



**ECONOMIC
DEVELOPMENT IN**

AFRICA

REPORT 2019



Made in Africa

Rules of origin for enhanced
intra-African trade



Economic Development in Africa Report 2019

Made in Africa – Rules of Origin for Enhanced
Intra-African Trade



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Chapter 3

The African Continental Free Trade Area, regional value chains and rules of origin

3.1 Introduction

Chapter 3 considers the mapping of intra-African trade and the evidence on rules of origin regimes to explore the following issue: What type of rules of origin would help generate the greatest development impact within the African Continental Free Trade Area? Given the context of the African Continental Free Trade Area and its relationship to other continental policy frameworks, a related issue is the extent to which rules of origin can be conducive to the emergence of regional value chains as a springboard to structural transformation and export diversification.

RULES OF ORIGIN:

can enhance consistency between
trade policy and industrial policy
objectives...



...in order to deepen regional value chains



Addressing these issues and assessing the impact of different rules of origin in Africa is a challenging endeavour for three reasons. First, it implies considering the impact of rules of origin in an increasingly complex context of international trade, where the emergence of regional and global value chains has made producers interdependent across countries, through trade in intermediate products. Second, the limited access to legal texts and the lack of data on preference utilization for most regional economic communities in Africa make a thorough assessment even more challenging. Third, there are a number of technical and analytical complexities involved in accurately quantifying the effects of rules of origin on trade. For example, the same legal formulations can have different impacts across various sectors; further, there are several econometric issues related to the identification of the impact of rules of origin.

To overcome these constraints and provide more concrete insights into the interplay between the regional integration of Africa, structural transformation and the role of rules of origin, this chapter adopts a case-study approach, focusing on how the African Continental Free Trade Area could affect selected regional value chains and how rules of origin shape the space in which this process takes place. In this respect, although the selection of the sectors analysed is inevitably subjective, it was informed by four broad criteria: sectoral coverage, relevance to intra-African trade (see chapter 1), importance for continentally agreed policy frameworks and/or national development plans, and representation of distinct legal elements of the formulation and implementation of rules of origin.

The advantage of a case-study approach over other methodologies is that it does not rely as much on systematic data that is difficult to obtain; moreover, it speaks more clearly to the economics of each regional value chain. A caveat applies, however, to the case-study approach, as it does to other *ex ante* simulation techniques such as computable general equilibrium models. By construction, the case study looks solely at the impact of rules of origin on existing trade relations (i.e. the intensive margin); it is considerably more difficult to assess how a given set of rules affects the entry barriers and opportunities for new entrants (i.e. the extensive margin).

Overall, the chapter finds that the impact of rules of origin is highly context specific, varying as a function of the country and sector considered, their input–output structure, the complexity of production and the governance and geographical features of the value chain. Nonetheless, some general principles can be drawn from the analysis. First, it is important that rules of origin be as business friendly as possible, in the sense of minimizing the cost of compliance, for any given level of restrictiveness adopted. Second, rules of origin should be simple (in the sense of being clear and understandable), transparent,

predictable and trade-facilitating and should be applied in an impartial manner. Third, it is of paramount importance that rules of origin formulation be informed by a thorough understanding of the productive sectors involved and by due consideration of the structural asymmetries across the countries in the Continental Free Trade Area.

The chapter consists of six case studies that are presented in increasing order of sectoral complexity, namely tea, cocoa and chocolate products, cotton textiles and apparel, beverages, cement and the automotive industry. The final section contains a synthesis of the discussion, with suggested policy recommendations.

3.2 Tea value chain

The tea value chain is a compelling example of the key channels through which the current trade regimes of Africa – including in relation to rules of origin – affect its integration and transformation agenda. It also provides some insights into the prospects that the African Continental Free Trade Area may have in reshaping the scope for the emergence of regional value chains. The relative simplicity of the production process and of the associated legal framework relating to rules of origin make the analysis of the value chain fairly straightforward from a technical point of view. At the same time, tea is a key cash crop, especially in Eastern and Southern Africa, and widespread consumption is high. Further, the study of African regional value chains makes it possible to identify some of the main constraints imposed by the current trading arrangements, as well as some potential gains achievable under the Continental Free Trade Area.

The tea value chain can be subdivided into five stages: production, processing, trading, blending/packaging and retail. Tea is made of leaves from an evergreen shrub (*Camellia sinensis*) that is cultivated mainly by smallholders. Plucked leaves must be rapidly brought to the processing factory, where they are withered and undergo different types of processing, depending on the tea varieties. In the case of black tea, leaves are either crushed or rolled, then fermented (to obtain the classical dark colour through the oxidation process) and finally dried; green teas are steamed or pan-fired to stop the fermentation process before being rolled and dried. Once processed, leaves are then sold to international buyers, which ship them overseas and perform the blending and packaging, and at times even the retailing. It is estimated that 70 per cent of global tea production is sold through auctions; the rest is mainly traded within vertically integrated companies that retain control of the entire processing phase (Food and Agriculture Organization of the United Nations (FAO), 2018a).²⁰

²⁰ Tea products are classified under the HS heading 0902, which includes the following subheadings: green tea in small packages (HS code 090210), green tea in bulk (HS code 090220), black tea in small packages (HS code 090230) and black tea in bulk (HS code 090240).

High levels of vertical integration and horizontal concentration characterize the tea value chain. The three largest companies, Lipton (Unilever), Tetley (Tata Global Beverages) and Twinings (Associated British Foods) control one fifth of the world market (FAO, 2018a; FAO, 2018b). This is particularly pronounced in relation to the downstream stages of the value chain. The governance structure is thus a key determinant of the extent to which participation in the tea industry translates into broader developmental gains among the players involved, especially smallholders (UNCTAD, 2015c). In particular, brokers and intermediaries play the crucial role of linking often-dispersed producers with international buyers; they can greatly enhance the transparency and inclusivity of the chain by sharing with such buyers valuable information on prices and quality requirements, or by favouring the diffusion of key inputs (FAO, 2014; FAO, 2018a).

Kenya is one of the most successful examples of the inclusion of smallholder farmers in the tea value chain, owing to deliberate efforts to enhance their stake in the governance of the processing and marketing stages (FAO, 2014). They account for over 70 per cent of national tea production, with half a million people deriving their livelihood from this cultivation. Kenyan tea growers deliver their products to buying centres – which also function as quality-control points – from where they are transported to tea factories, each receiving tea from roughly 60 buying centres. Each tea factory is a separate company, fully owned by some of the farmers that supply it, and all of them in turn own the Kenya Tea Development Agency. Whether they hold a share in the factories or not, smallholder producers are required by law to sell through the Agency, which provides inputs to farmers and management and secretarial staff to the factories and is tasked with marketing the tea. Since most of the sales profits flow back to the smallholder tea growers, Kenyan tea farmers benefit not only from higher factory-gate prices for made tea (processed tea in bulk) than in neighbouring countries, but they also capture a larger share of it – 75 per cent, compared with 25 per cent (Trade Law Centre, 2017).

After a decade of robust growth, the global tea industry was estimated to be worth over \$14 billion in 2016 (FAO, 2018a). This expanding trend, mainly caused by buoyant demand in developing countries, is expected to continue at a rate of 5 per cent per year until 2024. Simultaneously, the dynamics of the tea value chain have evolved radically. After years of “commoditization”, when undifferentiated price competition was the driving factor, there appears to be a gradual shift towards greater differentiation and higher value added products, which can accrue substantial price premiums on the international market. In this respect, certification schemes could enable the emergence of a broader range of diversified products, especially in niche segments, such as organic tea and geographical indications. This could improve the inclusivity of the value chain, even though there is considerable variability across certification schemes and their

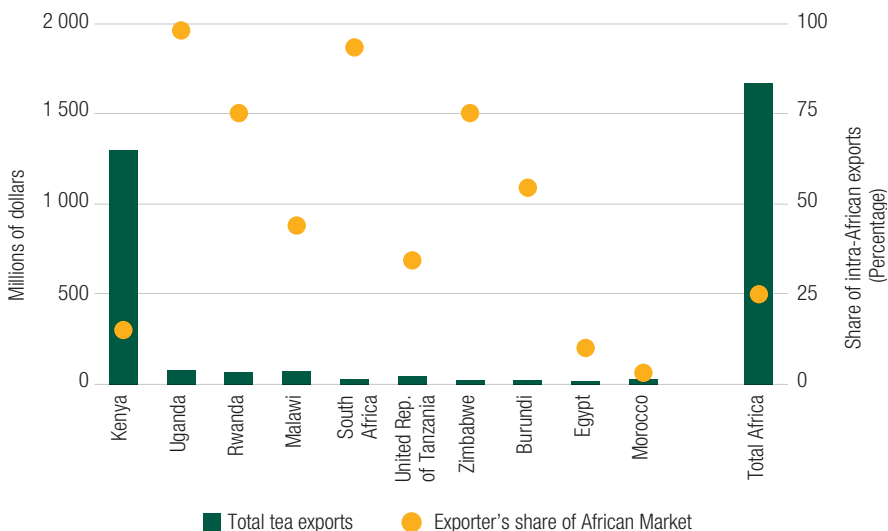
different outcome in terms of broader developmental gains.

While Asian countries such as China, India and Sri Lanka retain a dominant position in the global tea market, several African countries are playing an increasingly visible and dynamic role. Africa accounted for over 20 per cent of global tea exports and 12 per cent of imports in 2015–2017. In this respect, Kenya is by far the leading African country as the world’s third-largest tea exporter, with a market share of approximately 17 per cent during the same period. Tea represents an important cash-crop export for a number of other African countries, especially in Eastern and Southern Africa (figure 19).

In contrast, Northern African countries are the main importers of tea in Africa. Egypt and Morocco alone account for over half of total tea imports, followed by Libya, South Africa and Ghana (figure 20). Between 2015 and 2017, about 43 per cent of tea imports to Africa was sourced from China, another 40 per cent from within Africa; the rest originated primarily from India and Sri Lanka. While over 90 per cent of tea exports from Africa are made up of black tea (overwhelmingly in bulk, under HS code 090240), green tea, widely consumed in the Maghreb region, accounts for over 40 per cent of the tea imported to Africa.

Figure 19

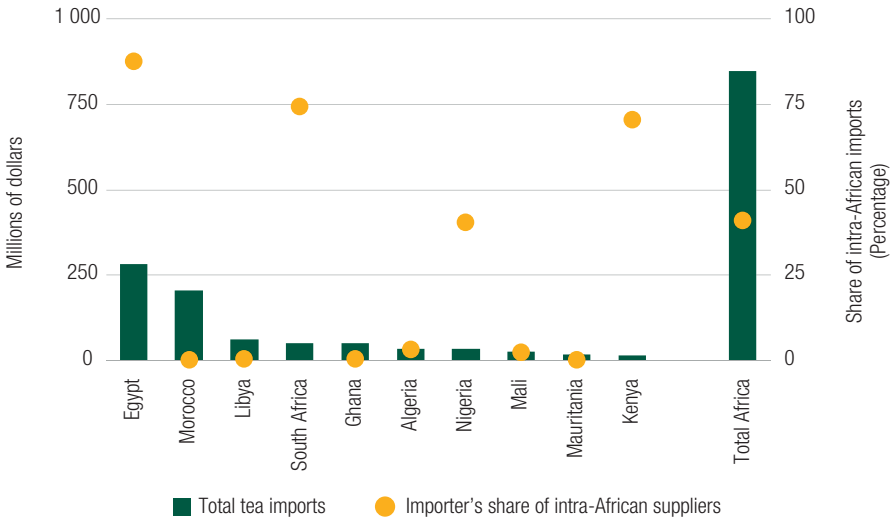
Top 10 African tea exporters (Harmonized System code 0902), 2015–2017



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

Figure 20

Top 10 African tea importers (Harmonized System code 0902), 2015–2017



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

Overall, the intra-African market accounts for roughly 25 per cent of tea exports from Africa; the remainder is sold mainly to Kazakhstan, Pakistan, the Russian Federation, the United Arab Emirates, the United Kingdom of Great Britain and Northern Ireland and the United States. Even though Kenya only exports 15 per cent of its tea to the rest of Africa, it is the leading player in intra-African trade, mainly because of its exports to Egypt (\$173 million), and to a lesser extent, Nigeria (\$12 million). The pivotal role of Kenya in intra-African tea trade goes beyond mere export flows; its prominence also stems from the importance of Mombasa as a venue of dollar-based tea auctions, where tea from the whole subregion is traded under the auspices of the East African Tea Trade Association (Trade Law Centre, 2017; Wambui, 2015). Over 90 per cent of the tea exported from Rwanda and Uganda and 40 per cent of the tea exported from Burundi and the United Republic of Tanzania are directed to Kenya, where the tea is auctioned along with domestic produce. South Africa also imports significant amounts of tea from other African countries, especially Malawi, the United Republic of Tanzania and Zimbabwe. Part of such imports are destined for internal consumption, and part for re-export to neighbouring markets, often after blending and packaging.

Though tea production is largely centred in Eastern and Southern Africa, the regional value chain extends well beyond COMESA, EAC and SADC. Many existing and potential trade corridors span across different regional economic communities and might thus be unlocked by tariff cuts envisaged in the context of the African Continental Free Trade Area. Figure 21 (a) shows through box-plot diagrams²¹ the distribution of simple average tariffs levied by African countries on tea imports, reporting the most-favoured nation tariff rates and intra-African preferential tariffs in figure 21 (b). For each importer, the difference between the most-favoured nation rate and the preferential tariff provides an indication of the potential preference margin that could be accrued through the African Continental Free Trade Area.

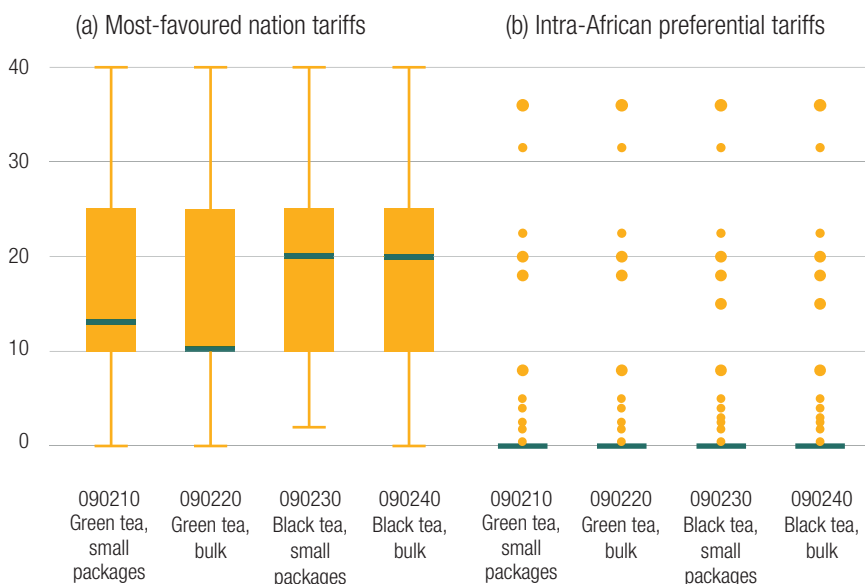
Two main observations can be drawn from figure 21. First, apart from a few countries such as Egypt and South Africa, it appears that most-favoured nation tariffs remain substantial in the African context, even for a product that is not particularly sensitive, such as tea. This is especially relevant since many of the main African tea exporters trade with key regional markets such as Algeria or Ghana and other ECOWAS countries at most-favoured nation rates. In this context, the establishment of the African Continental Free Trade Area could significantly boost intra-African tea trade, as it could extend preferential treatment across existing regional economic communities, resulting in sizeable preference margins. However, these potential gains do not depend solely on supply responses from tea producers, but also on the capacity to broaden the range of available products, notably by moving into green tea production to satisfy demand in the Maghreb region and by enhancing value addition through blending, flavouring, final packaging or the preparation of ready-to-drink tea (FAO, 2018a). Not all these diversification options may be attainable in the short term, but some related activities, such as green tea processing, packaging and blending, require relatively smaller enhancements to existing productive capabilities.

²¹ Box plots display the distribution of data over their quartiles, highlighting the median (horizontal green line), first/third quartile (shaded box), upper/lower extreme (whiskers) and outliers (dots).

Figure 21

Distribution of average tariffs levied by African countries on tea, by Harmonized System subheading, 2014–2016

(Percentage)



Source: UNCTAD secretariat calculations, based on data from the TRAINS database (accessed September 2018).

Note: Figures on the x-axis refer to HS codes.

Second, consideration of the prevalence of overlapping regional economic community membership also points to some of the flaws of the existing configuration, which could be addressed by the Continental Free Trade Area. Given the differential extent of tariff liberalization in such communities, overlapping membership of different regional economic communities has important consequences in terms of different tariff rates faced by exporters, a situation with the potential to hinder the viability of regional value chains, or at the very least, to shape their configurations in a suboptimal manner. For instance, tea exports from EAC to Egypt are subject to different tariffs. This depends on whether the exports originate in Kenya, which like Egypt, is a member of COMESA, or whether they originate in the United Republic of Tanzania. As a member of EAC and SADC, but not of COMESA, the United Republic of Tanzania is subject to the most-favoured nation tariff. Likewise, Burundi, Rwanda, Uganda and the United Republic of

Tanzania benefit from duty-free treatment for African LDCs with regard to exports from Morocco. In contrast, tea exported from Kenya is subject to a 2.5 per cent tariff. While understandable from a historical perspective, these kinds of disparity may inadvertently disrupt the smooth working of EAC trade integration and create incentives for trade deflection.

Given the situation described above, it would be worthwhile to compare the rules of origin provisions for tea products across selected regional economic communities, with a view to examining commonalities and/or differences, in an attempt to determine how they have shaped the corresponding value chain and to assess the scope for harmonization. The summary comparison in table 5 suggests that even for a fairly simple product such as tea, there is a considerable degree of variability in the rules of origin discipline across the regional economic communities. Such variability is even greater when considering some of these, such as ECCAS and ECOWAS, which have general rules that are formulated in terms of uniform percentages of value added content applied across the board. In principle, among the regional economic communities considered in table 5, the degree of restrictiveness varies between EAC, where all tea must be wholly obtained; SADC, where a more permissive regime applies to black tea; and COMESA, where variable percentages of non-originating inputs can be utilized without prejudice to preferential treatment, depending on which criterion is utilized to prove originating status. In comparison, the rules of origin provisions of the European Union Generalized System of Preference scheme are even more liberal, as they do not require a change in classification.

While the political economy motives behind the more restrictive regime in EAC are understandable in light of tea's importance for the subregion, the interplay of these different regimes has a determining effect on the market potential of the region. For instance, the pivotal role of Kenya in the regional value chain is not only due to its dominance in terms of tea production, but is also partly facilitated by its overlapping membership of COMESA and EAC. Although blending does not confer origin, the relatively looser rules of origin criteria adopted by the former imply that tea from the United Republic of Tanzania may, for example, be exported to Kenya duty free under the EAC arrangement, then blended with an equivalent value of Kenyan tea in Mombasa and again exported duty free to other COMESA countries, provided that the value of non-originating material is less than 60 per cent. The same option, however, would incur higher costs if blending took place in Dar-es-Salaam, as the United Republic of Tanzania is a member of EAC, but not of COMESA; hence the final product would not be eligible for COMESA treatment. At the same time, the differences in rules of origin provisions might inadvertently have contradictory implications in practice. For instance, the same

blend of 70 per cent Tanzanian black tea and 30 per cent non-African black tea may be considered an originating product within SADC, but not within EAC, with ensuing effects on the level of market access across different African countries and regional economic communities.

