



**ECONOMIC
DEVELOPMENT IN**

AFRICA

REPORT 2019

EMBARGO

The contents of this Report must not be quoted or summarized
in the print, broadcast or electronic media before
26 June 2019, 17:00 GMT



Made in Africa

Rules of origin for enhanced
intra-African trade



“This year’s edition of the UNCTAD *Economic Development in Africa Report* is an important contribution to the understanding of rules of origin in the African Continental Free Trade Area. It is a valuable policy tool that will be complementary to the online Rules of Origin Facilitator of the International Trade Centre. The work of our two institutions on this critical issue can help set the basis for simpler and more transparent rules of origin and, in turn, make it easier for microenterprises and small and medium-sized enterprises to expand their intra-Africa trade.”

Arancha González

Executive Director, International Trade Centre

“A major milestone towards achieving economic sustainability of the African continent is the entry into force of the Agreement Establishing the African Continental Free Trade Area, which will further enhance regional integration and trade facilitation. The World Customs Organization believes that this offers African leaders an opportunity to agree upon an ambitious and tailor-made set of rules of origin that will serve to reinvigorate intracontinental trade and development. This report makes a significant contribution in support of this African initiative”

Kunio Mikuriya

Secretary-General, World Customs Organization

“In a world of spreading preferential trade agreements and of growth of trade in tasks, rules of origin stand in the middle, which risks making these two incompatible. Nowhere is this more evident than in Africa. This report is the first in-depth scrutiny of the challenges ahead on the road towards the necessary convergence of rules of origin across the regional economic communities.”

Jaime de Melo

Senior Fellow, Foundation for Studies and Research on International Development

Economic Development in Africa Report 2019

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



UNITED NATIONS
Geneva, 2019



**United Nations Conference
on Trade and Development**

Sales No. E.19.II.D.7

29 October 2019

Original: English

**Economic Development in Africa
Report 2019: Made in Africa – Rules
of Origin for Enhanced Intra-African Trade**

Corrigendum

Page 46

The second sentence *should read*

Prior to the 2011 Generalized System of Preferences reforms, the more flexible rules of origin under the African Growth and Opportunity Act of the United States (requiring single transformation) were found to stimulate exports from LDCs in Africa, rather than the more restrictive rules of origin under the Everything but Arms initiative of the European Union (De Melo and Portugal-Pérez, 2013; De Melo and Tsikata, 2015).

© 2019, United Nations
All rights reserved worldwide

Requests to reproduce excerpts or to photocopy should be addressed to the
Copyright Clearance Center at copyright.com.

All other queries on rights and licences, including subsidiary rights,
should be addressed to:

United Nations Publications,
300 East 42nd Street,
New York, New York 10017,
United States of America
Email: publications@un.org
Website: un.org/publications

The designations employed and the presentation of material on any map in this work
do not imply the expression of any opinion whatsoever on the part of the United
Nations concerning the legal status of any country, territory, city or area or of its
authorities, or concerning the delimitation of its frontiers or boundaries.

Mention of any firm or licensed process does not imply the
endorsement of the United Nations.

References to country names in this publication correspond to the names in use
historically during the periods for which data were reviewed.

United Nations publication issued by the United Nations
Conference on Trade and Development.

UNCTAD/ALDC/AFRICA/2019

ISBN: 978-92-1-112943-4
eISBN: 978-92-1-003974-1
ISSN: 1990-5114
eISSN: 1990-5122
Sales No. E.19.II.D.7

Acknowledgements

The *Economic Development in Africa Report 2019: Made in Africa – Rules of Origin for Enhanced Intra-African Trade* was prepared by Junior Davis (team leader), Constantine Bartel, Bineswaree Bolaky, Milasoa Chereh-Robson, Matthew Heiden, Aminata Loum, Jane Muthumbi, Simon Neumuller, Claudia Roethlisberger, Carlotta Schuster, Giovanni Valensisi and Stefanie West (the report team). The work was completed under the overall supervision of Paul Akiwumi, Director of the UNCTAD Division for Africa, Least Developed Countries and Special Programmes.

An ad hoc expert group meeting on maximizing opportunities for value addition and trade creation through the African Continental Free Trade Area was held in Geneva, on 10 and 11 January 2019, to conduct a peer review of the report. The meeting brought together specialists in African trade, regional integration and rules of origin. The following people participated in the meeting and contributed to the report: Jaime De Melo (Professor, University of Geneva), David Luke (Economic Commission for Africa), Darlan Marti (World Trade Organization) and Stefan Moser (independent consultant). Yinka Bandele (Commonwealth Secretariat), Sotheara Kong (World Trade Organization), Peter Lunenborg (South Centre), Nassim Oulmane (World Trade Organization), Thomas Verbeet (World Trade Organization) and members of the Economic Development in Africa Report team also attended the meeting.

The following UNCTAD staff members took part in the meeting and/or made comments on the draft report: Celine Bacrot, Lisa Borgatti, Hamed El Kady, Stefanie Garry, Stefano Inama, Taisuke Ito, Alexandra Laurent, Mingcong Li, Janvier Nkurunziza, Bonapas Onguglo, Matfobhi Riba, Michaela Summerer, Antipas Touatam, Rolf Traeger and Anida Yupari.

Judith Leclercq provided administrative support; Nadège Hadjémian designed the cover; Adriana Díaz Fuenmayor was responsible for the layout, infographics and desktop publishing; Rudaina Aloufi and Magali Studer also designed infographics; and the Intergovernmental Support Service of UNCTAD edited the report.

UNCTAD expresses its appreciation to the African Union Commission for comments on the draft report.

Note

Country-level detailed figures are available on request to the UNCTAD secretariat.

In tables, a hyphen (-) indicates that the item is not applicable.

Any references to dollars (\$) are to United States dollars.



Contents

Foreword	xi
Abbreviations	xiii
Regional classifications and membership of regional economic communities	xiv
Glossary	xvi

INTRODUCTION

Made in Africa: Rules of origin for enhanced intra-African trade	1
---	----------

CHAPTER 1

On the road to the African Continental Free Trade Area: Challenges and opportunities	13
---	-----------

1.1 Introduction: Challenges, opportunities and the role of rules of origin	13
1.2 The vision of the Abuja treaty, regional value chains and the African Continental Free Trade Area	15
1.3 The state of trade in Africa: Key impediments and prospects	19
1.4 Potential gains for Africa from the African Continental Free Trade Area	35
1.5 Why do rules of origin matter for the African Continental Free Trade Area?	44
1.6 Conclusion	48

CHAPTER 2

The role of preferential rules of origin in African trade	51
--	-----------

2.1 Introduction	51
2.2 What are preferential rules of origin?	54
2.3 Rules of origin for African trade	63
2.4 Empirical relationship between rules of origin and African trade	74
2.5 Conclusion	94

CHAPTER 3

The African Continental Free Trade Area, regional value chains and rules of origin	97
---	-----------

3.1 Introduction	97
3.2 Tea value chain	100
3.3 Cocoa–chocolate value chain and scope for commodity-based industrialization	108
3.4 Cotton–apparel value chain	120
3.5 Beverage value chain, rules of origin and regional integration	134

3.6	Cement value chain, rules of origin and regional integration	144
3.7	Automotive value chain, rules of origin and regional integration	150
3.8	Key insights from the six case studies: Synthesis	159

CHAPTER 4

The rules of the game: Implementation of rules of origin **169**

4.1	The African Continental Free Trade Area and the implementation of its rules of origin	169
4.2	Expanding cumulation to facilitate compliance with origin requirements	174
4.3	Documentary requirements and compliance costs	177
4.4	Institutional set-up, transparency and dispute-settlement mechanisms	183
4.5	Implementation of rules of origin	185
4.6	Using new technology	189
4.7	Monitoring	190
4.8	Shared goals, different capacities and perspectives	190
4.9	Conclusions	192

CHAPTER 5

Main messages and recommendations **195**

5.1	Introduction	195
5.2	Main findings	197
5.3	Main messages and policy recommendations	198

FIGURES

1.	Trade (exports and imports, all products) to rest of world by region	20
2.	Intraregional merchandise trade (all products) by region	21
3.	Intra-regional economic community trade in Africa, 2010–2012 and 2014–2016	22
4.	Composition of exports from Africa, 2014–2016 average	25
5.	Product complexity index, weighted by trade flows, 2010–2012 and 2014–2016	26
6.	Cost to import and export: Selected trade facilitation indicators by region, 2016	33
7.	Ad valorem equivalents of non-tariff measures in Africa	34
8.	Top 40 intra-African agricultural-exports, 2014–2016	40
9.	Rules of origin: Subcriteria for determining substantial transformation	54
10.	Bilateral, diagonal and full cumulation	60
11.	Africa: 20 products with highest import values, 2014–2016 average	82
12.	Africa: 20 products with highest export values, 2014–2016 average	83

13. Southern African Development Community: 20 products with highest import values, 2014–2016 average	84
14. Economic Community of West African States: 20 products with highest import values, 2014–2016 average	85
15. Eastern African Development Community: 20 products with highest import values, 2014–2016 average	86
16. Imports to the European Union from Africa, by value and utilization rate, 2009–2016	88
17. Share of imports from Africa by preference eligibility status and external trading partner, 2016	90
18. Types of tariffs applicable to imports from Africa, selected external partners, by sector, 2016	92
19. Top 10 African tea exporters (Harmonized System code 0902), 2015–2017	102
20. Top 10 African tea importers (Harmonized System code 0902), 2015–2017	103
21. Distribution of average tariffs levied by African countries on tea, by Harmonized System subheading, 2014–2016	105
22. Top 10 African exporters of cocoa and cocoa preparations (Harmonized System code 18), 2015–2017	112
23. Intra-African exports of cocoa and cocoa preparation, by main exporting country and product, 2015–2017	113
24. Top 10 African importers of cocoa and cocoa preparations (Harmonized System code 18), 2015–2017	114
25. Distribution of simple average tariffs levied by African countries on cocoa and cocoa preparations, by Harmonized System heading, 2014–2016	116
26. Cotton–apparel value chain	121
27. Cotton exports (Harmonized System code 52) by stage of processing, 2015–2017	124
28. Imports of cotton to Africa (Harmonized System code 52) by processing stage, 2015–2017	125
29. Main apparel exporters (Harmonized System codes 61 and 62), 2015–2017	126
30. Regional integration and specialization pattern of African cotton exporters, 2015–2017	127
31. Distribution of simple average tariffs levied by African countries on cotton and apparel products, 2014–2016	129
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	132
33. Share of least developed countries in apparel imports in	

the European Union, 2001–2017	133
34. Intra-African exports of beverages by product, 2015–2017	137
35. Intra-African imports of beverages by product, 2015–2017	138
36. Intra-African exports of selected beverages, by regional economic community, 2015–2017 average	140
37. Distribution of simple average tariffs levied by African countries on beer, spirits and water products, by Harmonized System heading, 2014–2016	141
38. Trade balance in cement products (Harmonized System code 2523), 2015–2017	146
39. Distribution of simple average tariffs levied on cement, 2014–2016	148
40. Automotive value chain	152
41. Africa's automotive exports and imports, by product type, 2015–2017	154
42. Share of intra-African trade in the automotive industry by product type, 2015–2017	155

TABLES

1. Main origin subcriteria: Advantages and disadvantages	59
2. Main characteristics of rules of origin, selected regional economic communities in Africa and under the Tripartite Free Trade Agreement	64
3. African Growth and Opportunity Act and Everything but Arms initiative: Main characteristics of rules of origin	73
4. Imports of African goods by extracontinental trading partners: Harmonized System sections with three highest values of unused preferences, 2016	93
5. Comparison of rules of origin provisions regarding tea (Harmonized System code 0902) in selected regional economic communities in Africa	107
6. Progress towards economic integration in Africa	173

BOXES

1. What are rules of origin?	18
2. Calculation methodologies for the ad valorem percentage criterion, selected regional economic communities in Africa and under the Tripartite Free Trade Agreement	56
3. Restrictiveness indices	75
4. Rules of origin and special economic zones	134
5. Value chain integration and the low-cost beer market segment in Africa	136

Foreword

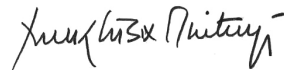
The African Continental Free Trade Area is a landmark achievement, in the context of the continent's long and rich history, in fostering regional integration to unify the continent. The African Continental Free Trade Area will lead to the creation of a single continental market of more than 1.3 billion people, with a combined annual output of \$2.2 trillion. The transition phase to the Continental Free Trade Area alone could generate welfare gains of \$16.1 billion and boost intra-African trade by 33 per cent.

Realizing the full potential gains from the African Continental Free Trade Area will require a broad range of complementary policies, to address multiple challenges, designed to enhance an emerging trade–industrialization nexus on the continent: from business and trade facilitation to infrastructure, from productive capacities to entrepreneurship policies. But, under the African Continental Free Trade Area, it is the rules of origin – establishing the nationality of products produced in Africa – that will determine whether preferential trade liberalization can be a game changer for Africa's industrialization.

How these rules are designed, enforced and verified will critically determine the size and distribution of the economic gains from the African Continental Free Trade Area, and will shape the future regional value chains on the continent. How lenient, flexible, easy to use and understand and accessible rules of origin are will shape the net benefits to the African private sector under the African Continental Free Trade Area. African countries should also consider the differing levels of productive capacities and competitiveness of African countries when enforcing rules of origin. Policies are needed to build institutional capacities of customs authorities to ensure impartial, transparent and predictable implementation of agreed rules of origin. New and emerging technologies must also be leveraged to lower compliance costs for the private sector.

The African Continental Free Trade Area is Africa's renewed opportunity to steer its economic relations away from a reliance on external donors, foreign creditors and excessive commodity dependence, ushering in instead a new economic and political era focused on self-reliant cooperation, deeper integration and higher levels of intra-African trade. The African Continental Free Trade Area could boost African economies by harmonizing trade liberalization at the continental level, promote economic diversification and intra-African trade, and foster a more competitive manufacturing sector.

The United Nations Conference on Trade and Development (UNCTAD), as the leading United Nations body on trade and development, has embarked on this historic initiative with African member states to support them in exploiting the potential gains of the African Continental Free Trade Area. I am certain that this report will prove to be a valuable guide to policymakers as we journey along the road towards the African Continental Free Trade Area and beyond.

A handwritten signature in black ink, appearing to read 'Mukhisa Kituyi', with a stylized flourish at the end.

Mukhisa Kituyi
Secretary-General of UNCTAD

Abbreviations

AMU	Arab Maghreb Union
CEN-SAD	Community of Sahelo-Saharan States
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of West African States
FAO	Food and Agriculture Organization of the United Nations
GDP	gross domestic product
IGAD	Intergovernmental Authority on Development
LDC	least developed country
SADC	Southern African Development Community
SME	small and medium-sized enterprise
TRAINS	Trade Analysis and Information System
WTO	World Trade Organization

REGIONAL CLASSIFICATIONS AND MEMBERSHIP OF REGIONAL ECONOMIC COMMUNITIES*

REGIONAL CLASSIFICATION	MEMBERSHIP IN REGIONAL ECONOMIC COMMUNITIES							
	AMU	CEN-SAD	COMESA	EAC	ECCAS	ECOWAS	IGAD	SADC
Eastern Africa								
Burundi			•	•	•			
Comoros		•	•					
Djibouti		•	•				•	
Eritrea		•	•				•	
Ethiopia			•				•	
Kenya		•	•	•			•	
Madagascar			•					•
Malawi			•					•
Mauritius			•					•
Mozambique								•
Rwanda			•	•				
Seychelles			•					•
Somalia		•					•	
South Sudan								
Uganda			•	•			•	
United Republic of Tanzania				•				•
Zambia			•					•
Zimbabwe			•					•
Middle Africa								
Angola					•			•
Cameroon					•			
Central African Republic		•			•			
Chad		•			•			
Congo					•			
Democratic Republic of the Congo			•		•			•
Equatorial Guinea					•			
Gabon					•			
Sao Tome and Principe		•			•			
Northern Africa								
Algeria	•							
Egypt		•	•					
Libya	•	•	•					
Morocco	•	•						
Sudan		•	•				•	
Tunisia	•	•						

REGIONAL CLASSIFICATION	MEMBERSHIP IN REGIONAL ECONOMIC COMMUNITIES							
	AMU	CEN-SAD	COMESA	EAC	ECCAS	ECOWAS	IGAD	SADC
Southern Africa								
Botswana								•
Eswatini			•					•
Lesotho								•
Namibia								•
South Africa								•
Western Africa								
Benin		•				•		
Burkina Faso		•				•		
Cabo Verde						•		
Côte d'Ivoire		•				•		
Gambia		•				•		
Ghana		•				•		
Guinea		•				•		
Guinea-Bissau		•				•		
Liberia		•				•		
Mali		•				•		
Mauritania	•	•						
Niger		•				•		
Nigeria		•				•		
Senegal		•				•		
Sierra Leone		•				•		
Togo		•				•		

- Regional classifications as used in the report. Membership in regional economic communities as recognized by the African Union. Figures for all periods in the report calculated based on the membership reflected in this table.

Source: UNCTAD.

Abbreviations: AMU, Arab Maghreb Union; CEN-SAD, Community of Sahelo-Saharan States; COMESA, Common Market for Eastern and Southern Africa; EAC, East African Community; ECCAS, Economic Community of Central African States; ECOWAS, Economic Community of West African States; IGAD, Intergovernmental Authority on Development; SADC, Southern African Development Community.

Glossary

AD VALOREM PERCENTAGE

Regardless of a change in the classification of a good, the good is considered substantially transformed when the value added of that good increases up to a specified level, expressed in terms of an ad valorem percentage. This value added criterion can be expressed in two ways, namely, as a maximum allowance for non-originating materials or as a minimum requirement of domestic content.

CUMULATION

Under cumulation rules, contracting parties to a preferential trade agreement or beneficiary countries under the Generalized System of Preferences schemes may source non-originating raw materials or components from specified countries and count them as originating. There are three types of cumulation: (a) bilateral cumulation allows two partner countries to treat materials originating in one of the partner countries as materials of the other partner country; (b) diagonal cumulation permits countries within a regional grouping to treat materials originating in a specific third country as their own materials; and (c) full cumulation, which concerns processing operations carried out by any of the participating preferential trade agreement countries that may be considered for cumulation purposes.

CHANGE IN TARIFF CLASSIFICATION

Origin can be conferred after a change in tariff heading. This implies that the final good should fall under a different tariff heading than the imported goods used in the production of the product, according to the **Harmonized System** of nomenclature for goods.

DE MINIMIS RULE

See **tolerance rule**.

TRIPLE, DOUBLE AND SINGLE TRANSFORMATION REQUIREMENTS

In rules of origin, the extent to which non-originating inputs can be used for the production of preference-eligible apparel products is typically referred to as double transformation or single transformation requirements. For origin determination, double transformation requires that two stages of production take place in a free trade area region (yarn → fabric → apparel). Under single transformation requirements, only one production step needs to take place within a region for the apparel product to acquire originating status (i.e. fabric → apparel). A triple transformation requires that three stages of production take place in a free trade area region (fibre → yarn → fabric → apparel).

FREE TRADE AREA

A free trade area is a grouping of countries within which tariffs and non-tariff trade barriers between the members are generally abolished but with no common trade policy toward non-members (i.e. the North American Free Trade Agreement and the European Free Trade Association).

GENERALIZED SYSTEM OF PREFERENCES

The Generalized System of Preferences is a preferential tariff system, in favour of developing countries, which provides for a formal scheme of exemption from the more general rules of the World Trade Organization.

HARMONIZED COMMODITY DESCRIPTION AND CODING SYSTEM

The Harmonized Commodity Description and Coding System, first introduced in 1988, is an international nomenclature for the classification of products. It allows participating countries to classify traded goods on a common basis for customs purposes. At the international level, the Harmonized System for classifying goods is a six-digit code system. Descriptions of articles or products appear as headings and subheadings, arranged in chapters that are grouped into sections. Also known as the **Harmonized System**.

MOST-FAVoured NATION

A most-favoured nation clause requires a country to provide any concessions, privileges or immunities granted in a trade agreement to one nation to all other World Trade Organization member countries. Although the term name implies favouritism towards another nation, it denotes the equal treatment of all countries.

NON-TARIFF BARRIER

A non-tariff barrier increases the cost of trade. It generally expresses a negative impact of an unnecessary and, probably, protectionist regulation or customs or administrative procedure or processes. These include lack of infrastructure or lack of transparency in trade regulation, arbitrary application of trade regulations, non-recognition of certificates, etc. It may be subjective, and there is no exhaustive list.

NON-TARIFF MEASURE

A non-tariff measure refers to regulations officially issued by a country that may affect trade, even in cases where the main objective is not to regulate trade, but rather, to address safety or quality, for example. This term should not be used interchangeably with non-tariff barrier.

PREFERENTIAL TRADE AREA

A preferential trade area is a trading bloc that gives preferential access to certain products from the participating countries. This is done by reducing tariffs but not by abolishing them completely. A preferential trade area can be established through a trade pact.

REGIONAL INTEGRATION

Regional integration is a process in which neighbouring States enter into an agreement to upgrade cooperation through common rules. Intraregional trade refers to trade which focuses on economic exchange, primarily between countries of the same region or economic zone.

RULES OF ORIGIN

Rules of origin cover laws, regulations and administrative determinations of general application applied by the Governments of importing countries to determine the country of origin of goods. Rules of origin are important in implementing trade policy instruments, such as anti-dumping and countervailing duties, origin marking and safeguard measures.

TOLERANCE RULE

The tolerance rule permits a specific share (often between 10 per cent and 15 per cent) of the value or volume of the final product to be non-originating without the final product losing its originating status. In some agreements, the components to which the rule applies are specifically identified. Alternatively, there may be a list of components that may not be included in the allowance or a list of products (e.g. chapters, under the **Harmonized System**) to which the tolerance rule does not apply. Also known as the *de minimis* rule.

TRADE CREATION

Trade creation is the increased trade that occurs between member countries of trading blocs following the formation or expansion of the trading bloc. This comes about as the removal of trade barriers allows greater specialization according to comparative advantage. This means that prices can fall, and trade can thus expand.

TRADE DEFLECTION

Trade deflection is the movement of goods or components of goods from outside a trading arrangement to a country within such an arrangement for the seller to benefit from trading preferences.

WHOLLY OBTAINED CRITERION

The wholly obtained or wholly produced criterion, relates to goods that are entirely the product of one country and do not have inputs from non-contracting parties in the production process. It also refers to natural products and goods made from natural products that are entirely obtained in one country. Goods wholly obtained in one country are considered as originating in that country. The concept is still relevant for some agricultural and mining products.

Introduction

Made in Africa: Rules of origin for enhanced intra-African trade

On 21 March 2018 in Kigali, 44 member States of the African Union signed the Agreement Establishing the African Continental Free Trade Area. This was a major historical landmark for Africa, and it can arguably be a game changer for the continent's economy. In signing the Agreement, African countries honoured the spirit of the Treaty Establishing the African Economic Community, signed in 1991 in Abuja, and delivered on a 2012 African Union summit decision to fast-track the establishment of a continental free trade area by an indicative date of 2017. By creating a single African market for goods and services for 1.3 billion people, the African Continental Free Trade Area is a promise to fulfil the dream of the African Union's Agenda 2063: The Africa We Want (2015). As such, it carries tremendous hope for decent job creation, poverty reduction and prosperity for the continent.

Critically, strong political will continues to back progress towards implementation of the African Continental Free Trade Area. As of April 2019, 22 countries had ratified the Agreement, of which 15 had also deposited the instrument of ratification. Building on these premises the African Continental Free Trade Area will enter into force in May. In addition to the Protocol on Trade in Goods, phase I of the Agreement includes the Protocol on Trade in Services and the Protocol on Rules and Procedures on the Settlement of Disputes (African Union, 2018b). Phase II has the Protocol on Investment, the Protocol on Competition and the Protocol on Intellectual Property Rights. In addition, member countries signed a protocol on the movement of persons, which is part of the Treaty establishing the African Economic Community Relating to Free Movement of Persons, Right of Residence and Right of Establishment. Although not technically part of the African Continental Free Trade Area, the Protocol on Free Movement of Persons, Right of Residence and Right of Establishment is nevertheless highly relevant to the good functioning of the future free trade area.



Rules of origin:
A passport for circulating
goods under preferential tariffs

The Agreement includes several provisions that cater for differing development levels among countries. On the scheduling of tariff liberalization, for instance, the Agreement allows countries to negotiate a list of sensitive products and a list of products to be excluded from liberalization. It stipulates that sensitive products would be liberalized over 10 years in non-least developed countries and over a period of 13 years in least developed countries (LDCs). And yet, significant differences in economic wealth, population size, geophysical characteristics and legal and political systems, as well as variations in experiences with regional economic communities, are likely to influence the mapping out of expected long-term gains and temporary losses from trade liberalization across the continent. The question is to what extent could rules of origin be refined, to increase the contributions of the African Continental Free Trade Area to the continent's industrial and agricultural development and the emergence of regional value chains.

