



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 5

Main messages and recommendations

5.1 Introduction

This report argues that rules of origin are a cornerstone of the effective implementation of preferential trade liberalization among members of the African Continental Free Trade Area, without which gains cannot accrue towards Africa. Rules of origin should consider different levels of productive capacities and competitiveness between countries, to help foster regional production. Complementary policies such as business, competition and trade facilitation measures, to keep local inputs competitive relative to external suppliers, are critical to ensure trade creation rather than trade diversion. The sourcing of intermediate goods is key in the ability of firms to specialize and participate in regional and global value chains. Rules of origin should account for this need and not be overly restrictive, in particular in trading areas in which competitive intermediates cannot easily be sourced. This chapter recapitulates some of the main findings, messages and policy recommendations emanating from the report.

GETTING RULES OF ORIGIN RIGHT COULD:



Enhance **the gains from the AfCFTA***



Boost **intra-African trade**



Reduce **informal trade**



Support **industrialization**



Strengthen **regional value chains**



Foster **structural transformation**



Create **decent jobs**

GETTING RULES OF ORIGIN WRONG COULD:

Erode benefits of the AfCFTA*

Lead to low utilization of trade preferences

*African Continental Free Trade Area

5.2 Main findings

This report finds that most regional integration in Africa has taken place at the level of regional economic communities or at a subregional level, and at an uneven pace. The bulk of trade across such communities takes place on a most-favoured nation basis. The African Continental Free Trade Area can redress this situation by encouraging trade across communities, thereby ensuring a better harnessing of trade complementarity across the continent. For example, cocoa-producing countries in West Africa export most produce, in its raw, unprocessed, form, to outside the continent, yet the most important continental chocolate manufacturers, in Egypt and South Africa, rely mainly on cocoa paste and cocoa butter imported from outside Africa (see chapter 3). The Continental Free Trade Area can help address such continental disconnects, which also arise with regard to other primary commodities.

The analysis using the product complexity index shows that there are opportunities for deeper regional integration to support structural transformation in both small and large economies in Africa (see chapter 1). This is due to the relative degree of sophistication of products exported to regional markets, compared with those exported to the rest of the world. Therefore, rules of origin need to be reasonably simple (in the sense of being clear and understandable), transparent and predictable, to facilitate intra-African supply chain trade. There is an inherent complication, however, with the commitment as part of the Continental Free Trade Area to respect the “acquis” of the regional economic communities. There is a critical need to increase investment in transport infrastructure (road, rail, air and port) in Africa, to address supply-side constraints and bottlenecks to intra-African trade.

Rules of origin are a necessary instrument to implement preferential trade liberalization. As such, how they are addressed in the Continental Free Trade Area will directly affect the size and distribution of economic benefits among member countries and, ultimately, the political will of members to advance regional integration to create an African economic community. In this context, appropriate rules of origin can enhance the gains accruing to members and enable more inclusive outcomes. However, the design of rules of origin should not lead to a situation in which trading with extracontinental firms is easier and less costly than trading with firms in Africa. This would undermine the rationale of the Continental Free Trade Area.

The smooth and impartial implementation of rules of origin requires adequate institutional and organizational capacities among firms and customs authorities. Such requirements become greater as the rules become more complex and certification becomes more

difficult. In Africa, the complexity of relevant rules of origin regimes and certification procedures varies. In several instances, overlapping regional economic community memberships and competing regimes add to the level of complexity.

The findings in this report reinforce the suggestion that the African Continental Free Trade Area could represent a game changer for development prospects in Africa, for at least three sets of reasons. First, given the relatively high levels of most-favoured nation tariffs across all value chains considered and the fact that most trade across regional economic communities takes place on a most-favoured nation basis, there is scope to extend significant preference margins to all exporters in Africa. Second, in commodity-based value chains (e.g. cocoa, cotton and tea), redressing the fragmentation of the market in Africa across regional economic communities could greatly contribute to better harnessing trade complementarities, opening opportunities to enhance value addition on the continent. Third, as shown with regard to the automotive value chain, strategic outward orientation, in this instance at the regional level, could have an impact on enhancing the viability of value chains that rely heavily on economies of scale. Consolidating a critical mass of potential customers could help to attract original equipment manufacturers, providing an incentive to deepen the engagement of countries in Africa in activities connected with lower-tier suppliers.