Table 5

Comparison of rules of origin provisions regarding tea (Harmonized System code 0902) in selected regional economic communities in Africa

COMESA	EAC	SADC
<p>Goods are considered originating if they have been produced in member States wholly or partially from materials imported from outside the member States or of undetermined origin under the following conditions:</p> <ul style="list-style-type: none"> • The cost, insurance and freight value of those materials does not exceed 60 per cent of the total cost of the materials used in the production of the goods. • The value added resulting from production accounts for at least 35 per cent of the ex factory cost of the goods. • Manufacture from materials classified in a heading other than that of the goods (workings and processing conferring origin under this rule are contained in appendix V of the COMESA rules of origin). 	<p>Manufacture in which all the products of this HS chapter are wholly produced.</p>	<p>Manufacture in which all the materials used of this HS chapter must be wholly obtained.</p> <p>Ex-0902 black tea: manufacture in which the weight of the materials used does not exceed 40 per cent of the weight of the product.</p>

Source: UNCTAD secretariat, based on data from the COMESA–EAC–SADC Tripartite Rules of Origin database and corresponding legal texts.

Although similar complications could in principle be addressed in the context of the African Continental Free Trade Area through ad hoc flexibilities, the previous examples provide a clear illustration of the complications resulting from distinct disciplines, which may obstruct the smooth emergence of regional value chains, particularly when levels of protection vary significantly across different trade arrangements. Even for a relatively simple product such as tea, similar complexities are likely to arise even more frequently in the future, given the ongoing shift towards more diverse products and blends, which could capture significant price premiums (FAO, 2018a). Moreover, the fixed-cost elements of rules of origin compliance – and of certification – are likely to disproportionately

affect smaller firms with lower traded volumes, potentially exacerbating the asymmetry in market power along the value chain (World Bank and Organization for Economic Cooperation and Development, 2016). This calls for pragmatism and flexibility, for instance through the adoption of a simplified rules of origin regime for shipments valued below a given threshold, to ensure that the outcome of the Continental Free Trade Area is as inclusive as possible, even in sectors such as tea, characterized by strong vertical integration and market concentration.

3.3 Cocoa–chocolate value chain and scope for commodity-based industrialization

The cocoa industry provides another telling example of how the Continental Free Trade Area could support the structural transformation agenda of Africa through the emergence of viable agro-processing regional value chains for one of its main cash crops and strategic commodities (Ba, 2016). In terms of worldwide turnover, the market value of cocoa beans at the farm gate was estimated at \$9 billion in 2016, while downstream chocolate sales represented about \$112 billion and are set to grow after plateauing for a few years (Anga, 2016; *Financial Times*, 2018). Cocoa production is mainly carried out by smallholders, and its economic relevance to Africa is difficult to overstate, given that the region accounts for 75 per cent of the world's production of cocoa beans and 20 per cent of total grinding (International Cocoa Organization, 2018; UNCTAD, 2016b).²²

Broadly speaking, the cocoa–chocolate value chain is comprised of five stages: production, marketing and trading, processing, manufacturing and distribution, and retailing. These stages are in line the classification of HS chapter 18 (cocoa and cocoa preparations), ranging from raw materials (cocoa beans, HS code 1801; cocoa shells, HS code 1802) to intermediates and semi-finished products (cocoa paste, HS code 1803; cocoa butter, fat and oil, HS code 1804; cocoa powder, HS code 1805) and chocolate and other food preparations containing cocoa (HS code 1806).²³

²² South America and Asia accounted for 16 and 8 per cent of worldwide cocoa bean production, respectively, and 20 per cent each of grindings of cocoa beans; the remainder of cocoa bean grindings take place in European countries, which, along with the United States, represent the main consumer markets.

²³ Although there are related products within the same HS four-digit code 1806, from an industrial perspective, this segment is divided into industrial chocolate couverture (typically in liquid form and with a short shelf life of a few days) and chocolate confectionery (UNCTAD, 2008; UNCTAD, 2016b).

CURRENT SITUATION

Africa:
75% of world
production of cocoa
beans, yet a net importer
of chocolate



POTENTIAL SITUATION



While the production of cocoa beans remains dominated by smallholders, which account for over 90 per cent of global output (Anga, 2016), the downstream stages of the cocoa value chain are characterized by a relatively high degree of horizontal concentration and vertical integration (African Centre for Economic Transformation, 2014; UNCTAD, 2008; UNCTAD, 2016b). This stems from multiple factors, including economies of scale in the trading and processing stages – which tend to be capital intensive and largely based on cost-competitiveness – but also from the increasing importance of brand recognition, marketing research and product development in the confectionery segment. Thus, multinational companies have developed a growing interest in retaining a tight control over sourcing and intermediate processing, in order to pursue strategies of product differentiation and to meet quality and traceability requirements. This is all the more important since compliance with taste and colour specifications of high-quality chocolate often requires the blending of different varieties of beans, including fine cocoa, which is largely sourced from Latin America (African Centre for Economic Transformation, 2014).

The ongoing consolidation of the value chain contributes to enhanced cost-effectiveness and ensures the degree of traceability and quality demanded by increasingly sophisticated consumers. Yet, it may also result in an oligopsonistic market structure, whereby upstream producers – especially if they are geographically dispersed and lack the support of strong farmer-based organizations – derive relatively small benefits from their participation in the value chain, while manufacturers and retailers capture the bulk of value added (African Centre for Economic Transformation, 2014; UNCTAD, 2016b).²⁴ This situation is compounded by a worldwide chocolate consumption that is still dominated by mature developed country markets, notwithstanding the greater dynamism of emerging markets. As a result, coupled with the fact that some intermediate products, such as couverture chocolate, have a relatively short shelf life, companies prefer to locate processing plants near large destination markets, or at least in areas with good infrastructure and logistics, disadvantaging African countries whose trade costs are significantly higher than their competitors (African Centre for Economic Transformation, 2014; Valensisi et al., 2016).²⁵

The interplay of the aforementioned factors has resulted in a global division of labour whereby exports from Africa along the cocoa value chain continue to embody limited

²⁴ It is estimated that only 12 per cent of the value added embodied in a milk chocolate bar is captured during the production of cocoa beans, 8 per cent during intermediate processing, 23 per cent during the manufacturing of industrial chocolate and 57 per cent during final production, retailing and distribution (African Centre for Economic Transformation, 2014).

²⁵ Good logistics and infrastructural provision, as well as proximity with expanding Asian markets, have been key enablers of success in the case of Indonesia and Malaysia (African Centre for Economic Transformation, 2014; United Nations Economic Commission for Africa, 2015).

value addition, with most cocoa producers in the region unable to embark on the kind of product upgrading that has characterized other developing countries such as Brazil, Indonesia or Malaysia (United Nations Economic Commission for Africa, 2015; United Nations Economic Commission for Africa and African Union Commission, 2013). Further, the African region has been a sizeable net exporter of raw materials and intermediates in early stages of the value chain – most notably cocoa beans, which alone account for over 70 per cent of the continent’s exports under this HS chapter. Yet, it has been a net importer of downstream products embodying greater value added, such as cocoa powder and chocolate and other food preparations containing cocoa.

The overall picture should not overshadow the significant but largely untapped opportunities offered by intra-African trade, both in terms of prospective demand that could stimulate a supply response from cocoa farmers, but also – and perhaps more fundamentally – in terms of supporting economic diversification.²⁶ Although exports of cocoa and related products from Africa to the rest of the world dwarf the intra-African market – on average \$7.8 billion per year, compared with \$170 million in the 2015–2017 period – the latter’s composition is centred primarily on higher value added products, with chocolate accounting for nearly 60 per cent of the total. Similarly, while the regional market plays a negligible role as a vent for raw material and intermediate products – those segments which account for the bulk of export revenues in Africa – it also absorbs over 9 per cent of exports of cocoa powder (HS code 1805) from Africa and 27 per cent of its exports of chocolate and related preparations (HS code 1806).

With regard to major exporters, figure 22 shows that three main groups of African countries are involved in the cocoa value chain.

The first group is comprised of large cocoa producers that are primarily involved in the early stages of the value chains and export mainly outside the continent. The group is composed of Cameroon, Côte d’Ivoire, Ghana and Nigeria – which together produce over 70 per cent of the world’s cocoa beans. They have made some progress in attracting investment in grinding plants, allowing them to export part of their products in the form of cocoa paste or cocoa butter, mainly to developed countries.²⁷

²⁶ Given the presence of competing cash crops such as rubber and palm oil, improving yields and replacing ageing trees are key policy priorities for the expansion of cocoa bean production in the region; moreover, they remain critical objectives in seeking to improve the livelihoods of the millions of smallholder farmers involved in this business (UNCTAD, 2016b).

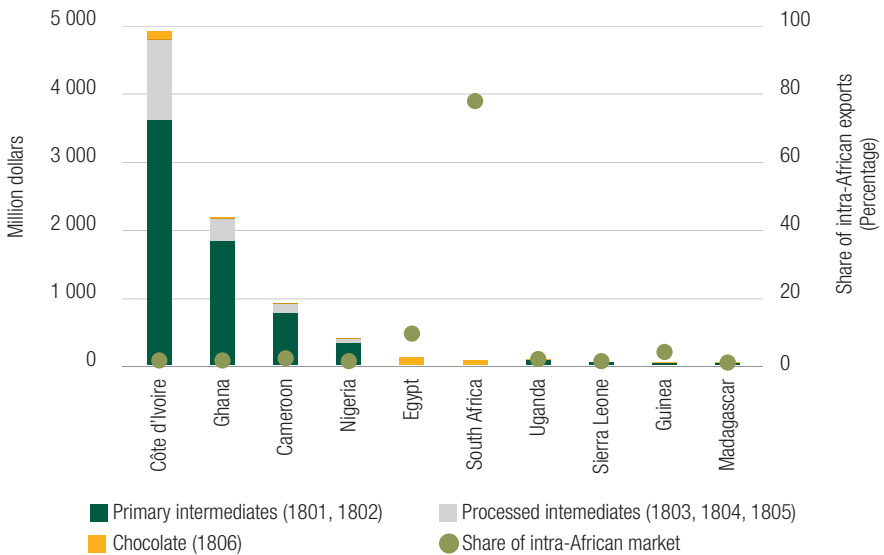
²⁷ Côte d’Ivoire and Ghana, in particular, have successfully put in place incentives to attract investors in cocoa processing, thereby becoming major grinders of cocoa beans. Their diverse experiences show how support for domestic value addition can be provided under different policy frameworks, ranging from a fully liberalized market in Côte d’Ivoire, to a liberalized domestic market in Ghana, where the national cocoa board (Ghana Cocoa Board) is responsible for marketing cocoa internationally (UNCTAD, 2016b). Nonetheless, cocoa bean production in West Africa largely outstrips processing capacity, and this balance is unlikely to be reversed, given the characteristics of the cocoa–chocolate value chain.

The second group consists of larger and more diversified economies such as Egypt and South Africa, which engage only in the final stages of manufacturing production and re-export. They mainly cater for the SADC subregional market, where South Africa is concerned; and the Middle East and North Africa, where Egypt is concerned (essentially through COMESA and the Pan-Arab Free Trade Area). In both cases, the size of the domestic market, the relatively more sophisticated productive basis and the role of regional point of entry have attracted the presence of confectionery multinationals such as Mars, Mondelez and Nestlé.²⁸

Figure 22

Top 10 African exporters of cocoa and cocoa preparations (Harmonized System code 18), 2015–2017

(Millions of dollars and percentage)



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

Note: Figures in the legend refer to HS codes.

The third group includes smaller cocoa producers such as Guinea, Madagascar, Sierra Leone and Uganda, where processing is not cost-competitive. As a result, they remain essentially confined to the export of cocoa beans, except for some niche products, such as artisanal or fair trade chocolate, including brands such as “Guittard” or “Uganda”, from Madagascar and Uganda, respectively.

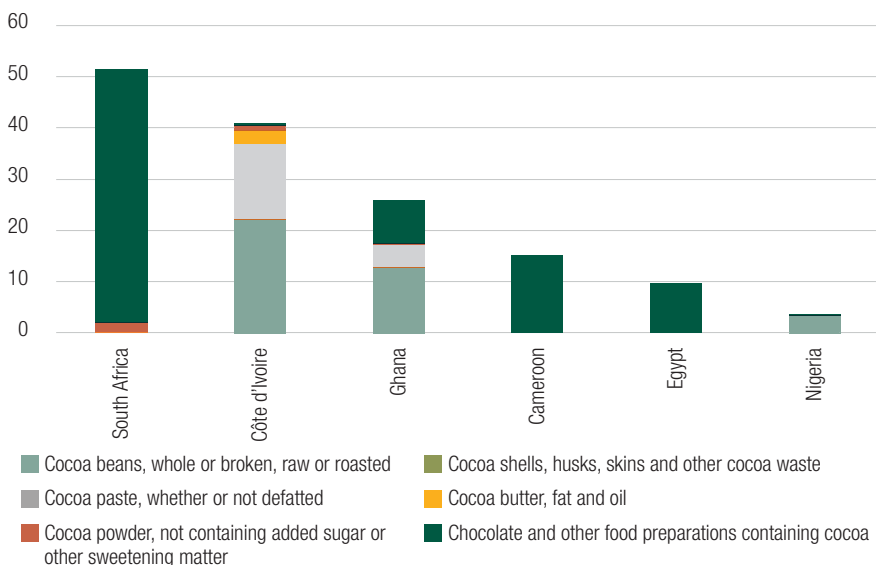
²⁸ See www.whoowinswhom.co.za/store/info/3296 (accessed 15 January 2019).

These findings are further corroborated by the composition of intra-African trade in cocoa and cocoa preparations for the main intra-African exporters, i.e. those for which exports to Africa under HS chapter 18 averaged at least \$3 million per year in 2015–2017, namely South Africa, Côte d'Ivoire, Ghana, Cameroon, Egypt and Nigeria (figure 23). Apart from Egypt and South Africa, as previously discussed, the main cocoa-producing countries have harnessed intra-African trade only to a limited extent as a springboard to diversify into downstream stages of production and exports.²⁹

Figure 23

Intra-African exports of cocoa and cocoa preparation, by main exporting country and product, 2015–2017

(Millions of dollars)



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

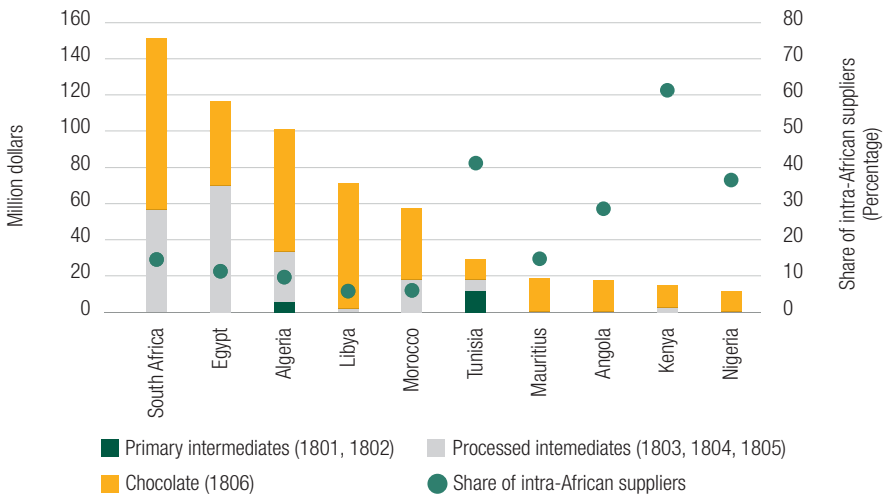
The main importers of cocoa and related products in the region are South Africa and Northern African economies (Egypt, Algeria, Libya, Morocco and Tunisia), followed by

²⁹ Some caution is needed in the interpretation of the data, since they do not discriminate between exports and re-exports, with the latter likely inflating the figures for final products, especially along routes connecting relatively large hubs of containerized transport with smaller countries (for instance Cameroon–Gabon or Ghana–Togo).

Mauritius, Angola, Kenya and Nigeria (figure 24). In terms of composition, imports of HS chapter 18 products to Africa are concentrated on semi-finished and final goods, with chocolate accounting for over 70 per cent of the total; in contrast, raw material and primary intermediates play a lesser role.³⁰ The main exceptions to this overall pattern are the manufacturing hubs in Egypt and South Africa, and to a lesser extent, Algeria, Morocco and Tunisia. Reliance on imports from outside Africa is generalized and particularly pronounced for downstream products such as chocolate, cocoa butter and cocoa powder – the larger and often most profitable market segments. Only with respect to cocoa paste do African-processed intermediate imports play a significant role – at least in relative terms – along key corridors such as Côte d’Ivoire–South Africa, Ghana–Egypt and Ghana–South Africa.

Figure 24

Top 10 African importers of cocoa and cocoa preparations (Harmonized System code 18), 2015–2017



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018). Note: Figures in the legend refer to HS codes.

³⁰ Tunisia is a clear outlier, with a significant share of its imports in the form of cocoa beans, mainly from Ghana. The cocoa beans are processed domestically mainly to supply the local confectionery industry, dominated by Société tunisienne de chocolaterie et de confiserie. Further, the substantial reliance of Kenya on intra-African imports of chocolate is largely explained by its imports from Egypt, with which Kenya shares COMESA membership.

While the case of cocoa paste testifies to the potential scope for regional integration to support the relatively recent emergence of Côte d'Ivoire and Ghana as major grinding hubs, the overall picture is not as bright. There appears to be a sort of dichotomy in the participation of Africa in the cocoa value chain. On the one hand, most cocoa-producing countries are integrated through the supply of raw materials and semi-processed intermediates (forward participation) embodying limited value added and are directed mainly to developed markets. On the other hand, a few manufacturing hubs – for example, Egypt and South Africa, and to a lesser extent Algeria, Morocco and Tunisia – supply final chocolate products for their domestic and subregional markets, but predominantly source their intermediate inputs (backward participation) from outside the continent.

