perspective of the poor – are effective. However, this owes partially to non-enforcement of formal crossing processes and points, raising concerns about loss of public revenues and security. Physical, verbal or sexual harassment is not occurring.

In addition to the reduction of formal trade costs (i.e. customs charges), OSBP can help to reduce informal trade costs such as bribes and market fees. Bribery, for example is pervasive and a significant drain on the incomes of the poor.

There was evidence among the most vulnerable group – low-skill casual workers – of declining livelihoods due to reduced volumes of manual transportation and handling of goods and people, and the provision of other services to traders in the border. However, these effects were limited to the specific workers and businesses associated with these activities. The ongoing construction work and traffic congestion have disrupted temporarily local businesses and caused loss of livelihood opportunities.

There has been little effect on non-financial issues such as family and community lives and access to health, education and financial services. However, this is mainly because people access services in their country of nationality only.

The results of this study has to be read in conjunction with the main report under which this research was conducted (Jouanjean et al., 2016). As this report highlights, there might some short-term negative or neutral effects for vulnerable groups at the borders, however, in the medium term these could be offset by the increased productivity caused by increased trade, which could provide alternative employment opportunities to those vulnerable groups.

The results presented in these studies are in line with other studies, for example a joint World Bank and World Trade Organization study on trade and poverty published in 2015. The report highlights that trade can drive poverty reduction by boosting growth. The report looks at four leading characteristics of the poor that have a particularly strong impact on their capacity to extract the full potential benefits of trade: rural poverty; fragility and conflict; informality; and gender. In addition the poor face several risks that affect their capacity to benefit from trade opportunities – these include economic shifts, labour market adjustments, and vulnerability to weather events and to climate change. At the same time, the poor often lack access to the instruments and support necessary to mitigate these risks.

The World Bank and World Trade Organisation report looks at how these risks can be mitigated. Jouanjean et al. (2016) complements this by adding that the indirect effects of reducing trade costs can also generate additional opportunities for the poor through increased productivity in the economy.

3. The role of development partners in boasting trade and investment in Africa

Basnett et al (2012) and Basnett (2013) conducted a project on Aid-for-Trade, aimed at understanding what works, how and under which circumstances. The empirical literature tends to confirm that Aid for Trade has been effective in raising exports and improving the investment climate. More precisely, Aid for Trade investments in improving trade facilitation and developing trade-related infrastructure have significant positive impacts on recipient countries' exports. For example, empirical assessment indicates that a 10% increase in Aid for Trade investment to trade-related infrastructure leads to an average increase of 2.3% in the developing country's exports to gross domestic product (GDP) ratio. Similarly, a 10% increase in Aid for Trade investment in improving transportation and energy results in a 6.8% increase in manufacturing exports. And Aid for Trade investment in enhancing trade policy and reform significantly lowers the costs of trading in the processed agriculture and primary agriculture sectors.

However, the impact of Aid for Trade tends to vary considerably depending on the type of intervention, the income level and geographical region of the recipient country and the sector to which Aid for Trade flows are directed. The study also found that the present ways of identifying Aid for Trade do not always align with the trade-related binding constraints of the recipient country/region. In many cases, Aid for Trade needs draw on a particular Ministry of Trade's project list, rather than addressing the country's trade-related binding constraints, or its market and co-ordination failures.

The paper finds that a wide variety of instruments and modalities are used to deliver Aid for Trade, including loans, grants, pooled funds and trust funds and channelling funds through multilateral institutions. Generally, Aid for Trade is desirable in addressing transnational and regional, rather than national constraints to trade. Blended financing mechanisms and corridor approaches to delivering Aid for Trade are found to be particularly effective.

The project found that Aid for Trade works best when:

4. It is targeted at reducing the cost of trading, for example through investment in infrastructure, improving trade facilitation and strengthening value chains. These should be driven and guided by support to the capacity of institutions that devise trade policies and regulations.

5. It addresses the binding constraint to growth. This will be largely country-specific and, according to traditional growth diagnostics, can relate to factors that affect the availability of finance of an investment project or factors (e.g. infrastructure, skills, transport costs) that affect returns to an investment.
6. There is effective coordination between donors and recipients around the design, implementation and monitoring of the Aid for Trade programmes, as well as coordination among different donors, within donor agencies, between different ministries within a recipient country government and between recipient governments and their regional trading partners.
7. The selection of instruments and modalities for delivering Aid for Trade are able to address trade-related constraints at the transnational and regional level. Many Aid for Trade projects are targeted towards improving trade for individual countries, when in fact greater gains can be made by focusing on ensuring greater integration of trade within regions.
8. The M&E of impacts, outcomes and outputs is realistic (the achievement of objectives can be traced along a feasible results chain), based on the collection of baseline data, and lessons contribute to the design of future projects.

In addition to Aid for Trade, the actions of Development Finance Institutions (DFIs) in the private sector in developing countries are playing an increasingly important role in promoting growth and investment. These institutions can help to enhance private sector development in areas where aid cannot reach or where foreign direct investment (FDI) does not find the necessary conditions to flourish.

Evidence from Massa (2011), Jouanjean and te Velde (2013) and Massa et al. (2016) has pointed to the role that these type of actions can have on investment. For example, investments in power generation and on the financial sector are key to catalyse investments in other sectors. The participation of DFIs such as CDC, Norfund and others has been key in unlocking these opportunities.

There is a marked relationship between levels of development and DFI participation. As countries grow, the sources of finance for development change – the relative importance of aid tends to decline while DFIs (and FDI) become increasingly more influential. While aid tends to address bottlenecks associated with basic infrastructure, DFIs address other constraints associated with poor private sector development and missing or incomplete markets.

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