This report focuses on rules of origin, for which, at the time of writing, negotiations are still under way. Along with tariff liberalization schedules, rules of origin are an indispensable element for the implementation of the African Continental Free Trade Area, as of any other preferential trade agreement. By defining the nationality of a product, rules of

origin dictate the conditions for the application of tariff concessions, delimiting the range of products eligible for preferential treatment. They cover laws, regulations and administrative determinations that are generally applied by Governments of importing countries to determine the country of origin of goods. As such, they represent one of the elements that may determine the answer to the question above.

The overall impact of the African Continental Free Trade Area, however, will not be solely determined by tariff liberalization and rules of origin. Other trade-specific factors include customs cooperation, transit, trade facilitation and trade remedies, as well as non-tariff barriers, including technical barriers to trade and sanitary and phytosanitary measures. It is the interaction between these factors and the specifics of other Protocols under phase I and phase II of the Agreement that will determine the outcome of the implementation of the African Continental Free Trade Area. Furthermore, for the African Continental Free Trade Area to contribute to achieving specific policy objectives at the continental and national levels, specific attention should be devoted to tackling perennial dependence on exports of primary commodities.¹

The objectives of this report are the following:

- To build on existing work on the trade–industrialization nexus in Africa, while making linkages to developmental regionalism and industrial policies
- To sensitize stakeholders in Africa on the need to ensure greater coherence between trade policy and industrial policy objectives at a continental level
- To analyse how well intra-African trade can support structural transformation, and how continental preferences and rules of origin can help maximize opportunities for value addition and boost trade in Africa.

The agricultural sector and associated value chains are among the leading sectors in Africa with regard to investment attraction (PricewaterhouseCoopers, 2015). Similarly, minerals have significant potential for the development of regional value chains on the continent. However, production in most countries is hampered by structural constraints and lower competitiveness further up in value chains, compared to other subregions of the developing world (Hallward-Driemeier and Nayyar, 2017). Processing capacity is still limited in most African countries. Additionally, the volatility of revenues from the commodity sector and rampant macroeconomic instability has stopped most commodity-dependent developing countries from reaching substantial levels of industrialization.

¹ See UNCTAD and FAO (2017), which addresses the harmful macroeconomic and microeconomic impact of commodity dependence.

In Africa, commodity-dependent developing countries are less industrialized than even LDCs (UNCTAD, 2017). As some case studies of selected sectors show (see chapter 3), although by no means a sufficient condition, the choice of rules of origin plays a central role in determining the shape and impact of value chains across the continent.

Strategic elements of the African Continental Free Trade Area

More than 25 years after the Abuja treaty, Africa is on the verge of a historic step as it moves towards finalizing negotiations for one of the milestones of regional integration envisaged by its pan-Africanist founding fathers.

Political will has been built since the 2012 decision to fast-track the African Continental Free Trade Area and capitalizing on this momentum is thus critical to pave the way for the continentally agreed vision enshrined in Agenda 2063. A successful African Continental Free Trade Area could also play an important role in achieving the Sustainable Development Goals in Africa, insofar as it will foster structural transformation and contribute towards a more inclusive distribution of static and dynamic gains from trade (Valensisi and Karingi, 2017).

Given long-term socioeconomic trends, the African Continental Free Trade Area also allows space for leveraging the dynamism of the African market, with several fast-growing economies, a rising middle class and a young and expanding population. Estimates show that Africa could nearly double its manufacturing output, from \$500 billion in 2016 to \$930 billion in 2025. Three quarters of this could come from meeting domestic demand, mostly in food, beverages and similar processed goods (McKinsey Global Institute, 2016). Moreover, in the current context of globalization and potential “trade wars” (Coke-Hamilton, 2019), this strategy may help temper some of the uncertainties that surround the global context. This diversification strategy could be particularly important, as Africa’s exports are skewed towards primary commodities, making the continent vulnerable to adverse price shocks. Africa is also largely dependent on unilateral preferences in key export markets.

Against a background of uneven progress of African regional economic communities towards regional integration and consolidation (United Nations Economic Commission for Africa et al., 2017; De Melo, et al., 2017), the African Continental Free Trade Area represents an opportunity to address high tariffs and trade costs across these regional

economic communities. This in turn may help the continent reap the benefits of regional integration, by achieving greater scale economies and – perhaps more fundamentally – harnessing trade complementarities across large economies and subregions which are currently trading with each other mainly on a most-favoured nation basis.

More fundamentally, the African Continental Free Trade Area should be regarded as an opportunity to enhance the consistency between trade policy and industrial policy objectives, on the one hand, and the continent’s transformation agenda, on the other. The reason for this is three-fold:

- a) There is evidence that a strategic approach towards regional integration offers greater scope for diversification, by providing a springboard to engage in increasingly more complex activities, targeting first more proximate and less standard-intensive markets, to gradually develop the productive capabilities required to compete at a global scale. The African Continental Free Trade Area will not lead to a significant expansion of intra-African trade if productive capacities are not developed. Africa currently has fewer kilometres of roads than it did 30 years ago and has the highest costs of transporting goods in the world. Industrial policy, development corridors, special economic zones and regional value chains are some of the important tools and vehicles for promoting intra-African trade within the context of developmental regionalism (UNCTAD, 2013; Harvard University, 2018).
- b) The African Continental Free Trade Area also represents a key step towards ensuring that trade liberalization in Africa takes place gradually and with an appropriate sequencing, putting the continent in a condition to better cope with broader developments, whether economic partnership agreement negotiations, mega-regional agreements or potential “trade wars” (United Nations Economic Commission for Africa, 2015; Brookings Institution and United Nations Economic Commission for Africa et al., 2013).
- c) In the current context of potential “trade wars”, revived nationalism and disenchantment with the multilateral trading system (Nicita et al., 2018; UNCTAD, 2018a; Coke-Hamilton, 2019), the African Continental Free Trade Area also represents a strategic step towards deepening continental ties and giving a strong signal in support of open regionalism and development cooperation.

The economics of the African Continental Free Trade Area

Broadly speaking, the outcome of the African Continental Free Trade Area depends on the interplay between (a) tariff changes (and final levels of protection); (b) differences between the tariffs faced by African exporters and those faced by their competitors (i.e. preference margins); (c) import/export specialization patterns; (d) second-round macroeconomic linkages, such as balance of payment adjustments and government revenue/budget effects; and (e) broader dynamic effects, with productivity enhancing impacts such as the flow of knowledge and innovation.

As they define the goods eligible for preferential treatment by the African Continental Free Trade Area, rules of origin are a necessary element for the implementation of the African Continental Free Trade Area. This is why, unlike other non-tariff measures, which may be discussed in the second phase of the negotiations, rules of origin need to be prioritized to make the Agreement actionable. It is equally clear that rules of origin can impact the outcome of tariff liberalization (see (a) and (b) above), the alternative being the status quo: either regional economic community-level tariffs or most-favoured nation treatment, depending on the specific case. In this context, while tariff schedules and modalities shape the future structure of preference margins, rules of origin circumscribe the commercial value of preferential treatment by defining the set of goods that can be eligible for such treatment. Consequently, they will have a key bearing on preference utilization under the African Continental Free Trade Area and, therefore, ultimately on the outcome of the Agreement.

While not per se an industrial policy instrument (and rather inadequate, on their own, for that purpose), rules of origin nonetheless clearly have wide-ranging implications on the depth and pattern of regional integration, as they affect the choice of intermediate inputs utilized in the production of goods eligible for preferential treatment. These effects have become increasingly important with the splintering of production phases and the rise of global and regional value chains. In other words, rules of origin shape the space in which regional value chains operate.

In this respect, it is important to realize that rules of origin do not operate in a vacuum, and their impact is context specific. Their impact varies not only as a function of the country considered and of its level of development, but also of the sector in question and the sector's input–output structure, the complexity of its production processes and the governance and geographic features of related value chains (see chapter 3). In this

context, some degree of flexibility while avoiding overly restrictive requirements² will be important to ensure that economically weaker countries (e.g. LDCs) can also profit from the opportunities unlocked by the African Continental Free Trade Area. It should also be noted that the architecture of African Continental Free Trade Area negotiations is such that countries retain a much greater margin to manoeuvre through tariff schedules than through rules of origin, especially considering the differences in country-specific production structures. Beyond the differentiated length of the transition period, individual countries can adjust tariff schedules, within the limits defined in the modalities, to their legitimate interests. In most cases, this means that individual countries will be able to protect strategic industries much more effectively through an appropriate identification of the sensitive products than through overly restrictive rules of origin, which ultimately apply to the whole continent. The relative merits of flexible versus stringent rules of origin has been a long-debated issue and a question for which it may be difficult to offer an unambiguous, empirical answer (Draper et al., 2016; De Melo and Portugal-Pérez, 2013). Broadly, this report offers three suggestions on the matter:

- a) Stringent rules to promote local value addition
- b) Simple (in the sense of being clear and understandable), transparent and predictable, to facilitate intra-African supply chain trade
- c) “Evolutionary” rules, starting with simple rules that can gradually be made more stringent later, as economies develop.

Beyond trade liberalization

Given the issues outlined above, it is critical to capitalize on the current political momentum, foster a candid and pragmatic debate about the genuine interests of all Africans and forge consensus around an ambitious agenda for regional integration, identifying the best realistic negotiation points of convergence and pressing ahead with African Continental Free Trade Area implementation. This approach could contribute to supporting structural transformation and paving the way for the vision enshrined in Agenda 2063.

² It should be noted that the need for flexibilities and special and differential treatment, particularly for LDCs, is generally recognized as one of the African Continental Free Trade Area principles. However, special and differential treatment in the African Continental Free Trade Area has become a politically sensitive issue. There is a view among some African policymakers that the African Continental Free Trade Area should limit the scope of special and differential treatment and flexibilities, as the majority of the 55 African Union members are LDCs and allowing too large a scope for special and differential treatment might defeat the original objective of the African Continental Free Trade Area to boost intra-African trade. Thus, there is a need for a degree of flexibility in the elaboration of rules of origin under the African Continental Free Trade Area.

At the same time, it should be noted that, as important as it may be, trade is only one element of the picture. Various studies have found that the African Continental Free Trade Area can boost the continent's real income, especially if the selection of sensitive products does not erode the scope for trade liberalization within the continent (UNCTAD, 2016a; United Nations Economic Commission for Africa et al., 2017). As is generally the case, however, the growth effects of trade liberalization tend to be relatively small in the short to medium term (Depetris Chauvin N et al., 2016; United Nations Economic Commission for Africa, 2018). There are potentially additional dynamic benefits, as the African Continental Free Trade Area should lead to export diversification. This generates more sustainable growth, while a larger regional market better attracts foreign direct investment and the promotion of industrial exports may help to catalyse structural transformation.

It should thus be clear that the development of Africa's productive capacities requires much more than strategic trade integration. Trade policy, for instance, cannot be a substitute for bold industrial policies. Equally, while regional integration can help in attracting market-seeking foreign direct investment, it is not a substitute for domestic resource mobilization, nor for ambitious public investment programmes capable of redressing the continent's infrastructural deficits (UNCTAD, 2018b). This is the rationale behind the Action Plan for Boosting Intra-African Trade,³ which marries the African Continental Free Trade Area with a broad range of interventions that address related development challenges, ranging from trade facilitation to productive sector development.

In the same vein, as the recent backlash against globalization suggests, policymakers cannot simply assume that trade gains will be equitably distributed, even when in aggregate terms their magnitude justifies some degree of liberalization. Often, lead firms in global value chains – and those in regional value chains, though to a lesser extent – have captured a disproportionately high share of these gains (Rodrik, 2018; UNCTAD, 2018c; UNCTAD, 2018d). For this reason, it is imperative to prevent special interest groups from capturing trade negotiations, as well as to devise appropriate competition policies to discourage excessive concentration of market power and proactively support a more equitable distribution of bargaining power along the various value chains to make them more inclusive (UNCTAD, 2015a; UNCTAD, 2016b; UNCTAD, 2018c).

Also important is paying explicit attention to the interests of the economically weakest countries and the most vulnerable groups, namely women, youth, rural smallholders and small and medium-sized enterprises (SMEs) (through, respectively, special and

³ See <https://www.uneca.org/pages/action-plan-boosting-intra-africa-trade>.

differential treatment and targeted measures, such as simplified documentation requirements). Though the arguments in favour of trade liberalization through the African Continental Free Trade Area are clear, as most analyses of the estimated aggregate benefits outweigh the costs, success in a more competitive global economy also requires assisting the potential losers through job retraining, targeted social protection and other welfare measures that mitigate the negative effects. The Economic Commission for Africa and the International Labour Organization have highlighted the importance of the human rights and possible social safety net implications of the African Continental Free Trade Area,⁴ which are likely to be significant for women and informal cross-border traders, and the differential impacts of trade liberalization on workers according to skill-level or sector of employment (UNCTAD, 2018e) and on food security.

As the conclusion of the current round of African Continental Free Trade Area negotiations approaches, Africa is on the verge of a turning point that may help define a new narrative for the continent and provide both consistency and content to the vision enshrined in Agenda 2063. In practice, however, the devil lies in the details of negotiations and how Africa copes with implementation challenges. This report helps to shed light precisely on some of these technical elements. It also provides new detailed comparisons of rules of origin across the regional economic communities (not done before) and, as “the devil is in the details”, six case studies that highlight the need for crafting rules of origin provisions 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 maximizing the utilization of the African Continental Free Trade Area.

Organization of the report

The report is organized in five chapters. Chapter 1 discusses the key impediments to trade in Africa and the potential gains of the African Continental Free Trade Area for the continent. It also maps intra-African trade, at the continental level, in terms of the regional economic communities and countries involved, as well as product composition. Chapter 2 discusses what preferential rules of origin are and what approaches are followed in free trade agreements within Africa and preferential trade agreements relevant for the African context. Chapter 3 assesses how distinct rules of origin provisions affect the working of six selected regional value chains (tea; cocoa; cotton, textile and apparel; beverages; cement; and automobiles). It elaborates on how distinct formulations of rules of origin

⁴ United Nations Economic Commission for Africa and Friedrich-Ebert-Stiftung, 2017; International Labour Organization, 2014.

provisions need to be carefully assessed against sectoral considerations related to the availability of inputs and domestic processing capacity, as well as competing policy priorities in terms of broader developmental effects. Chapter 4 explores the challenges associated with the implementation of rules of origin within the African Continental Free Trade Area.

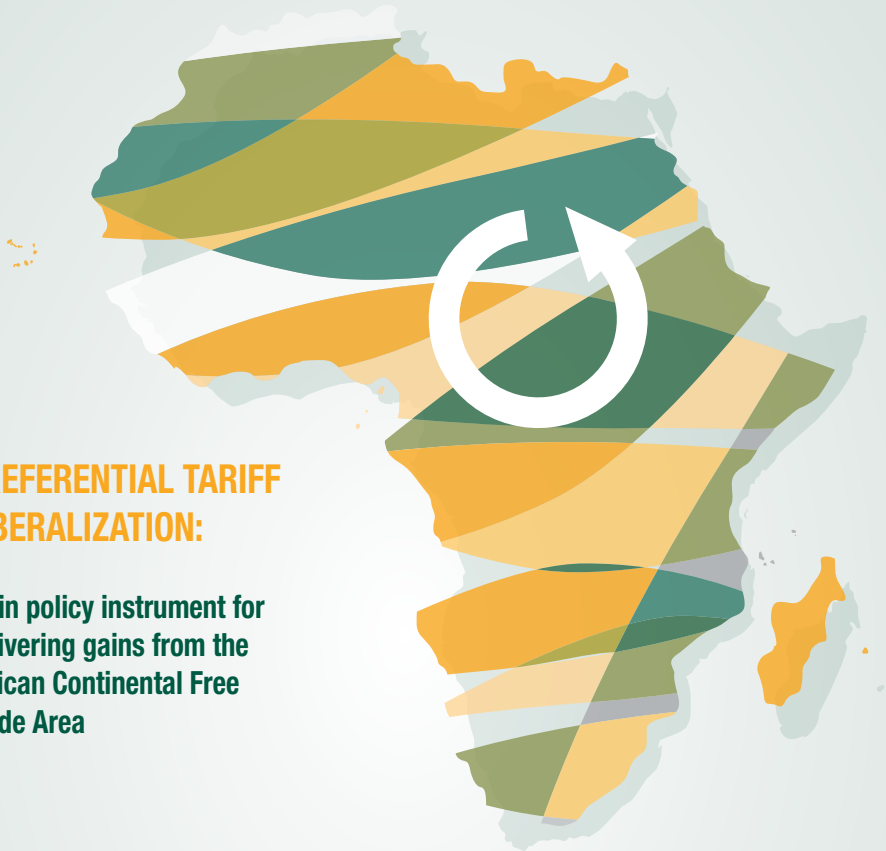
On the basis of the analysis in the previous chapters, chapter 5 provides an outline of the main policy findings and recommendations for maximizing the impact, on trade creation and structural transformation in Africa, of rules of origin under the African Continental Free Trade Area.

Chapter 1

On the road to the African Continental Free Trade Area: Challenges and opportunities

1.1 Introduction: Challenges, opportunities and the role of rules of origin

This edition of the *Economic Development in Africa Report* focuses on the role of preferential rules of origin (henceforth rules of origin) in shaping the development of regional value chains in the African Continental Free Trade Area, with the objective of maximizing gains from the Continental Free Trade Area for structural transformation. Chapter 1, section 1.2 situates the role of rules of origin within the vision of the Abuja treaty and Agenda 2063 of the African Union. Section 1.3 analyses the state of trade and related impediments to trade in Africa, which will influence the magnitude of the potential gains that rules of origin and regional value chains may generate. Section 1.4 discusses the potential gains from the Continental Free Trade Area and a few of the factors that can affect these gains, in addition to rules of origin. Section 1.5 makes the economic case for rules of origin as a critical factor in the effectiveness of preferential tariff liberalization as a policy instrument to achieve the objectives of the Continental Free Trade Area. Section 1.6 concludes the chapter.



PREFERENTIAL TARIFF LIBERALIZATION:

Main policy instrument for delivering gains from the African Continental Free Trade Area



RULES OF ORIGIN:

Ensure gains accrue to Africa, provided certain conditions are met



Competitive input costs



Productive capacities



Sophisticated products



Efficient business and trade facilitation

1.2 The vision of the Abuja treaty, regional value chains and the African Continental Free Trade Area

The establishment of the African Continental Free Trade Area, one of the flagship projects of Agenda 2063, represents a critical step in the journey of Africa towards the operationalization of an integrated market that is meant to culminate in the formation of an African economic community, in accordance with the Abuja treaty. The signing of the Agreement Establishing the African Continental Free Trade Area is a landmark historical achievement that signals the crossing of an important milestone in the continent's long regional integration history.

Two of the four objectives of the African economic community as stated in the Abuja treaty are to “promote economic, social and cultural development and the integration of African economies in order to increase economic self-reliance and promote an endogenous and self-sustained development” and “to coordinate and harmonize policies among existing and future economic communities in order to foster the gradual establishment of the community”.

To achieve the final objectives of the regional integration process in Africa, the effective operationalization of the Abuja treaty requires the implementation of complementary strategic continental initiatives and programmes, such as the Comprehensive Africa Agriculture Development Programme, the Programme for Infrastructure Development in Africa of the New Partnership for Africa's Development, the action plan of the Accelerated Industrial Development for Africa initiative of the African Union and the Action Plan for Boosting Intra-African Trade of the African Union. Coherence in vision, along with the timely implementation of multiple continental programmes, such as those cited, is central to ensuring that regional integration delivers on its stated overarching goals.

Regional integration that solely emphasizes the removal of tariff and non-tariff barriers, on its own, cannot deliver on the stated goals of promoting sustainable development for the continent, but should be accompanied by the building of productive capacities, the acceleration of structural transformation and the unleashing of the potential of the private sector. Critical requirements include fostering domestic entrepreneurship, domestic resource mobilization, political stability and peace, and establishing appropriate institutional structures and mechanisms to ensure an equitable distribution of socioeconomic costs and benefits across all 54 countries in Africa in a way that is politically acceptable to all.

Developmental regionalism (a development-based approach to regional integration)

in Africa is necessary to ensure sustainability in the continent's regional integration process, in order for it to culminate in the creation of an African economic community (UNCTAD, 2013). Africa needs deeper integration that goes beyond preferential tariff liberalization alone.

Regional integration in Africa is not meant to be an agenda for trade and investment protectionism, intended to build the competitiveness of Africa behind walls and to significantly scale down the continent's development partnerships with external trading partners. Self-reliance and endogenous self-sustained development are the overarching goals of the continent's regional integration process, yet it is imperative for countries in Africa, in particular the 33 LDCs, to continue to take advantage of the special and differential treatment provisions of the World Trade Organization (WTO) under, for example, the African Growth and Opportunity Act of the United States of America and the Everything But Arms initiative of the European Union and many other bilateral preferential agreements and free trade agreements (with, for example, China and India), to boost the share of African trade in the global economy. Regional integration in Africa should be a launch pad to deepen integration in the world economy by accelerating the building of productive capacities and competitiveness among African enterprises. The African Continental Free Trade Area, which will be the largest free trade area since the formation of WTO in terms of the number of participating countries, marks a pivotal shift for Africa in terms of accelerating trade, investment and industrialization within the continent and strategically leveraging Africa as a key economic player on the global stage.

The end goals of self-reliance and endogenous self-sustained development necessitate the implementation of a range of policy tools and instruments, central to which is the development of regional value chains in Africa, within the broad industrialization agenda of Africa.

A critical policy instrument that can shape both the size and distribution of economic gains to countries in Africa, generated within regional value chains and the industrialization strategy of Africa, is preferential trade liberalization. The role of rules of origin is to ensure that gains from preferential trade liberalization accrue to the members of the African Continental Free Trade Area. This report argues that rules of origin within the Continental Free Trade Area should be purposefully crafted and enforced in such a way as to support and shape the development of regional value chains on the continent and foster industrialization and structural transformation, with the final aim of maximizing the gains from the Continental Free Trade Area. How rules of origin and preferential trade liberalization 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.

The *raison d'être* of regional trade agreements is to provide members with preferential access, relative to non-members, to the markets of all member countries and, in so doing, support regional trade in intermediate and final goods. To be eligible for the preferential tariff rates that apply only to members when exporting under regional trade agreements, each member country must meet a set of eligibility requirements, which include the requirements of an originating status clause, whereby the goods traded, or a certain percentage of the contents of the goods traded, must originate within the regional trade area.

This requirement is critical for the following two reasons: to ensure that preferences accrue only to members and are not deflected to non-members, i.e. to avoid trade deflection and trans-shipment; and to ensure that preferences contribute to stimulating local production and the sourcing of intermediates from within the regional trade area rather than the rest of the world, so as to result in increased net trade among members, i.e. to promote net trade creation. Without an originating status clause, the economic benefits to regional trade area members are diminished, undermining the political will to remain in an agreement, while the objectives of regional trade agreements (e.g. regional industrialization, regional structural transformation, regional economic diversification and enhanced regional trade) are undermined. In other words, the originating status concept is fundamental to delivering on the potential benefits of agreements to member countries. Under regional trade agreements, the only way to certify where goods have originated is by establishing rules of origin. The message is clear: there can be no economic benefits accruing to regional trade area members unless rules of origin are properly defined and credibly enforced within the regional trade area. Rules of origin are thus the cornerstone of the effective application of preferences towards regional trade area members. Moreover, rules of origin are necessary for preferential trade liberalization and are critical to the development of the African Continental Free Trade Area. Box 1 provides a general definition of rules of origin (see chapter 2 for details on the technicalities behind rules of origin and a mapping of rules of origin in regional economic communities and under other preferential trade arrangements in Africa).

The *raison d'être* of preferential rules of origin is the avoidance of trade deflection, yet actual practice under regional trade agreements has diluted this objective, and rules of origin are increasingly becoming an economic, political and trade-related instrument (Abreu, 2013).

Challenges in implementation can affect the benefits that rules of origin should bring to a regional integration process in terms of increased intraregional trade, increased economic diversification, faster industrialization and deeper structural transformation. There are compliance costs associated with rules of origin with regard to verifying and enforcing compliance with originating status criteria and procedures, and such costs also vary according to the different types of rules of origin (Mizuno and Takauchi, 2013).

Box 1

What are rules of origin?

Rules of origin are the rules for determining the country of origin of goods. According to UNCTAD, “rules of origin are like a passport for a product to enter a free trade area and circulate without being imposed a duty”. The World Customs Organization states that “the basic role of rules of origin is the determination of the economic nationality as opposed to the geographical nationality of a given good” and also states as follows: “The rules of origin are used as an important trade measure. They do not constitute a trade instrument by themselves and are not to be used to pursue trade objectives directly or indirectly or as a policy measure. The rules of origin are used to address different commercial policy instruments and they can be used to attain specific purposes of national or international policies.”