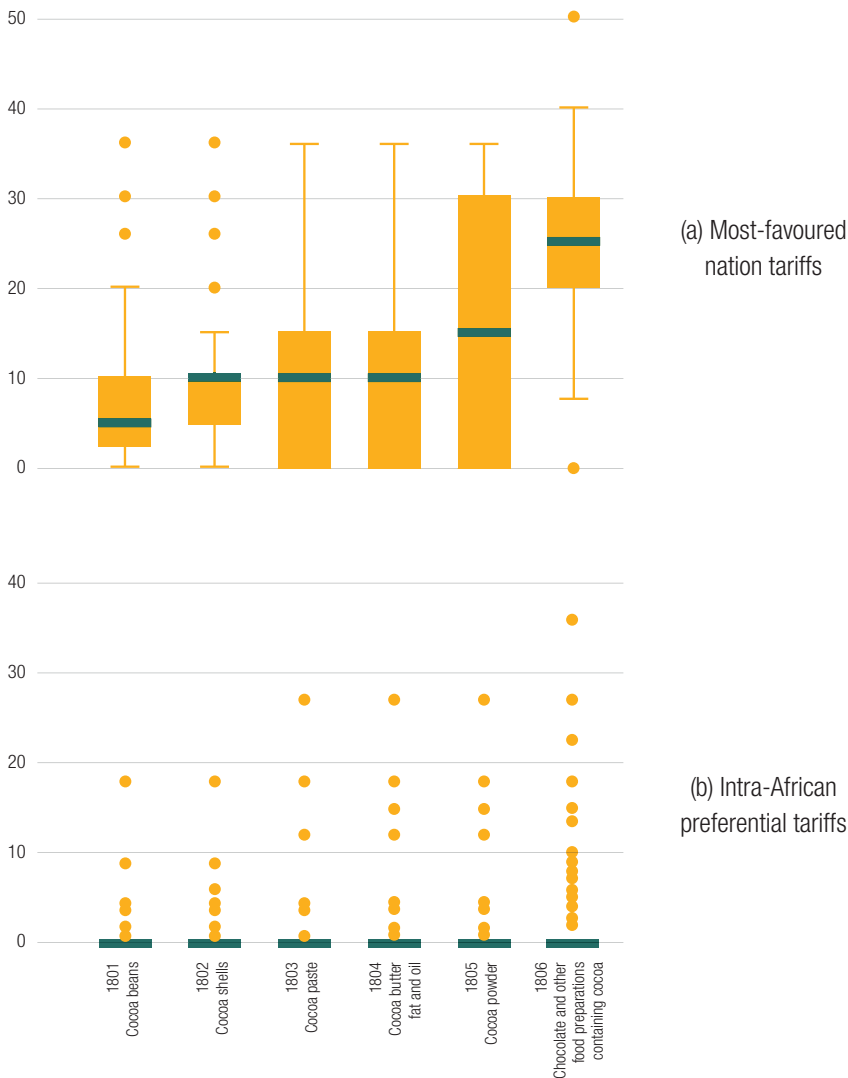
As a result, not only is processing capacity in African countries much lower than cocoa production, but few countries are currently engaged in those downstream activities in chocolate and confectionery production, which appear to generate wider employment gains. Such an outcome represents a missed opportunity for export diversification, especially considering the share of Africa in world cocoa production. The limited degree of integration between raw material producers and regional manufacturing hubs ultimately restricts the scope for enhancing regional value addition both in relation to the products exported to the rest of the world and in part to the final goods consumed in the African market. It also makes Africa largely reliant on imports of final chocolate and confectionery products from the rest of the world.

While the above dichotomy is largely driven by the fundamentals of the cocoa value chain (economies of scale, market concentration, infrastructural and logistic considerations and the like), the current trade policy regime may not be fit for purpose. As shown in figure 25 (a), the cocoa–chocolate sector remains heavily protected in Africa, with median most-favoured nation tariffs ranging from roughly 5 to 25 per cent, depending on the HS heading. Moreover, in relation to most-favoured nation tariffs, there is clear evidence of tariff peaks – tariff rates of 15 per cent or more – and tariff escalation (tariff rates increase in the transition from raw materials to semi-processed and final products).

Figure 25

Distribution of simple average tariffs levied by African countries on cocoa and cocoa preparations, by Harmonized System heading, 2014–2016

(Percentage)



Source: UNCTAD secretariat calculations, based on data from the TRAINS database (accessed October 2018).
 Note: Figures on the x-axis refer to HS codes. Tariff rates are aggregated at HS subheading (six-digit) level by simple average.

Trade liberalization, mainly in the regional economic communities, has significantly reduced the level of protection and the degree of tariff escalation along the cocoa value chain, with exceptions mainly due to deferred tariff reduction schedules within such communities (figure 25 (b)). Yet, progress has been uneven across these economic communities; moreover, the structure of the value chain is such that the greatest potential for intra-African trade and regional value addition in cocoa-related products would presumably lie along corridors that cut across the regional economic communities – basically from ECOWAS to SADC and COMESA – where trade continues to take place on a most-favoured nation basis. Somewhat paradoxically, the levels of protection faced by many cocoa exporters within Africa contrast with the relatively lower tariffs facing the rest of the world, where many countries (notably LDCs) benefit from preferential treatment such as that provided by the African Growth and Opportunity Act and the Everything but Arms initiative. Only chocolate and other food preparations containing cocoa are intensively traded on a preferential basis in the region. Egypt is the entry point to the Pan-Arab Free Trade Area and COMESA, and South Africa, to SADC. As stated previously, however, even manufacturing firms in these countries rely chiefly on inputs from the rest of the world. What is more, the fragmentation of the regional market is exacerbated by the lack of cumulation across the regional economic communities, which makes downstream producers indifferent to the origin of inputs, unless they originate from members of their own regional economic community.

The difference between most-favoured nation rates and intra-African preferential rates in the region suggest that there exists ample scope for the Continental Free Trade Area to decrease the levels of protection across the regional economic communities and provide sizeable preference margins to African exporters, especially in downstream segments of the chain. This would be an important step towards realigning trade policy instruments to foster value addition and value capture along the cocoa value chain. It would also be consistent with the long-held view that “regional trade liberalization to create regional-level addressable consumer markets is a precondition for the development of retail chocolate and couverture production” (African Centre for Economic Transformation, 2014, p. 6).

Potential preference margins for intermediate products originating in Africa may at least partly offset the lower cost-competitiveness of local processing, supporting the upgrading efforts of cocoa-producing countries. In turn, cheaper access to intermediate inputs may bolster the competitiveness of downstream processing and chocolate manufacturing, allowing them to take full advantage of the broader continental market. Moreover, even though a similar reconfiguration is unlikely to give rise to a market for

chocolate and confectionery as large as in developed countries, it would allow Africa to better profit from the dynamism of a growing consumer base and from its systemically relevant position in terms of global cocoa production, by enhancing value addition all along the value chain. While the possibility of adverse impacts on import-competing producers cannot be ruled out, these risks appear somewhat circumscribed, since chocolate manufacturers in smaller African countries have typically targeted niche segments such as premium chocolate, and fair trade and organic products (African Centre for Economic Transformation, 2014; Independent.ie, 2015).

The effective integration of the regional market is, however, contingent on the adoption of a conducive set of rules of origin that can prevent trade deflection while avoiding undue complications and constraints for African-based firms. The experience of the regional economic communities in this respect reveals the presence of distinct approaches in the related discipline, even leaving aside regional economic communities such as ECOWAS, which apply a single criterion across all products. COMESA rules of origin provide for the application of three alternative criteria to determine originating status: material content, value added content and change in tariff classification. These rules of origin distinguish between upstream and downstream products, with exceptions applied in the latter case with regard to a change in tariff classification criterion. In both cases, the exceptions are aimed at fostering the use of already originating cocoa products in the downstream phases of production. In contrast, EAC rules of origin foresee two alternative criteria applicable to all intermediate products of this HS chapter (HS codes 1801–1805): either a change in tariff heading or a material content threshold, whereby the value of non-originating materials should not exceed 70 per cent of the ex works price of the product. However, different rules of origin apply to chocolate, whose originating status requires a change in tariff heading and is contingent on the condition that the weight of the non-originating materials used should not exceed 30 per cent of the weight of the final product. In SADC, a single provision applies along the whole value chain, foreseeing as an origin-conferring transformation a change in tariff heading, with an exception to safeguard the use of already originating sugar and sugar confectionery – but not of cocoa-related products, unlike in COMESA.

The above summary of rules of origin for cocoa and cocoa preparations illustrates the complexity and the trade-offs involved in complying with rules of origin requirements, and of the different considerations that should thus inform the legislator. In principle, the presence of alternative criteria to confer originating status – as in the case of COMESA – allows firms to have some additional margin of manoeuvre, for instance complying with the 35 per cent value added content requirement (or the 60 per cent ceiling for

non-originating material content) for chocolate, while partly using non-originating cocoa powder. However, under the change in tariff classification criterion, the use of non-originating cocoa powder is ruled out by the exclusion. From a firm's point of view, however, the use of material or value added content criteria, instead of the change in tariff classification, might come at the cost of having to adopt more rigorous and detailed accounting practices to demonstrate compliance, especially when intermediate inputs are sourced from multiple countries, as is often the case for sugar. A similar scenario could pose challenges to SMEs, whose accounting systems are often basic.

The above discussion suggests that a convergence in the discipline at the continental level is conceivable, notwithstanding the potentially conflicting interests of cocoa-producing countries (upstream), which are likely to favour a stricter stance on rules of origin, and those of downstream manufacturers, which may favour a more lenient approach to retain the ability to choose from a broader set of inputs, while maintaining originating status for the final product.³¹ This said, three considerations are warranted with respect to any final outcome. First, considering the nature of the value chain, some degree of flexibility in the use of different varieties of cocoa and/or non-originating inputs might be justified to allow chocolate manufacturers to satisfy a broader array of quality, taste and colour requirements. This margin of manoeuvre would be important, regardless of whether it is achieved through a combination of different criteria, through *de minimis* provisions (which, however, do not normally apply to wholly obtained products) or through other technical and legal flexibilities.

Second, compliance with a new continental rules of origin discipline, which may differ from existing regional economic community-level ones, could entail some adjustment costs and strategic repositioning on the part of downstream industries. Small legal details, such as calculation methods, thresholds levels and the like, may have major consequences on the ground. For instance, Chocolate, Biscuits and Confectionery Industries of Europe (2017) has strongly opposed the adoption of weight-based rules of origin for sugar in the European Union–Japan negotiations, rather than value-based ones, because of the significant additional costs and administrative burden that this would represent for producers. The challenges highlighted by this example, even in the context of developed economies where firms' compliance costs are lower, suggest that it is important to consult closely with producers during the negotiation phase and

³¹ It is plausible that niche producers of premium chocolate products also lean towards a more restrictive approach to rules of origin, ensuring a narrow definition of originating products, so that preferential treatment can partly offset their higher costs, compared with more standardized industrial competitors. By and large, however, the likely conflict of interests at the continental level will be between upstream and downstream players, reflecting the differences evident at the multilateral discussions on non-preferential rules of origin (Inama, 2009).

to favour simple, easy-to-implement rules that avoid undue constraints, especially for SMEs. In particular, SMEs may find it more difficult than larger firms to readily adjust the choice of their suppliers to ensure compliance, especially if they depend on key intermediates, which are typically imported from non-originating countries, such as milk powder for use in chocolate production. Accordingly, it is important for rules of origin to consider the reality of sectoral dynamics, if undue administrative burdens and disruptions are to be avoided.

Third, given the relatively capital-intensive nature of cocoa processing and chocolate production, attracting investments in the downstream segments of the value chain would be a key objective to boost value addition. Transparency and predictability of the rules of origin regime thus play a central role for market-seeking investors, whose decision-making and business strategies cannot but be shaped by the features and viability of the regional market.

3.4 Cotton–apparel value chain

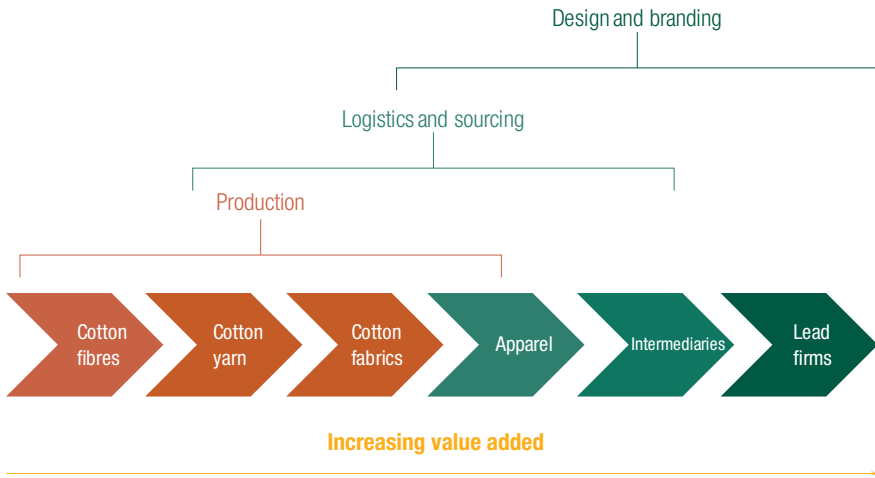
Since the industrial revolution, the textiles and clothing sector has been regarded as the first rung in the light-manufacturing ladder, deserving particular attention because of its labour-intensive nature, which creates scope for the reallocation of mainly unskilled labour across sectors, as well as of the size of the potential market. It is thus understandable that the sector is traditionally among the most sensitive in the trade-negotiation arena. The prominence of cotton in this context is reinforced by the long tradition of its cultivation in Africa, as well as by its identification as one of its strategic crops in the Summit on Food Security in Africa, held in Abuja in 2006, which foresaw the strengthening of regional value chains, including by “fast-tracking the implementation of trade arrangements adopted in the regional economic communities” (African Union, 2006). For these reasons, the extent to which the establishment of the Continental Free Trade Area could support the deepening of regional value chains. This warrants careful consideration; so does the definition of preferential tariffs and rules of origin, which will ultimately shape the contours of the continental market.

Since the phasing out of the Multifibre Arrangement³² in 2005, the international apparel market has been characterized by heightened levels of competition and the emergence

³² Under the Multifibre Arrangement, a large portion of textiles and clothing exports from developing countries to industrialized countries was subject to a system of quotas, under a special regime outside the normal rules of the General Agreement on Tariffs and Trade. On 1 January 1995, this was replaced by the WTO Agreement on Textiles and Clothing, which sets out a transitional process for the ultimate removal of such quotas.

of global value chains. The internationalization of production has enabled lead firms to splinter offshore production phases to better exploit cost differentials and comparative advantages, with market incentives replacing quotas as major drivers of international trade and investment flows (UNCTAD, 2018c; World Bank, 2016a). These developments have boosted the role of Southern markets, above all in Asia, in the global trade of clothing and textiles, notably through trade in intermediates. Nonetheless, developed economies still account for about half of global apparel imports in a market characterized by rapidly changing consumer demand and the importance of timely delivery and quality assurance (Pricewaterhouse Coopers, 2008). In this context, foreign direct investment has increasingly become one of the main drivers of the inclusion of developing countries in textile and clothing value chains, while preferential access to key developed countries' markets, through schemes such as the African Growth and Opportunity Act and the Everything but Arms initiative, is a key determinant of lead firms' locational choices.

Figure 26
Cotton–apparel value chain



Source: Adapted from World Bank, 2016a, p. 23.

Textiles and apparel production phases are depicted in figure 26. In relation to textile production (i.e. yarn and spinning), they range from the cultivation and production of cotton fibres (which account for roughly 30 per cent of the world textile fibre consumption), to yarn spinning and weaving; the resulting fabrics, along with other

inputs such as buttons and zippers, are then utilized for apparel production, which is then dispatched and distributed. Upstream textile production (i.e. yarn and spinning) remains a relatively capital-intensive industry with significant economies of scale, unlike the apparel segment, which tends to be more labour-intensive (International Trade Centre, n.d.; World Bank, 2012). The degree of control exerted by lead firms along the value chain can vary from captive arrangements³³ to original design manufacturing, full-package service providers or original brand manufacturing, whereby contractors take up more complex and higher value added functions such as design, supply-chain coordination or retailing of own-branded products (Esho, 2015; Gereffi et al., 2005; UNCTAD, 2018c). This dimension has an important bearing on upgrading opportunities for the actors on the lower rung of the value chain, not only in terms of product and process upgrading, but perhaps more fundamentally of functional and intersectoral upgrading (UNCTAD, 2018c).

The share of Africa in the international cotton and apparel market is indeed limited, particularly if compared with Asia, which encompasses three of the world's leading cotton producers (China, India and Pakistan), and which continues to be “the epicentre of export-oriented apparel production” (Gereffi et al., 2005). According to data from FAO,³⁴ some 1.6 million tons of cotton lint – about 6 per cent of the world total – were produced in Africa in 2014. This figure accounted for 5 per cent of global exports of cotton (HS chapter 52) and 2 per cent of global exports of apparel (HS chapters 61 and 62). Nonetheless, cotton is a key export of numerous countries in the region, in particular the “Cotton four” – Benin, Burkina Faso, Chad and Mali – and a source of livelihood for the local population. Likewise, apparel exports from Africa totalled nearly \$9 million per year in 2015–2017, and the sector accounted for at least 5 per cent of merchandise exports in 9 African countries out of 52 for which data are available.³⁵

Like other agricultural commodities, the analysis of the cotton value chain in Africa points to missed opportunities in terms of harnessing trade to foster structural transformation. Some 70 per cent of cotton exports from Africa are represented by primary intermediates (HS codes 5201–5203) embodying limited value addition, such as cotton fibres (whether carded or not); only 12 per cent take the form of yarn (HS codes 5204–5207), and 18 per cent of cotton fabrics (HS codes 5208–5212). The composition of cotton imports

³³ For example, cut, make and trim arrangements, whereby fabrics are sourced and owned by the lead firms and the contractor is paid through a processing fee.

³⁴ FAOstat database. See <http://www.fao.org/faostat/en/#home>.

³⁵ The share of apparel in total merchandise exports surpassed 5 per cent in Cabo Verde (8.6 per cent), Egypt (5.5 per cent), Swaziland (9.2 per cent), Kenya (5.2 per cent), Lesotho (52.2 per cent), Madagascar (19.4 per cent), Mauritius (29.7 per cent), Morocco (12.7 per cent) and Tunisia (15.6 per cent).

is almost symmetrical: some 12 per cent is accounted for by primary intermediates; 16 per cent, by yarn; and as much as 72 per cent, by cotton fabrics. As a result of this specialization pattern, while Africa as a whole is a net exporter of cotton fibres, it consistently reports a trade deficit in yarn, and even more so in cotton fabrics.

Apart from Egypt, the largest cotton exporters in Africa are generally confined to the production of cotton fibres, as are most of the smaller exporters (figure 27). The integration of Africa in the cotton global value chain is thus driven by forward integration – exports of intermediate inputs – mainly with Asia, and to a lesser extent, Europe.³⁶ Southern Africa is the main exception to this pattern, with several countries involved at a deeper level of integration in a cotton value chain of largely regional reach, with Zambia and Zimbabwe exporting mainly cotton fibres, and Lesotho, Mauritius, South Africa and Swaziland trading in cotton yarn and fabrics. Ghana and the Niger also provide promising examples of regional integration – most of their cotton exports are fabrics destined for Benin and Nigeria. In overall terms, however, the fact that intra-African trade accounts for only 15 per cent of cotton exports and 12 per cent of imports underscores the shallowness of regional integration.

As shown in figures 28 and 29, cotton imports to Africa are dominated by large apparel producers in Northern and Southern Africa, which mainly source cotton fabrics from outside Africa. This occurs in the framework of value chains primarily geared towards supplying branded products to developed country markets, whereby lead firms provide intermediate inputs to be processed, often under cut, make and trim arrangements (UNCTAD, 2018c; World Bank, 2012). In 2015–2017, intra-African trade only accounted for 10 per cent of the continent's apparel exports, and 17 per cent of its imports, underscoring the peripheral role of the region, as much as its fragmentary pattern of integration in the value chain.

³⁶ The leading destinations of cotton exports from Africa, in decreasing order of importance, are Bangladesh, Turkey, India, Singapore, Switzerland, Malaysia, Viet Nam, Italy, China and Pakistan.