5.3 Main messages and policy recommendations

The creation of a single market of 1.3 billion people creates opportunities for businesses to trade and grow across the continent. However, trade does not automatically lead to more inclusive and sustainable development, nor does it automatically translate into higher levels of employment. By shaping the space for regional value chains, well-designed rules of origin can play a role in turning more trade into more decent jobs that, in turn, can contribute to a more inclusive growth path. Establishing the right mix of rules of origin and sector-specific industrial policy instruments is key in achieving these objectives. Ideally, policy decisions should be informed by a careful assessment of the direct and indirect effects of trade at the sectoral level on the labour market in each member country. Without such studies, policymakers might rely on existing knowledge on the characteristics of sector-specific labour impacts. For example, the clothing sector may be associated with a high share of women's employment.

The rules of origin of the African Continental Free Trade Area will be the gatekeepers of continental regional integration. Getting the rules of origin wrong could erode the

benefits of the Continental Free Trade Area, leading to low utilization rates of trade preferences; getting them right could enhance commercial value under the Continental Free Trade Area and support structural transformation. Rules of origin are not sufficient in themselves to boost intra-African trade, since the incentive to trade a given product within Africa is determined by the interplay of relative prices (adjusted for quality); preference margins (studies suggest that the utilization of preferential trade agreements requires margins of at least 4.0 to 4.5 per cent to justify incurring the costs of compliance with rules of origin; see chapter 2); and supply, or the capacity to source goods from within the preferential treatment area. This is why the relation between tariffs and rules of origin is important and indivisible. However, the underutilization of preferences is not always a function of poorly designed rules of origin, but may also be a function of insufficient preferences (e.g. if most-favoured nation tariffs are low) or the presence of multiple trade arrangements between two partners (e.g. exports from countries in Africa to the United States under both the African Growth and Opportunity Act and the Generalized System of Preferences; see chapter 2).

The rules of origin agreed upon for the African Continental Free Trade Area will influence firm-level decisions on applying for preferential treatment, depending on the costs of compliance with the technical content of the rules, as well as procedural and documentary requirements. Moreover, the fixed-cost element in complying with rules of origin (e.g. to obtain required documentation) may disproportionately affect SMEs, which have lower volumes of trade compared with large companies. Such factors, in turn, also play a role in determining sourcing and investment patterns, affecting not only the intensive margin (changes in the level of existing trade flows), but the extensive margin (product and market diversification).

The impact of rules of origin is context specific, varying as a function of not only a country and its level of development, but also a sector, its input and output structure, the complexity of production processes and the governance and geographic features of related value chains. It is therefore critical for the formulation of rules of origin to be informed by a thorough understanding of the productive sectors involved and include due consideration of the structural asymmetries among the countries in the African Continental Free Trade Area. Rules of origin should not be set in stone, but instead allow for adjustments in the regional and global environment.

Whatever the technical level of restrictiveness agreed, rules of origin provisions should be crafted and implemented in such a way as to minimize hurdles and uncertainties for firms, thereby reducing compliance costs. This implies making rules of origin simple, transparent, predictable and trade-facilitating for businesses and trade operators (see chapter 3).

Moving towards greater regulatory convergence with regard to rules of origin could reduce the complexities faced by firms in Africa, which would otherwise have to comply with different requirements. Given the multiplicity of regional economic communities and preferential trade arrangements in the region, regulatory convergence could greatly reduce overall transaction costs and prevent regulatory arbitrage.