Sources: UNCTAD, 2016c; World Customs Organization, 2012.

The effectiveness of rules of origin in delivering sizeable economic benefits to countries in Africa under regional trade agreements depends on a range of factors that include cost competitiveness in sourcing inputs among regional trade area members compared with sourcing from non-members. Cadot, Esteveordal et al. (2006) note that “if rules of origin impose the use of expensive local materials and burdensome administrative procedures to confer originating status, they can also render the preference margin worthless” and that “stringent rules of origin can prevent the smooth operation of cross-border supply chains or foster the emergence of inefficient ones”. For the African Continental Free Trade Area to deliver economic gains to member countries through the development of regional value chains, in a politically sustainable way that ensures the long-term viability of regional integration, many countries must participate. However,

such participation is contingent on improved production competitiveness conditions within member countries, compared with conditions in non-members. There are a set of preconditions to be met in order for rules of origin and preferential trade liberalization to deliver on the goals of developing regional value chains and generating economic benefits large enough to be equitably distributed across a range of member countries. Such preconditions include the implementation of trade and business facilitation measures in participating countries and measures to build productive capacities and enhance product sophistication. A few of these preconditions are discussed in greater detail in section 1.3.

1.3 The state of trade in Africa: Key impediments and prospects

Africa is a marginal player in the global trade in goods. Total trade from Africa to the rest of the world averaged \$760,463 million in current prices in the period 2015–2017, compared with \$481,081 million from Oceania, \$4,109,131 million from Europe, \$5,139,649 million from America and \$6,801,474 million from Asia.⁵ Figure 1 shows the total trade trends for each region in 2000–2017.

Africa was adversely affected by the recession in 2008 and its aftermath, reflecting the high dependence of the region on trade with the rest of the world. Regional trade can help reduce the vulnerability of the continent to external forces. More concretely, the share of exports from Africa to the rest of the world ranged from 80 to 90 per cent in 2000–2017. The only other region with a higher export dependence on the rest of the world is Oceania. Conversely, the share of intraregional exports in total exports is lowest in Africa, compared with other regions, except Oceania. Intra-African exports were 16.6 per cent of total exports in 2017, compared with 68.1 per cent in Europe, 59.4 per cent in Asia, 55.0 per cent in America and 7.0 per cent in Oceania.⁶

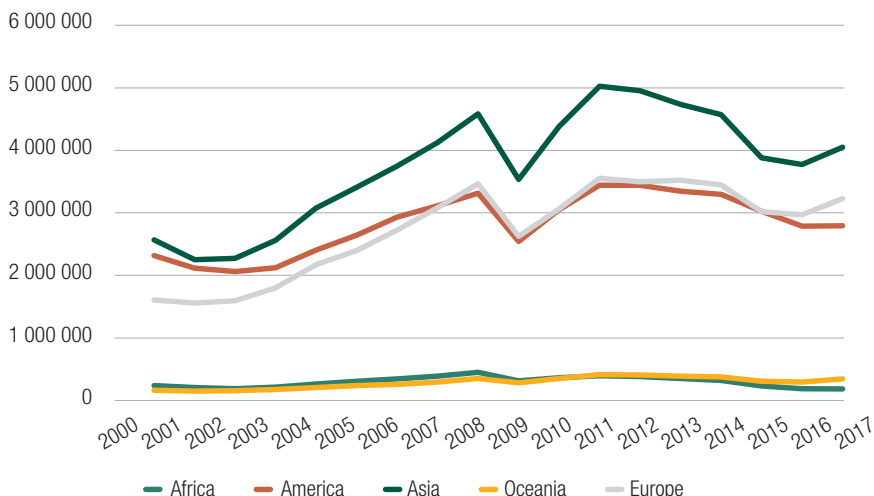
⁵ Trade in this section refers to merchandise trade unless otherwise stated. Regional classifications in the UNCTADstat database are Africa, America, Asia, Europe and Oceania.

⁶ UNCTAD calculations, based on the UNCTADstat database.

Figure 1

Trade (exports and imports, all products) to rest of world by region

(Millions of dollars (constant 2000 prices deflated by consumer price index of each region))



Source: UNCTAD calculations, based on the UNCTADstat database.

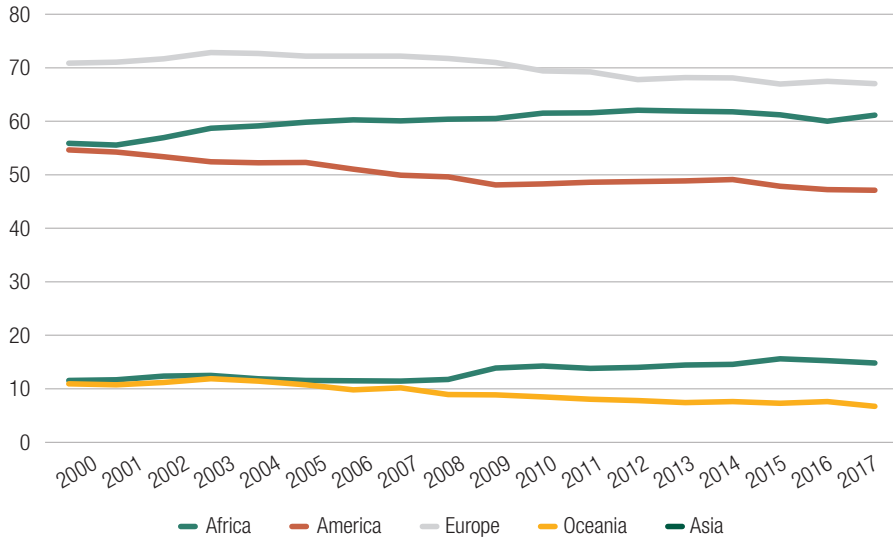
Intra-African trade, defined as the average of intra-African exports and imports, hovered at around 15.2 per cent in the period 2015–2017, while comparative figures for America, Asia, Europe and Oceania were, respectively, 47.4, 61.1, 67.1 and 7.2 per cent (figure 2). Africa, along with Asia, is the only region with a rising trend in intraregional trade from 2008.

In interpreting shares of intra-African trade in total trade, there are three caveats. First, there is evidence to suggest that intra-African trade may be subject to double counting, amounting to 7 per cent of intra- regional economic community exports and 9 per cent of intra-regional economic community imports, owing to overlapping memberships (Chidede and Sandrey, 2018). Second, intra-African trade is likely to be underestimated due to the prevalence of informal trade. Third, increases in intra-African trade may not necessarily be welfare-improving if most intraregional trade displaces cheaper extraregional trade (i.e. the trade diversion effect). For intra-African trade to be welfare-improving, the trade creation resulting from increased intra-African trade must be greater than trade diversion.

Figure 2

Intraregional merchandise trade (all products) by region

(Percentage)



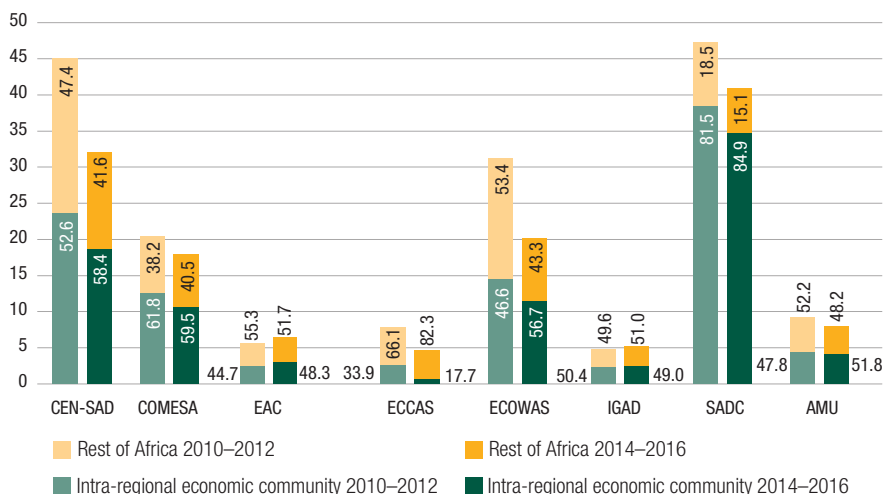
Source: UNCTAD calculations, based on data from Harvard University, 2018.

There are eight regional economic communities in Africa, yet the share of intra-African trade remains low, at around 14.8 per cent in 2017. Figure 3 shows a comparison of levels of trade in the communities. In 2016, intra-regional economic community trade was highest in SADC (\$34.7 billion), followed by CEN-SAD (\$18.7 billion), ECOWAS (\$11.4 billion), COMESA (\$10.7 billion), AMU (\$4.2 billion), EAC (\$3.1 billion), IGAD (\$2.5 billion) and ECCAS (\$0.8 billion). With regard to the share of intra-regional economic community trade in total trade in Africa, in 2016, there were deeper levels of integration in SADC (84.9 per cent), followed by COMESA (59.5 per cent), CEN-SAD (58.4 per cent), ECOWAS (56.7 per cent), AMU (51.8 per cent), IGAD (49.0 per cent), EAC (48.3 per cent) and ECCAS (17.7 per cent).

Figure 3

Intra-regional economic community trade in Africa, 2010–2012 and 2014–2016

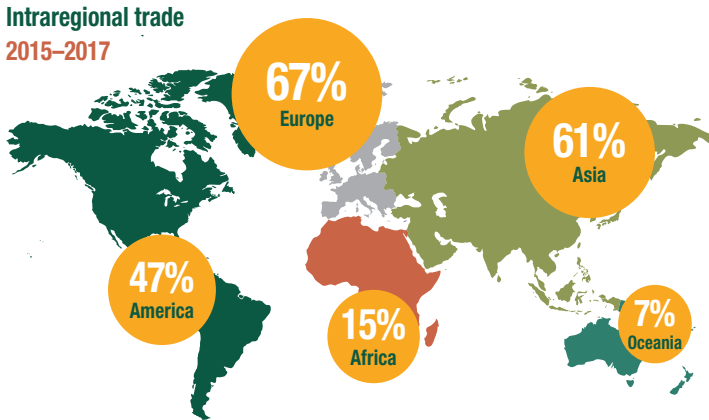
(Billions of dollars and percentage of total African trade)



Source: UNCTAD calculations, based on data from Harvard University, 2018.

The level of intra-regional economic community trade in Africa differs between communities, reflecting economic factors such as differences in stages of industrial and economic development and degrees of complementarity in production structures; differences in the state of political relations among member countries; and varying levels of political commitment towards the implementation of the agreements underpinning the regional economic communities. Progress towards the regional integration of Africa has been uneven to date, with some countries fairly well integrated at the regional and/or subregional level and others much less so. The 10 leading intra-African exporters in 2015–2017 were Swaziland (70.6 per cent), Namibia (52.9 per cent), Zimbabwe (51.6 per cent), Uganda (51.4 per cent), Togo (51.1 per cent), Senegal (45.6 per cent), Djibouti (41.9 per cent), Lesotho (39.9 per cent), Kenya (39.3 per cent) and Malawi (38.3 per cent). The 10 countries with the lowest share of exports were Chad (0.2 per cent), Guinea (1.6 per cent), Eritrea (2.3 per cent), Equatorial Guinea (3.5 per cent), Cabo Verde (3.6 per cent), Angola (3.9 per cent), Libya (4.5 per cent), Guinea Bissau (4.7 per cent), Liberia (5.1) and Algeria (5.5 per cent).⁷

⁷ UNCTAD calculations, based on the UNCTADstat database.



Countries that have more diversified exports tend to have higher shares of intra-African exports than countries that have less diversified exports. Simple correlation coefficient calculations between the shares of intra-African exports and UNCTAD product concentration indices at the country level for the period 2015–2017 show a negative association of 0.53.⁸ This indicates that the more concentrated the index, the lower the share of intra-African exports in total exports for a given country. Diversifying the range of goods produced within countries in Africa creates greater possibilities for intraregional trade.

With regard to the product and sectoral composition of intra-African trade, the continental market remains limited in size, yet intra-African exports appear to be more diversified and less primary commodity-dependent than exports from Africa to the rest of the world. Mineral products (petroleum, ores, etc.) account for 33 per cent of intra-African exports and constitute 50 per cent of total exports from Africa to the rest of the world (figure 4). The concentration of exports to the rest of the world on mineral products is also markedly evident at the regional economic community level. At the aggregate level, in 2015–2017, exports of manufactures accounted for 45 per cent of intra-African exports, but only 20 per cent of exports from Africa to the rest of the world.

With regard to product complexity, Hausmann and Hidalgo (2011) state that the process of economic development involves the accumulation of capabilities or productive

⁸ The UNCTAD product concentration index shows the degree to which the exports and imports of individual economies or groups of economies are concentrated on a few products rather than being distributed in a more homogeneous way across several products. The correlation coefficient was statistically significant at a 1 per cent level.

knowledge that allows a country to produce a diverse range of increasingly complex products. Products differ by the level of complexity that is required for their production. Higher levels of complexity are strongly correlated with a higher level of income in a country, and variations in economic complexity in certain products can be predictors of future overall growth for a country. Countries that increase the production and trade of products with an above average complexity, are more likely to experience higher growth in the future. Given the economic complexity of each economy, a product complexity index can be derived by comparing, for a given product, the complexity of the country producing that product. The product complexity index can infer information about a country's productive capabilities from its export basket, helping to explain differences in GDP per capita between countries and to predict economic growth.

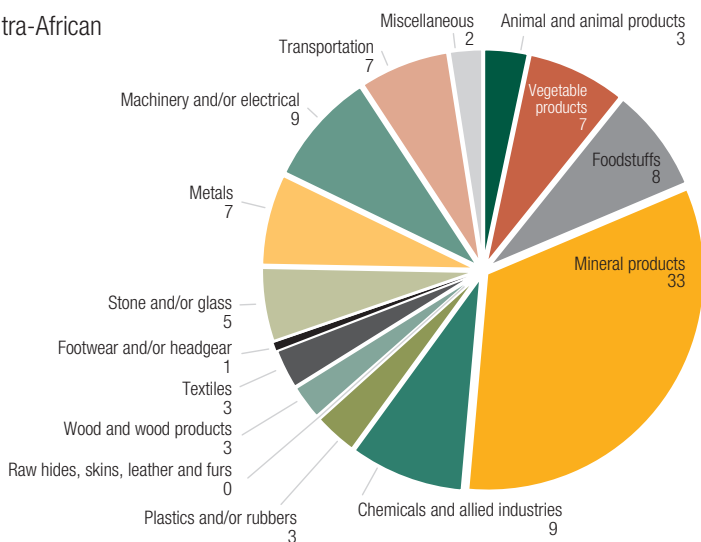
Figure 5 shows the average trade-weighted product complexity index for all countries in Africa in 2010–2012 and in 2014–2016 for trade within Africa and with the rest of the world. The line shows the 45-degree angle; countries above this line have a higher product complexity in their trade flows within Africa than with the rest of the world. As shown in the figure, this is true for most countries in Africa in both periods. This is coherent with the well-established finding that intra-African trade is more intensive in manufactures than trade between Africa and the rest of the world; the latter is dominated by primary commodities. Manufactures in general have higher levels of product complexity than primary commodities. The Democratic Republic of the Congo, Djibouti, the Niger and Seychelles are notable exceptions in both periods. The African Continental Free Trade Area is expected to lead to an increase in intra-African trade flows, and African trade flows could therefore increase in products of relatively higher complexity, which could in turn lead to potentially higher economic growth in the future.

Figure 4

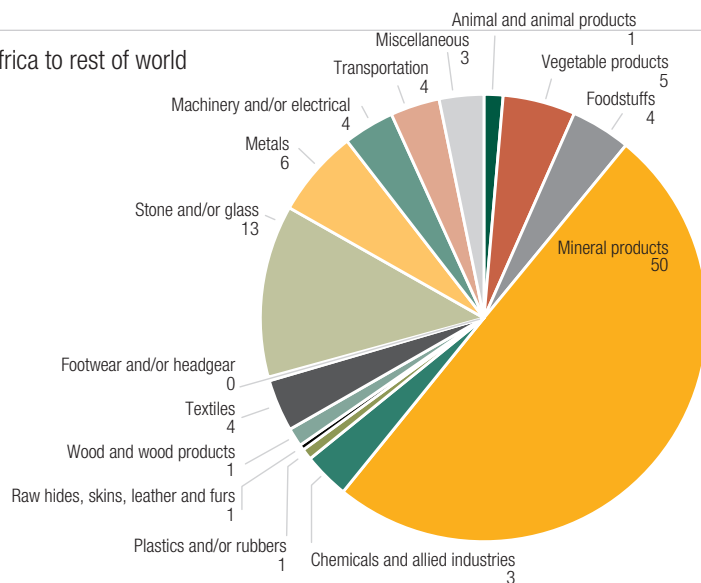
Composition of exports from Africa, 2014–2016 average

(Percentage)

(a) Intra-African



(b) Africa to rest of world

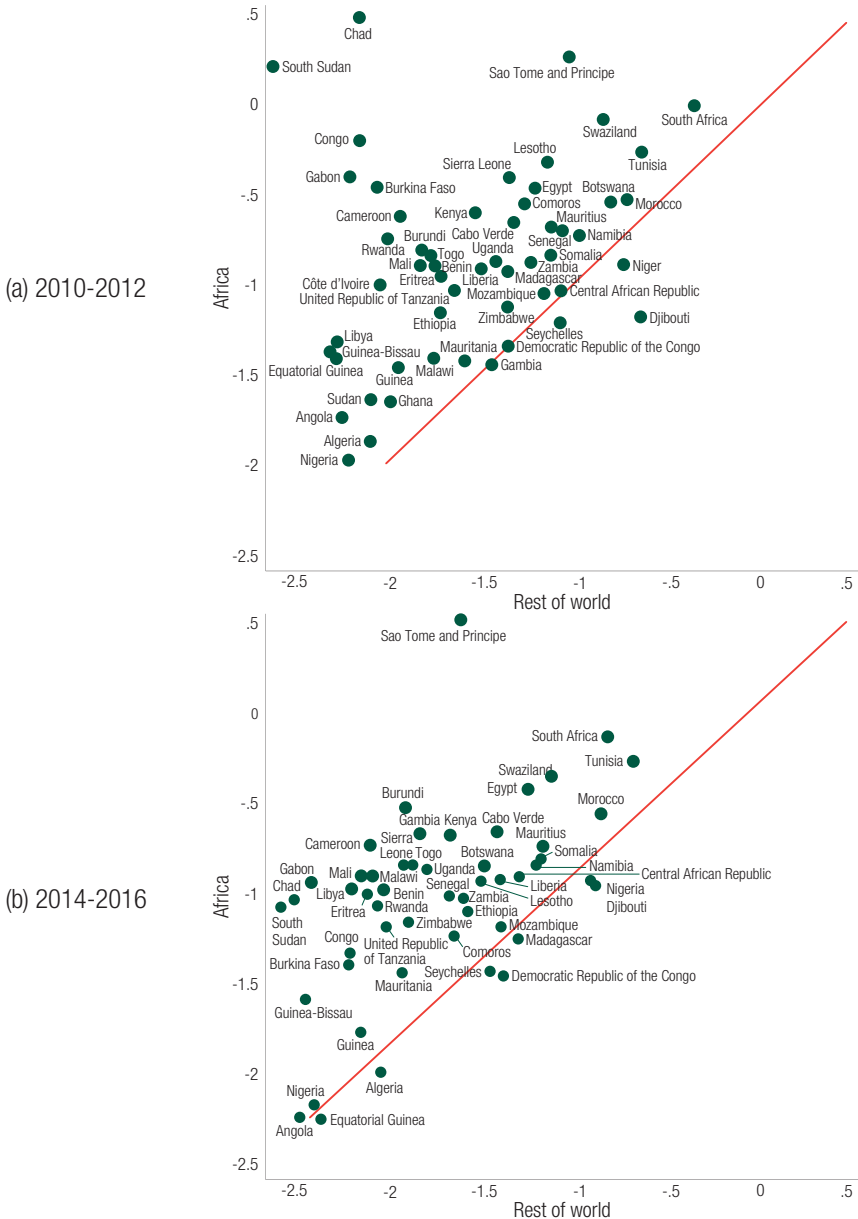


Source: UNCTAD calculations, based on data from Harvard University, 2018.

Note: Exports at Harmonized Commodity Description and Coding System (HS) four-digit level.

Figure 5

Product complexity index, weighted by trade flows, 2010–2012 and 2014–2016



Source: UNCTAD calculations, based on data from Harvard University, 2018.

The economic complexity index provides “a rank of countries based on how diversified and complex their export basket is. Countries that are home to a great diversity of productive know-how, particularly complex specialized know-how, are able to produce a great diversity of sophisticated products”.⁹ The index provides a measure of the ability of a country to apply knowledge to produce a range of diversified goods that are complex. Based on the data available for 31 countries in Africa in 2016, the leading 10 countries on the index were Tunisia, Egypt, South Africa, Mauritius, Uganda, Namibia, Mali, Morocco, Senegal and Kenya. Simple correlation coefficient calculations between the economic complexity index and manufacturing value added per capita (at constant 2010 dollars) in the 31 countries show a statistically significant (at a 1 per cent level) positive association of 0.53. In general, countries that have higher levels of manufacturing value added per capita have a higher economic complexity index score. This result is to be expected, given that the manufacturing sector involves the production of more complex products than the non-manufacturing sector. For countries with higher levels of manufacturing development, this suggests a greater initial role in leading in the development of regional value chains on the continent.

There is significant scope to enhance inter-regional economic community trade in Africa. Most of the African trade in regional economic communities takes place either within communities (intra-regional economic community trade) or with another community, rather than being fairly distributed across the remaining communities (inter-regional economic community trade). Trade interactions among the eight communities tend to be concentrated among a few groups, and there is scope to enlarge inter-regional economic community trade. The African Continental Free Trade Area can provide a platform of dialogue and negotiations across all eight regional economic communities, allowing communities to increasingly trade with one another to accelerate harmonization and coordination among them, as stipulated in the objectives of the Abuja treaty, and to strengthen their roles as building blocks of the African Continental Free Trade Area.

The African Continental Free Trade Area can boost intra-African trade by increasing the economic viability of industrialization on the continent and accelerating structural transformation, with commensurate positive effects on product diversification. The development of regional value chains in Africa depends on the implementation of national and regional industrial policies that promote diversification in the range of goods produced, both intermediate and final. The higher the level of product diversification in Africa, and the more cost competitive the production relative to external competitors, the greater the incentives for countries in Africa to implement and enforce rules of origin incentivizing the sourcing of inputs within Africa. Without adequate levels of product diversification and competitiveness, the expected benefits of rules of origin may be

⁹ See <http://atlas.cid.harvard.edu/learn/glossary>.

diminished, given that producers in Africa may find it cheaper to source inputs abroad or find it difficult to source the inputs they need within the relevant regional trade area to engage in production.

Building industrial productive capacities and competitiveness takes time. In the short term, therefore, rules of origin that are too restrictive (i.e. requiring a large portion of inputs to be sourced from within a regional trade area or imposing several stages of transformation to allow member countries to qualify for reduced duties) can deter regional trade or create trade diversion, that is, divert trade from less costly suppliers from outside a regional trade area to costlier supplies within. Therefore, rules of origin should be less restrictive and less complex at the initial stages of implementation of the Agreement Establishing the African Continental Free Trade Area, as many member countries have weak institutional capacities, low levels of competitiveness and limited capabilities to participate in regional value chains due to insufficient productive capacities for supplying sourced inputs. Simplified, flexible and lenient rules of origin are needed, in particular for LDCs in Africa, in the early stages, to help kickstart regional industrial production. The rules of origin regime can increase in complexity and restrictiveness gradually, once member countries have reached a threshold level of competitiveness and productive capacities, whereby they can satisfy the eligibility criteria set by more complex rules of origin to qualify for preferential treatment.

At higher levels of competitiveness, product sophistication and product diversification, more complex and restrictive rules of origin can boost regional trade, accelerate the development of regional value chains and ensure that a larger share of the value added and rents created during production is retained within a regional trade area. The degree of complexity and restrictiveness in rules of origin should consider the levels of product diversification, sophistication and competitiveness in member countries; too restrictive and complex rules of origin at low levels of regional productive capacities can provide incentives to member countries to trade outside a regional trade area rather than within. Such incentives may be greater for small and/or low-income countries such as LDCs, in which productive capacities and competitiveness levels may be lower. For example, LDCs, with assistance from UNCTAD, have expressed concerns at WTO about the challenges they face in complying with rules of origin under duty-free, quota-free schemes (WTO, 2014). One concern relates to the design of rules of origin not having followed developments in world trade. Their design should be context specific, that is, specific to the time, sector and industry, since the design of rules of origin should consider the specificities of the product sector to which they will apply and the constraints faced by firms in the sector, including challenges arising from changing regional and global environments. Such factors will influence the costs of compliance with rules of origin.