Figure 27

Cotton exports (Harmonized System code 52) by stage of processing, 2015–2017

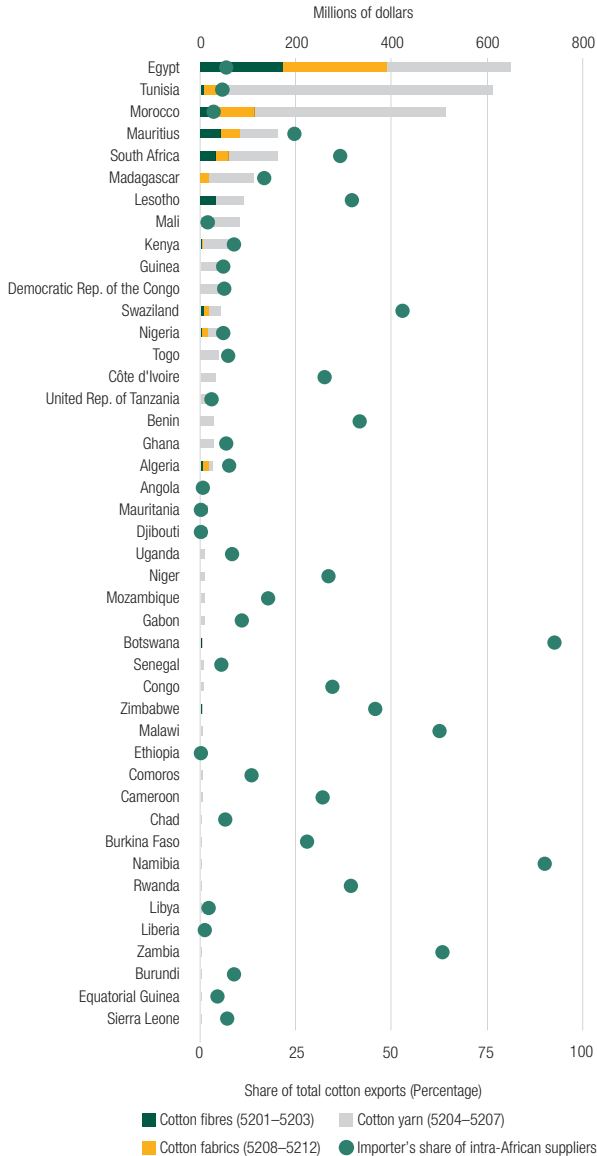


Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

Note: Figures in the legend refer to HS codes. The graph is truncated to report only countries with an export revenue exceeding \$1 million.

Figure 28

Imports of cotton to Africa (Harmonized System code 52) by processing stage, 2015–2017

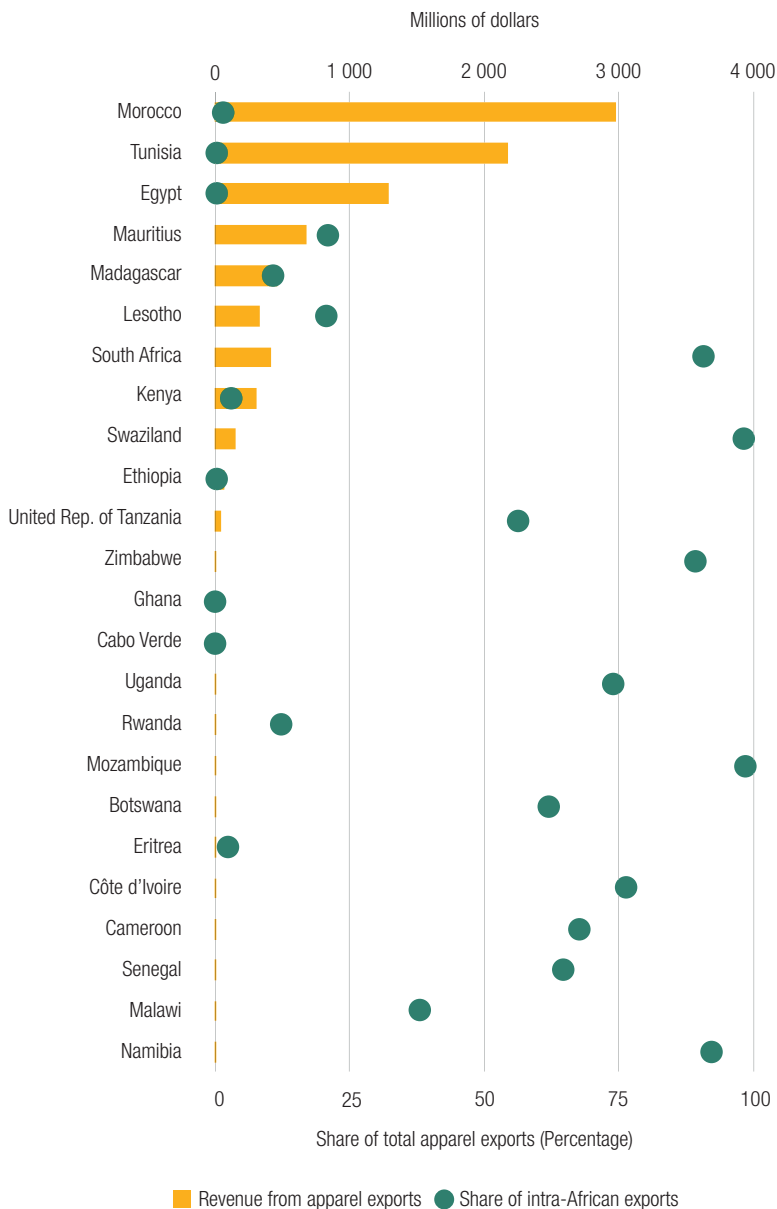


Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

Note: Figures in the legend refer to HS codes.

Figure 29

Main apparel exporters (Harmonized System codes 61 and 62), 2015–2017



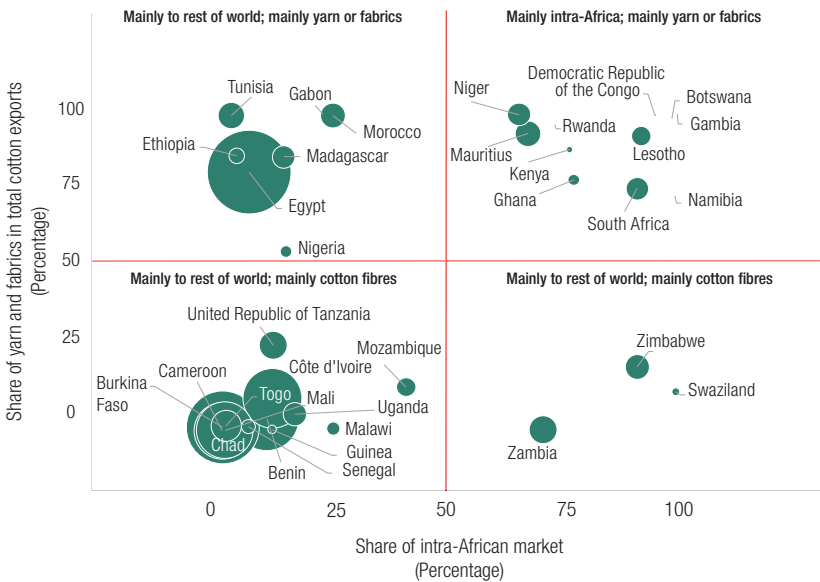
Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

Note: The graph is truncated to report those countries with an export revenue exceeding \$1 million.

Only Southern Africa stands out for having a regional value chain with somewhat greater depth than the rest of the continent. Further, South African investors are increasingly operating in neighbouring countries to take advantage of lower labour costs in the context of near-shoring strategies (Staritz et al., 2016; UNCTAD, 2018c). This is partly a reflection, however, of the importance of South Africa as a pivotal market for the subregion, both in terms of supply of inputs, as well as an outlet for exports of processed goods. Even in this case, the reliance on imports from outside Africa is such that over the last decade, South Africa has been consistently running a trade deficit in apparel, with as much as 70 per cent of its imports originating outside Africa (China accounted for half of its apparel imports alone).

Figure 30

Regional integration and specialization pattern of African cotton exporters, 2015–2017



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).
 Note: The size of the bubble is proportional to cotton export revenue; some country labels for minor exporters with export revenues under \$1 million have been omitted to enhance readability.

Despite the dynamism of the African market, both for cotton and apparel products, the previous discussion highlights missed opportunities in terms of value addition, both regionally and domestically. Not only does the size of the regional market remain relatively small – at least in relation to the global market – but major markets and producers are

weakly integrated – except in Southern Africa (figure 30). Moreover, African producers tend to be engaged at the extremes of the production process, either as suppliers of raw materials, or in low-value activities of assembly (cut, make and trim), where broader developmental benefits are more limited.

It is true that trade barriers are only a partial explanation of this outcome. The decline of the African textile industry can be largely attributed to structural factors, including fierce international competition, lower economies of scale compared with main competitors, limited bargaining power in the context of captive value chains, and high trade costs in both time and monetary terms. Nonetheless, uneven progress towards regional integration in Africa, with members of different regional economic communities trading with one another mainly on a most-favoured nation basis, only exacerbates the situation, as the largest scope for trade in cotton would lie across regional economic communities, with the leading exporters in Western and Central Africa, and the leading importers, in the Northern and Southern subregions.

The rationale of the Continental Free Trade Area for overcoming some of these barriers, harnessing trade complementarities more effectively across African countries and enhancing the consistency of trade policy with industrial objectives is even clearer when the levels of protection along the value chain are considered. In line with the traditional sensitivity of the textile and apparel sector, the distribution of most-favoured nation tariffs on cotton and apparel products (figure 31 (a)) reveals a generally high level of protection, significant tariff peaks and clear signs of tariff escalation. Significantly lower levels of protection are testament to the liberalization of trade in the regional economic communities, when moving to intra-African preferential tariffs (figure 31 (b)), even though some tariff peaks remain. More importantly, the large difference between most-favoured nation tariffs and intra-African preferential tariffs suggests that there is ample scope to grant meaningful preferential margins to regional exporters, thereby creating a potential incentive to spur the emergence of viable regional value chains. Even if tariff cuts in the context of the Continental Free Trade Area were hypothetically half as deep as those agreed at the level of the regional economic communities, this could give rise to sizeable preference margins for African goods, which could at least partly offset the cost disadvantage, compared with other competitors from outside the region.

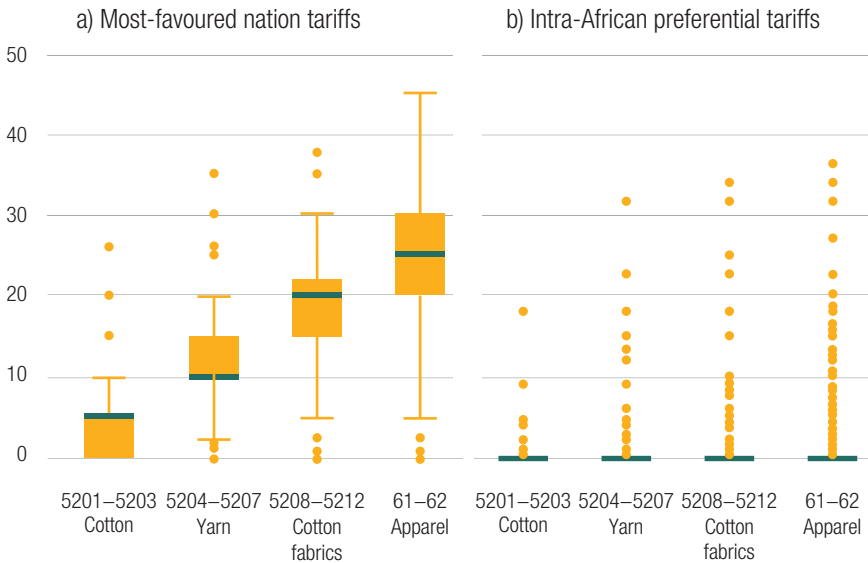
Against this backdrop, the scope for substantial margins of preference at the continental level suggests that rules of origin provisions inevitably warrant special consideration in the context of negotiations relating to the Continental Free Trade Area, since the incentive for trade deflection is likely to be higher. High levels of protection and restrictiveness of rules of origin tend to be associated with similar political economy considerations

(Cadot, Carrere et al., 2006; Estevadeordal and Suominen, 2008). This explains the sensitivity of textile and apparel industries for developed and developing countries alike, to the extent that the sector is typically identified as one where rules of origin are both most intricate and restrictive (Cadot and Ing, 2016; Cadot, Carrere, et al., 2006; Inama, 2009; de Melo and Portugal-Pérez, 2013).

Figure 31

Distribution of simple average tariffs levied by African countries on cotton and apparel products, 2014–2016

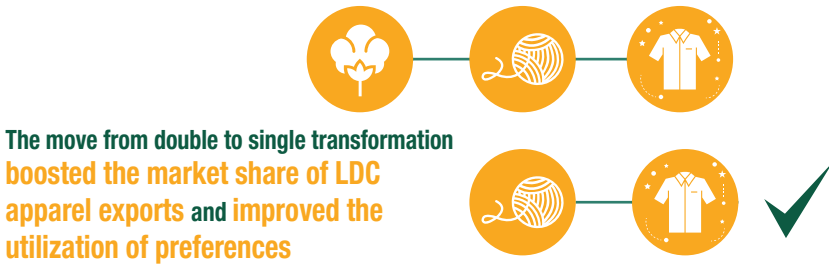
(Percentage)



Source: UNCTAD secretariat calculations, based on data from the TRAINS database (accessed October 2018). Note: Figures on the x-axis refer to HS codes. Tariff rates are aggregated at HS subheading (six-digit) level through simple average.

Nevertheless, there is little doubt that the main obstacle will likely relate to the extent to which non-originating inputs can be used for the production of preference-eligible apparel products. In declining order of restrictiveness, this is typically referred to as triple, double, or single transformation requirements. Under the triple transformation requirement – which is used, for example, in the North American Free Trade Agreement – the fibre, fabric and garment must be processed within the region for the final good

to be eligible for preferential treatment (cotton → yarn → fabric → apparel). In contrast, under the double transformation requirement, which is applied, for instance, through the reformed post-2011 Generalized System of Preferences scheme of the European Union to non-LDC beneficiary countries, two stages of production must take place in the region concerned (yarn → fabric → apparel) for origin determination. Finally, under the single transformation requirement, only one production step needs to take place within the region for the apparel product to acquire originating status (fabric → apparel). This more lenient requirement, which allows the use of non-originating fabrics, is applied to LDC beneficiaries of the aforementioned scheme, as well as to lesser developed beneficiaries of the African Growth and Opportunity Act that qualify for the wearing apparel provisions and third-country fabric rule (UNCTAD, 2018i).



The challenges faced by developing countries, especially LDCs, in complying with restrictive rules of origin have been long identified and researched in the context of preferential trading schemes granted by developed countries, and increasingly by developing countries (UNCTAD, 2016c; WTO, 2014). In particular, the choice between double and single transformation epitomizes the trade-off between restrictive rules of origin – which in principle favour upstream textile producers from the region, at the cost of reducing the commercial value of trade preferences – and more lenient rules of origin, which would instead support the competitiveness of downstream apparel industries, by allowing them to use the cheapest inputs, regardless of their origin. Empirical analyses suggest that rules of origin that seriously limit the choice of intermediates could significantly reduce trade opportunities and lead to considerable trade diversion from more efficient inputs producers (Cadot and Ing, 2016; Cadot, Carrere et al., 2006; Conconi et al., 2018). A panel data analysis looking specifically at the adoption of the third-country fabric rule under the African Growth and Opportunity Act showed how the switch from double to single transformation significantly boosted exports of eligible African countries to the United States, acting on both intensive and extensive margins, hence improving not just export revenues but also prospects for economic diversification (de Melo and Portugal-Pérez, 2013). Similarly, computable general equilibrium simulations suggest

that the extension of the third-country fabric provision to all beneficiaries of the Act would have positive effects on apparel exports from Africa (Brookings Institution and United Nations Economic Commission for Africa, 2013).

Less formally, the differential impact of the single and double transformation requirements can be seen also in figure 32, which provides data on apparel exports under different preferential schemes and for distinct groups of African countries as a share of total United States apparel imports.³⁷ Until 2004, the trends confirm that the implementation of the African Growth and Opportunity Act provided a broadly similar boost to apparel exports across all groups of beneficiaries, regardless of the third-country fabric provision, for which most exporters became eligible between 2001 and 2004. Further, the introduction of this scheme was accompanied by a corresponding decline in exports under the Generalized System of Preferences and other preferential and non-preferential schemes. Since the phasing out of the Multifibre Arrangement, however, eligibility for the third-country fabric provision³⁸ has come to play a much more significant role. Largely by utilizing cheaper imported fabrics from the rest of the world, countries eligible for single transformation can retain most of their market share – and in the case of Ethiopia, Ghana, Kenya, Mauritius, Rwanda and the United Republic of Tanzania, even slightly improve it – notwithstanding increased competition from exporters mainly from Asia. In contrast, other beneficiaries of the Act, as well as exporters utilizing other schemes, have witnessed a further erosion of their market share. The main exception to this declining trend can be attributed to African exporters of goods to the United States under bilateral schemes, namely Egypt and Morocco.

Similarly, the positive effect of more lenient rules of origin reforms on downstream apparel industries can be gauged by examining the export performance of the 47 LDCs to the European market (figure 33).³⁹ In 2001–2017, LDCs benefited from duty-free, quota-free market access to the European Union under the Everything but Arms initiative; since the 2011 reform of the Generalized System of Preferences, however, the new rules of origin approach applicable to textiles and apparel originating from LDCs switched from double to single transformation. As can be seen, this reform was accompanied by a significant boost to the market share of LDCs in the European Union, as well as by improvements in the rate of preference utilization (UNCTAD, 2016c; WTO, 2014).

³⁷ Beneficiary countries of the African Growth and Opportunity Act that were suspended or reinstated are reported separately to avoid conflating the often strong impact of these policy decisions with issues related to rules of origin.

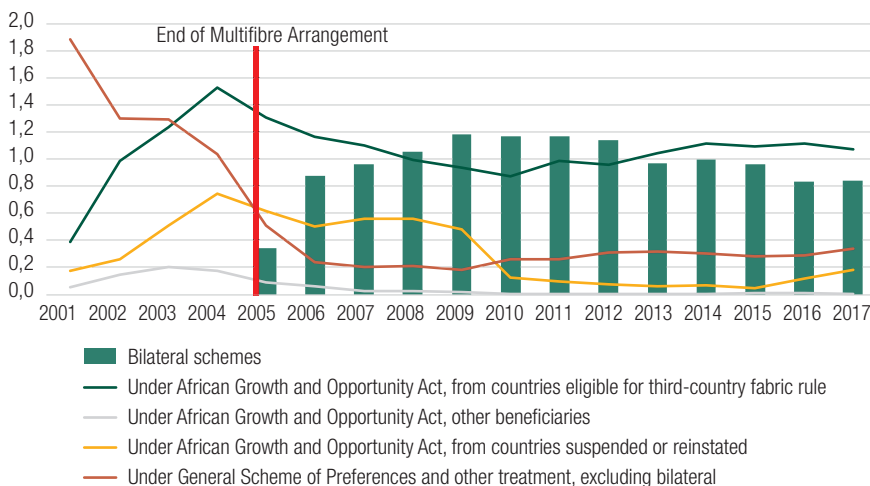
³⁸ Eligible countries are as follows: Benin, Botswana, Burkina Faso, Cameroon, Cabo Verde, Chad, Ethiopia, Ghana, Kenya, Lesotho, Liberia, Malawi, Mauritius, Mozambique, Namibia, the Niger, Nigeria, Rwanda, Senegal, Sierra Leone, the United Republic of Tanzania, Uganda and Zambia.