Ensuring an inclusive outcome will likely require some degree of flexibility in the preparation and application of rules of origin, given the variety of economies in the African Continental Free Trade Area, as well as the broad range of economic actors involved. For example, a simplified rules of origin regime for shipments valued below a given threshold could be a valuable form of support for small-scale cross-border traders, as illustrated with regard to COMESA (see chapter 3).

The tolerance rule, which allows for a specified maximum percentage of non-originating materials to be used without affecting originating status, could assist in lowering the costs of compliance with rules of origin. Similar flexibilities may be considered for products typically subject to the wholly obtained criterion, such as chocolate and tea, which may require a modest use of non-originating varieties to achieve a certain level of quality. Cumulation and absorption rules, conversely, play an important role in long and complex value chains, in which trade in intermediate products plays a more fundamental role.

Introducing the possibility of alternative criteria for ascertaining originating status, such as the change in tariff classification and ad valorem percentage criteria, may leave a margin for heterogeneous firms to choose their best-fit compliance strategies. This would be consistent with current practice in several regional economic communities in Africa, and possibly reduce regulatory divergence.

Substantial preference margins for cotton yarn and fabrics in Africa, in combination with a single transformation approach, could link the objective of boosting intra-African trade in upstream products such as cotton textiles with the accrual of some of the benefits of the African Continental Free Trade Area to weaker apparel exporters. However, exporting processed goods made from intermediate inputs imported from outside the continent will not be enough for the continent to deliver on its agenda for job creation and poverty reduction. As advocated by UNCTAD, Africa should address perennial commodity dependence to mitigate missed opportunities from exporting raw materials. By bridging corridors across multiple regional economic communities, the African Continental Free Trade Area offers many possibilities for boosting such opportunities in many sectors (see chapter 3).

Protection for specific sectors may be better calibrated through an appropriate tariff schedule selection (i.e. for sensitive and excluded products), rather than through restrictive rules of origin, since sensitive sectors are likely to differ between countries.

Enhancing institutional capacities, in particular of customs authorities, is fundamental to ensuring the impartial, transparent, predictable, consistent and neutral implementation of agreed rules of origin. Similar efforts may be complemented by commensurate investments in training and hard infrastructure, particularly at remote border posts. A customs academy may also be established under the African Continental Free Trade Area, for sharing best practices in the areas of customs and excise and international trade.

Harnessing information and communications technology could yield benefits through enhancing transparency and lowering compliance costs. One way could be to set-up an online intra-African trade platform that provides user-friendly access to a repository of rules of origin provisions under the African Continental Free Trade Area and regional economic communities in Africa.

Consultation with all stakeholders, including the private sector, from business associations to trade unions and farmer-based associations, plays a fundamental role in informing negotiations on sectoral dynamics and the practical impacts of regulations on the ground. Establishing regular platforms for public–private dialogues can be valuable in identifying any implementation issues and periodically assessing the impact of the African Continental Free Trade Area.

Looking ahead, the Agreement Establishing the African Continental Free Trade Area makes a provision for revisions in the future. With regard to rules of origin, whatever the outcome of ongoing negotiations, such opportunities could be seized to take the time to fully assess the ripple effects that might arise from establishing gradually more restrictive requirements in a limited set of strategic sectors. For example, given the strategic considerations in the Pan-African cotton road map (UNCTAD, 2014), such a future move is likely to be welcomed by stakeholders in the cotton sector (see chapter 3). More generally, creating a stronger link between raw materials and processing could result in greater incentives for increased productivity and competitiveness at the production level, in line with the vision in the Malabo Declaration on Accelerated Agricultural Growth and Transformation for Shared Prosperity and Improved Livelihoods (African Union, 2014) and in the 2009 Africa Mining Vision of the African Union. On the institutional front, the leadership of the African Union Commission, in facilitating the process leading to the signing of the Agreement Establishing the African Continental Free Trade Area and

the fast-tracking of the ratification process, is noteworthy. Such momentum provides a good indication of the likelihood of increased attention being given to institutional capacity-building in the implementation phase of the African Continental Free Trade Area.

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