1.3.1 Key impediments to trade in Africa

The gains from the African Continental Free Trade Area can potentially be numerous, but are not automatic. One of the major goals is to boost intra-African trade. Besides the challenges of implementing the Agreement Establishing the African Continental Free Trade Area and progressively liberalizing tariffs on goods, there are obstacles to trade in Africa independent of tariff liberalization. The major impediments to trade have been identified in the Action Plan for Boosting Intra-African Trade of the African Union, which states that “the growth of intra-African trade has been constrained by a number of factors. These include differences in trade regimes; restrictive customs procedures, administrative and technical barriers; limitations of productive capacity; inadequacies of trade-related infrastructure, trade finance and trade information; lack of factor market integration; and inadequate focus on internal market issues” (African Union, 2013).

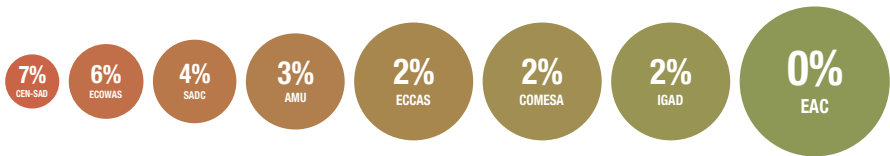
There are three major categories of obstacles to intra-African trade, namely, weak productive capacities and limited economic diversification, which constricts the range of intermediate and final goods that can be traded and potentially inhibits the fuller development of regional value chains; tariff-related trade costs, associated with the slow implementation of the tariff liberalization schedules underpinning free trade agreements; and high non-tariff-related trade costs that hamper the competitiveness of firms and economies in Africa. Such high trade costs, related to business and trade facilitation, can be explained in terms of the hard and soft infrastructure deficits in Africa that have an impact on transport and transit costs and at-the-border and behind-the-border costs (UNCTAD, 2009; United Nations Economic Commission for Africa et al., 2017). They can also be explained in terms of non-tariff measures that act as non-tariff barriers. Non-tariff measures refer to regulations officially issued by a country that may affect trade, even in cases where the main objective is not to regulate trade but, for example, to ensure safety and quality. Non-tariff barriers are cost-increasing obstacles to trade and should be removed to enhance trade and integration. Not all non-tariff measures are non-tariff barriers, and vice versa. Rules of origin fall within the category of non-tariff measures. According to Brenton (2011), complex rules of origin can be a significant constraint on trade, a substantial burden on customs and a hindrance to trade facilitation, while the nature of the rules of origin can undermine the stated intentions of preferential trade agreements. Many of these obstacles are the results of policies that can be altered. Each category of obstacles is discussed in turn in this section.

Weak productive capacities

Addressing supply-side constraints and weak productive capacities is a policy imperative in Africa to boost intraregional trade through the development of regional value chains.

Such chains can be a critical vehicle for spreading the economic benefits of African trade (e.g. jobs in the formal sector and gains from manufacturing) to a wider set of countries, if they participate in such value chains and gain opportunities to upgrade technologically and move up within the value chains. The potential for converting primary commodities in Africa, including agricultural materials, into industrially processed finished products within regional value chains remains largely untapped. The Action Plan for Boosting Intra-African Trade of the African Union includes a productive capacities cluster with the objective of creating “regional and continental value chains/complementarity, to increase local production/trade in goods produced in Africa” (African Union, 2013).

Intra-regional economic community tariffs
2014–2016 average



Tariff-related trade costs

Advances in trade liberalization are being made across all regional economic communities (United Nations Economic Commission for Africa et al., 2017). However, the liberalization of tariffs within communities has been slower than scheduled, due in part to human and institutional capacity constraints in trade policy implementation, and also to a lack of operationalization of regional economic community agreements. According to the Abuja treaty, all regional economic communities should have established a common external tariff within customs unions and fully functional free trade agreements by end-2017. This has not yet occurred. For example, among all communities, ECCAS has the lowest share of intraregional trade in its total trade in Africa and would need to reduce on average 66 per cent of its tariff lines on intra-ECCAS tariffs to zero. In the other communities, the proportion of tariff lines on intraregional tariffs that have yet to be reduced to zero are 90 per cent in ECOWAS, 85 per cent in SADC, 78 per cent in IGAD, 51 per cent in AMU, 45 per cent in COMESA and zero in EAC, which has the highest share of intraregional trade in total trade in Africa among all communities. On average, applied tariff rates to intra-regional economic community members amount to 7.4 per cent in CEN-SAD, 5.6 per cent in ECOWAS, 3.8 per cent in SADC, 2.6 per cent in AMU, 1.89 per cent in COMESA, 1.86 per cent in ECCAS, 1.80 per cent in IGAD and zero in EAC (United Nations Economic Commission for Africa et al., 2016). However, reducing

tariffs among regional economic community members or among countries in Africa will not automatically result in increased intra-regional economic community and intra-African trade. Some member countries, as exporters, may not fully utilize the preferential tariff lines under which tariffs have been reduced, because their export supply capacities in these lines are weak; their preferential tariff margin for exports is nullified by high non-tariff trade costs, making production and trade under these lines unattractive; or the costs of compliance with the rules of origin associated with these lines are too high.

Non-tariff barriers

There is a growing literature on the positive effects that trade facilitation reforms can have on intraregional and global trade due to the impact on reducing trade transaction costs (Organization for Economic Cooperation and Development, 2005; United Nations Economic Commission for Africa, 2018; United Nations Economic Commission for Africa et al., 2017; WTO, 2015). According to WTO, trade costs in developing countries can be equivalent to applying a 219 per cent ad valorem tariff on international trade and, even in high-income countries, the same product could face an ad valorem equivalent of 134 per cent in trade costs (WTO, 2015). It is estimated that full implementation of the Agreement on Trade Facilitation could reduce trade costs globally by between 9.6 and 23.1 per cent, with the highest average reduction in trade costs in countries in Africa and LDCs, in excess of 16 per cent (WTO, 2015). Broadly defined, trade facilitation reforms should encompass policies to reduce trade transaction costs that result from customs administrations, documentary requirements and border procedures, as well as policies for creating an enabling environment for trade that include behind-the-border policy reforms, improvements in transport infrastructure (roads, rails, ports, airports, etc.) and reduced bureaucracy and corruption (United Nations Economic Commission for Africa et al., 2017).

Non-tariff barriers can act as a significant hindrance to international and regional trade and offset expected gains from tariff reductions to firms. For example, while the average applied rate of tariff protection in Africa is 8.7 per cent, other obstacles have been found to increase the cost of African trade by an estimated 283 per cent (Sommer et al., 2017). Non-tariff barriers raise trade and transaction costs for businesses. Countries in Africa face large trade costs, associated with their hard and soft infrastructure deficits (in energy, transport, information and communications technology, logistics performance, etc.), complex customs and administrative procedures and other obstacles to moving goods across borders and delivering them to the final point of sale. Several studies have estimated the impact of trade facilitation reforms on international trade and trade in Africa and found positive results. For example, Portugal-Pérez and Wilson (2012) show

that trade facilitation reforms improve the export performance of developing countries, in particular when they target investment in physical infrastructure and regulatory reform to improve the business environment. Freund and Rocha (2011) examine the effects of transit, documentation and ports and customs delays on exports from Africa and find that transit delays have the most economically and statistically significant effect on exports. For example, UNCTAD has noted the additional costs that poor transport and transit facilitation impose on the competitiveness of exports from Ethiopia; the labour costs of making a T-shirt in Ethiopia are one third of the costs in China, yet the logistics expenses of exporting the shirt mean that, in international markets, a shirt made in Ethiopia sells for the same price as a shirt made in China (UNCTAD, 2018e).

Calculations by the Economic Commission for Africa, based on a computable general equilibrium model, indicate that under the African Continental Free Trade Area, intra-African trade could increase from 10.2 per cent in 2010 to 15.5 per cent in 2022 but, if matched by improved trade facilitation and tariff reductions, such trade could more than double in the same period, to 21.9 per cent (United Nations Economic Commission for Africa, 2015; Mevel and Karingi, 2012). The Agreement Establishing the African Continental Free Trade Area, in annex 5 of the protocol on trade in goods, presents a general categorization of sources of non-tariff barriers (not all of which should be systematically removed) as follows: Government participation in trade and restrictive practices tolerated by Governments; customs and administrative entry procedures; technical barriers to trade; sanitary and phytosanitary measures; specific limitations; and charges on imports. Rules of origin are treated separately in annex 2. Annex 5 provides for a mechanism for the identification, categorization and progressive elimination of non-tariff barriers within the African Continental Free Trade Area and institutional structures for the elimination of non-tariff barriers, reporting and monitoring tools and the facilitation of resolution of identified non-tariff barriers.

Countries in Africa tend to perform less well with regard to most indicators of trade facilitation relative to other regions. A comparison of sub-Saharan Africa with other regions and the world with regard to selected trade facilitation indicators is shown in figure 6. Sub-Saharan Africa has the highest cost to export compared with all other regions, as well as the highest cost to import, except for Latin America and the Caribbean, based on border compliance, and South Asia, based on documentary compliance.

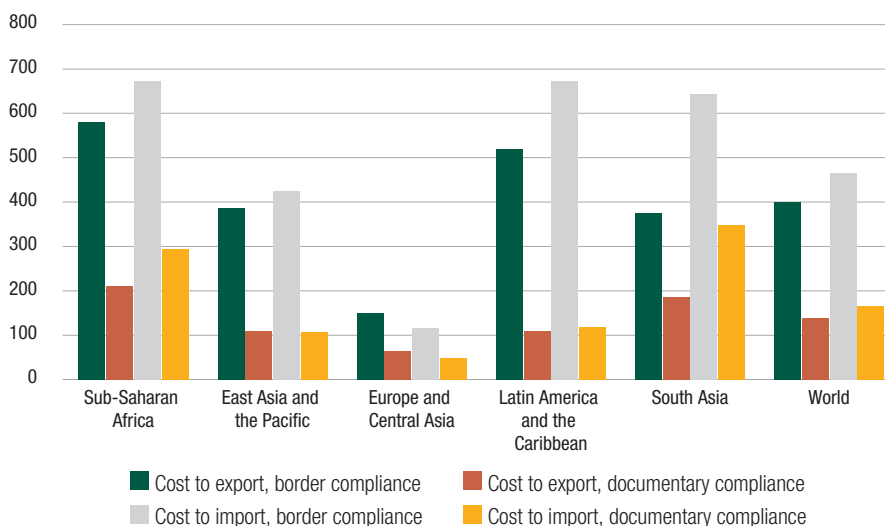
Comprehensive and reliable data on non-tariff measures in Africa and their conversion to ad valorem equivalents is ongoing, yet some estimates are available and show that rates that can be as high as 14 per cent for vegetables, 11.4 per cent for beverages and tobacco, 11.3 per cent for machinery and 11.1 per cent for optical and medical

devices (figure 7). Further, the impacts on trade, output, employment and income of reducing non-tariff measures are found to be positive in all countries in SADC and, depending on the initial trade flows and the magnitude and scope for removing the trade distorting effects of non-tariff measures, national exports can increase by up to 2.2 per cent (UNCTAD, 2016a). Efforts to enhance the regulatory convergence of trade regulations or the elimination of non-tariff measures need to be in parallel with the process of liberalizing market access conditions in the African Continental Free Trade Area. For example, UNCTAD has worked with several regional economic communities on non-tariff measures and non-tariff barriers and on developing systems to identify and remove non-tariff barriers and to promote mutual recognition or convergence (UNCTAD, 2016c).

Figure 6

Cost to import and export: Selected trade facilitation indicators by region, 2016

(Dollars)



Source: UNCTAD calculations, based on the World Development Indicators Database of the World Bank.

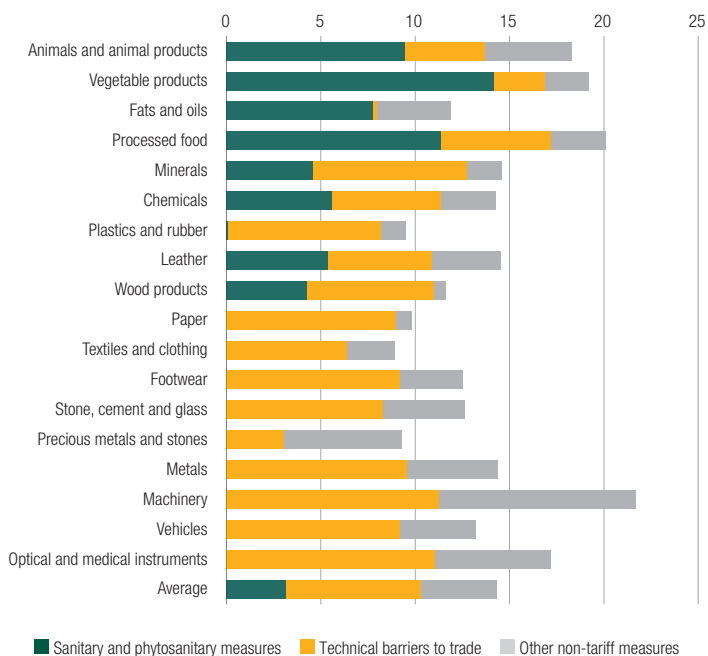
Note: The data cover sub-Saharan Africa separately from North Africa as the latter is included in the Middle East. The cost measure is the fees levied on a 20-foot container in dollars. All fees associated with completing the procedures to import or export goods are included, including costs for documents, administrative fees for customs clearance and technical control, customs broker fees, terminal handling charges and inland transport costs. The cost measure does not include tariffs or trade taxes; only official costs are recorded.

Evidence based on surveys conducted by the International Trade Centre in 23 developing countries (13 in Africa) and LDCs in the period 2010–2013 indicates that for manufactured products, 35 per cent of the most difficult non-tariff measures applied by partner countries to manufacturing exports concern rules of origin and the related documentation. The stringency or complexity of rules of origin in industry appear much more difficult to comply with than rules of origin in agriculture (International Trade Centre, 2015). The most frequent complaints registered on the non-tariff barriers reporting, monitoring and eliminating mechanism of the Tripartite Free Trade Agreement relate to rules of origin (11 per cent of filed complaints).¹⁰ For exporters, complying with rules of origin represents an additional cost to production, and for importers, enforcing compliance with rules of origin can exceed the capacities of weak customs administrations.

Figure 7

Ad valorem equivalents of non-tariff measures in Africa

(Percentage)



Source: UNCTAD, 2015a.

¹⁰ See www.tradebarriers.org.

The establishment of online platforms through which businesses can register complaints about non-tariff barriers has been a welcome development among regional economic communities and in several countries in Africa, including Uganda, the United Republic of Tanzania and EAC. However, while mechanisms are in place to report non-tariff barriers, they may be ineffective or demanding, discouraging the reporting of non-tariff barriers by the private sector (Calabrese and Mendez-Parra, 2016).

Addressing the costliness to the private sector of complying with and enforcing the different types of rules of origin, as well as dealing with the consequences to intra-African trade of the non-recognition and non-application of rules of origin, should be at the core of the continent's agenda for eliminating the trade costs of non-tariff barriers, to ensure that the static and dynamic gains from the African Continental Free Trade Area are fully reaped. Such gains are discussed in section 1.4.

1.4 Potential gains for Africa from the African Continental Free Trade Area

The African Continental Free Trade Area presents opportunities for Africa, yet the translation of such opportunities into tangible socioeconomic benefits is contingent on the containment of a set of risks and on addressing implementation challenges (see chapter 4).

Traditional trade theory posits that free trade areas lead to both trade creation and trade diversion, with the former often outweighing the latter and generating, overall, a net positive effect on economic welfare (Viner's theory). Trade creation refers to increased levels of trade coming from members of a free trade agreement area due to the removal of tariff and non-tariff barriers and to better exploitation of comparative advantages, economies of scale and productivity enhancing resource allocation. This increases economic welfare if a trade partner is the low-cost provider in the first instance under the most-favoured nation clause. Trade diversion occurs when trade is diverted from more efficient third-party suppliers to the benefit of higher-cost producers under the free trade agreement, leading to reductions in economic welfare. However, trade diversion is not always welfare-reducing, for example, if there is a sudden cessation of imports from third parties. Simulations by Mevel and Karingi (2012) show that the removal of tariffs, supplemented by trade facilitation in the African Continental Free Trade Area, could lead to trade creation effects that are stronger than trade diversion effects, with intra-African

trade estimated to increase by 52.3 per cent or \$34.6 billion in 2022, compared with a baseline scenario of not having a free trade area. The simulations also indicate that the real wages of unskilled workers may rise, accompanied by a slight shift in employment from the non-industrial to the industrial sector (Mevel and Karingji, 2012).

There are also static and dynamic gains to the preferential trade liberalization underpinning the African Continental Free Trade Area. Static gains arise from short-term increases in economic welfare, and dynamic gains arise from competitive pressures that lead to long-term productivity gains. Competitive pressures provide incentives to producers to improve on their offers through innovation and technological upgrading and to build dynamic comparative advantages to perform better than the competition. The African Continental Free Trade Area, through preferential trade liberalization, could generate long-term increases in consumer and economic welfare through increased competition and faster innovation.

There will be short-term adjustment costs in the African Continental Free Trade Area, as labour, capital and resources are reallocated across sectors, yet most studies concur that the long-term benefits will outweigh such costs (UNCTAD, 2018f). Short-term adjustment costs include temporary job losses among groups in the labour force that will need to redeploy from shrinking economic sectors towards expanding sectors, in addition to lost tariff revenues for Governments, requiring more domestic resources. Long-term economic benefits will arise from unleashing the potential of regional value chains to foster industrialization, promote technological sophistication, boost economic growth and create decent jobs in the formal sector.

Some examples of potential gains from the opportunities presented by the African Continental Free Trade Area are discussed in this section.

1.4.1 Increased competitiveness of firms in Africa and boosting of intra-African trade and investment

The African Continental Free Trade Area is expected to provide momentum towards the consolidation of regional economic communities and the Tripartite Free Trade Agreement, with more communities having to align themselves to the provisions and obligations in the Agreement Establishing the African Continental Free Trade Area. Under the assumption that tariffs and non-tariff barriers will be reduced more quickly for members of regional economic communities and members in Africa, compared with non-members, such tariff and non-tariff barrier reductions should benefit intra-African trade by giving companies in Africa a boost to their competitiveness. New markets in

Africa will be created for African firms, as long as, inter alia, they are able to benefit from preferential trade margins compared with foreign competitors, highlighting the crucial role of the enforcement of rules of origin in this regard; the objectives in article 4 of the Agreement, including those on trade facilitation measures, are met; and the Action Plan for Boosting Intra-African Trade of the African Union is effectively implemented. Increased intra-African trade in the short-term can have a positive effect on intra-African investment in a range of areas, from infrastructure and services to technology. As the gains from the African Continental Free Trade Area become more visible and tangible to economic operators and the perceptions of long-term benefits improve, the incentives to invest in regional economic communities and on the continent strengthen, leading to a mutually reinforcing relationship involving higher levels of trade and investment, coupled with positive spillover effects on innovation and firm and industry-level productivity.

1.4.2 Improved business and investment climate that attracts foreign direct investment and fosters linkages between foreign and local firms

The implementation of article 15 of the Agreement Establishing the African Continental Free Trade Area and annex 4 on trade facilitation can lead to significant reductions in the indirect and invisible costs (World Economic Forum et al., 2009) of doing business in Africa. As tariffs and non-tariff barriers decline on the continent, there will be increased competitive pressures on firms in Africa to compete in non-price dimensions such as quality and differentiated marketing strategies based on branding that may involve, for example, the use of geographical indicators of origin and voluntary sustainability standards. The private sector may make a greater demand on Governments to improve on the investment climate and for States to scale up support to national entrepreneurial systems. Improvements in the business and investment climate, matched by stronger State support for entrepreneurs, could attract a larger volume of foreign direct investment and offer opportunities to local firms to engage in equity and non-equity forms of investment with foreign firms. The enforcement of article 4 of annex 4, requesting parties to promptly publish trade facilitation information on the Internet in a non-discriminatory and easily accessible manner, and other articles of the Agreement that emphasize the disclosure of information and transparency in guiding business transactions, can reduce sources of uncertainty and concern for both domestic and foreign investors. This can provide incentives for higher levels of domestic and foreign investment.

1.4.3 Economic growth and structural transformation

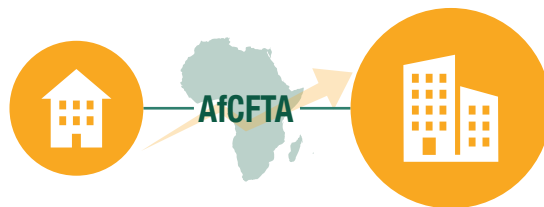
Regional integration can serve as a launch pad for building industrial capabilities in Africa and intensifying African trade in manufactured goods. The advent of digitalization and

electronic commerce and the future potential application of additive technologies such as three-dimensional printing could transform the manufacturing and entrepreneurial landscape in Africa, generating opportunities for the customized mass-production of a range of consumer and intermediate goods by firms in Africa (Bolaky, 2019). If regional economic communities implement regional industrial policies and individual countries implement national industrial policies, supported by the implementation of the Accelerated Industrial Development for Africa initiative by the African Union, the African Continental Free Trade Area has the potential to act as a catalyst for manufacturing and industrial development in Africa and to drive inclusive structural transformation. Africa currently has the youngest population in the world. Harnessing this demographic dividend necessitates employment and entrepreneurship strategies, underpinned by structural transformation and the creation of marketable opportunities, which the African Continental Free Trade Area can provide.

1.4.4 Participation of small and medium-sized enterprises in regional and global value chains

If the African Continental Free Trade Area acts as a catalyst for industrialization on the continent and supports the development of regional value chains in manufacturing and agro-industry, gains can accrue to the private sector in Africa, as it taps into investment and commercial opportunities in these sectors. The development of regional value chains can also stimulate local entrepreneurship. Gains can accrue to SMEs in Africa, provided their insertion into regional value chains is facilitated by targeted public policies within SME development strategies (UNCTAD, 2018c).

African Continental Free Trade Area **creates new
and larger markets for SMEs to grow**



Many SMEs in Africa have low chances of survival and expansion due to a range of constraints that affect their profitability (International Trade Centre, 2017; UNCTAD, 2018c). In the African Continental Free Trade Area, the creation of new and larger

markets, matched by possibilities to produce at a larger scale behind preferential walls and engage in learning by exporting, can raise the odds of survival and expansion for SMEs, first in regional markets, then in global markets. There is empirical evidence in favour of the view that regional integration agreements raise survival rates and the performance of firms in export markets (Fugazza and McLaren, 2014; Kamuganga, 2012; Türkcan K and Saygılı, 2018). Participation in regional value chains can be a stepping stone for SMEs in Africa to enter global value chains once they have built a requisite level of competitiveness and possibly begun to operate as fully fledged stand-alone companies trading directly with a regional and international customer base. Electronic commerce can provide an additional development opportunity for SMEs in Africa, if countries in Africa improve their electronic readiness. The inclusion of negotiations on electronic commerce within the context of the African Continental Free Trade Area could support countries in Africa in engaging in strategic and forward-looking planning and policies to harness digitalization for augmenting the potential gains of the African Continental Free Trade Area and creating opportunities for SMEs in Africa.

1.4.5 Development of agriculture and agribusiness and implications for rural development

The potential for boosting intra-African trade in agriculture is substantial (UNCTAD, 2013). Intra-African trade in agriculture was 22 per cent in 2017, compared with 52 per cent in manufacturing, and down from 24 per cent in 1995.¹¹ In addition, the range of agricultural goods exported by Africa to the rest of the region or outside the region is narrow (figure 8). In 2014, in the Malabo Declaration on Accelerated Agricultural Growth and Transformation for Shared Prosperity and Improved Livelihoods, the African Union committed to, by 2025, tripling intra-African trade in agricultural commodities and services through, among others, the fast-tracking of the establishment of the African Continental Free Trade Area and the transition to a continental common external tariff scheme (African Union, 2014).¹²

There are many challenges to agricultural and rural development in Africa. Operationalization of the Agreement Establishing the African Continental Free Trade Area, along with its annexes on investment, trade facilitation, services, technical barriers to trade, sanitary and phytosanitary measures and rules of origin, can contribute to agricultural development in the following four major ways: by creating larger markets for small farmers through the removal of tariffs and non-tariff barriers; by bringing farmers to markets through improved trade facilitation and trade connectivity (e.g. better roads, faster transport and thinner borders); by attracting domestic and foreign investment

¹¹ UNCTAD calculations, based on the UNCTADstat database.

¹² See also www.fao.org/food-loss-reduction/news/detail/en/c/250883/.