³⁹ During the period under review, these countries were beneficiaries of the Everything but Arms initiative and the African Growth and Opportunity Act, qualifying for the third-country fabric provision in the United States.

Figure 32

Share of African countries in apparel imports to the United States (Harmonized System codes 61 and 62), by trading scheme and country group, 2001–2017

(Percentage)



Source: UNCTAD secretariat calculations, based on data from the United States International Trade Commission database (accessed November 2018).

Note: Apparel exporters under the African Growth and Opportunity Act that have been suspended or reinstated: Burundi, Swaziland, Madagascar and Mali. Apparel imports under the Generalized System of Preferences and other preferential and non-preferential schemes, as well as under bilateral agreements in the case of Egypt and Morocco, are reported separately.

The interest of cotton-producing countries in more stringent rules of origin is legitimate and could in principle encourage local value addition by fostering the sourcing of intermediates from the region. However, the literature suggests that undue restrictiveness may depress the commercial value of a given preference. In addition, weaker countries and producers, whose productive capacities are inadequate to comply with stricter requirements, are likely to be disproportionately affected. This concern may be especially relevant in the case of apparel, since most exporters to the region are net importers of intermediate products from the rest of the world. Likewise, anecdotal evidence suggests that even in countries with reasonably vibrant apparel industries such as Mauritius, SMEs often find it more difficult to maintain competitiveness than larger firms, while having to comply with double transformation requirements.⁴⁰ This suggests that achieving an inclusive outcome from the negotiations relating to the Continental Free Trade Area

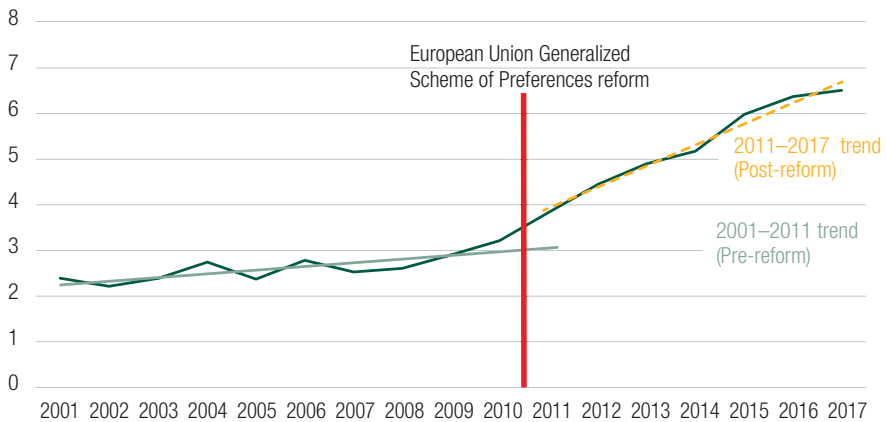
⁴⁰ This example is drawn from complaints No. NTB-000-676, reported through the online Tripartite mechanism for reporting, monitoring and eliminating non-tariff barriers (www.tradebarriers.org/about, accessed 15 February 2019).

requires a careful balance between the valid concern of preventing trade deflection and supporting spinning and weaving industries throughout Africa, and the equally important objective of ensuring that weaker downstream producers can also benefit from the African Growth and Opportunity Act. For example, a two-track approach could be envisaged to ensure ambitious preference margins for upstream textile producers, while at the same time avoiding overly restrictive rules of origin that would penalize the most vulnerable apparel-exporting countries.

Figure 33

Share of least developed countries in apparel imports in the European Union, 2001–2017

(Percentage)



Source: UNCTAD secretariat calculations, based on data from Eurostat database (accessed November 2018).
 Note: Countries considered in the sample only include the 47 countries classified as LDCs throughout the period, to eliminate the effect of graduation from the list.

The degree of splintering of processing phases along the cotton–apparel value chain implies that issues related to cumulation merit attention. As many of the activities performed in relation to apparel products (for instance printing or trimming) do not configure substantial transformation and thus do not confer origin as such, the choice between diagonal and full cumulation may be especially important. In particular, if a double-transformation approach is considered, full cumulation might play a pivotal role to ensure that preferences applying to the Continental Free Trade Area remain commercially valuable and do not excessively hamper the strategies of African firms. A related issue pertains to the rules of origin applicable to special economic zones (box 4).

Box 4

Rules of origin and special economic zones

Given the rising number of special economic zones set up by African countries and the broad array of incentives to boost their development, it is understandable that the treatment of goods produced in such zones has been a thorny issue in the context of African Continental Free Trade Area negotiations. Several parties have voiced concern that goods originating from special economic zones already benefit from significant incentives, ranging from tax holidays and duty-free imports, to streamlined business environments, dedicated infrastructures and lower restrictions for profit repatriation. Consequently, subjecting goods originating from these zones to preferential treatment would result in unfair competition. The argument goes that, in the light of the above, rules of origin should exclude from preferential treatment products obtained in special economic zones in Africa.

This position, however, overlooks two key issues. First, special economic zones have evolved from their original form of geographically circumscribed enclaves, and many countries nowadays grant similar investment incentives, regardless of a firm's location (i.e. also to firms located outside special economic zones). Second, not all forms of incentive necessarily affect production costs. Moreover, some of the underlying infrastructures, for example, ports or airports, may also benefit producers outside the zones. Therefore, utilizing rules of origin to exclude goods originating from special economic zones from preferential treatment would be counterproductive and would risk eroding the reach and effectiveness of the Continental Free Trade Area. A more appropriate strategy to address the above concerns would be to make use of WTO rules on subsidies and countervailing measures, as stated in the Protocol on Trade in Goods of the Agreement Establishing the African Continental Free Trade Area, annex 9, article 2. This would also be more consistent with the experience of the African regional economic communities, most of which either grant originating status to special economic zones or have no specific provision on this issue.

Source: UNCTAD, 2018h.

3.5 Beverage value chain, rules of origin and regional integration

This case study focuses on selected beverage industries, namely beer, soft drinks and water products, and spirits. Further, the study examines the dynamics of intra-African

trade in related products and the scope for opening up opportunities for value addition and trade creation provided by the Continental Free Trade Area. It also discusses the impact rules of origin could have on related outcomes. By looking at consumption goods characterized by relatively tractable production processes and prospects for rising demand, the study suggests how the regional market could be leveraged to support the quest for industrialization and economic diversification.

Despite the difficulty in quantifying the demand for beverage products in Africa, there is little doubt that it is a significant and expanding market. The growing population and middle class, and shifting patterns of demand clearly contribute to higher consumption trends. For example, Africa is the world's fastest growing beer market, estimated at \$13 billion in 2017, with volumes projected to grow at 4.7 per cent, compared with 1.7 per cent globally (*Financial Times*, 2017). Similarly, although the scope of its spirits market is unknown, there is evidence of a significant and expanding commercial value (Global Agriculture Information Network, 2012).

Notwithstanding some differences across specific industries, the beverage value chain can be divided into the following stages: supply of primary inputs (such as water, grapes or syrup and glass and plastic for bottling), production of beverages (carried out in factories, breweries, or distilleries, depending on the product), distribution and marketing, and wholesale or retail. The value chain is largely characterized by vertical integration, with multinational firms operating across key segments in numerous markets. In the beer industry, for instance, major players include Diageo (United Kingdom) Castel Group (France), Heineken (Netherlands) and Anheuser-Busch InBev (Belgium) (Diageo, 2018). Similarly, Pernod Ricard (France), Diageo and Coca-Cola Beverages Africa (United States) feature prominently in the spirits industry; while in the soft drinks and sweetened water products segment, Coca-Cola Beverages Africa and Pepsi Co (United States) are the key players (Coca-Cola, 2018). Despite the importance of multinational firms, local firms are increasingly penetrating markets across the three industries. For example, in EAC, locally owned Brasseries des Mille Collines competes with Heineken-owned Bralirwa, the largest beer manufacturer in Rwanda. In the spirits industry, local distillers, such as Van Ryn, Distell and KWV of South Africa or Nigeria Distilleries and Tanamont Nigeria, also compete with multinational brands. In the soft drinks and sweetened water products industry, locally owned Softbev, Little Green Beverages and Twizza are major players in the South African soft drinks market.

Unlike in other stages in the chain, which tend to be dominated by vertically integrated firms, the supply segment, at least with respect to the beer and spirits industries, often includes smallholder farmers that produce raw materials such as cereals or grapes

(box 5). The scope for backward linkages with domestic agriculture is somewhat smaller in the soft drinks and sweetened water products industry, where multinational corporations generally produce their own syrup and concentrates to be supplied to bottling firms. Bottling, packaging, transport and distribution create scope for linkages with the domestic services sector. Further, African firms in the three industries are increasingly investing in markets across the continent. For example, Distell of South Africa has invested in spirits production in Angola, Ghana and Nigeria, while First National Choice has invested in the production of soft drinks and bottled water in Mozambique.

Box 5

Value chain integration and the low-cost beer market segment in Africa

The low-cost beer market in Africa has grown in significance: a trend reflected in the proliferation of grain-based beers made with local raw materials, including sorghum, cassava, millet and rice. In part, this development is due to the shift away from more expensive premium beers, which are largely out of the reach of price-conscious consumers. Sorghum beers manufactured in markets on the continent include Sorghum and iJuba (South Africa), Salone (Sierra Leone), Senator Keg (Kenya) and Chibuku (South Africa and Zimbabwe). Cassava-based beers include Eagle and Ruut (Ghana), Impala (Mozambique), Eagle (Zambia) and Ngule (Uganda), while Ivoire (Côte d'Ivoire) is made from locally grown rice.

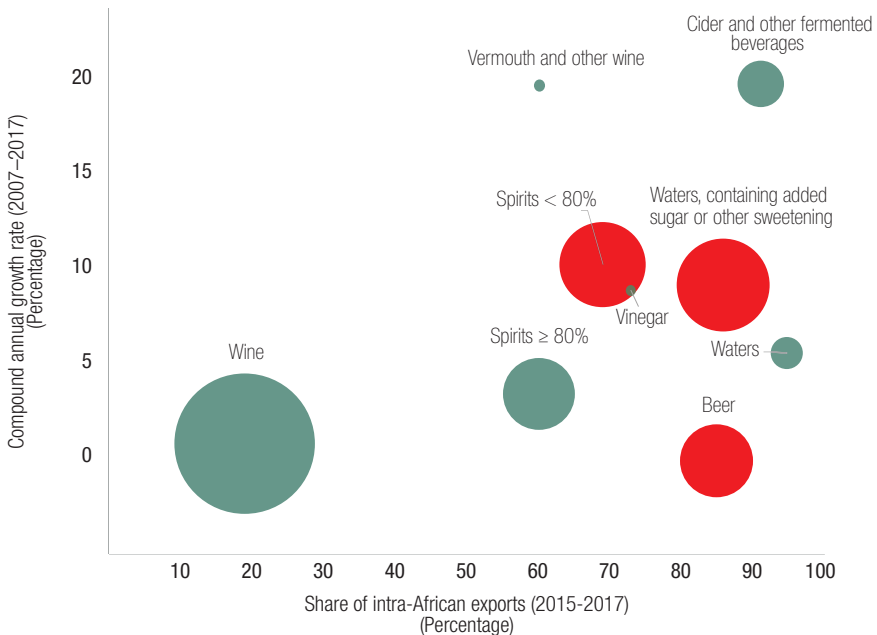
The growth of the low-cost beer segment has led to an increase in the production of commodities such as sorghum, millet and cassava. Such commodities have replaced barley malt, which is sourced from abroad, thus helping to reduce costs. Firms in the value chain have generated backward linkages by sourcing some of their raw materials locally. East Africa Maltings, a subsidiary of the Diageo-owned East African Breweries Limited, sources 80 per cent of its raw materials for its sorghum-based Senator beer from local farmers.

Sourcing locally has generated multipliers, including by creating economic opportunities for farmers employed to grow sorghum. Nigeria Breweries, a subsidiary of Heineken, has created jobs for over 250,000 farmers contracted to grow sorghum and cassava, contributing to poverty reduction. Besides boosting sorghum production, the growth of the low-cost beer segment has resulted in spillovers in other sectors of the economy, including in investment in agro-processing. Diageo has established three plants in South Africa to manufacture sorghum-based brands Sorghum, Chibuku and iJuba, and a brewery in Kisumu, Kenya, to manufacture its Senator beer.

Sources: Beverage Industry News, 2016; Diageo, 2018; Heineken, 2015; The Star, 2017.

Although Africa is mainly a net importer of beverages (HS chapter 22), exports have recently grown considerably. Unlike wine, the main beverage sold outside the continent, soft drinks and water products (HS code 2202), beer (HS code 2203) and spirits (HS code 2208) account for sizeable shares of beverages exports and are sold predominantly within the region (figure 34). While African exports of spirits and soft drinks and water products have recorded double-digit growth rates over the past decade, however, beer exports have remained stagnant, in part due to changes in consumer preferences. South Africa accounts for more than half of the total beverages exports, followed by Namibia, Kenya, Togo, Zambia, Swaziland, Mozambique, Ghana, Malawi and Uganda.

Figure 34
Intra-African exports of beverages by product, 2015–2017

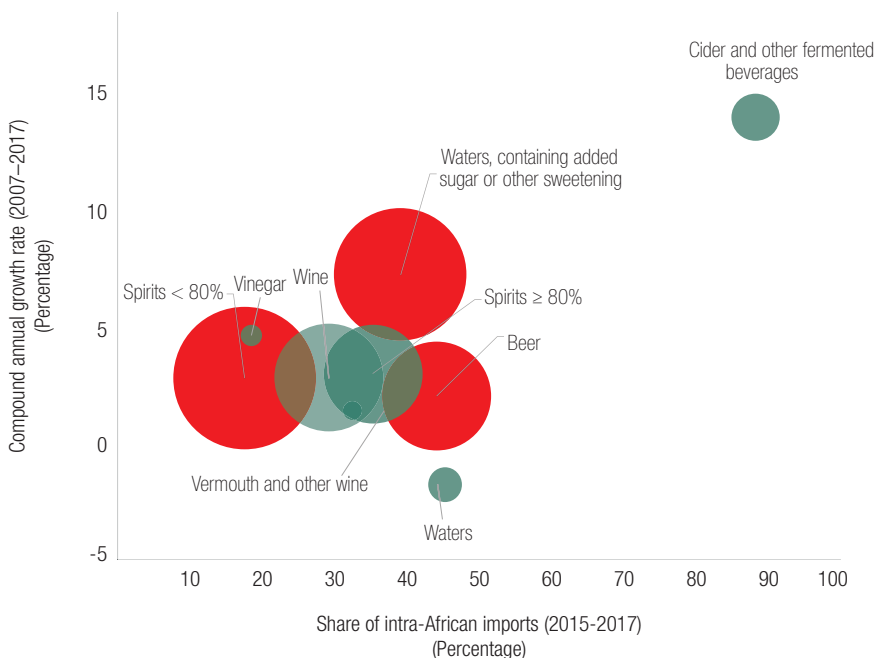


Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed December 2018).

Note: The size of the bubble is proportional to average export revenue for the corresponding product in 2015–2017; red bubbles denote the subsectors specifically discussed in this section.

In 2015–2017, imports of beverages to Africa averaged \$2.6 billion, with soft drinks and water products, beer and spirits representing the leading imports (figure 35). In 2007–2017, the value of imports of beverages increased at a compound annual growth rate of 4 per cent; growth was even faster in the case of soft drinks. Roughly two thirds of total imports to Africa are products originating from outside Africa. Reliance on intra-African imports is comparatively higher for beer (44 per cent) and soft drinks (39 per cent) than for spirits (14 per cent). Leading importers in the region are Namibia, Mozambique, Uganda, Lesotho, the United Republic of Tanzania, Ghana, Rwanda, Mauritius, Mali, Benin and Tunisia.

Figure 35
Intra-African imports of beverages by product, 2015–2017



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed December 2018).

Note: The size of the bubble is proportional to average export revenue for the corresponding product in 2015–2017; red bubbles denote the subsectors specifically discussed in this section.

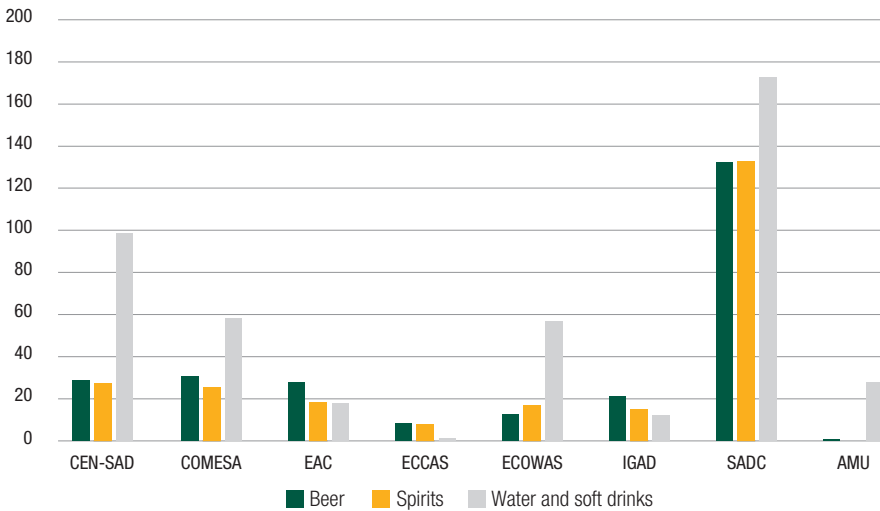
Among the African regional economic communities, the prominence of SADC as a leading space for trade in beverages is unrivalled (figure 36). This position pivots around the role of South Africa as a key exporter of spirits intraregionally to Botswana, Zambia and Zimbabwe, and outside of SADC to Kenya, Nigeria and the United Republic of Tanzania. Albeit volumes are much lower than in SADC, trade in spirits and soft drinks and water products has also acquired burgeoning weight also for ECOWAS, in part due to the growing importance of the spirits market in Nigeria. Although beer accounts for a small share of the products traded in the region, Côte d'Ivoire and Nigeria are among the leading African beer markets in terms of volume (consumption). Similarly, EAC is a net exporter of beer and soft drinks and water products, while Kenya, Uganda and the United Republic of Tanzania are exporters of beer to Somalia and South Sudan; soft drinks and water products are also traded intraregionally and to other African markets. Like ECCAS, COMESA is a net importer of the three products, although its share in intra-African trade in beverages is considerable.

Notwithstanding the increases, the scope for intra-African trade of beverages is limited by several factors. According to the TRAINS database, beverage exports in the region are subject to substantial tariffs, considering that most countries within Africa trade with one another at most-favoured nation rates (figure 37). In 2014–2016, the median rates for countries in sub-Saharan Africa ranged from 20 to 30 per cent, depending on the tariff heading (figure 37(a)). Similarly, high tariffs have been widely documented in the literature, and while often aimed at supporting domestic processing industries, they often raise production costs, reducing regional competitiveness and adversely affecting the scope for intra-African trade (Brenton et al., 2005; International Trade Centre, 2010; Trade Law Centre, 2018).

Figure 36

Intra-African exports of selected beverages, by regional economic community, 2015–2017 average

(Millions of dollars)



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

In addition to tariffs, non-tariff barriers have also undermined intra-African trade, ultimately reducing products’ competitiveness in international markets (Brenton et al., 2005). With regard to beverages, for instance, a duty-remission scheme previously implemented in Kenya in 2004, aimed at protecting the local sorghum-based Senator beer from competition from other grain-based beer products manufactured in EAC partner States, has arguably limited trade within the Community.

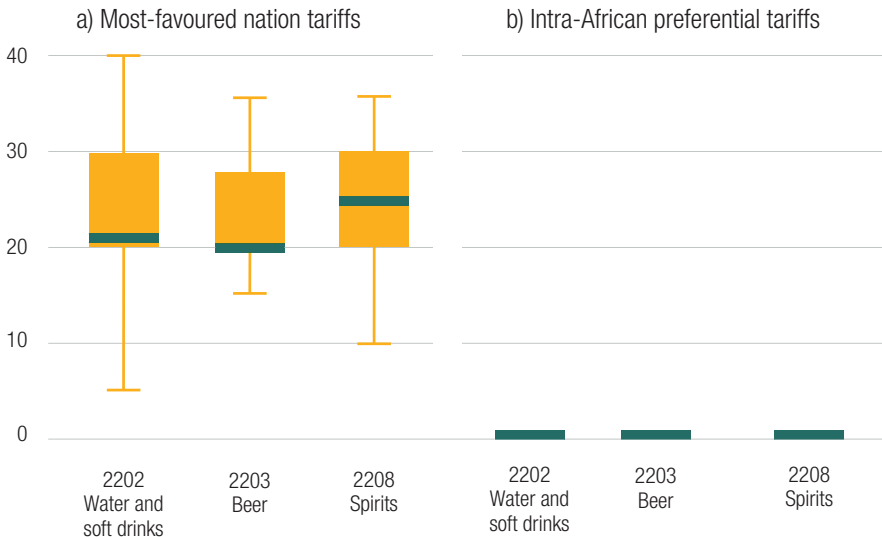
With regard to rules of origin, the way in which the regional economic communities have disciplined beverages displays a broad variety of approaches to products partially obtained from non-originating materials. ECCAS and ECOWAS, for instance, foresee an ad valorem percentage criterion based on value added; in comparison, other regional economic communities, such as SADC, have mainly adopted the change in tariff classification criterion; while yet others, such as COMESA or EAC, have opted for variable combinations of these two approaches, leaving firms the possibility of deciding among alternative criteria for compliance. Beyond this generalized aspect, an

additional area where the rules of origin of the regional economic communities have been somewhat divergent relates to the exceptions ruling out the use of non-originating inputs for a beverage product to qualify as originating. For example, the COMESA rules of origin (appendix V) exclude the use of non-originating fruit preparations in the production of sodas and sweetened water products (HS code 2202) when specifying the change in tariff heading criterion. Depending on the specific product and regional economic community considered, similar restrictions are found among the regional economic communities in relation to the use of sugar and fruit preparations for the production of soft drinks and sweetened water products, the use of grapes and related derivatives in the manufacturing of alcoholic beverages, and to the use of grains for beer production. This restriction may become increasingly relevant, considering that several African markets have recently witnessed a shift from expensive premium beers to low-cost beers, many of which use locally grown raw materials, such as sorghum, cassava, millet and rice.

Figure 37

Distribution of simple average tariffs levied by African countries on beer, spirits and water products, by Harmonized System heading, 2014–2016

(Percentage)



Source: UNCTAD secretariat calculations, based on data from TRAINS database.

Note: Figures on the x-axis refer to HS codes. Outliers are not represented in order to eliminate the visual effect of prohibitive tariffs levied by some Muslim countries on alcoholic beverages.

While similar exceptions are explicitly aimed at encouraging the use of intermediate inputs and raw materials produced within the subregion, they have also exacerbated the fragmentation of the intra-African agricultural market by discouraging the sourcing of inputs from outside a regional economic community. Doing so limits the scope of backward linkages, potentially reducing farmers' supply response and opportunities for agribusiness. Moreover, by hindering producers' sourcing decisions, these restrictions may weigh down the competitiveness of downstream beverage industries, especially in cases of idiosyncratic shortfalls in input availability caused by adverse meteorological conditions, pests and the like. Insufficient supplies of agricultural inputs in producing countries pose challenges for beer manufacturers, forcing them to source inputs from outside the region (Diageo, 2018; Food Business Africa, 2018).

By consolidating the regional market into a single entity, the Continental Free Trade Area is capable of redressing the above-mentioned market fragmentation, regardless of rules of origin exceptions to protect wholly obtained inputs, since the latter will apply solely at the continental level. In this sense, whatever the precise formulation of the rules of origin, the Continental Free Trade Area will likely allow a stronger reliance on regionally sourced inputs, better harnessing complementarities within Africa in terms of agricultural comparative advantages. In the soft drinks and sweetened water products segment, this may allow firms to source at a cheaper price from other African markets raw materials used in the production of concentrates and syrups, enabling local manufacturers to lower their production costs. This could unlock significant opportunities upstream, including in the sourcing of raw materials such as malt to meet the growing demand for non-alcoholic malt drinks in markets such as Nigeria, as well as in manufacturing concentrates and syrups for use in soft drinks and ready-to-go beverages. Growth in the market for low-calorie drinks may considerably improve the prospects for value addition in niche markets such as water seltzers and sparkling water.

Similarly, sorghum and/or barley demand from beer manufacturers could stimulate investment in agro-processing (box 5), contributing to local development. In Zambia, local sourcing of barley has triggered a significant supply response from farmers, leading to the establishment of a malt-processing plant. This could result in an estimated savings of \$10 million for Zambian Breweries, which previously imported barley from Europe (Food Business Africa, 2016). In addition to the low-cost market segment, there is a potential in niche markets, such as craft beers and flavoured alcoholic beverages, which are gaining popularity in the local market and among tourists (African Business, 2016). Firms' ability to source key ingredients, including hops, is, however, critical, and being able to locate suitable suppliers on the continent could therefore provide a strong boost

to these incipient market segments.⁴¹ This may provide opportunities for economic diversification, supporting the development of local brands and local enterprises, and generating employment, while reducing leakages associated with the repatriation of profits by multinationals to foreign countries.

Similarly, South African regulations, which require brandy producers to use wine as a base product, have supported the development of strong backward linkages between local brandy manufacturers and grape growers and wine grape producers that supply the raw materials, with reliable markets stimulating production (Reuters, 2017). Enabling firms to source inputs from regional markets in Africa may provide incentives that allow firms to participate in regional value chains, possibly engaging in higher-value activities that foster diversification through the production of intermediate products. Given the fragmented nature of the spirits value chain in Africa, there may be opportunities for firms to specialize in differentiated market segments, penetrating markets that have largely been dominated by multinational corporations.

A critical issue remains, however. It has to do with the complex interplay of divergent rules of origin at the regional economic community and continental levels, which may unwittingly create complications and possibilities of regulatory arbitrage. For example, a soda producer from Ghana that is allowed to source a certain proportion of fruit syrup from outside Africa when exporting under ECOWAS regimes (as long as it complies with the uniform ad valorem percentage requirement), might find this possibility curtailed when exporting under the regime of the Continental Free Trade Area, if related rules of origin, as in the case of COMESA, adopt an exception for fruit preparations. Given the presence of multiple competing disciplines at the subregional and continental levels, it is highly complex to ascertain a priori the impact of similar legal divergences. Nonetheless, it remains vitally important to acknowledge that they might pose significant challenges to exporters, as well as to authorities certifying rules of origin compliance. This example also highlights the importance of leveraging the Continental Free Trade Area to move towards greater regulatory convergence, so as to streamline compliance across the various layers of regional trade agreements.

⁴¹ For instance, while beer manufacturers in Africa often import hops from Europe and the United States, countries such as Ethiopia and South Africa among others, could be viable suppliers of the commodity on the continent.

3.6 Cement value chain, rules of origin and regional integration

A key ingredient of concrete, cement represents a vital input to the construction sector, and its availability at competitive prices plays a fundamental role in infrastructural provision and related development planning. Nowhere is this relevance more evident than in Africa, a region with rapid economic and demographic growth, large infrastructural deficits and rapid urbanization, where demand is growing and is expected to continue to rise (African Competition Forum, 2013; Birshan et al., 2015). This rationale largely explains the strategic dimension of the industry, the attention it receives in the media and business community, and the significant role traditionally played by Governments. Beyond its importance for infrastructural investments, the cement industry provides opportunities to add value to otherwise low-value minerals, generating employment opportunities in limestone processing, kilns and cement terminals, as well as in transport, logistics and distribution.

In terms of value-chain structure, there are two distinct but interrelated levels in the cement business model: production, and distribution. Production entails a capital- and energy-intensive process: cement is obtained from heating limestone (i.e. calcium carbonate) with other materials to form hard nodules (clinker), which constitute the key processed intermediate (HS code 252310). Clinker is then ground with gypsum and other materials to obtain ordinary Portland cement powder or different varieties of the final product.⁴² It is estimated that raw materials account for 30–40 per cent of the overall cost of production, energy for 30 per cent, transport for 10 per cent and other cost elements, including labour and administration, for the remaining 20 per cent (Byiers et al., 2017). With regard to distribution, the bulk and bagged cement markets coexist, with broadly distinct supply-chain strategies. Considerations related to long-term efficiency and capacity utilization are critical in the bulk segment, while the provision of bagged cement must be more responsive to short-term demand fluctuations. In both cases, the provision of infrastructure and logistics is an important determinant of transportation costs, with land transport being significantly more expensive than maritime transport, given cement's low value-to-weight ratio. The cost difference between these two modes of transport is such that, according to the European Cement Association, it is cheaper to cross the Atlantic Ocean with a cargo of 35,000 tons of cement than to transport it 300 km.⁴³

⁴² Variations of the product are obtained by using an extender, such as slag or fly ash, to produce different strengths and chemical properties, especially in the presence of water, hence the distinction between hydraulic or non-hydraulic cement. In Africa, the variety of products is somewhat limited to ordinary Portland cement, limestone filler or pozzolana-blended cement.

⁴³ See <https://cembureau.eu/cement-101/key-facts-figures/> (accessed 18 February 2019).

In 2017, global cement production was approximately 4.1 billion metric tons (United States Geological Survey, 2018). China is by far the world leader in cement production, followed by India and the United States. Africa accounts for 10 per cent of global cement exports, while its share of global imports hovers around 21 per cent. Major players in the African region include Egypt, Morocco, Senegal, South Africa and Tunisia. In contrast to the global context of overcapacity, the African region has traditionally been a net importer of cement. The corresponding trade deficit rose sharply between 2004 and 2010, and since then has remained about \$2 billion per year. Domestic demand outstrips supply in most African countries (figure 38), and intraregional imports of cement products only account for one third of the corresponding import bill. Further, cement prices have long been high in Africa. According to some estimates, a 50 kg bag of cement costs an average of \$9.57, compared with \$3.25 in the rest of the world (World Bank, 2016b).

Beyond price differentials, factors such as market size and geographical considerations have an important bearing on investment decisions, such as investing in additional kiln or grinding capacity. Given the cost structure discussed above, locational choices are driven not by proximity to limestone deposits and cheap energy sources alone, but also by the characteristics of infrastructure provision and the ensuing access to large sources of demand at competitive prices. The level of demand, in turn, dictates the appropriate size of investments in kiln and grinding capacity, as considerations relating to economies of scale need to be combined with sufficiently high utilization rates. These elements, possibly coupled with mark-ups and demand fluctuations, determine price levels and thus affect the pattern of international trade. Three scenarios can arise in relation to countries' involvement in the cement value chain:

- Countries endowed with limestone deposits. These typically engage in clinker and cement production and trade both products internationally to meet local demand and supply.
- Countries that lack competitive access to limestone deposits, but possess grinding capacity. These rely on imported clinker to produce cement domestically and complement domestic production with international trade.
- Countries that are not endowed with adequate limestone deposits and do not possess grinding capacity (typically because the small domestic market is insufficient to achieve the minimum efficient scale). These rely entirely on imported cement (World Bank, 2016b).

With reference to this general classification, most African economies find themselves in the first group: they produce clinker and cement domestically – cement is obtained

from local and imported clinker, depending on relative prices – and also trade in the intermediate and the finished product. Several countries in West Africa, including Burkina Faso, Côte d’Ivoire, Liberia, Sierra Leone and Togo, are in the second group. As they do not possess economically viable limestone deposits, they rely on a mix of imported cement and cement obtained locally from imported clinker. Smaller economies, such as the Gambia, Lesotho, Mauritius, Seychelles and Swaziland belong to the third group, as they are entirely reliant on cement imports.

Figure 38

Trade balance in cement products (Harmonized System code 2523), 2015–2017



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed December 2018).

Pervasive economies of scale, both at the plant level and in overall logistics and distribution, have encouraged vertical integration and market concentration along the cement value chain. Globally, the volume of mergers, acquisitions and consolidations during the past decade has reinforced this direction. In Africa, the ownership structure

of the cement business is characterized by oligopolistic tendencies, with few companies dominating the market, even at the subregional level. Leading cement manufacturers in the African market include AfriSam (South Africa), Cemex (Mexico), Dangote (Nigeria), Heidelberg Cement (Germany), Holcim (Switzerland), Italcementi (Italy) and Lafarge (France). Cemex and Italcementi operate cement facilities in North Africa, namely in Egypt and Morocco. Heidelberg, Holcim and Lafarge own or operate cement-processing units in other African subregions. Over the years, leading transnational corporations have consolidated their positions by acquiring former publicly held companies and merging with other groups for strategic positioning so as to better exploit economies of scale in sourcing transport and distribution and to deter external competitors. Several studies have shown how the cement business is one where players can cartelize a whole region, warranting a regional approach to deal with cartels, abuse of market power and anticompetitive behaviour (African Competition Forum, 2013; United Nations Economic Commission for Africa et al., 2017).

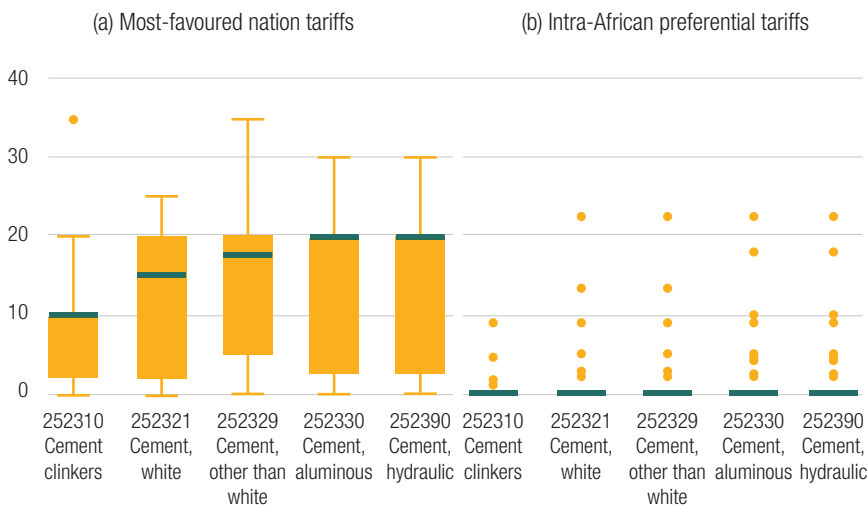
This discussion highlights the complexity of the cement industry in Africa, as well as the political economy trade-offs that need to be considered in the context of trade liberalization discussions. Given the dynamism of cement demand in the region, as well as the generally high prices compared with the international market, investors clearly see a case for expanding capacities in kilns and grinding facilities. For instance, Dangote has penetrated the market of a number of African countries, from Mali to Ethiopia, largely through greenfield investments in new capacity, a strategy that has put downward pressure on cement prices, but has also been questioned by the incumbent producers (Akinyoade and Uche, 2017; Source Supply, 2017). Against this background, the establishment of the Continental Free Trade Area – if buttressed with robust competition policies – could be expected to contribute to an overall reduction of prices by fostering more efficient economies of scale and a more competitive outlook. This rationalization of the production structure may not be painless for import-competing producers but could trigger considerable gains for the provision of infrastructure. Yet, in a context of global overcapacity, an overly restrictive approach to tariff and non-tariff issues, including rules of origin, could artificially segment the market, leading to inefficient investment and sourcing outcomes. This concern is all the more important because of the spatial considerations associated with different costs of maritime and inland transport. With the long-term decline in shipping costs, the relative price of imported cement might fall gradually, eventually eroding the rationale for adding more and more capacity. Whether landlocked countries can also benefit from this development, however, will hinge on the degree of smoothness of intra-African trade, as well as on the quality of hard and soft infrastructure and logistics that enable it.

Current levels of protection for cement products (HS code 2523) remain relatively high in Africa, in line with the sensitivity of the industry, as well as its multifaceted political economy. This is particularly evident with respect to most-favoured nation rates (figure 39 (a)), which tend to be weighty and tariffs levied on clinker (HS code 252310) tend to be slightly lower than those on downstream products (notably Portland cement, HS code 252329, the most widely traded variety of cement in the region). The comparison with figure 39(b), which captures the distribution of intra-African preferential tariffs, suggests that considerable progress has been made in terms of liberalization in the regional economic communities. Ample scope for tariff cuts remains across such communities, where trade is mostly conducted on a most-favoured nation basis. Moreover, in light of the large difference between most-favoured nation tariff rates and intra-African preferential rates, there is room for the Continental Free Trade Area to extend substantial preference margins to all African traders, which could significantly boost intra-African trade if the supply response were complemented by decisive improvements in infrastructure and logistics across the continent.

Figure 39

Distribution of simple average tariffs levied on cement, 2014–2016

(Percentage)



Source: UNCTAD secretariat calculations, based on data from TRAINS database (accessed October 2018). Note: Figures on the x-axis refer to HS codes. Tariff rates are aggregated at HS subheading (six-digit) level through simple average.

While the case for liberalization may appear straightforward from a theoretical perspective, the reality on the ground and its political economy ramifications are extremely complex (Akinyoade and Uche, 2017). Even within the context of relatively well-integrated regional economic communities, such as EAC and ECOWAS, contrasting interests have led to various disputes on unilateral measures, such as duty-remission schemes and ad hoc taxes and surcharges (Collectif régional pour la coopération Nord-Sud, 2015; lentreprenuriat.net, 2014; *The East African*, 2014). Moreover, across Africa, the political economy of the cement sector, coupled with its oligopolistic nature, have resulted in the widespread use of non-tariff barriers, ranging from import bans to quotas or more subtle measures such as deliberate efforts to limit foreign exchange availability for cement importers (Akinyoade and Uche, 2018; Pulse Ghana, 2016; World Bank, 2016b). Similarly, the penetration of imported cement or even of African investors in many countries has often been greeted by resistance and controversies stirred by incumbent producers decrying unfair competition (Afriki Presse, 2016; Akinyoade and Uche, 2017; lentreprenuriat.net, 2014).