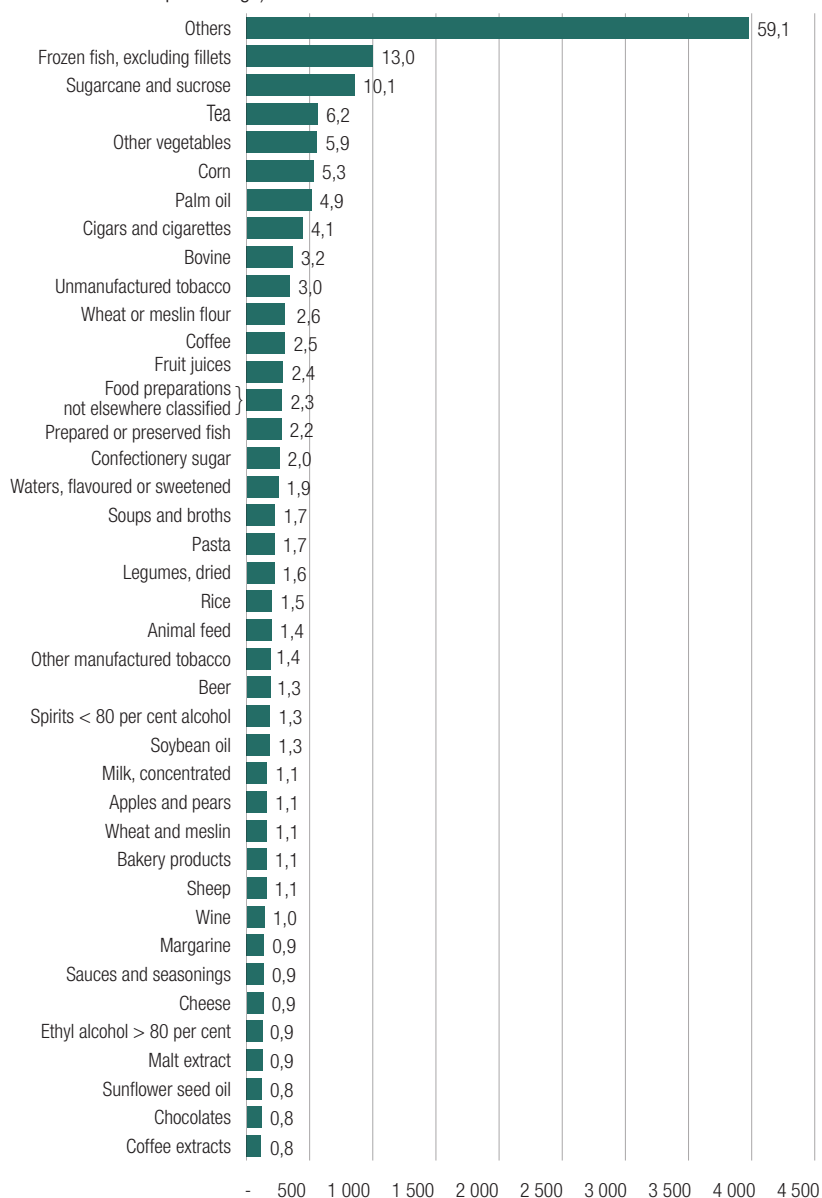
to the sector that can provide the necessary hard infrastructure (such as rural energy, rural water, cold storage facilities and warehousing); and by allowing the exploitation of opportunities in agribusiness and agro-industry linked to developing national and regional agricultural value chains whose end products are exported regionally and globally (see chapter 3).

Implementing the goals in the Malabo Declaration, such as allocating in national budgets at least 10 per cent of public expenditures annually to agriculture, and translating the African Agribusiness and Agro-industry Development Initiative into action will be important complementary measures to harnessing the African Continental Free Trade Area as a driver of agricultural transformation for the continent.

Figure 8

Top 40 intra-African agricultural-exports, 2014–2016

(Millions of dollars and percentage)



Source: UNCTAD calculations, based on Harvard University, 2018.

1.4.6 Unleashed potential of the services sector

The services sector has a critical role to play in the structural transformation of the region, as a high value added standalone sector of its own (including in information and communications technology, energy, financial services and tourism) or as an intermediate sector facilitating the transformations of the industrial and agriculture sectors in Africa.

Intra-African trade in services is estimated to be low, and the services sector in Africa tends to be dominated by low value added and informal transactions, and does not exhibit or encompass sufficient levels of competitiveness, sophistication and efficiency to act as a backbone of economic activity for industry and agriculture, with the exception of a few subsectors in a few countries (International Trade Centre, 2017; UNCTAD, 2015b). Services should be the oil that greases the wheels of economies during transformative growth when it comes to facilitating transport and transit, providing efficient and rapid logistics, supplying reliable and affordable infrastructure services in energy, water and telecommunications and easing access to credit and finance for enterprises (UNCTAD, 2015b). The creation of a continental market could provide to services suppliers the scale of operations and the long-term finance they need to boost competitiveness in services provision and, in turn, contribute to improving trade facilitation on the continent and strengthening the gains from the African Continental Free Trade Area stemming from increased trade in goods.

1.4.7 Informal cross-border trade, gender implications and reduced illicit trade

Informality in economic transactions is prevalent in Africa. Informal trade is estimated to account for up to 30 to 40 per cent of regional trade in Africa. Informal cross-border trade in Africa can contribute up to 43 per cent of incomes in the region according to some estimates, and much of this involves women trading on a small scale, with the long-term impact on developmental outcomes unclear (Brenton and Soprano, 2018). A potential cost of informality lies in the fact that it undermines the effective operationalization of public and trade policies and the delivery of their goals, since economic agents operate outside of formal structures. Informal businesses and informal cross-border trade prevail for a range of reasons, including the lack of job and trade-related opportunities in the formal sector, as well as the prohibitive costs of operating in the formal sector.

The deepening of regional integration, to the extent that it can gradually provide more opportunities in the formal sector, in terms of jobs, entrepreneurship and trade, by accelerating transformative growth and the development of supply chains in several sectors, can contribute to the gradual reduction of vulnerability in employment, including



**AFRICAN CONTINENTAL
FREE TRADE AREA:**

Can help to **create decent jobs
for all**, especially **women, youth
and vulnerable groups**

among women and youth and, in the medium term, reduce the incentives to engage in informal trade and informal business transactions. Supporting informal traders in formalizing their trade matters for regional integration in Africa, as such a transition provides Governments with much needed tax revenues that can be used to finance regional integration programmes and compensate for lost tariff revenues under tariff liberalization.

Besides affecting domestic resource mobilization, regional integration can also have an impact on the levels of illicit trade and illicit financial flows in Africa. As regional integration accelerates and increases the returns on investment in licit activities in formal sectors, in which investors can have access to a range of tax breaks, State support and recourse to the judicial system in the event of disputes, the incentives to engage in unlawful activities are reduced. In other words, regional integration, by generating benefits and by opening up investment and trade opportunities, increases the returns to investors in retaining and reinvesting their profits in Africa.

1.4.8 Political stability and peace that can strengthen economic gains

Regional integration and regional trade tend to provide member countries with a common vision and set them on a common journey, whereby their economic interests are intertwined and contribute to the maintenance of regional peace and stability. By increasing the dependence of members on each other for trade and economic development, regional integration increases the cost of conflicts for member countries. Economic and political forces have the potential to become complements rather than substitutes, although the mechanisms underpinning this are often subtle.

Many factors can affect the degree and rate of implementation of the Agreement Establishing the African Continental Free Trade Area, including political economy factors that will impinge on the distribution of costs and benefits across countries, sectors and economic actors; success rates in implementing the complementary measures and initiatives that should underpin the African Continental Free Trade Area; global economic conditions; third-party arrangements entered into by countries in Africa such as the economic partnership agreements; the interface between regional economic communities and the African Continental Free Trade Area; and the sequencing, coherence and timing of areas of negotiation among regional economic communities and the African Continental Free Trade Area.

1.5 Why do rules of origin matter for the African Continental Free Trade Area?

Whether countries and firms in Africa decide to utilize the preferential tariff and non-tariff preferences to which they are entitled in the African Continental Free Trade Area depends on the expected costs and benefits of doing so, and rules of origin are a critical determinant of these costs and benefits.

If rules of origin in the African Continental Free Trade Area are too costly to be implemented by firms in Africa relative to the expected benefits or to the expected net benefits under third-party arrangements, firms will find it optimal to forgo utilizing preferences in the African Continental Free Trade Area. No matter how low preferential tariffs may be for firms in Africa under the Agreement compared with under other arrangements, the gains associated from such trade liberalization will be null and void unless the preferences are utilized. Rules of origin have a direct impact on the uptake of preferences and the rate of preference utilization.

Rules of origin in the African Continental Free Trade Area must be designed such that a sufficiently large number of firms in Africa utilize the tariff and non-tariff preferences to enter and participate in regional value chains and become active actors in the industrialization process in Africa. In addition, rules of origin perform the same role as local content requirements in the production of final goods and directly affect the range of local intermediate goods that are necessary to finalize the production of a given good. The wider the range of intermediate goods to be sourced from within Africa, the wider the possibilities for more firms in Africa to participate as suppliers and for countries in Africa to engage in manufacturing, technological upgrading and economic and export diversification and the larger, in principle, the expected gains to beneficiaries in Africa. However, locally made intermediate goods need to be as cost competitive as those that can be sourced from outside the African Continental Free Trade Area. Therefore, there is a need for complementary measures to improve on the business environment in Africa and accelerate business and trade facilitation reforms. For example, evidence from the implementation of the North American Free Trade Agreement shows that rules of origin contributed to lowering the amount of imports of intermediate goods from third parties (Conconi et al., 2018).

The nature of rules of origin, that is, how they are designed and their requirements and procedures, and the associated compliance costs, affect export performances and more. Depending on how rules of origin are specified, they can, “to varying degrees,

restrict trade, misdirect investment, inhibit productivity growth and reduce welfare from levels otherwise attainable” (Gretton and Gali, 2005). Research comparing the different effects of different types of rules of origin shows that differences in product-specific rules of origin affect increases in export volumes (see chapter 3). For example, the more flexible rules of origin under the African Growth and Opportunity Act of the United States (requiring single transformation) have been found to stimulate exports from LDCs in Africa more so than do the restrictive rules of origin under the Everything but Arms initiative of the European Union (requiring double transformation) (De Melo and Portugal-Pérez, 2013; De Melo and Tsikata, 2015). Based on a gravity model for 155 countries and about 100 preferential trade agreements, Estevadeordal and Suominen (2005) find evidence that preferential trade agreements that have restrictive rules of origin tend to depress aggregate trade flows; regime-wide rules of origin that allow for flexibility in the application of product-specific rules of origin facilitate trade; restrictive rules of origin in final goods encourage trade in intermediate goods; and the negative effects of stringent product-specific rules of origin dissipate over time.

Making rules of origin too restrictive or administratively complex for eligibility for a trade preference increases compliance costs, even more so if domestic supplies are not as cost competitive as supplies from outside a free trade area. In extreme cases, firms may prefer to eschew preferential trade agreements altogether and trade on a most-favoured nation basis. If rules of origin are too flexible, the benefits decline in terms of domestic value added creation and domestic participation in regional value chains. There is a trade-off between increasing benefits to a region, in terms of stimulating regional production and trade by applying more stringent domestic requirements in rules of origin; and increasing costs, through the potential misallocation of resources by deviating sourcing from less expensive suppliers outside a free trade area. If rules of origin are too strict, the benefits to regional producers of lower tariffs may be offset by the higher costs of meeting rules of origin requirements. In addition, complex and stringent rules of origin require capable customs officials and administrative systems that can enforce them. Finally, countries in Africa suffer from a missing middle problem, meaning that a high number of SMEs coexist with a few large and more productive firms (UNCTAD, 2018c), and the costs for SMEs of compliance with rules of origin requirements must be given due attention when framing policies on developing regional value chains in Africa.

Rules of origin negotiations have at times involved a clash between two contrasting and at times dogmatic views. On the one hand, some economists argue that rules of origin should not be used as a protectionist or industrial policy tool, altered to support

the development of linkages between upstream and downstream producers. They should be confined to the simple role of authenticating the origin of goods and not be ascribed a developmental role, as this undermines overall efficiency and distorts trade. This approach largely neglects the dynamic effects that rules of origin may have on the emergence of new productive activities and more integrated regional production networks. On the other hand, rules of origin negotiations have often departed from orthodox economic stances, showing the lack of progress in rules of origin convergence, and typically been inundated by lobbying and protectionist pressures. In this context, the risk of regulatory capture is exacerbated by the increasingly technical and often opaque nature of rules of origin negotiations, as well as by well-known asymmetric information problems, with results that might derail well-intentioned efforts to deepen regional integration and enhance the development of productive capacities.

In departing from both of these extreme views, this report argues that the best way to approach this dilemma is to leverage the African Continental Free Trade Area as an opportunity to enhance the consistency of trade policy with industrial policy objectives and the continent's transformation agenda. With regard to rules of origin, as with other elements of the negotiations with regard to the African Continental Free Trade Area, dynamic processes of learning by doing and the progressive acquisition of technological capabilities, political economy factors and distributional concerns all matter in ensuring long-term economic viability. In this regard, rules of origin can have a functional role to play in stimulating and shaping the development of regional value chains in Africa; static economic efficiency is not enough. However, rules of origin are not an industrial policy tool, and should not be crafted as such, nor should they be used as a protectionist tool to build non-tariff barriers around regional suppliers.

A key question concerns how restrictive and stringent or how flexible rules of origin should be, and the answer must come from an in-depth knowledge of sectoral dynamics, a thorough understanding of the African Continental Free Trade Area process and a strategic assessment of the positioning of the free trade area in the context of the developmental and industrialization strategy of Africa.

Rules of origin must be flexible enough, especially at the beginning, to allow countries in Africa with weak supply capacities to take up trade preferences, benefit from trade liberalization and start building capabilities and competitiveness in domestic production, to participate in regional value chains. Rules of origin may become gradually more restrictive and stringent, increasing the content requirements for domestic processing, as the region continues to improve both productive capacities and competitiveness. Countries in Africa may pursue a gradual, incremental approach in terms of flexibilities

for weaker economies, graduating towards increasing the stringency and complexity of rules of origin as regional value chain-based industrialization develops on the continent. Changes to the rules of origin regime should also be based on evidence gathered on the impact of rules of origin on industrial capabilities in Africa. This requires instituting a set of guiding principles or best practices to govern the design of rules of origin, developing indicators to measure the degree of restrictiveness or flexibility of rules of origin and establishing a monitoring and evaluation system to assess the effectiveness of the current rules of origin regime. The implication of rules of origin on the work of customs authorities who must verify and enforce them is critical and capacity-building programmes for customs authorities in Africa are needed, in addition to platforms that facilitate speedy, automatic and transparent exchanges of information among all customs authorities in Africa.

The African Continental Free Trade Area should adopt rules of origin that are simple (in the sense of being clear and understandable), transparent, predictable and trade-facilitating for businesses and trade operators, as well as stable in the short to medium terms yet evolutive in the longer term to allow for adjustments to changes in the business environment, while remaining context, industry and sector-specific, and aimed at making the best use of existing technologies (see chapters 2 and 4). Both the contents of rules of origin and their administration matter in determining the net benefits of compliance to parties. The framing of procedural requirements for complying with rules of origin should be given proper attention, in addition to design considerations, and should involve consultations with the private sector. For example, the International Convention on the Simplification and Harmonization of Customs Procedures, 1974, revised 1999 (Kyoto Convention) emphasizes the importance of the application of simple yet efficient procedures.

The building of a restrictiveness index on rules of origin for all regional economic communities in Africa and the African Continental Free Trade Area could help coordinate and ensure convergence among rules of origin requirements under the various regional integration arrangements on the continent, to ease the burden on customs and firms in Africa, with a view to boosting intra-African, intra-regional economic community and inter-regional economic community trade. These issues are further addressed in chapter 2.

1.6 Conclusion

The degree of complexity and restrictiveness in rules of origin should consider the levels of product diversification, sophistication and competitiveness in member countries; too restrictive and complex rules of origin at low levels of regional productive capacities can provide incentives to member countries to trade outside the African Continental Free Trade Area rather than within. Such incentives may be greater for small and/or low-income countries such as LDCs, in which productive capacities and competitiveness levels may be lower.

The nature of rules of origin, that is, how they are designed and their requirements and procedures, and the associated compliance costs affect export performances and more. Depending on how rules of origin are specified, they can, to varying degrees, restrict trade, misdirect investment, inhibit productivity growth and reduce welfare from levels otherwise attainable. However, rules of origin have a functional role to play in stimulating the development of regional value chains in Africa and the participation of downstream and upstream suppliers in Africa in regional value chains, to achieve the goals of the Abuja treaty.

Chapter 2

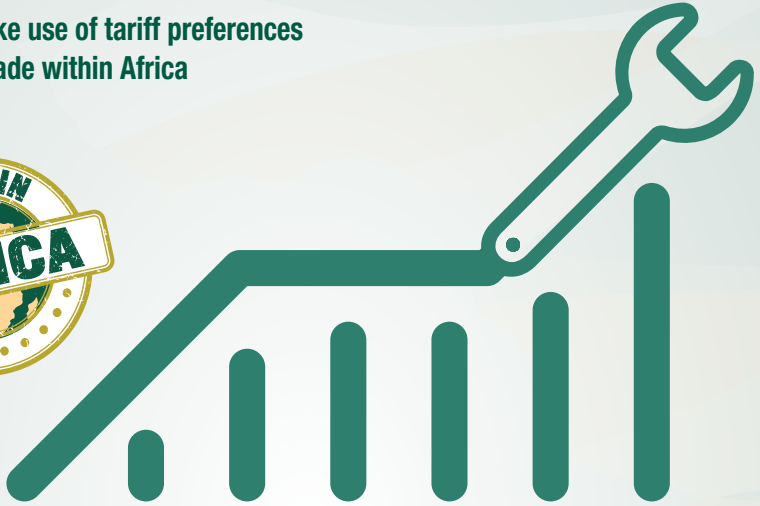
The role of preferential rules of origin in African trade

2.1 Introduction

The focus of this report is on preferential rules of origin, as they can have a significant impact on trade creation and trade diversion. The main objectives of and economic justification for preferential rules of origin are to prevent trade deflection and trans-shipment. Yet rules of origin have also been used to attain other objectives, namely, as a development tool. Cadot and De Melo (2008) state that in the context of preferential trade agreements between developed and developing countries, rules of origin have been justified as promoting manufacturing activities in developing economy members. Since trade preferences granted to eligible goods increase the price competitiveness of domestic products and of products from the preferential trade agreement region, the use of rules of origin can help retain and promote production capacities in the region. This can stimulate regional value chains and promote economic development.

PREFERENTIAL RULES OF ORIGIN:

A tool to make use of tariff preferences and boost trade within Africa



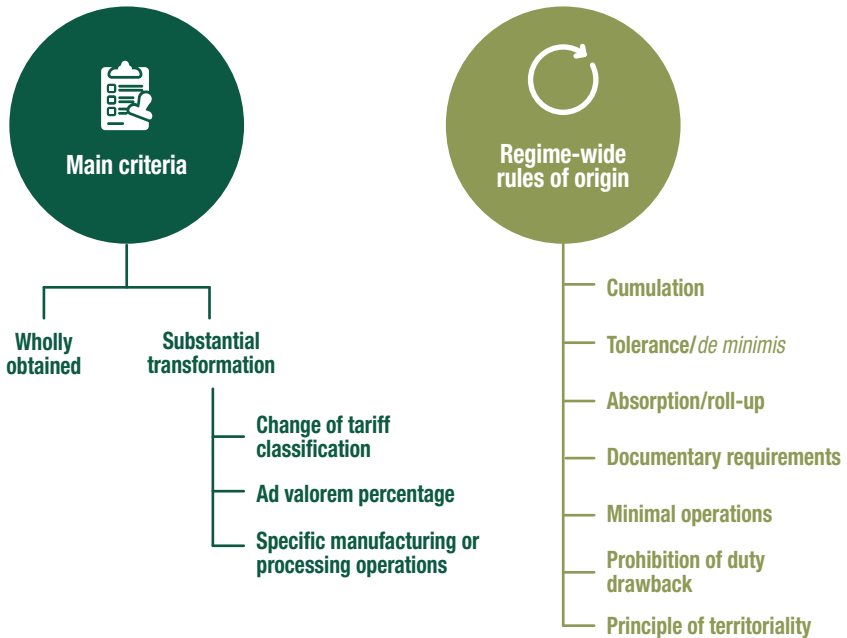
RULES OF ORIGIN SHOULD BE:



Rules of origin have become more complex over time in line with the proliferation of trade agreements, increasingly fragmented production processes and associated political economy interests. This chapter sets out the main issues related to the economic dimension of rules of origin in Africa. Section 2.2 discusses rules of origin and the respective approaches in free trade agreements in Africa and preferential trade agreements relevant to the African context. Section 2.3 discusses how such experiences contribute to the current negotiations with regard to rules of origin in the African Continental Free Trade Area and the aim of fostering trade in sophisticated products. Section 2.4 addresses the empirical relationship between rules of origin and African trade in terms of the restrictiveness of rules of origin regimes, preference margins and respective trade flows and utilization rates of trade preferences. Section 2.5 provides lessons learned on how rules of origin have impacted trade within Africa and with the rest of the world.

2.2 What are preferential rules of origin?

Governments have applied different sets of criteria, rules and approaches to determine the economic origin or national source of a product. Broadly, there is a distinction between main origin criteria (also referred to as product-specific rules) and regime-wide rules.



2.2.1 Main origin criteria

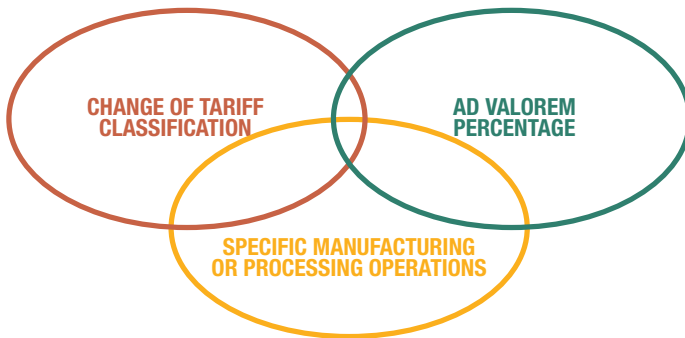
Main origin criteria are established for individual products. This implies that originating status is conferred on a product-by-product basis or, in some cases, for a specific sector. There are two basic criteria for determining the origin of products, namely, wholly obtained and substantial transformation.

The wholly obtained criterion applies to products that have been entirely grown, harvested or extracted from the soil in the territory of a member country or have been manufactured exclusively from such products, in line with annex K1 of the revised Kyoto Convention. This usually applies to commodities and related products. The convention provides that for products “where two or more countries have taken part in the production of the goods, the origin of the goods should be determined according to the substantial transformation criterion”.

The substantial transformation or sufficient working or processing criterion is typically determined according to three subcriteria that can be applied separately or in combination, as shown in figure 9 and detailed in this section.

Figure 9

Rules of origin: Subcriteria for determining substantial transformation



Change of tariff classification

According to this criterion, an imported input must be processed to a degree that the resulting exported product is classified under a different tariff classification than all of its imported inputs. This implies that the final good must be of a different tariff classification than the imported goods used in its production. The rule is usually specified in reference

to a level in the Harmonized System nomenclature, that is, either at the chapter, heading, subheading or tariff line level. Rules at a more disaggregated level take precedence over rules at a higher aggregation level. The more that a change is required at an aggregate level (chapter versus heading, heading versus subheading or subheading versus tariff line), the more restrictive the criterion typically is. A change is often requested at the chapter or heading level, yet appendices to rules of origin specify many exceptions to the rules.

A concern over this subcriterion is that the Harmonized System was designed as customs nomenclature and not to confer originating status to goods. As a result, transformation requirements or changes to tariff classifications at a certain level are not equally stringent across products and sectors. For example, a change required at the subheading level in the processing of coffee beans is relatively easily achieved, given that raw coffee beans (HS code 090111) transformed into roasted coffee beans (HS code 090121) are listed under different subheadings. With regard to diamonds, however, raw and cut diamonds are both classified under the same subheading (HS code 710210). This shows that a uniform change of tariff classification criterion does not necessarily reflect how easy or sophisticated a transformation process might be.

The Harmonized System undergoes periodic revisions and the classification of a specific product or sector may therefore change. For example, a recent revision includes a clearer distinction of environmental goods. The economic impact of a change of tariff classification requirement thus depends on the current classification of a product or sector.

The change of tariff classification rule is clear and unambiguous, yet it can lead to a proliferation of product-specific rules, which can also be influenced by domestic industries (Brenton, 2011).

Ad valorem percentage

This criterion refers to the percentage of value addition that must occur in an exporting country or within a specified region. It can be expressed as either the minimum share of value addition that must occur or material content that must originate in an exporting country or region; or as the maximum share of non-originating value addition. Non-originating value refers to the value of imported inputs in relation to the value of the product.