With regard to the treatment of rules of origin, the complex political economy of the cement industry reflects the variety of approaches followed by the regional economic communities. In this respect, while some, such as EAC, have adopted a more restrictive stance, requiring that cement be obtained from wholly produced minerals, others have opted for more lenient rules of origin allowing the use of imported clinker either through a change in tariff heading rule, or through ad valorem percentage criteria. Given the cost structure of the cement industry – where roughly 30–40 per cent of the production cost is represented by raw materials (Byiers et al., 2017) – the choice of the specific criterion and related threshold may hamper sourcing strategies, potentially creating a captive market for African clinker producers. This in turn could affect the competitiveness of grinding plants in countries relying on imported clinker for their cement production, especially in coastal areas that could otherwise access clinker imports from outside the continent. In this respect, it is important to exclude costs of freight and insurance from the calculation of ad valorem percentages for rules of origin compliance to ensure that the disproportionate incidence of transport costs does not translate into overly demanding thresholds for origin determination (UNCTAD, 2018i).

Among the regional economic communities, the strategic dimension of the cement industry in achieving economic development is considered a rationale for both a more protectionist and a more liberal approach. Under the COMESA trade regime, cement and all related products under HS heading 2523 are designated “goods of particular importance to the economic development of the member States” and as such are

subject to a more lenient rules of origin, namely that they should contain no less than 25 per cent of value added, instead of the 35 per cent threshold generally applicable to other products. This contrasts with the position of ECOWAS, which included cement among the specific goods for economic development, subject to the highest band of the common external tariff at 35 per cent (De Melo et al., 2014). Such a contrast speaks to complex political economy considerations, which are likely to affect trade policy decision-making. The use of the same rationale for radically different trade policy stances also points to the distance between the theory and practice of regional integration. Clearly, the latter is a political as much as an economic process, hence differences in political and institutional arrangements – notably in terms of competition policy frameworks – could lead to radically different outcomes (United Nations Economic Commission for Africa et al., 2017).

Against the backdrop of multifaceted trade-offs involved in the liberalization of politically sensitive industries, such as cement, it is important to keep in mind that, given the modalities for market access negotiations in the context of the Agreement Establishing the African Continental Free Trade Area, protection for specific sectors can be better calibrated through an appropriate selection of the tariff schedule (i.e. of sensitive and excluded products), than through overly restrictive rules of origin.⁴⁴ This is because sensitive sectors are likely to differ from one country to another, and the degree of freedom in negotiating tariff schedules is much greater than in negotiating a single set of rules of origin to be applied *erga omnes*.

3.7 Automotive value chain, rules of origin and regional integration

Although the automotive sector has a fairly long tradition in a few countries such as Egypt, Nigeria or South Africa, the African continent continues to play a peripheral role in an industry characterized by strong geographic concentration around key markets. Demand for new vehicles has long been restricted by limited purchasing power of the average consumer, high lending rates, comparatively low road density and overall poor state of the road network (French Development Agency and World Bank, 2010; Gwilliam et al., 2008). As a result, Africa has the lowest rate of motorization – 38.9 vehicles per 1,000 people (2016 figures) compared with 105.6 vehicles in East Asia and 174.7 vehicles in Central and South America (Davis et al., 2017).

⁴⁴ For a detailed discussion of the modalities of the Agreement and their impact, see United Nations Economic Commission for Africa, 2018.

While small by global standards, the African market has largely untapped potential and is regarded as the last frontier of the automotive industry (Deloitte, 2018). From a burgeoning middle class to ambitious infrastructural projects, many of the above-mentioned limiting factors are gradually changing, and the African market has witnessed slow but steady expansion. Major original equipment manufacturers, such as Daimler, Fiat, Ford, General Motors, Nissan and Toyota, are thus showing more and more interest in Africa at a time when several African Governments are also stating their intention to establish, revive or strengthen a domestic automotive industry. The automotive master plan 2021–2035 of South Africa, the 2030 development plan of Ghana and the industrial acceleration plan 2014–2020 of Morocco are examples of this trend.

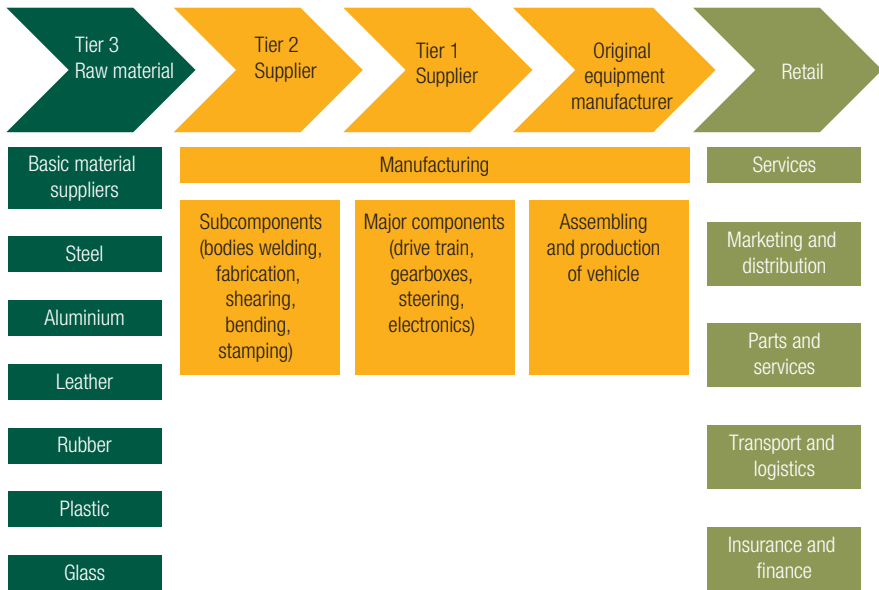
The global automotive industry operates in a highly competitive environment, with many differentiated brands operating in multiple segments of the market, as well as with evolving standards and rising customer requirements (Ambe and Badenhorst-Weiss, 2011; KPMG, 2014). These features require a value chain with a high degree of flexibility and responsiveness to changing market requirements in a cost-effective manner, as well as with sophisticated management and intensity of information technology. The structure of the automotive value chains evolved into the current multi-tiered model (figure 40), when suppliers moved away from standardized pre-designed products to customization and the provision of whole systems. The original equipment manufacturer leads and coordinates the whole chain, starting from upstream tier 1 suppliers of chassis and automobile bodies, and the downstream distribution system that ends at the dealership (Erwin, 2016; Vonderembse and Dobrzykowski, 2009). Tier 1 suppliers often cluster around their original equipment manufacturer customers, in order to more effectively meet customer requirements and ensure a greater dissemination of tacit and explicit specialized knowledge and capabilities, while sourcing their components from tier 2 suppliers, which usually manufacture them in the region (KPMG, 2014).

In line with the complexity of the value chain, a broad range of factors informs location and sourcing choices of the lead firms. Given the capital-intensive and long-term nature of their investments, location decisions tend to favour stable countries with low political risk, access to a large domestic or regional market, a skilled workforce, access to finance⁴⁵ and good-quality infrastructure, especially in terms of electricity provision and trade-related infrastructures and connectivity. Beyond labour costs, many of these elements also affect the identification of the best-cost-country sourcing, notably in view of the importance of respecting quality standards and timely delivery. In general,

⁴⁵ The constraints posed by inadequate access to credit and financial services are typically more binding for local enterprises – especially at the early-stages of their ventures – than for companies related to transnational corporation-led value chains, thereby undermining opportunities to spur local entrepreneurship and upgrading (UNCTAD, 2018c).

the opportunities for developing-country firms to connect with the automotive value chain lie mainly within tier 2 and tier 3 suppliers (Erwin, 2016; United Nations Industrial Development Organization, 2003). An alternative to this would be to set up joint ventures between local companies and original equipment manufacturers – a popular model in China and India – and increasingly applied in African countries such as Morocco, Nigeria and Rwanda, as well. While not all African economies can conceivably embark on nurturing the development of the automotive industry because of its intrinsic nature, successful countries could reap sizable benefits in technological upgrading, job creation and extensive backward and forward linkages, including to the services sector.

Figure 40
Automotive value chain



Source: UNCTAD secretariat, based on information from the International Organization of Motor Vehicle Manufacturers.

Developing countries aspiring to connect to the automotive value chain face four main challenges. First, a sufficiently large domestic market and/or good access to a regional market – both in commercial terms, as well as in relation to infrastructure and logistics – is a prerequisite for the establishment of the automotive sector because of the industry’s

heavy reliance on economies of scale and long production runs. Second, if countries are to move beyond the stage of assembling from complete knocked-down kits,⁴⁶ thereby enhancing local value addition, they should gradually aim at fostering the emergence of competitive suppliers in all tiers of the value chain. Third, skill development plays a key role in achieving and maintaining competitiveness in the business, which calls for long-term investment in a broad array of disciplines, ranging from technical professions to those in science, technology, engineering and mathematics. Fourth, the effective management of the supply chain, as well as the harnessing of after-sale services, warrants top-class logistics competences matched by adequate hard and soft infrastructure.

It is therefore clear that Africa plays a peripheral role in the automotive industry. In 2017, Africa accounted for 1 per cent of world vehicle production and 1.2 per cent of sales (mainly of passenger cars), with three countries – Egypt, Morocco and South Africa – representing the lion's share.⁴⁷ Similarly, Africa has recorded a growing structural net trade deficit in every segment of the automotive market (figure 41).⁴⁸ Data from the International Trade Centre indicate that in 2015–2017, total exports of automotive products reached an average of \$4.4 billion per year, compared with \$11.2 billion of imports, with passenger cars accounting for the bulk of these trade flows. Leading exporters in the region were South Africa and Morocco. Other key players included Côte d'Ivoire, Egypt, Namibia, Kenya and Tunisia. Except for Namibia, these countries also featured prominently among the main importers of automotive products. Algeria, Ethiopia, Ghana and Nigeria imported over \$1 billion dollars in automotive products per year during the period considered.

Unlike in other regions, the automotive industry in Africa remains extremely outward-oriented (see figure 42), especially in relation to passenger cars, where the regional market accounted for less than 10 per cent of exports and 2 per cent of imports. With regard to commercial vehicles, the share of the regional market appears to be significantly greater both in terms of imports and exports, but this is mainly a reflection of the pivotal role of South Africa in SADC. The relevance of the regional market is somewhat more encouraging in relation to parts and components, suggesting that some African countries, especially in Northern and Southern Africa, are starting to harness the opportunities to connect with the automotive value chain as tier 2 and tier 3 suppliers.

⁴⁶ Complete knocked-down is a common practice in the automotive sector, and it involves supplying a vehicle in the form of a kit containing all its completely non-assembled parts, which are typically manufactured in a different country.

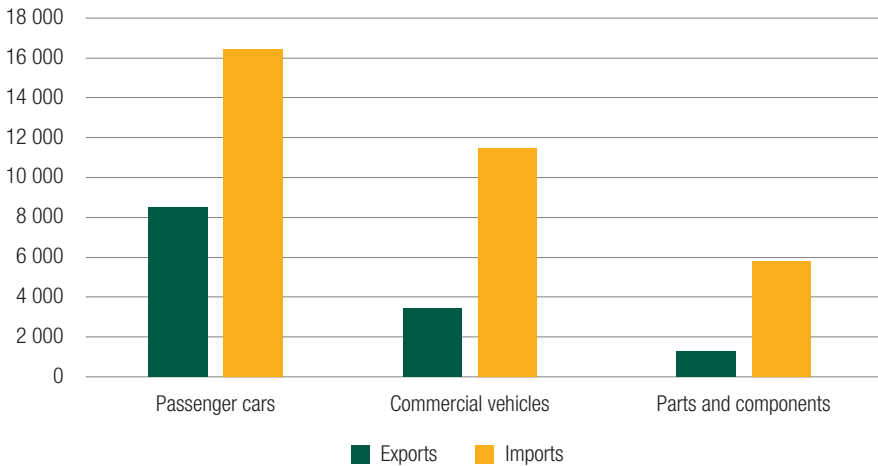
⁴⁷ Figures are obtained from estimates of the International Organization of Motor Vehicle Manufacturers (www.oica.net/; accessed 18 February 2019).

⁴⁸ For the purpose of this case study, trade figures related to the automotive industry are classified as follows: passenger cars, HS heading 8703; commercial vehicles, HS headings 8701, 8702, 8704, 8705 and 8709; and parts and components, HS headings 8706, 8707 and 8708.

Notwithstanding, barely 6 per cent of overall imports to Africa of automotive products are sourced from the region. Though tariff rates are significant in the industry, the weakness of the regional market seems to stem more from the structural limitations discussed above, than from mere trade protection. While it is unlikely that trade liberalization at the continental level would radically affect import-competing businesses, given African countries’ heightened dependency on imports from outside the continent, it may help reach larger economies of scale to attract market-seeking investments. One related area where the Continental Free Trade Area could make a visible difference would be in generating substantial preference margins for parts and components, even across the regional economic communities. This could allow a greater deepening of the regional trade networks in parts and components, creating additional opportunities for tier 2 and tier 3 suppliers.

Figure 41
Africa’s automotive exports and imports, by product type, 2015–2017

(Millions of dollars)



Source: UNCTAD secretariat calculations, based on data from the Trade Map database of the International Trade Centre (accessed December 2018).

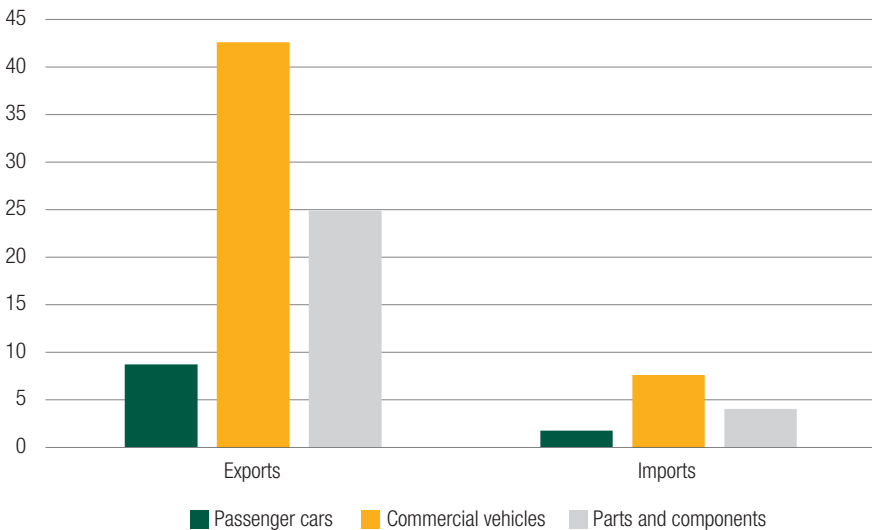
With prospects of creating an integrated regional market of over one billion people, the Continental Free Trade Area could be a game changer for the automotive sector in Africa, given its heavy reliance on economies of scale and its potential for creating strong regional supply networks (Erwin, 2016; Lejarraga et al., 2016). The development of the automotive industry in Africa is strongly correlated with preferential trade

agreements, which shape sourcing decisions along the value chain. This is particularly the case of countries such as Morocco or South Africa, whose automotive industry is primarily geared towards exports to developed-country markets, and where rules of origin and bilateral cumulation play an important role. In this context, going beyond existing regional economic communities to consolidate the continental market could thus boost the attractiveness of Africa for original equipment manufacturers, and tier 1 and tier 2 suppliers with a pan-African focus. This could facilitate the dispersion of automotive supply chains across the Continental Free Trade Area, provided that trade policy developments are complemented by decisive improvement of connectivity within Africa. Moreover, reaching a sufficient critical mass could also allow African consumers and producers to have a greater say in defining quality requirements and technical standards for the continental market. Indeed, some African players already envisage the manufacture of an affordable and uniquely African vehicle that would meet consumer demands for rugged performance, fuel economy, low chances of overheating and readily available spare parts.⁴⁹

Figure 42

Share of intra-African trade in the automotive industry by product type, 2015–2017

(Percentage)



Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed December 2018).

⁴⁹ See <http://innosonmotors.com/about-ivm>.

Therefore, the important lesson for this emerging automotive industry as it strives to increase local content is to strike a balance between encouraging a substantial autonomous development of the sector and dependence on foreign technology. Overemphasis on directly supporting local research and development, while ignoring the key role of foreign firms would be of little benefit in the short and medium terms, given the leading role of foreign firms, as well as the incipient nature of the African market, which currently lacks domestic tier 1 and tier 2 firms. This calls for enhanced technology transfer, whether this technology is embodied in machinery; developed in collaboration with a supplier; or obtained through domestic licensing, hire of foreign personnel, or in-house research and development.

In an industry characterized by a complex configuration, multiple tiers of suppliers and a strong correlation with preferential or regional trade agreements, rules of origin inevitably play a significant role by affecting original equipment manufacturers' options to source parts and components. In this respect, cumulation and absorption issues take on added significance in view of the region's long-standing reliance on imported components. In the context of the Continental Free Trade Area, this structural dependence also calls for realism in defining critical thresholds for the ad valorem percentage criterion. Local content levels currently reach 30–35 per cent in South Africa – presumably the region's most advanced vehicle producer (Bloomberg, 2018; Independent Online, 2018). The establishment of the Continental Free Trade Area may open up additional opportunities to localize value addition in the sector, by breaking the current fragmentation across the regional economic communities and thus deepening regional value chains in upstream activities. Nevertheless, most African vehicle manufacturers may struggle to comply with ad valorem percentage criteria that are more stringent than those of the African regional economic communities, which generally prescribe threshold levels of 25–35 per cent of value added (chapter 2).⁵⁰ While it may be significantly easier to comply with other rules of origin criteria such as change in tariff classification, this example represents a warning against excessive restrictiveness, which would ultimately hamper incipient value chains.

To better gauge the effect of preferential or regional trade agreements and related rules of origin on the automotive industry, it is worthwhile comparing the experiences of four major producing countries: Egypt, Kenya, Morocco and South Africa. In the first two examples, the inability to reach adequate economies of scale, despite attempts to leverage preferential and regional trade agreements, have undermined the performance of the automotive sector, leaving it exposed to growing international competition. In comparison, the two latter cases provide examples of how strategic export orientation,

⁵⁰ Some automotive products feature in the COMESA list of goods of particular importance to the economic development of member States and are thus subject to lower thresholds to determine originating status.

including through international trade agreements, has helped attract key original equipment manufacturers and contributed to the emergence of a viable industry, despite the challenges of domestic value addition.

In Egypt, the automotive industry has traditionally catered to the domestic market, especially in relation to its most important component, passenger cars. Once heavily protected and subsidized, the sector has been negatively affected by the fallout caused by the Arab Spring and the subsequent devaluation of the Egyptian pound, which increased the cost of imported inputs. In addition, the automotive industry has faced growing competition as the tariffs levied on vehicles originating from Europe and components have been gradually reduced within the framework of the Euro-Mediterranean Free Trade Agreement. With domestic production spread across small-scale factories unable to attain sufficient economies of scale, imports have risen sharply, to the extent that 59 per cent of vehicles sold in 2014 were locally assembled, down from 66 per cent in 2004 (Black et al., 2018).