Various forms of calculation methods and percentage criteria are used (box 2). An important consideration in the calculation is how the value of the product is determined,

that is, whether the ex-works price, free on board price or cost, insurance and freight price is used. The calculation also requires the capacity to determine domestic costs, which are inherently complex. With regard to the percentage, some rules of origin set a uniform percentage across all products and others specify different percentages for different product categories.

A concern over this subcriterion is that, based on the method used, compliance with rules of origin requirements may be more or less demanding for exporters. Exporters need to devise and operate accounting systems tailored to the requirements of the free trade and/or preferential trade agreement under which they operate. The systems may not only differ from internal legal requirements in terms of definitions of concepts, applications of accounts, detail, scope and control, but also differ between free trade or preferential trade agreements (UNCTAD, 1998). For many exporters, especially in LDCs, this exceeds existing accounting capabilities. Further, movements in prices (e.g. commodity prices and wages) and exchange rates for finished products that use imported raw materials have an impact on the percentage criterion. Another concern is that the local value addition requirement may turn the competitive advantage of relatively inexpensive labour in developing countries into a penalty, if labour is too inexpensive to reach the required level of local value addition (WTO, 2014). The stringency or leniency of a rule also depends on the cumulation provision, that is, from which countries materials may be considered as originating.

Specific manufacturing or processing operations

This criterion relates to the specific manufacturing or processing operations required to confer originating status. The criterion is relatively clear and unambiguous once defined.

Box 2

Calculation methodologies for the ad valorem percentage criterion in selected regional economic communities in Africa and under the Tripartite Free Trade Agreement

The rules of origin regimes of regional economic communities and under the Tripartite Free Trade Agreement contain ad valorem percentage criteria. Notably, the methodologies used to calculate the criteria, and the stipulated minimum or maximum percentages, differ. Some communities, such as ECOWAS, use a uniform ad valorem percentage criterion across all products, and others, such as COMESA, apply different thresholds for different products or product groups or combine the criterion with other criteria. Some communities, such as COMESA, ECCAS and SADC, and the Tripartite Free Trade Agreement, also offer alternative criteria.

The methodologies applied in the communities are summarized in the table.

Calculation methodologies for the ad valorem percentage criterion

	COMESA OPTION 1	COMESA OPTION 2	EAC	ECCAS OPTION 1	ECCAS OPTION 2	ECOWAS	SADC	TRIPARTITE FREE TRADE AGREEMENT
Numerator	Value of non-originating materials	Ex-factory cost of finished product minus cost, insurance and freight value of non-originating materials	Value of non-originating materials	Value added (no clear definition provided)	Raw materials and materials originating from within Community	Ex-factory price of finished product before tax minus cost, insurance and freight value of non-originating materials	Cost, insurance and freight price of non-originating materials	Value of non-originating materials
Denominator	Value of materials used in production of goods	Ex-factory price	Ex-works price	Post-production cost before tax	Total cost of raw materials and consumables used	Ex-factory price	Ex-works price	Ex-works price
Method of calculation	Maximum value of non-originating materials	Value added by subtraction	Maximum value of non-originating materials	Value added by addition	Minimum value of originating materials	Value added by subtraction	Maximum value of non-originating materials	Maximum value of non-originating materials
Is ad valorem percentage criterion applied in combination with other product-specific rules?	No	No	Yes	No	No	No	Yes	Yes
Percentage	Maximum 60 per cent	Minimum 35 per cent	30 per cent for chapters 1–24 (except 70 per cent for chapter 18); 20–70 per cent for chapters 25–97	Minimum 35 per cent	Minimum 40 per cent	Minimum 30 per cent	30–60 per cent for chapters 1–24; 40–60 per cent for chapters 25–97 (except maximum 15 per cent for chapter 63)	Maximum 70 per cent
Are freight and insurance included?	Yes	Yes	Yes	Yes	Yes	No clear provision in legal text	Yes	Yes

Source: UNCTAD calculations, based on legal texts of origin provisions in respective regional economic communities as available in November 2018. Notes: The analysis does not include the rules of origin in AMU, as the text of the most recent rules was not available at the time of preparation of this report. See <https://unctad.org/en/pages/MeetingDetails.aspx?meetingid=1910> for a note on the methodologies of drafting an ad valorem percentage criterion.

As with the change of tariff classification criterion, domestic industries can influence the specification of manufacturing or processing operations, and they can quickly become obsolete due to technological progress (Brenton, 2011).

The requirement of substantial transformation is universally recognized, yet the use of the three subcriteria varies widely between free trade and preferential trade agreements. Each of the three subcriteria – change in tariff classification, ad valorem percentage and special manufacturing or processing operations – has particular advantages and disadvantages and consensus has not yet been reached as to which of the three is superior or facilitates trade the most (European Commission, 2005; Kommerskollegium, 2012; Naumann, 2011). The advantages and disadvantages of each are detailed in table 1. Most regimes use a combination of all three. For example, Estevadeordal and Suominen (2004), assessing 87 preferential trade agreement regimes worldwide, find that 83 use change of tariff classification requirements, 74 use specific technical requirements, 68 apply a value added rule based on import content and seven use a value added rule based on local value added.

2.2.2 Regime-wide rules of origin

Regime-wide rules of origin are those rules that apply to all products and/or sectors. Some of the rules allow for leniency with regard to the main criteria/product-specific rules (such as cumulation and tolerance rules) and others set out documentary requirements and additional criteria (such as minimal operations and prohibition of duty drawback rules).

Cumulation

Cumulation relates to non-originating materials imported from a fellow member of a preferential trade agreement or from a specific third country. In other words, cumulation allows for non-originating inputs to qualify as originating if they are imported from other members of a free trade or preferential trade agreement or third countries specifically mentioned in the agreement. A distinction is made between bilateral, diagonal and full cumulation, as represented in figure 10 and described in the following paragraphs.

Table 1

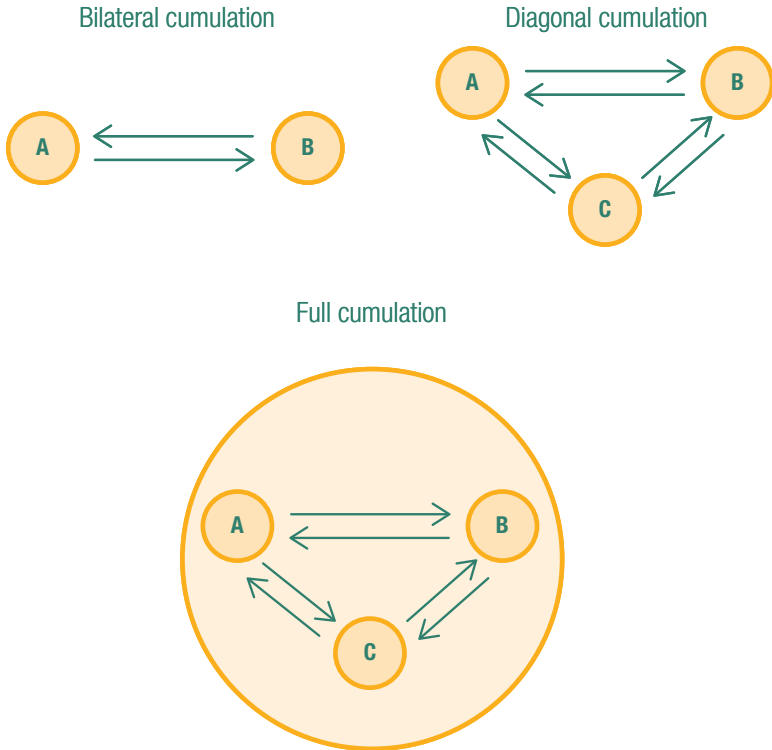
Main origin subcriteria: Advantages and disadvantages

	ADVANTAGES	DISADVANTAGES
Change of tariff classification	<p>Permits specific and objective formulation of conditions determining originating status.</p> <p>If required to produce evidence, manufacturers normally have no difficulty in furnishing data establishing that goods meet the conditions.</p>	<p>Preparation of lists of exceptions often difficult and require updating to keep abreast of technical developments and economic conditions.</p> <p>Any descriptions of manufacturing or qualifying processes must not be unduly complicated, to not lead manufacturers to commit errors in good faith.</p> <p>A prerequisite for use of the structure of a systematic goods nomenclature for determining originating status is that both country of export and country of import must have adopted same nomenclature as basis for respective tariffs, and must apply it uniformly.</p> <p>Difficulties likely to arise in borderline cases in which a slight difference above or below prescribed percentage causes a product to meet or fail to meet originating status requirements.</p>
Ad valorem percentage	<p>Precision: Value of constituent materials imported or of undetermined origin can be established from available commercial records or documents.</p> <p>If value of exported goods is based on ex-works price or price at export, as a rule, both prices can be readily ascertained and supported by commercial invoices and commercial records of traders concerned.</p>	<p>Origin attributed depends largely on fluctuating world market prices for raw materials and on currency fluctuations that may at times be significant enough that application of rules of origin formulated on this basis is appreciably distorted.</p> <p>Elements taken as basis for calculating value added, such as cost of manufacture or total cost of products used, often difficult to establish and may have a different make-up and interpretation in country of export and country of import.</p> <p>Disputes may arise as to whether certain factors, in particular overhead, are to be allocated to cost of manufacture or, for example, to cost of selling, distribution, etc.</p>
Specific manufacturing or processing operations	<p>Permits specific and objective formulation of conditions determining originating status.</p> <p>If required to produce evidence, manufacturers normally have no difficulty in furnishing data establishing that goods meet the conditions.</p>	<p>Preparation of lists of exceptions often difficult and require updating to keep abreast of technical developments and economic conditions.</p> <p>Any descriptions of manufacturing or qualifying processes must not be unduly complicated, to not lead manufacturers to commit errors in good faith.</p> <p>A prerequisite for use of the structure of a systematic goods nomenclature for determining originating status is that both country of export and country of import must have adopted same nomenclature as basis for respective tariffs, and must apply it uniformly.</p>

Source: UNCTAD.

Figure 10

Bilateral, diagonal and full cumulation



Source: UNCTAD.

Bilateral cumulation allows materials imported from a fellow member of a free trade or preferential trade agreement to be treated as originating. Originating input from country A is considered originating input in country B, and vice versa. This is the most common type of cumulation.

Diagonal cumulation is similar, but extends to more than two countries that have concluded preferential trade agreements. This type of cumulation may also be called regional cumulation. Only originating products or materials can benefit from diagonal cumulation. Fully originating inputs from each country are considered originating inputs in the other countries. Countries under a free trade or preferential trade agreement can therefore use materials that originate in any member country as if the materials had originated in the country in which processing was undertaken.

The most liberal or lenient form of cumulation is full cumulation, which allows for a country under a free trade or preferential trade agreement to consider working and processing carried out in any member country as having occurred in its territory. This allows for a greater use of materials from members of an agreement and more fragmented production processes within a region, and works to facilitate regional value chains. Full cumulation is therefore the most extensive and generous form of conferring originating status on a product. However, the documentary requirements under full cumulation can be more complex than those required under diagonal cumulation (Augier et al., 2005).

In LDCs, cumulation is of particular relevance, as they depend to a greater extent on imported inputs. Therefore, more liberal and generous cumulation provisions have an important impact on the capacity of LDCs to meet rules of origin requirements.

Tolerance/de minimis

This rule alleviates the manufacturing and/or production requirements for originating goods. It is called the tolerance rule in Europe and the *de minimis* rule in the context of the Association of Southeast Asian Nations, the North American Free Trade Agreement and the Trans-Pacific Partnership. The rule stipulates a maximum percentage of non-originating materials that can be used in production without affecting the defined origin of a final product. For example, in SADC, the change of tariff classification rule for certain products is combined with a maximum 15 per cent share of the ex-works price; this share can be non-originating without a product losing its originating status.

Absorption/roll-up

This rule allows for non-originating materials that have acquired originating status by meeting specific processing requirements to maintain this status when used as inputs in a subsequent transformation. This implies that a part of all non-originating inputs contained in an intermediate product is disregarded when assessing the origin of a final good.

Documentary requirements: Certification and direct transport

There are different models of certification that provide proof of originating status, including self-certification by exporters, certification by an industry umbrella group or certification by authorities of exporting countries, or a combination of the three (Kommerskollegium, 2012). The rule on direct transport relates to the direct transport of preferential goods, to ensure that goods arriving in an importing country are strictly the same as those that were exported. Related provisions usually allow for goods to pass through or stop over in a third country if they remain under customs supervision.

Minimal operations/list of insufficient working or processing

This rule sets out the operations that are insufficient to confer originating status, such as cleaning, preservation during transport and storage or packing.

Prohibition of duty drawback

This rule prohibits the refund of tariffs on imported inputs that are later included in a final product exported to a fellow member of a preferential trade agreement. Such a refund would allow an exporter to benefit from a double preference and thereby create unfair competition. However, duty drawback can stimulate trade in intermediate goods.

Principle of territoriality

This rule stipulates that working or processing must take place in a certain territory, and sets out derogations under certain conditions that allow for outward processing.

In sum, countries have defined different sets of rules and criteria to confer originating status on products. According to WTO (2018), the main criteria and requirements that must be met simultaneously are as follows: compliance with origin criteria, that is, a good must be wholly obtained in a beneficiary country or comply with minimum substantial transformation requirements to change its origin; compliance with such requirements demonstrated through a certificate; and direct consignment of a good from a beneficiary country to a preference-granting country, i.e. direct transportation requirements or exceptions to it. Non-compliance with one requirement may disqualify a product from preferences even if the other two requirements are met.

The difficulty of meeting rules of origin requirements has increased over time in line with ever more fragmented production processes and global sourcing networks. Moreover, the proliferation of trade agreements and trade regulations have further added to the complexity of determining the economic origin of a product. There are at least 291 preferential trade agreements, each with its own set of rules, and there is a lack of

compatibility between the rules in the agreements. Demonstrating compliance is costly in terms of the time required by customs agents to verify and certify compliance. In addition, there is evidence of complaints that some countries do not accept certificates of origin (see www.tradebarriers.org/). Further, the possibilities for direct consignment are constrained in Africa due to limited transportation networks. Such factors have made it more difficult for businesses to comply with requirements and take advantage of rules of origin and, as a result, rules of origin have become more controversial (Draper et al., 2016).

2.3 Rules of origin in African trade

2.3.1 Rules of origin in regional economic communities and under the Tripartite Free Trade Agreement

In Africa, each regional economic community has negotiated or is in the process of negotiating its own set of rules of origin. The main characteristics of rules of origin approaches in COMESA, EAC, ECCAS, ECOWAS, SADC and under the Tripartite Free Trade Agreement are summarized in table 2, including information on the main origin criteria (change of tariff classification and ad valorem percentage) and the most common regime-wide rules, namely, cumulation, tolerance, absorption and documentary requirements. Each regional economic community applies an ad valorem percentage criterion but the underlying methodologies for calculating the relevant percentages and the percentages applied differ (box 2).

COMESA provides three options for the ad valorem percentage calculation, in combination with a change of tariff heading requirement. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, yet there are many specifications and exceptions in the legal text. COMESA allows for diagonal cumulation and the absorption rule, but does not provide for the tolerance rule. With regard to documentary requirements, COMESA does not allow for self-certification and requires direct shipment, yet the documents required to prove direct shipment are not specified. There is a simplified procedure for small-scale traders, yet it remains subject to validation.

EAC does not have a general ad valorem percentage criterion applicable to all products, but has a list of product-specific rules of origin. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, with 13 exceptions

Table 2
Main characteristics of rules of origin, selected regional economic communities
in Africa and under the Tripartite Free Trade Agreement

	COMESA	EAC	ECCAS	ECOWAS	SADC	TRIPARTITE FREE TRADE AGREEMENT
MAIN ORIGIN CRITERIA						
Ad valorem percentage	General: Yes Three ad valorem percentage change of tariff heading (not an across-the-board criterion; limited to specific headings in appendix V of COMESA protocol on rules of origin)	General: No	General: Yes Uniform percentage across all products (minimum 30 per cent of regional value content; minimum value contingent on calculation criterion used)	General: Yes Uniform percentage across all products (minimum 30 per cent of regional value content; minimum value added by subtraction ^a)	General: No	General: No
Change of tariff classification	91	51	Not applicable	Not applicable	24	28
REGIME-WIDE RULES						
Cumulation	Yes	Yes	Yes	No explicit terms in legal text	Yes	Yes
Tolerance	No	Yes	No	No	Yes	Yes
Absorption	Yes	Yes	Yes	No	Yes	Yes
Documentary requirements: Certification and direct transport						
Certificate of origin	COMESA: certificate of origin Yes: specimen impressions of stamps and specimen signatures of officials required	EAC: certificate of origin Yes: specimen impressions of stamps and specimen signatures of officials required	ECCAS: certificate of origin Yes: specimen impressions of stamps required	ECOWAS: certificate of origin (agricultural products, livestock products and handmade articles exempt from this requirement) Yes: signature must be provided in name and function	SADC: certificate of origin Yes: specimen impressions of stamps and specimen signatures of officials required	Tripartite Free Trade Agreement: certificate of origin Yes: specimen impressions of stamps and specimen signatures of officials required
Certifying authorities						
Notification requirement to certifying authorities	Yes	Yes	Yes	Yes	Yes	Yes
Exporter declaration (self-certification)	No	No	No	No	No	No
Approved exporter	No	Yes	No	No	No	Yes
Exporter declaration for small consignments	No	Yes: maximum \$500 for persons; personal shipment; or maximum \$200 for traveller luggage	No	No	No	Yes: maximum \$500 for persons; personal shipment; or maximum \$200 for traveller luggage
Direct shipment requirement	Yes	Yes	No clear provision in legal text	No explicit terms in legal text, but definition of consignment is provided	Yes	Yes
Documentary evidence of direct shipment requirement	No clear provision in legal text	No clear provision in legal text	No clear provision in legal text	No explicit terms in legal text, but definition of consignment is provided	Single transport document or document certified by customs authorities of third country	Single transport document or document certified by customs authorities of third country; any substantiating evidence may be accepted)
Obligation of pre-shipment approval of manufacturer and/or exporter	No	No	Yes	Yes	No (recommended but not compulsory)	No

Source: UNCTAD calculations, based on legal texts of rules of origin provisions in respective regional economic communities as available in November 2018. Note: The number of product-specific rules of origin, based on the number of pages in the relevant appendices of the legal texts of regional economic communities, is used as a proxy for the complexity of the change of tariff classification criterion.
^a Change of tariff subheading also provided as a general rule, but must be accompanied by list of exemptions.

specifying a change at the subheading level. EAC allows for diagonal cumulation and the tolerance and absorption rules. The manual on the application of rules of origin provides for full cumulation, yet there is no such provision in the legal text. With regard to documentary requirements, EAC does not allow for self-certification, but has provisions for approved exporters and an exporter declaration for small consignments. EAC requires direct shipment, but provides for the possibility of trans-shipment.

ECCAS applies a uniform percentage across all products for the ad valorem percentage criterion, amounting to a minimum of 30 per cent of regional value content. ECCAS allows for diagonal cumulation and the absorption rule, but does not provide for the tolerance rule. ECCAS does not allow for self-certification and has no clear provision for direct shipment.

ECOWAS applies a uniform percentage across all products for the ad valorem percentage criterion, amounting to a minimum of 30 per cent of regional value content. ECOWAS does not have explicit terms for cumulation in the legal text. However, in practice, diagonal cumulation is applied to some extent, under article 2 of the ECOWAS trade liberalization scheme. ECOWAS does not allow for the tolerance and absorption rules. With regard to documentary requirements, ECOWAS does not allow for self-certification and has no explicit terms for direct shipment, but a definition of consignment is provided.

SADC does not apply a general ad valorem percentage criterion. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, with four exceptions specifying a change at the subheading level. SADC allows for full cumulation (Draper et al., 2016) and the tolerance and absorption rules. SADC does not allow for self-certification and requires direct shipment.

In the process of negotiating the rules of origin regime for the Tripartite Free Trade Agreement, the three constituting regional economic communities, namely, COMESA, EAC and SADC, expressed diverging preferences due to the different approaches followed at the regional economic community level. Members agreed that the rules of origin under the Agreement should not restrict trade; should be simple, flexible and easy for customs administrations to administer and businesses to comply with at a reasonable cost; should not be more stringent than existing rules under the regional trading arrangements of regional economic communities and economic partnership agreements; should promote trade and enhance global competitiveness; and should enable diagonal cumulation (Draper et al., 2016). The negotiation process resulted in a regime that does not stipulate a general percentage across all products for the ad

valorem percentage criterion. The change of tariff classification criterion consists mostly of specifications at the chapter and heading levels, with four exceptions specifying a change at the subheading level. The Agreement allows for the tolerance and absorption rules. With regard to documentary requirements, the Agreement does not allow for self-certification, but has provisions for approved exporters and an exporter declaration for small consignments. It requires direct shipment.

This analysis suggests that the rules of origin under ECCAS and ECOWAS tend to be more transparent and easier to understand by exporters due to the uniform ad valorem percentage criterion. The rules of origin under ECOWAS are also less restrictive, as the change of tariff classification criterion requires, in general, a change at the subheading level, whereas the rules of origin under the other regional economic communities require, in general, a change at the chapter and heading levels. However, the interpretation of restrictiveness related to changes in level is only indicative, as noted in the example provided of coffee beans and diamonds.

Regional economic communities that have an ad valorem percentage criterion applicable to all products as a general rule do not contain provisions for the tolerance and absorption rules. This is in line with practices under other preferential trade agreements. Estevadeordal and Suominen (2008) note that “many regimes with across-the-board rules of origin neither provide for tolerance nor feature many regime-wide provisions of flexibility”, and that the regime-wide rule that occurs the most often in such preferential trade agreements is duty drawback.

Specific manufacturing or processing operations are not referred to in table 2. However, it should be noted that SADC applies specific rules that identify the manufacturing or processing operations that qualify to confer originating status, and this adds to the restrictiveness of the rules of origin in SADC.

Draper et al. (2016) state that challenges in EAC relate to “issues of verification or origin, administrative procedures, compliance difficulties for small-scale producers”. This is a particular concern as the private sector in Africa is largely comprised of small-scale producers and SMEs. By contrast, the rules of origin in COMESA have greater administrative simplicity and transparency (Brenton et al., 2005).

Self-certification is not allowed for in any regional economic community or under the Tripartite Free Trade Agreement, contrary to the provisions in some of the preferential trade agreements with major trading partners, such as the African Growth and Opportunity Act of the United States and the Everything but Arms initiative of the European Union, and as recommended by WTO. In most regional economic communities, a certificate

of origin is delivered upon request from an exporter or producer. Some communities require registration of the exporter or producer prior to the delivery of a certificate of origin. This procedure can be demanding in terms of the details required, such as in ECCAS and ECOWAS, where firms need to submit a series of details on their calculation methodology and its breakdown to be admitted to trade under the respective trade arrangement.

Due to the constraints related to transportation networks and customs capacity in Africa, compliance with the rules of origin provisions for direct shipment and certification requirements and procedures applicable in most regional economic communities is challenging. This highlights the need for customs modernization and trade facilitation reforms.

With regard to the enforcement of compliance, regional economic communities have limited capacity or procedures. In COMESA, while there have been isolated retaliatory actions, in general there is a diplomatic-style rather than a rules-based approach to dispute resolution (Draper et al., 2016).

2.3.2 Rules of origin in the African Continental Free Trade Area

At the time of preparation of this report, the Agreement Establishing the African Continental Free Trade Area had been signed by 49 countries, and the rules of origin remained under negotiation. Throughout this process, countries in Africa can build on and draw from their vast experience in trade and rules of origin negotiations with partners in Africa and external partners, such as with regard to the free trade agreements under regional economic communities, the Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States and the European Community; the African Growth and Opportunity Act of the United States; the Generalized System of Preferences of the European Union; and economic partnership agreements.

In the Agreement, member States reaffirmed their existing rights and obligations under the other trade agreements of which they are members. Moreover, the Agreement considers the free trade agreements of the regional economic communities as building blocks, recognizes their best practices and guarantees the “acquis” obtained in them. Therefore, the Continental Free Trade Area will not replace existing regional agreements or those under negotiation such as the Tripartite Free Trade Agreement, and its rules of origin will be similar to those in the regional economic community protocols.

Accounting for these requirements has led to an extensive list of product-specific rules in the African Continental Free Trade Area. With regard to regime-wide rules, negotiators have agreed on the rules of cumulation, tolerance and absorption.

It is critical to formulate rules in language accessible by the main users, such as private operators, firms, brokers and customs authorities. If the language of the rules is overly complex, users will prefer to avoid risks and not use the arrangement, which would undermine the African Continental Free Trade Area. This emphasizes the need for rules of origin that are simple (in the sense of being clear and understandable), transparent, predictable and trade-facilitating for businesses and trade operators. Experiences in other regions, such as the Association of Southeast Asian Nations, shows that reliance on umbrella groups for certification could enhance transparency and help streamline procedures.