In Kenya, the automotive sector has traditionally focused on retail, distribution and after-sales services, extending in recent years to include locally assembled vehicles from complete knocked-down kits. In part, the National Industrialization Policy Framework for Kenya served as an incentive for the establishment of various plants to assemble complete knocked-down vehicles for domestic sale and exports to the regional EAC market. As the kits were all imported from outside EAC, access to preferential treatment critically relied on complete knocked-down assembling being considered as an origin-conferring operation. However, for a number of years, lack of recognition of criteria on a change in tariff heading for motor vehicles manufactured in Kenya has undermined related export opportunities within the Community, forcing assembly plants to operate well below full capacity, hence hindering their competitiveness (EAC, 2014). The 2015 reform of the EAC rules of origin was designed to ensure uniformity among the partner States in the application of those rules, including explicit mention of complete knocked-down assembling as an origin-conferring operation. In particular, it facilitated compliance by streamlining origin criteria and allowing for the retrospective issuance of certificates of origin (Federation of East African Freight Forwarders Associations, 2017). Nonetheless, challenges in accessing the EAC market persisted until 2018, when after a verification mission carried out by Kenyan and Tanzanian authorities, the issue was reportedly resolved (United States Agency for International Development East Africa Trade and Investment Hub, 2018).

In Morocco, the history of the automotive industry is closely linked to that of Renault, which opened its first automobile plants in that country in 1966 and remains by far the

largest original equipment manufacturer. Facilitating this partnership, which has been central to the experience of Morocco, were a combination of structural factors and deliberate policy measures and incentives to attract key investors. Structural factors include its geographical location, good infrastructure – notably Tanger Med port – and a competitive labour market. In line with the nature of its main original equipment manufacturers, the Moroccan automotive industry is highly reliant on the European Union both as a source of inputs and a vent for exports. Yet, its positioning as a regional hub is also driven by several factors. Morocco signed a free trade agreement (the Euro-Mediterranean Free Trade Agreement) not only with Europe, but also with Arab countries and the United States. It is currently negotiating the Deep and Comprehensive Free Trade Area and has recently joined ECOWAS. The possibility of benefiting not only from bilateral cumulation with the European Union, but also from the pan-Euro-Mediterranean cumulation of origin system has been critical to the country's success. This cumulation system allows for diagonal cumulation between its 23 contracting parties in the European Union, the European Free Trade Association, the Middle East and Northern Africa, the Western Balkans and the Faroe Islands (European Commission, 2019). While this has enabled Morocco to establish a viable automobile industry, the main challenge now lies in fostering a stronger inclusion of local firms in the value chain and a gradual shift towards higher value added. To that end, the country's industrial policy has evolved from a primary focus on labour-cost advantage to fostering synergies across sectors, creating ecosystems for different parts of the value chain and using targeted support measures for enhancing workforce capabilities and competencies.

In South Africa, the automotive industry originally focused on the domestic market, under high levels of protection and stringent local content requirements. More recently, however, the country adopted an outward orientation approach across all market segments, including parts and components. This strategy responded to the realization that the domestic market, albeit sizeable, was not large enough to sustain growing competition. The reorientation process has provided a strong boost to export revenues, associated with the penetration into the United States market, the Southern African Customs Union and SADC. Notwithstanding the high degree of dependence of the industry on foreign inputs, this has allowed South Africa to improve its net trade balance with regard to automotive products, recording trade surplus for most of the post-financial crisis period. Coupled with the country's connectivity and good infrastructure, this has been an important factor in attracting major original equipment manufacturers, such as Nissan, which from its South African hub is serving 45 other African countries.

The pattern of free trade agreements signed by South Africa has been pivotal to this process. Such agreements have guaranteed preferential access to its main market (the

European Union) under the bilateral Trade, Development and Cooperation Agreement, to the United States market under the African Growth and Opportunity Act and much of the subregion under the Southern African Customs Union and SADC. In particular, the fact that the African Growth and Opportunity Act and the Trade, Development and Cooperation Agreement allowed for bilateral and diagonal cumulation was of crucial importance for a value chain characterized by high reliance on imported components.⁵¹ In contrast, the Southern African Customs Union has adopted the concept of single origin, essentially defining products originating from the Union through horizontal cumulation. These distinct legal frameworks are carefully assessed by leading firms, which plan their sourcing decisions accordingly, to best harness the flexibilities of cumulation, while reaping the benefits of preferential treatment. In this respect, the role of leading original equipment manufacturers in coordinating the value chain and adapting sourcing decisions to the requirements of each trade agreement is also demonstrated by the high rates of preference utilization in the industry for the free trade agreement considered. As in the case of Morocco, the future challenge for the South African automotive industry will be to increase its domestic value added content, an objective which underpins the newly introduced Automotive Production and Development Programme (Bloomberg, 2018; Independent Online, 2018).

3.8 Key insights from the six case studies: Synthesis

Preferential rules of origin are a necessary element for the implementation of regional and other preferential trade agreements. Given the growing importance of trade in intermediate inputs, the emergence of global and regional value chains, and the increasing number of preferential trade agreements, there is a risk that rules of origin may give rise to an increasingly complex mass of regulations, and thus be lacking in progress towards greater regulatory convergence.

A similar concern is also relevant to regional integration in Africa, which is characterized by numerous regional economic communities, often with overlapping membership, and benefits from several preferential schemes, each with a distinct rules of origin discipline. For a relatively weak domestic private sector, dealing with an increasingly complex set of alternative regulations may lead to mounting administrative and compliance costs, ultimately undermining more vibrant intra-African trade. To achieve the vision of the Continental Free Trade Area, it is therefore necessary to consider rules of origin

⁵¹ Upon ratification, the Economic Partnership Agreement between the European Union and SADC will replace the Trade, Development and Cooperation Agreement, implying the adoption of less stringent rules of origin.

negotiations with a degree of pragmatism, forging consensus on a careful balance between preventing trade deflection and unduly restrictive disciplines. It also entails mediating between the interests of powerful incumbents and the need to ensure an inclusive win-win outcome for the Continental Free Trade Area by putting in place some flexibilities for countries with a weaker productive structure. This concern is particularly important because the impact of regulations on a given sector will be affected not only by the current stakeholders (i.e. the intensive margin), but also the entry barriers and the opportunities for new entrants (the extensive margin).

Far from taking a prescriptive approach, this chapter has highlighted the complex and wide-ranging implications of Continental Free Trade Area negotiations in the context of six African regional value chains, namely tea, cocoa, cotton and apparel, beverages, cement and the automotive industry. More specifically, it underscored how the interplay of sectoral dynamics, potential preference margins and rules of origin shape the contours in which regional market actors will operate. This final section summarizes the key insights drawn from the six case studies, with a view to informing deliberations and emphasizing how the Continental Free Trade Area could be harnessed to enhance the consistency between trade policy and the region's agenda for industrialization and productive capacity development. For conceptual clarity, such insights are divided into general principles, regime-wide rules of origin, selected product-specific issues, and capacity development and support institutions.

3.8.1 General principles

Overall, this chapter underscores the context-specific impact of rules of origin. It varies not just as a function of the country considered and its pattern of trade, but also – and perhaps more fundamentally – as a function of the sector, its input-output structure, the complexity of production, and the governance and geographic features of the value chain. Consequently, pragmatic approaches to rules of origin negotiations should be preferred to dogmatic ones. The context-specific nature of the impacts of rules of origin also explains the importance of close consultation between negotiators and producers and other private sector stakeholders, in order to gain a thorough understanding of sectoral dynamics, and of potential constraints in complying with proposed regulations.

In general, the case studies in this chapter highlighted the need for crafting rules of origin provision in a way that is as business-friendly as possible, in the sense of minimizing hurdles and uncertainties for firms, and in particular SMEs, for any given level of restrictiveness agreed upon. This is a critical objective in so far as it could help maximize the utilization of the Continental Free Trade Area. Therefore, it would be important to

establish relatively simple rules that are easy to implement and to avoid unnecessary burdens on businesses. This translates into the following principles:

- Transparency and simplicity. Regardless of the level of restrictiveness agreed upon, compliance will be less burdensome if regulations are easily accessible and businesses have a clear understanding of the legal texts and related practices. One proposal to enhance transparency could be to set up an online platform for intra-African trade that would provide user-friendly access to a repository of rules of origin provisions in relation to the Continental Free Trade Area, and ideally, to other regional economic communities in Africa; it would also be detailed at tariff-line level. To enable a thorough understanding of trade-related costs for the business community, this could be combined with detailed information on tariff rates, as well as documentation requirements, along the lines of the European Union Trade Help Desk.⁵²
- Predictability. As sourcing and investment decisions often entail fixed cost elements and take time to produce an effect, the predictability of rules of origin is critical to allow businesses to take informed decisions when revising their strategies and adjusting to the scenario beyond the Continental Free Trade Area. Given the long gestation periods associated with greenfield investments, predictability will be particularly important for leveraging the Continental Free Trade Area to attract market-seeking foreign direct investment.
- Move towards regulatory convergence. African businesses must deal with a set of overlapping and at times divergent rules of origin, at the various regional economic community levels, as well as under main preferential trading schemes, such as the African Growth and Opportunity Act, the Everything but Arms initiative and the Generalized System of Preferences. In this context, moving towards greater regulatory convergence is not only consistent with the principle of the “acquis” of the Continental Free Trade Area (i.e. that the Continental Free Trade Area should preserve what has been achieved at the regional economic community level and build on it), but more importantly, it could reduce overall transaction costs by streamlining and rationalizing legal complexity. In this respect, it could also be useful to reflect on the lessons to be learned from the experience of the regional economic communities, be it internally or in negotiations with other partners.

⁵² See <http://trade.ec.europa.eu/tradehelp/>.

- Simple, and impartial applicability. Ultimately, businesses will be affected by the practical implementation of rules of origin provisions, not by abstract legal considerations, as illustrated by the experience of assembly plants for complete knocked-down vehicles in Kenya. In this regard, it is of paramount importance to ensure that rules of origin be prepared and applied in an impartial, transparent, predictable, consistent and neutral manner. An important concern is the simplicity of rules of origin implementation, particularly in the light of the constraints faced by many African customs and revenue authorities at the institutional, capacity and logistical levels. In this respect, simple, transparent, predictable and trade-facilitating rules of origin could minimize the scope for unproductive rent-seeking and corruption, while facilitating the task of customs authorities. More broadly, the overall effectiveness of the African Continental Free Trade Area – as well as of any other regional trade agreement – will partly hinge on the involvement and expertise of customs administrations, which play a critical role in the implementation of key instruments and clauses, from the facilitation of transit procedures to valuation, and even trade defence instruments.

As will be discussed in greater detail in chapter 4, several instruments may be considered for implementing the above-mentioned principles: greater use of self-certification, longer validity periods and minimum data requirements.

3.8.2 Regime-wide rules of origin

Drawing from a variety of sectors and regional value chains, the case studies provided a number of insights into regime-wide rules of origin disciplines with regard to the following factors:

- Flexibility. In view of the wide array of heterogeneous members of the Continental Free Trade Area, as well as the broad range of economic actors involved – from transnational corporations to informal traders – reaching an inclusive outcome is likely to require some degree of flexibility in the crafting and application of rules of origin. Two examples of such flexibility are worth considering: special and differential treatment provisions for African countries with weak productive capacities (see below) and simplified rules of origin regime for shipments valued below a given threshold, for instance along the lines of the COMESA regime for small-scale cross-border traders.
- Cumulation. Several case studies, especially those related to sectors characterized by relatively long and articulated production processes (textile

and automotive industries), have highlighted the pivotal role of cumulation as an enabler of regional production networks. In this respect, the experience of numerous regional trade agreements, in particular that of the Association of Southeast Asian Nations, suggests that diagonal cumulation may provide a reasonable solution to enhance the depth and breadth of regional value chains at the continental level, thereby going beyond the current fragmentation at the level of the regional economic community. Full cumulation may, in principle, provide even greater benefits for regional integration in all those cases where given transformation stages are not sufficient, alone, to acquire originating status. This may be the case, for instance, of the bottling or dilution of beverages, or of the production of cut, make and trim apparel using non-originating fabrics, under a double transformation regime. By easing the joint acquisition of originating status, full cumulation may encourage relatively more advanced member countries to outsource these activities. However, full cumulation may be complicated in practice, since not all businesses may wish to disclose sufficient information to comply with the traceability requirements implicit in the application of full cumulation (Ing, 2015).

- Absorption or roll-up. Current rules of origin for processed goods, notably automotive parts and components, often tend to require relatively high local content, possibly limiting firms' sourcing decisions on key intermediates. In principle, this choice is aimed at enhancing domestic value addition. However, in value chains that are dependent on imported technologies, they may simply end up creating a captive market for a few suppliers located in the region. By allowing materials that have acquired origin by meeting specific processing requirements to be considered as originating when used as an input to a subsequent transformation, the absorption principle relaxes this constraint. Hence, non-originating inputs contained in intermediate materials that have acquired originating status and are used in the subsequent manufacturing of a good, are not considered for the origin determination of the final product. The absorption principle is extensively used in European legislation and the North American Free Trade Agreement. It is applied in a more restrictive manner in the latter, where it is limited to calculating regional value content but excludes its application in the automotive sector. There is, however, no absorption or roll-up principle in the origin model of the Association of Southeast Asian Nations; instead it developed a partial cumulation rule.
- Tolerance or *de minimis*. *De minimis* rules, which allow for a specified maximum

percentage of non-originating materials to be used without affecting origin, could help simplify rules of origin and lower costs of compliance. The adoption across the board of a *de minimis* rule would clearly represent the least restrictive approach and ease compliance, especially by weaker countries. *De minimis* provisions have occasionally been applied on a product-specific basis. At the very least, this kind of application would be important for products such as tea or chocolate, for which the adoption of a wholly obtained criterion is plausible, but whose final quality may require a modest use of non-originating varieties.

3.8.3 Selected product-specific issues

The case studies explored several of the following product-specific issues:

- Possibility of multiple criteria. One of the recurring messages of the case studies was the importance of taking into account the heterogeneity and sectoral dynamics of firms, especially with regard to the ease with which distinct producers may adjust to the scenario of the Continental Free Trade Area and comply with given regulations. In addition, larger firms with more sophisticated accounting systems may find it easier than SMEs to comply with rules defined on the basis of value added content. Correspondingly, implementing a change in the tariff classification method is simpler for customs authorities and for small businesses that might comply by simply providing import and export invoices with different classification codes. This shows how giving firms an alternative among different criteria, for example, a value added content and change in tariff classification, may allow heterogeneous firms a good margin to choose their best-fitting compliance strategy. Moreover, this would be consistent with the practice of various regional economic communities, such as COMESA and EAC, and might even reduce the regulatory divergence in relation to regional economic communities such as ECOWAS, applying a unique value added threshold across the board. However, if the multiplicity of criteria is to operate effectively, it is essential that alternative formulations of the origin criteria impose broadly similar requirements in terms of substantial transformation.
- Single versus double transformation in apparel. The case of the cotton-apparel value chain highlighted the central question of whether a single or double transformation regime would be more appropriate in the African context. While double transformation would ensure that trade preferences are applied to a smaller range of products with a higher local content, and hence be a preferable option from the point of view of upstream cotton yarn/

fabric producers, single transformation clearly opens additional avenues for downstream apparel manufacturers to fully harness the regional market without being overtly limited in their sourcing of intermediate inputs. The experiences of the African Growth and Opportunity Act and the Everything but Arms initiative suggest that countries with weaker productive capacities may indeed require a single transformation regime, if they are to take meaningful advantage of the opportunities opened up by the Continental Free Trade Area. Although these are unilateral preferential schemes unlike that of the Continental Free Trade Area, the point remains valid that more demanding criteria may hamper weaker economies disproportionately. Hence the adoption of a two-pronged approach is proposed as a possible compromise. One part of the approach would aim to secure a substantial preference margin for African cotton yarn and fabrics to boost intra-African trade in those products and correspondingly reduce their relative prices compared with those of non-African competitors. The other part would entail a single transformation approach, ensuring a more inclusive distribution of the benefits stemming from the Continental Free Trade Area.

- Sensitive products.⁵³ The analysis of the cement value chain describes what is at stake in the case of sensitive products, which may have relatively higher levels of protection or be critical for economic development. The experience of the regional economic communities in this respect offers a broad variety of approaches, which may inform deliberations at the continental level. These range from a more liberal approach such as that of COMESA, where cement is designated as one of the products of “particular importance to the economic development of member States” and is thus subject to less restrictive rules of origin requirements, to that of ECOWAS, where the sensitivity of cement translates into less ambitious tariff cuts, and in some cases, a ban on imports. This case highlights the contrasting interests of large incumbent producers of a given sensitive good, which may favour a more protectionist approach, and those of newer entrants and consumers, who might be keener to obtain greater liberalization within the regional market. Solving this conundrum will necessitate a careful balance, which cannot but be informed by case-by-case analysis and should take into account both sectoral dynamics and tariff liberalization schedules. In this respect, protection for specific sectors can be

⁵³ As negotiations on tariff concession schedules are ongoing, the expression “sensitive products” should be interpreted in a broader sense than the one utilized in the modalities for market access negotiations of the Agreement Establishing the African Continental Free Trade Area, which imply that the corresponding tariff lines will be liberalized over a longer transition period.

better calibrated through an appropriate selection of the tariff schedule (i.e. of sensitive and excluded products), than through restrictive rules of origin. The reason for this lies in the modalities for market access negotiations in the context of the Agreement Establishing the African Continental Free Trade Area. Sensitive sectors are likely to differ from one country to another, and the degrees of freedom in negotiating tariff schedules are much larger than in negotiating a single set of rules of origin to be applied *erga omnes*.

3.8.4 Capacity development and support institutions

Capacity development

Smooth implementation of the Agreement will depend on the institutional capacity of customs authorities, among other factors (chapter 4). With respect to the implementation of rules of origin, the complexity of the underlying legal discipline will put pressure on customs officials, not least because of the overlap of competing trade schemes in many African subregions. An impartial, transparent, predictable, consistent and neutral implementation of agreed rules of origin will thus require the enhancement of institutional capacities, commensurate investments in training and possibly hard infrastructures, particularly in remote border posts.

Harnessing information technology to streamline documentation and procedures

Information technology can help ease documentation requirements and streamline customs procedures, while improving transparency and predictability for firms and other stakeholders. It can, for example, help streamline the process of applying for exporters' documents and submitting self-declarations. Leveraging new technologies to reduce compliance costs, while ensuring a more transparent and neutral implementation of the rules of origin, will thus be of paramount importance. Similarly, it may provide scope for more effective customs cooperation, a point that may be particularly relevant to landlocked developing countries in Africa.

Public–private dialogue on rules of origin

Given the context-specific nature of rules of origin, consultation with private stakeholders, such as business associations, trade unions and farmer-based associations, plays a fundamental role in informing negotiations of sectoral dynamics and of the practical impacts of regulations on the ground. Establishing regular platforms for public–private dialogue will be valuable even beyond the end of the negotiations to identify implementation problems and periodically assess the impact of the Continental Free

Trade Area. In addition, this will eventually help adapt rules of origin provision to the evolving realities of production and trade on the ground. This will help foster a continental network of worker and business communities that can articulate more convincingly their needs, views and aspirations.