African Continental Free Trade Area negotiators need to account for regional and country-specific sensitivities. Only rules of origin that are well-balanced and have been fully consulted on can succeed in being accepted and applied. The protocol, including certification and verification methods, should be crafted with the future in mind, to avoid renegotiations and updates that may present challenges for Governments and private sector operators, and to account for future enhanced capacity in countries in Africa to participate in value chains.

Finally, the negotiation process should ensure that exporters in Africa will be provided with the required incentives to trade within Africa and avoid situations wherein exporting to the United States or Europe is easier and less costly than exporting to other countries in Africa.

2.3.3 Rules of origin at the multilateral level and in preferential trade agreements with major trading partners

Rules of origin at the multilateral level

Trade preferences for developing countries have been a longstanding issue in international trade negotiations.¹³ In 1968, the United Nations Conference on Trade and

¹³ The multilateral trading community has deliberated on rules of origin for many decades without reaching a conclusion. In 1953, the International Chamber of Commerce made an initial attempt to harmonize rules of origin by facilitating a resolution of the contracting parties to the General Agreement on Tariffs and Trade that recommended the adoption of a uniform definition for determining the nationality of manufactured goods, yet a consensus was not reached. In the 1960s, during discussions on the establishment of the Generalized System of Preferences, a second attempt was made to harmonize rules of origin, but was not successful. As a result, preference-giving countries retained their own rules of origin systems. In the 1970s, the international community succeeded in including guidelines on rules of origin in the Kyoto Convention. However, diverging views on harmonization remained. In the 1990s, the Uruguay round of multilateral trade negotiations included rules of origin, but specified that only non-preferential rules of origin should be addressed. The Agreement on Rules of Origin emerged from this process, which sought to harmonize all non-preferential rules of origin used by WTO members in a single set of international rules. Negotiations on the harmonization of non-preferential rules of origin have not been finalized, and each country continues to apply its own non-preferential rules of origin (see <http://www.wcoomd.org/en/topics/origin/overview.aspx>).

Development, at its second session, adopted the concept of the Generalized System of Preferences and established a Special Committee on Preferences as a subsidiary body of the Trade and Development Board, agreeing, in resolution 21 (II), that “the objectives of the generalized non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least advanced among the developing countries, should be: (a) to increase their export earnings; (b) to promote their industrialization; (c) to accelerate their rates of economic growth”.¹⁴

In 1970, the Special Committee on Preferences established the legal nature of commitments for preference-giving countries. Prospective preference-giving countries applied for a waiver from their obligations under article I of the General Agreement on Tariffs and Trade, which enshrined the most-favoured nation principle. Such waivers were initially granted on a temporary basis. However, in 1979, the contracting parties adopted a supplementary clause that enabled countries to permanently derogate from the most-favoured nation principle. The enabling clause also recognized the particular needs of LDCs, specifying that developed countries were allowed to grant special and preferential tariff treatment to LDCs in the context of any general or specific measures in favour of developing countries.

Resolution 21 (II) noted that a preference scheme should be based on generality, non-reciprocity and non-discrimination, yet its implementation has led to schemes that have differed substantially in terms of product coverage, the depth of tariff cuts, safeguards and rules of origin (UNCTAD, 2018g). A particular area of difference has been the treatment of the textiles and clothing sector; a sensitive sector for many developed and developing countries. Moreover, the rules of origin and ancillary requirements that emerged have been specific to each Generalized System of Preferences scheme. Unilateral preferences for LDCs have been an ongoing issue in this context. Rules of origin in LDCs began to be a subject of debate following the launch of the duty-free, quota-free initiative at the first Ministerial Conference of WTO in 1996.

The United States expanded its product coverage in its Generalized System of Preferences scheme in 1997, and amended the scheme in 2000 for countries in sub-Saharan Africa under the African Growth and Opportunity Act, enlarging the range of products and granting preferential treatment to selected apparel articles subject to special provisions, rules of origin and customs requirements. The European Union improved market access through its Everything but Arms initiative in 2001, which granted unrestricted duty-free access to all products from LDCs.

At the multilateral level, a decision on the duty-free, quota-free initiative and rules of

¹⁴ See <https://unctad.org/en/pages/MeetingsArchive.aspx?meetingid=22967>.

origin was made at the sixth Ministerial Conference of WTO in 2005. Members agreed that developed countries and developing countries in a position to do so should provide duty-free, quota-free market access on a lasting basis for all products originating from all LDCs or, for those members facing difficulties, for at least 97 per cent of products from LDCs. WTO members also agreed to “ensure that preferential rules of origin applicable to imports from LDCs are transparent and simple and contribute to facilitating market access” (WTO, 2014). However, preference-giving countries reiterated their position that rules of origin under the duty-free, quota-free initiative could not be discussed or negotiated, since preferences were unilateral (WTO, 2014). This argument had been made in the 1970s during discussions on the Generalized System of Preferences and rules of origin by the Special Committee on Preferences.

To initiate the commitment on rules of origin made at the sixth Ministerial Conference of WTO in 2006, the LDCs Group began work on a draft proposal for progress on the issue of rules of origin under the duty-free, quota-free initiative. The objective was to support a debate on rules of origin between LDCs and preference-giving countries on the basis of a legal text, rather than on declarations of principles and statements; and to counter the misperception that LDCs wished to emphasize the harmonization of preferential rules of origin. While theoretically desirable from the perspective of the LDC Group, it was understood that this was not a viable option (WTO, 2014).

Preference-giving countries recognized that their rules of origin were outdated and had not followed evolutions in world trade. For example, the European Commission noted that rules of origin had not been adapted to the trend of globalization in production and advances in technologies and transport, information technology and communications (European Commission, 2007). Moreover, lower preferential margins combined with high compliance costs made preferences unattractive. The European Union reformed its rules of origin; the revised legal texts became effective in 2011. Critically, the reform introduced a differentiation in favour of LDCs, allowing for a single transformation process in textiles and clothing and thereby accommodating a request that LDCs had made for over a decade. Further, it raised the threshold of the use of non-originating materials in many sectors, from 40 to 70 per cent for LDCs and to 50 per cent for other Generalized System of Preferences beneficiaries, and also eased the cumulation rule. As a result, the share of apparel exports from LDCs to the European Union increased significantly.

These developments supported the position of the LDCs Group at WTO that the rules of origin for LDCs needed to be reformed. Prior to the ninth Ministerial Conference of WTO in 2013, the Group prepared several proposals on rules of origin, which outlined

the challenges in LDCs of complying with existing rules of origin. The Conference adopted a decision on preferential rules of origin for LDCs that considered that duty-free, quota-free market access for LDCs could be effectively utilized if accompanied by simple and transparent rules of origin, and recognized that simple and transparent rules of origin may take into account the capacities and levels of development of LDCs.¹⁵ The decision also detailed certain elements for preference-granting members in the formulation of preferential rules of origin, including substantial transformation, cumulation, documentary requirements and notification. For example, with regard to substantial transformation, the guidelines recommended that, if the rules are based on the ad valorem percentage criterion, the level of value addition should be kept as low as possible, and noted that LDCs sought consideration of allowing non-originating materials to a maximum of 75 per cent of value. For rules based on the change of tariff classification criterion, a change of tariff heading or subheading should be sufficient for transformation, and rules based on specific manufacturing or processing operations should take into account the productive capacities of LDCs. Cumulation should be a feature of non-reciprocal preferential trade agreements, allowing for bilateral cumulation, cumulation with other LDCs, cumulation among Generalized System of Preferences beneficiaries of a preference-granting country and/or cumulation among developing country members forming part of a regional group. Finally, documentary requirements should be simple and transparent, avoid a requirement to provide proof of non-manipulation and, whenever possible, recognize self-certification.

The ninth Conference adopted the Agreement on Trade Facilitation, which requires a series of reforms in the operation of customs procedures, including with regard to rules of origin, to facilitate trade. Between the ninth and tenth Ministerial Conferences, at a meeting of the Committee on Rules of Origin, the LDCs Group stated: “No matter how rules of origin are designed or drafted, they should reflect global value chains. If not, trade will not be created and trade preferences will be underutilized. Rules of origin should not be used as a disguised form of industrial policy aiming at requiring substantial transformation in LDCs going beyond what is commercially meaningful and viable” (Third World Network, 2014). This implies, for example, that the degree of restrictiveness of rules of origin should be considered with regard to the existing value chain contexts in which they are expected to operate. The decision on preferential rules of origin of the ninth Ministerial Conference was expanded with more detailed guidelines in a decision adopted at the tenth Ministerial Conference in 2015, which aimed to reduce the administrative burden related to documentary evidence and ease the direct consignment rule through the avoidance of requiring non-manipulation certificates

¹⁵ See wto.org/english/thewto_e/minist_e/mc9_e/desci42_e.htm.

in transit countries. Other measures to streamline customs procedures should be considered, such as minimizing documentation requirements for small consignments or allowing for self-certification.

Following the tenth Ministerial Conference of WTO, the LDCs Group, at a meeting of the Committee on Rules of Origin, noted that even the 25 per cent value addition rule might be difficult or impossible to meet, given modern manufacturing methods and the globalization of value chains. Some commentators note that the decisions adopted at the ninth and tenth Conferences both contain best practices or benchmarks for drafting preferential rules of origin and the impact this can have (Inama, 2015).

In sum, the debate on rules of origin is ongoing. As long as the subject is not taken up in formal negotiations and an agreement reached, rules of origin largely fall outside WTO disciplines. As noted by Cadot and De Melo (2008), rules of origin are potentially a “choice candidate for creeping protectionism”.

Rules of origin in preferential trade agreements with major trading partners

The African Continental Free Trade Area is expected to boost regional integration in Africa and thereby facilitate and increase intra-African trade. However, external trading partners remain critical for growth in Africa and the participation of countries in Africa in global production networks. The European Union remains the major external partner for exports from Africa, followed by China and the United States. This section examines the rules of origin regimes that some major preference-giving partners apply to Africa. Table 3 summarizes the main features of two key non-reciprocal schemes, namely, the African Growth and Opportunity Act of the United States and the Everything but Arms initiative of the European Union. China has also established preferential rules of origin to facilitate market access for LDC products, which are important for many traders in Africa, but are not addressed in this report due to a lack of data.

The African Growth and Opportunity Act of the United States contains a uniform ad valorem percentage criterion that requires 35 per cent local and/or regional value addition. However, the uniform percentage is not applicable to the textiles and clothing sector, for which the change of tariff classification criterion is specified with regard to chapters 61 and 62, headings 6501, 6502 and 6504 and subheadings 6406.90.15 and 6505.00.02–6505.00.90 of the harmonized tariff schedule of the United States. The Act allows for full and diagonal cumulation. With regard to documentary requirements, a certificate of origin is, in general, not required, except for textiles and apparel goods. The Act provides for self-certification. Goods must be shipped directly to the United States. There is no obligation for pre-registration and approval of manufacturers and exporters.

Table 3

African Growth and Opportunity Act and Everything but Arms initiative: Main characteristics of rules of origin

	AFRICAN GROWTH AND OPPORTUNITY ACT	EVERYTHING BUT ARMS INITIATIVE
MAIN ORIGIN CRITERIA		
Ad valorem percentage	General: Yes Uniform percentage across all products (35 per cent value addition, excluding textiles and clothing)	General: No
Change of tariff classification	a	57
REGIME-WIDE RULES		
Cumulation	Yes	Yes
Tolerance		Yes
Absorption		Yes
Documentary requirements: Certification and direct transport		
Certificate of origin	Required for textile and apparel goods ^b	Yes (rules of origin form A or statement under registered exporter system)
Certifying authorities	No	No
Notification requirement to certifying authorities	No	No
Exporter declaration (self-certification)	Yes	Yes
Approved exporter	No	Yes
Exporter declaration for small consignments	Yes	Yes
Direct shipment requirement	Yes ^c	Yes; storage and splitting of consignments in a country of transit possible under certain conditions
Documentary evidence of direct shipment requirement	Yes	No
Obligation of pre-registration and approval of manufacturer and/or exporter	No	Yes

Note: The number of product-specific rules of origin, based on the number of pages in the relevant appendices of the legal texts of regional economic communities, is used as a proxy for the complexity of the change of tariff classification criterion.

^a Applies exclusively to chapters 61 and 62, headings 6501, 6502 and 6504 and subheadings 6406.90.15 and 6505.00.02–6505.00.90 of harmonized tariff schedule of the United States.

^b In general, certificate of origin not required, but when article not wholly grown in nor product or manufacture of a single beneficiary country, exporter of merchandise or other appropriate party with knowledge of relevant facts should be prepared to submit a declaration setting forth all pertinent detailed information concerning production or manufacture of merchandise.

^c In general, if shipment from beneficiary country to the United States passes through territory of any other country, merchandise in shipment cannot enter into commerce of any other country while en route to the United States, and invoice, bills of lading and other shipping documents must show the United States as final destination; or if goods shipped from beneficiary developing country, merchandise cannot enter into commerce of the country maintaining free trade area.

The Everything but Arms initiative of the European Union provides for a set of product-specific rules based on the ad valorem percentage and/or change of tariff classification criteria and specific working processes in the textiles and garments sector. The change of tariff classification criterion is product specific. The initiative allows for regional diagonal cumulation and the tolerance and absorption rules. With regard to administrative requirements related to certification, the process differs from the free trade agreements in Africa. The initiative provides for self-certification and thereby transfers the responsibility for certification to exporters rather than public authorities. Goods must be shipped directly, with provisions for storage and the splitting of consignments in a transit country under certain conditions. There is no obligation for pre-registration and approval of manufacturers and exporters.

2.4 Empirical relationship between rules of origin and African trade

Rules of origin are an intrinsic part of international trade. However, the study of rules of origin has been limited by challenges in measuring the restrictiveness of rules of origin regimes; how rules of origin have affected trade patterns and flows; and the extent to which trade preferences have been utilized. These issues are elaborated on in this section.

2.4.1 Restrictiveness of rules of origin regimes

The study of rules of origin has been limited by the challenges in measuring the restrictiveness of rules of origin regimes and the extent to which trade preferences are actually used. The restrictiveness of a rules of origin regime is a measure of the degree to which it restricts the options of producers and/or exporters and affects economic decisions and/or the impact a regime has on trade diversion. For example, with regard to the restrictiveness of the rules of origin regimes applicable to apparel exports of some countries in Africa, the rules of origin were initially more restrictive under the Everything but Arms initiative, compared with under the African Growth and Opportunity Act. As a result, exports of apparel to the United States increased at a faster rate than did those to the European Union (De Melo and Portugal-Pérez, 2013; see chapter 3).

Various measures of restrictiveness have been developed (Brenton and Manchin, 2002; Estevadeordal, 2000; Estevadeordal and Suominen, 2004; Grettton and Gali, 2005; Harris, 2007). The indices of Estevadeordal (2000) and Harris (2007) are discussed

in more detail in this section, as they include free trade agreements in Africa in their analyses, and several other studies are variations of these indices. Both restrictiveness indices are based on the characteristics of or observations from the text of the rules rather than their effects (box 3). However, the observed or ex ante restrictiveness may be different from the real or effective restrictiveness. The level of restrictiveness may not be relevant if producers can source enough competitive inputs from within their free trade areas, whereby their production costs are not affected by the costlier inputs that would result from strict rules of origin. An ex ante restrictiveness index therefore does not account for the sectors and the economic context within which rules of origin are applied. For example, a rule in Kenya or Rwanda that requires all tea products to be derived from tea originating from within EAC would not be restrictive, whereas the same rule in an agreement between Benin and Liberia would be highly restrictive as neither is a tea producer. Preferential tariffs between Benin and Liberia would therefore be irrelevant and trade would need to be conducted on a most-favoured nation basis. Overall, free trade areas among large and developed markets might have a high level of observed restrictiveness of rules of origin, while the real or effective restrictiveness would be lower due to the possibility of sourcing inputs from within the free trade area.

Box 3

Restrictiveness indices

The ordinal index developed by Estevadeordal (2000) uses the rules of origin under the North American Free Trade Agreement as a reference to reflect how demanding given rules of origin are for exporters, assigning values between 1 (least restrictive) and 7 (most restrictive). The index assesses product-specific rules based on the following two assumptions: a change at the chapter level in the Harmonized System is more restrictive than a change at the heading level, and so on; and the technical requirements attached to a given change of tariff classification and a regional content requirement add to the restrictiveness of rules of origin. The studies carried out by Cadot, Estevadeordal et al. (2006), Portugal-Pérez (2006) and Suominen (2004) are variations of this approach.

The index developed by Harris (2007) has a similar logic. The index allocates points to various elements used in the definition of the rule, namely, change of classification, exception, addition, value test, technical requirement and alternative rule. Both the exception and addition points reflect explicit choices by negotiators to give special treatment to a particular product. The index therefore captures more details in variations between products and agreements in the definition of rules of origin and, as a result, the values of this index show more variation.

The Harris index, in particular, suggests that the United States agreements, and rules of origin regimes among more developed trading partners, tend to be more restrictive, while African agreements are more generous. Gretton and Gali (2005) find similar results of high restrictiveness in the North American Free Trade Agreement and European Union agreements. Their methodology is also based on characteristics of the rules of origin model, and therefore has an ex ante approach, yet it expands on the range of rules of origin factors examined and includes, for example, details of regional value content requirements and factors influencing market access. This may suggest that, with increasing globalization and evolving strong exports lobbies, Governments have come under pressure to find ways to compensate industries facing increasing pressure from imported goods. More restrictive rules of origin offer a means to compensate potential losers from liberalization. Moreover, strict rules of origin also discourage final goods producers from outsourcing production abroad. The results may also indicate that large and developed markets have a greater availability of inputs and are therefore in a dominant position, able to dictate more restrictive rules of origin. For example, evidence from the implementation of the North American Free Trade Agreement shows that restrictive rules of origin allowed the United States to charge higher prices on textiles for apparel producers in Mexico.

The index values of the three agreements included for Africa, namely, COMESA, ECOWAS and SADC, show that the rules of origin in the ECOWAS agreement are the most generous for both indices, reflecting the fact that rules of origin in ECOWAS are uniform across products. According to the Estevadeordal index, restrictiveness has a value of 5 in COMESA, 2 in ECOWAS and 4.5 in SADC. According to the Harris index, restrictiveness has a value of 4 in COMESA, 1 in ECOWAS and 7 in SADC. Similar values for the restrictiveness of the COMESA rules of origin are obtained in both indices. Rules of origin in SADC are much more restrictive according to the Harris index than the Estevadeordal index, reflecting the fact that the calculations in the former capture in more detail the complexity of rules of origin in SADC, which apply different criteria and thresholds for specific products or product groups, as well as specific processing rules.

Both studies were conducted prior to rules of origin reforms. The COMESA protocol on rules of origin was revised in 2015, the revised Generalized System of Preferences of the European Union became effective in 2011 and the North American Free Trade Agreement rules of origin have become less restrictive. The comparative results of the indices should therefore be interpreted with caution. The indices reflect the aggregate average value across sectors and, as such, are a useful measure of the complexity of a rules of origin regime overall. In practice, rules of origin are relevant at the product level, and it is therefore useful to consider more disaggregated indices.

Estevadeordal and Suominen (2008) calculate the restrictiveness of rules of origin in SADC by sector at the HS two-digit level. In line with other free trade or preferential trade agreements, in SADC, agricultural products have some of the highest restrictiveness values and those for the textiles sector, the lowest, contrary to observations of many preferential trade agreements. Given the low overall value of rules of origin restrictiveness in ECOWAS, the sectoral restrictiveness values are all low.

The calculation of a restrictiveness index is the subject of debate, given the underlying methodological choices. For example, the impact of a transformation requirement at a specific level can be significantly different across products, as noted with regard to coffee beans and diamonds. This implies that the restrictiveness of rules of origin can diverge sharply between products and sectors. Despite its limitations, a restrictiveness index is a valuable analytical tool as it provides an overall measure of how trade-inhibiting rules of origin for products might be. Such an index also allows for comparisons between schemes and enables empirical studies that can provide information on the impacts and usefulness of rules of origin.

Sources: Cadot and De Melo, 2008; Cadot, Estevadeordal et al., 2006; Estevadeordal, 2000; Estevadeordal and Suominen, 2008; Grettton and Gali, 2005; Harris, 2007; Portugal-Pérez, 2006; Suominen, 2003; Suominen, 2004.

It is important to note that more restrictive and selective rules of origin are more difficult and costlier to administer and, in practice, some countries have applied flexibility to reduce restrictiveness. Estevadeordal and Suominen (2008) note that some rules of origin regimes “have created innovative optional means of calculating value content to reduce the regimes’ restrictiveness. In SADC, a more-developed member may allow a less-developed member to count processes as originating that are usually left outside the calculation of value content under the SADC agreement”.

2.4.2 Preference margins of intra-African trade: Where rules of origin could matter most

Rules of origin are a trade policy tool that defines the scope of a preferential trade agreement and indirectly provides industries with incentives to source from within a free trade area or preferential trade agreement area. The magnitude of the incentives depends on various factors but primarily on the preference margin, that is, the difference between the applicable most-favoured nation tariff and the preferential tariff, and the costs of compliance with rules of origin of a specific free trade or preferential trade agreement.

In light of the integration of the market in Africa through the African Continental Free Trade Area, this section considers the 20 products traded within Africa with the highest preference margins.¹⁶ Trade in these products provides theoretically high incentives to comply with rules of origin, to make use of preferential tariffs. The analysis showed that, in 2014–2016, the products with the highest margins were beverages (margins exceeding 50 percentage points), tobacco products (around 30 percentage points), some meats (around 26 percentage points) and clothing (around 24 percentage points). The analysis further indicated that the intra-African trade values in terms of both imports and exports of these 20 products were relatively low, with the exception of tobacco products, beer and spirits, knit T-shirts, wine and women's suits and pants. This may indicate that despite attractive preference margins, products cannot be easily sourced from within Africa. However, export capacity exists for several of these products, in particular clothing and wine, given their high export values to the rest of the world.

Where rules of origin could matter most



¹⁶ The following were used to calculate the margin: each product at the HS four-digit level; average most-favoured nation tariff; and average preferential tariff (average tariff of product by country and then average of all relevant countries). A simple average was used to ensure that all possible margins were represented. The analysis was conducted for Africa as a whole and for selected regional economic communities.

This underscores the argument that the restrictiveness of rules of origin critically depends on whether a trade area has the capacity to source the products in demand. In other words, if industries under a preferential trade agreement cannot import their products from within the agreement area because of a lack of availability and/or high compliance costs, the industries will source from outside and pay the most-favoured nation tariff. Therefore, the relevance of the preferential trade regime is a combination of the preference margin of the specific product, the demand for imports and the ability to import a product from within the preferential trade agreement area.

This relationship is shown in figure 11. For the 20 products with the highest import values in Africa, on average in 2014–2016, the figure shows their respective preference margins on the y-axis, and the current capacity to source these products from within the continent on the x-axis. The products with the highest demand for imports in Africa are refined petroleum (\$42 billion), cars (\$8.4 billion), packaged medicaments (\$7 billion), parts of motor vehicles (\$5.6 billion) and crude petroleum (\$4.9 billion). For crude petroleum and packaged medicaments, preference margins are low (2.7 and 1 percentage points, respectively). However, margins for cars and parts of motor vehicles are substantial (above 10 percentage points), along with several others of the top 20 products, and these products therefore provide incentives to source from within Africa. The ability to source from within the continent and use these incentives exists for only some products, primarily diamonds and motor vehicles for transporting goods. For most manufactures and products that require processing, countries in Africa depend predominantly on supplies from outside the continent.

Rather than examining the ability to source products from within Africa, i.e. focusing on imports, the focus is on exports, to analyse whether current trading relations provide incentives to intra-African exporters. Exporters assess whether using a preferential tariff provides sufficient incentives to cover the costs of compliance with rules of origin and thus forego the most-favoured nation tariff. François et al. (2006) find that exporters start to request preferences when preferential margins are around 4.0 and 4.5 per cent. Figure 12 shows that for the 20 products in Africa with the highest export values, preferential margins exceed 4.5 per cent for 11 products, including five of the six top export products, namely, petroleum gases; gold; petroleum oils, refined; diamonds; and cars. Similar to the main imports, for the main exports, firms in Africa mainly export to partners outside the continent. This may suggest that exporting to extracontinental partners is easier due to less stringent rules of origin, lower compliance costs and/or lower transport costs. A significant exception is motor vehicles for transporting goods, half of which are exported to other countries in Africa.

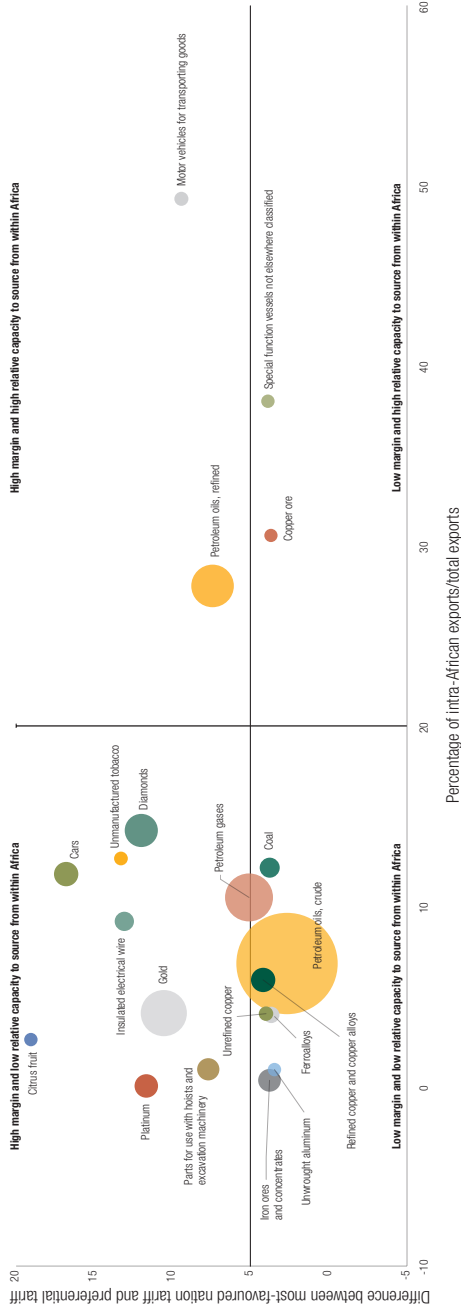
80 **Figure 11**

Africa: 20 products with highest import values, 2014–2016 average



Source: UNCTAD calculations, based on the UNCTAD Trade Analysis and Information System (TRAINS) database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated.
 Size of bubble is size of total imports to Africa.

Figure 12
Africa: 20 products with highest export values, 2014–2016 average



Source: UNCTAD calculations, based on the UNCTAD TRAINS database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated.
 Size of bubble is size of total exports from Africa.

Few studies have estimated the costs of compliance with rules of origin, in particular in Africa. Brenton (2011) finds that the trade-weighted average of compliance costs is 6.8 per cent for the North American Free Trade Agreement and 8 per cent under European Union rules of origin.¹⁷ Cadot and De Melo (2008) state that in preferential trade agreements, compliance costs range from 3 to 5 per cent of final product prices. Cadot and Ing (2016) estimate that costs of compliance with rules of origin in the Association of Southeast Asian Nations inhibit trade by around one fourth of its most-favoured nation tariffs, thereby nullifying about one quarter of the effect of tariff preference margins, but they emphasize that the effect differs largely by sector.

As rules of origin are negotiated with regard to the African Continental Free Trade Area, it may become easier and more attractive to producers to export to other countries in Africa and/or to source from within the continent. It may be insightful to consider how preference margins and trade volumes evolved in free trade agreements in Africa with established rules of origin regimes. In this regard, EAC, ECOWAS and SADC are considered in more detail. The rules of origin in SADC are based on an approach that is most similar to that preferred in current negotiations on rules of origin with regard to the African Continental Free Trade Area.

In SADC, the import basket of the 20 products with the highest import values is more balanced in terms of value and relatively similar in terms of content, compared with the import basket of Africa overall (figure 13). Yet it contains fewer primary commodities and more manufactures and/or processed products, highlighting the more advanced manufacturing capacities in SADC. It is a smaller market than the continental market, yet the SADC market is more diversified, and its capacity to source from within is relatively high. The regional sourcing capacity exceeds 40 per cent for several products. Rules of origin in SADC may thus support sourcing from within the regional economic community area. The preference margins of the top 20 products are, on average (unweighted), slightly lower and less dispersed than those of intra-African imports.

In ECOWAS, refined petroleum is largely the dominant import product (figure 14; the x-axis is scaled differently compared with the other charts to increase the visibility of the products). The ability to source from within ECOWAS is severely constrained for all main import products, with the exception of palm oil. Preference margins are spread similarly as in Africa overall. The combination of substantial preference margins, several processed products among the main imports and limited sourcing from within ECOWAS suggests that its rules of origin have not boosted processing activity within the regional

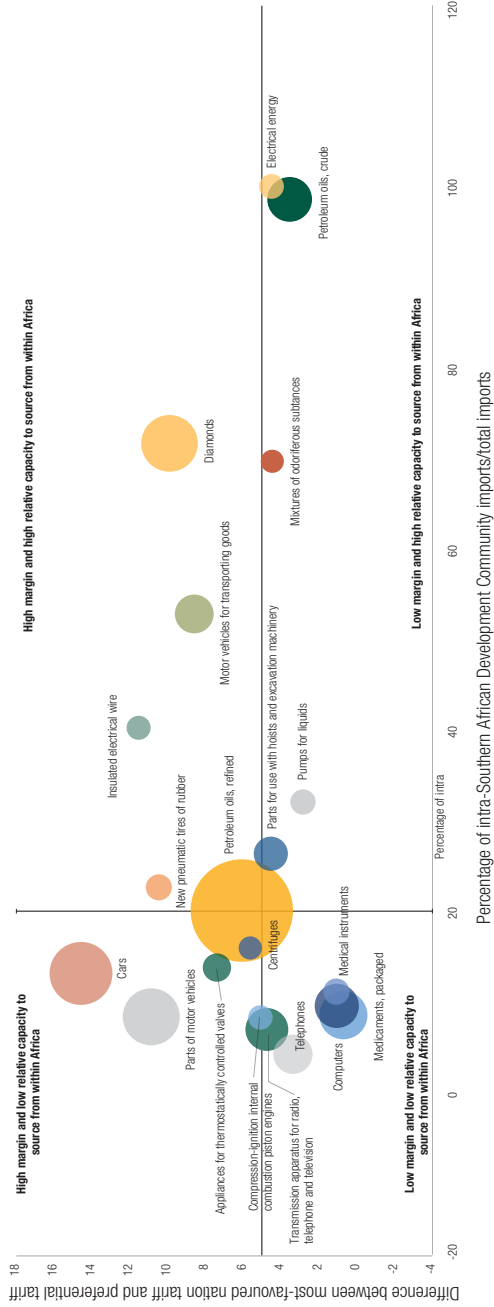
¹⁷ The studies are based on a non-parametric estimation of the upper and lower bounds of the costs of compliance with rules of origin by combining the restrictiveness index and information on the utilization of preferences.

economic community area and that rules of origin in ECOWAS may be difficult to comply with. The costly process of certification in ECOWAS is noted in section 2.3.

In EAC, the capacity to source major import products from within the regional economic community area is, in general, also severely limited (figure 15). There are, however, notable exceptions to trade capacity within EAC, namely, in tea, corn, monitors and projectors and cements, all of which have a high intra-regional economic community import share. This may suggest that these products could benefit from a larger market with favourable rules of origin, as trade capacity exists. In addition, the dispersion of preference margins of the main 20 products is significantly higher in EAC than in the other regional economic communities analysed, indicating that for some of these products, much can be gained through intraregional sourcing.

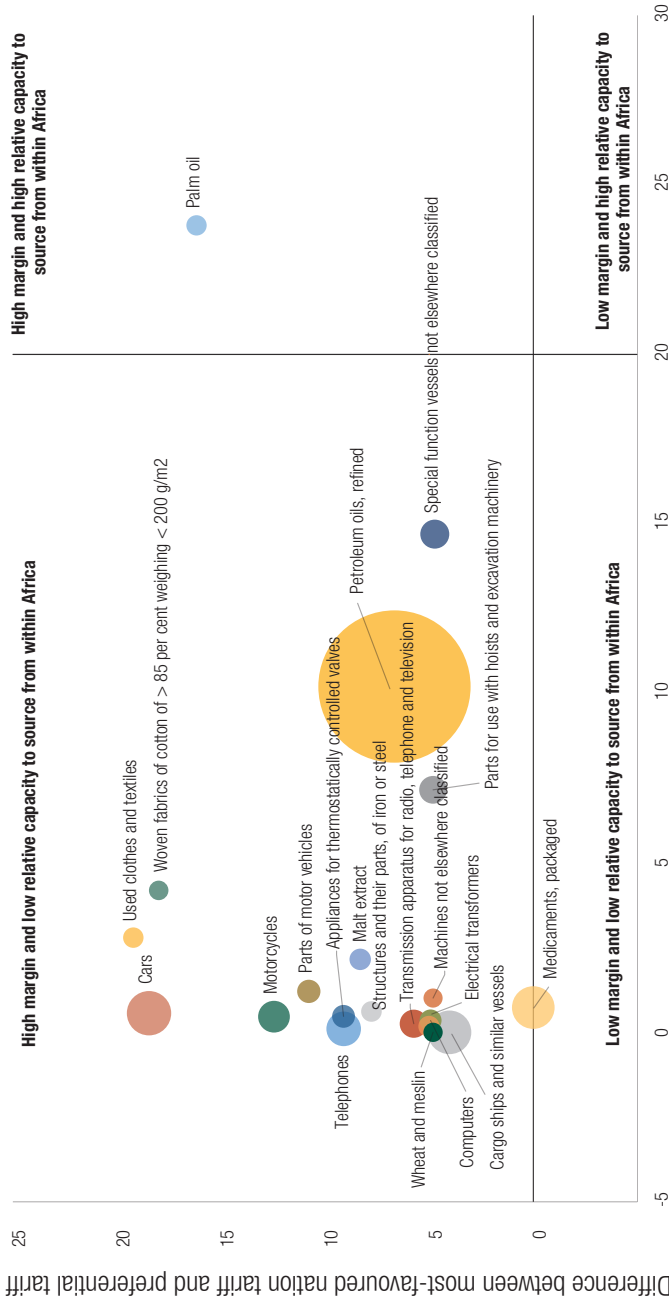
84 Figure 13

Southern African Development Community: 20 products with highest import values, 2014–2016 average



Source: UNCTAD calculations, based on the UNCTAD TRAINS database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated.
 Size of bubble is size of total imports to SADC.

Figure 14
Economic Community of West African States: 20 products with highest import values, 2014–2016 average

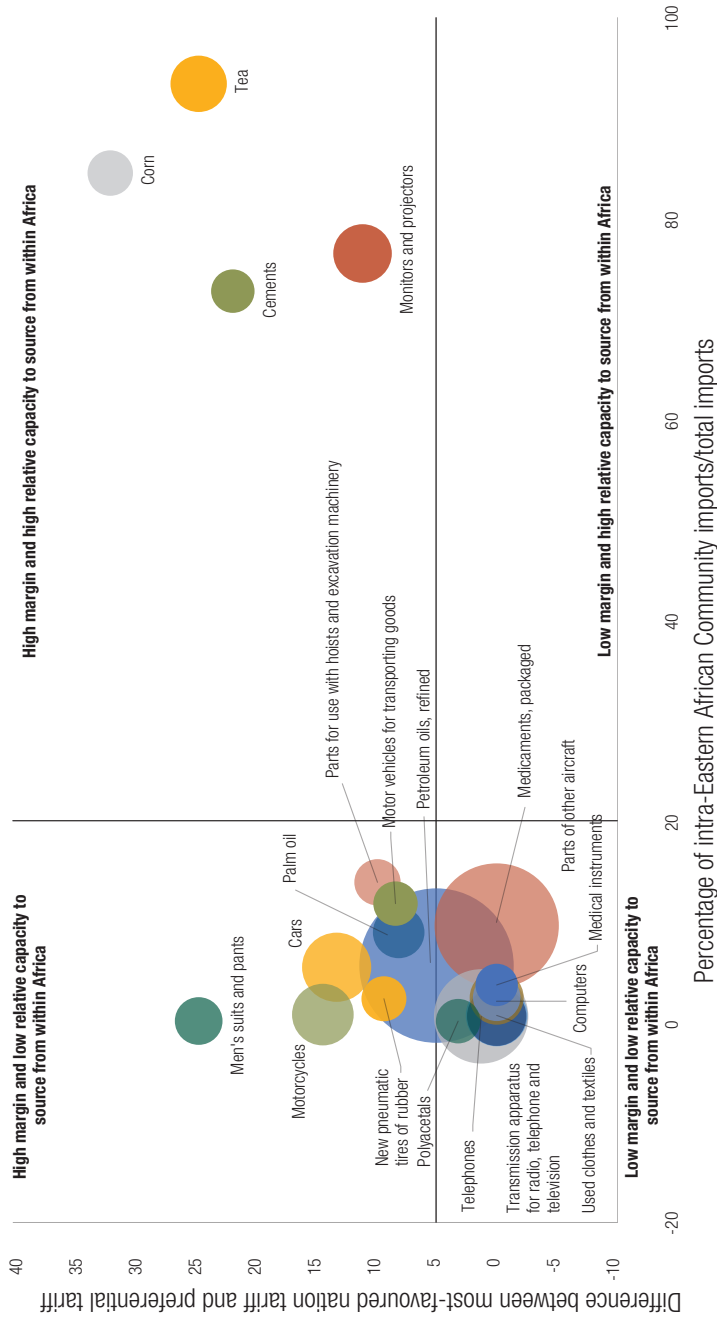


Percentage of intra-Economic Community of West African States imports/total imports

Source: UNCTAD calculations, based on the UNCTAD TRAINS database.

Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated. Size of bubble is size of total imports to ECOWAS.

86 **Figure 15**
Eastern African Community: 20 products with highest import values, 2014–2016 average



Source: UNCTAD calculations, based on the UNCTAD TRAINS database.
 Note: Commodities not specified according to kind, under the HS four-digit level, are not included, as the corresponding preference margin cannot be calculated. Size of bubble is size of total imports to EAC.

2.4.3 Utilization rates of trade preferences

The utilization of trade preferences depends on whether exporters can and have incentives to comply with the rules of origin of a given free trade or preferential trade agreement. High rates indicate that exporters are able to comply with administrative prerequisites and that preference margins are sufficient. Cadot and Ing (2016) show that in the Association of Southeast Asian Nations, preference margins tend to be substantial in comparison with the costs of compliance with rules of origin; the sensible choice for exporters is therefore to incur these costs and use preferences. Keck and Lendl (2012) show that utilization and/or compliance costs include an important fixed cost element and should therefore be expressed as a fixed amount rather than a percentage share of the trade value. According to their analysis, these costs range between \$14 and \$1,500.

Low rates may indicate the opposite, that rules of origin requirements cannot be met and could be operating as a trade barrier (WTO, 2018). Low utilization rates can also result from the existence of competing preference schemes. For example, many exporters from Africa to the United States have been utilizing the African Growth and Opportunity Act preference scheme and have established operating processes and accounting systems to comply with the requirements of this scheme. As a result, the utilization rate of the Generalized System of Preferences of the United States is rather low.

Utilization rates of trade preferences compare the value of imports that are eligible and make use of preferential treatment to all imports that are eligible for preferential treatment.¹⁸ This implies that preferences must be real, that is, the most-favoured nation tariff cannot be zero. The calculation of utilization rates requires custom authorities to record the value of imports, the tariffs levied and the preference schemes used. For trade with Africa, such data are available for various non-reciprocal schemes of preference-giving countries, but are unavailable for reciprocal schemes within Africa. The European Union remains the main external trading partner for Africa. This section therefore presents an analysis of the extent to which trade from Africa to the European Union makes use of trade preferences and the lessons that could be learned. The analysis is based on all preference schemes granted by the European Union to Africa, including reciprocal and unilateral schemes, namely, the Generalized System of Preferences of the European Union, the Everything but Arms initiative and the economic partnership agreements.

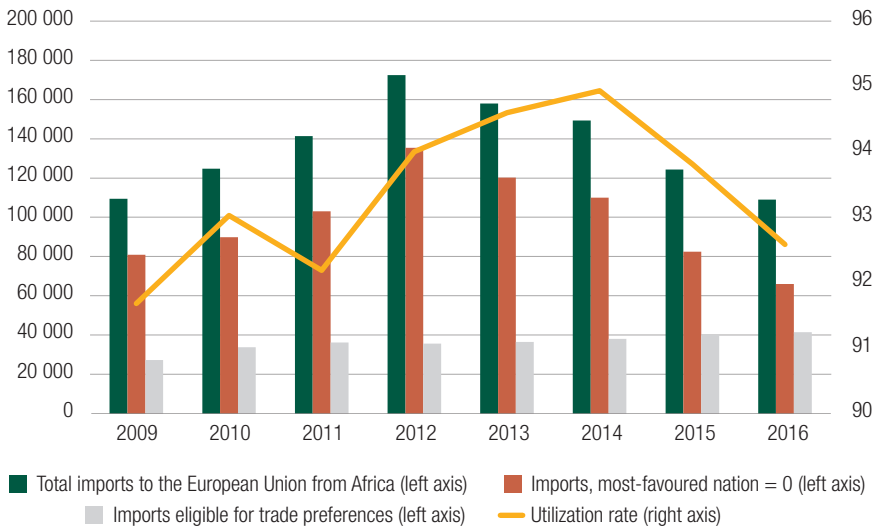
¹⁸ Trade takes place either under most-favoured nation terms, outside the scope of preference schemes, or within the scope of preference schemes. In the latter, a distinction can be made between trade that makes use of preferences and trade that does not, either because of an inability to meet preference requirements or because other preferential schemes have been used.

Figure 16 shows that preference utilization rates in 2009–2016 fluctuated but remained continuously above 90 per cent. Following the reform of the Generalized System of Preferences of the European Union, which simplified rules of origin, in particular for textiles and apparel, and became effective in 2011, preference utilization rates increased from 92.2 per cent in 2011 to 94.9 per cent in 2014. Thereafter, the rates decreased to 92.6 per cent in 2016. This is likely the result of new preference schemes that came into force in 2014 and the fact that exporters need time to adjust operations and procedures to comply with new requirements. Imports to the European Union from Africa eligible for preferential treatment increased in this period and reached 38 per cent of total imports in 2016, compared with 26 per cent in 2011. Therefore, it may be argued that the reform of the Generalized System of Preferences of the European Union stimulated preferential trade and that more lenient rules of origin with sizeable preference margins can be trade creating.

Figure 16

Imports to the European Union from Africa, by value and utilization rate, 2009–2016

(Millions of euros and percentage)



Source: UNCTAD calculations, based on the Eurostat database.

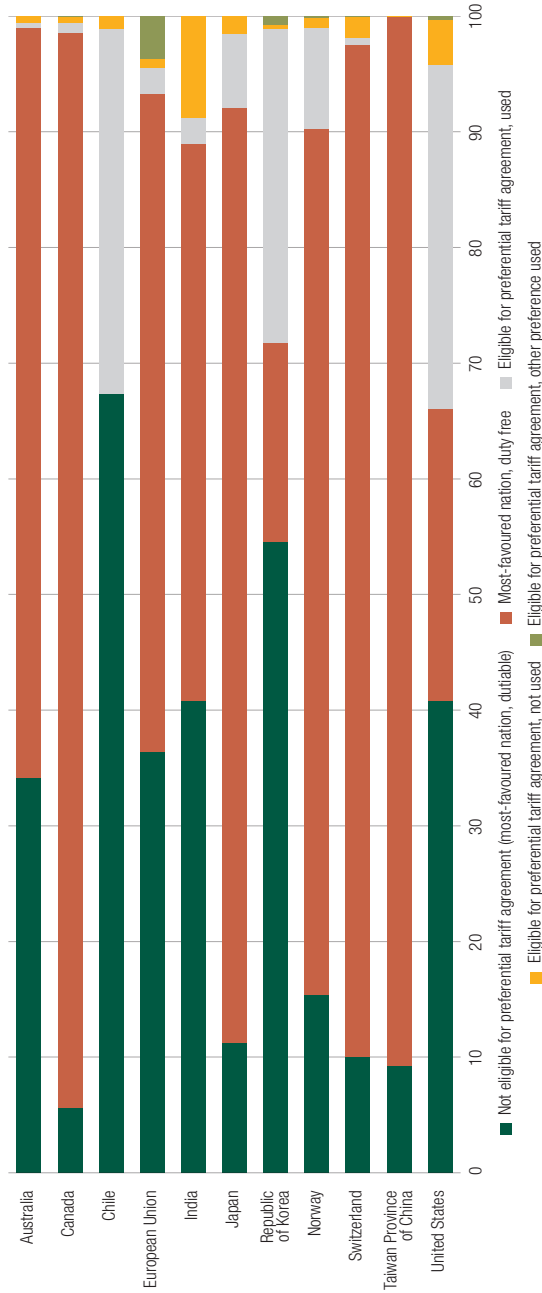
High utilization rates can also be obtained for continuously small amounts of trade, which shows that rules of origin are not a trade barrier, but might not foster trade and

investment. Such a situation could arise when rules of origin are relatively easy to comply with but are limited to sectors that are not appealing to investors. However, rules of origin could stimulate foreign investment in an exporting country, if they were favourable for products and sectors of interest to investors. Foreign direct investment outflows from the European Union to Africa increased substantially from 2011 to 2015, when preferential trade increased. However, prior to the effective date of the reform of the Generalized System of Preferences of the European Union, these outflows were higher and, in 2016, they became negative. It cannot be inferred, therefore, that there is a relationship between the preferential trade agreements of the European Union and European Union investment in Africa. The evolution may instead reflect that much of the foreign direct investment of the European Union in Africa is directed to the natural resources sector, in which applicable rules of origin tend to be easy to use and are typically not a barrier to trade.

Beyond trading relations between Africa and the European Union, insights into utilization rates of the tariff preferences granted by various partners can be drawn from the Tariff Analysis Online database of WTO. The database includes information on the types of tariffs applied to exports from Africa and the utilization rates of preferential schemes provided by Australia, Canada, Chile, India, Japan, Norway, the Republic of Korea, Switzerland, the United States, Taiwan Province of China and the European Union.¹⁹ Figure 17 shows that some of these external partners, namely, Canada, Switzerland and Taiwan Province of China, grant duty-free access for a large share of goods from Africa, and that the share of imports of goods from Africa that is eligible and makes use of preferential treatment varies greatly between trading partners, and is highest in Chile, the Republic of Korea and the United States.

¹⁹ The preferential trade agreements included in the analysis are the following: Australia, Generalized System of Preferences and LDCs, 2016; Canada, Generalized System of Preferences and LDCs, 2016; Chile, LDC-specific, 2015; India, LDC-specific, 2015; Japan, Generalized System of Preferences and LDCs, 2016; Norway, Generalized System of Preferences and LDCs, 2016; Republic of Korea, LDC-specific, 2016; Switzerland, Generalized System of Preferences and LDCs, 2016; United States, Generalized System of Preferences and LDCs, 2016, and African Growth and Opportunity Act, 2016; Taiwan Province of China, LDC-specific, 2016; and European Union, Generalized System of Preferences and LDCs, 2016.

Figure 17
Share of imports from Africa by preference eligibility status and external trading partner, 2016 (Percentage)



Source: UNCTAD calculations, based on the Tariff Analysis Online database of WTO.

For analytical purposes, it may be useful to focus on the underutilization of trade preferences, as it allows for an identification of sectors that may require further attention and/or research. Underutilization rates compare the imports that do not make use of eligible trade preferences with total eligible imports. With regard to the use of the schemes by countries in Africa, some countries are largely unable to make use of preferential treatment for their exports to external partners, namely, Benin (underutilization rate of 95.4 per cent), Burkina Faso (100 per cent), the Central African Republic (100 per cent), Djibouti (96.5 per cent), Equatorial Guinea (93.2 per cent), Guinea (100 per cent), Guinea-Bissau (100 per cent), Liberia (100 per cent), Libya (100 per cent), Mali (99.6 per cent), Seychelles (100 per cent), Sierra Leone (100 per cent), Somalia (98.9 per cent), Togo (100 per cent) and the United Republic of Tanzania (94 per cent). However, several of these countries export mainly products subject to a most-favoured nation tariff of zero, such as Guinea-Bissau and Libya. Conversely, underutilization rates are low for Botswana (1.1 per cent), Cabo Verde (3.6 per cent), Chad (0.1 per cent), Côte d'Ivoire (2 per cent), the Comoros (4.3 per cent), Ghana (2.3 per cent), Kenya (4.5 per cent), Lesotho (1.7 per cent), Madagascar (4.9 per cent) and Mauritania (3.1 per cent).

The foregone opportunities, in terms of volume of underutilization of trade preferences, are depicted in figure 18 (including Harmonized System sections with trade volumes of \$10 billion or more). In 2016, unused preferences were highest for mineral products, amounting to \$2.3 billion, followed by precious materials (\$1.4 billion) and vegetable products (\$0.6 billion). It is notable that some sections with relatively easy rules of origin requirements show the highest rates of underutilization in terms of value. In terms of shares of underutilization in 2016, precision instruments had the highest, followed by chemicals, wood and hides and skins.

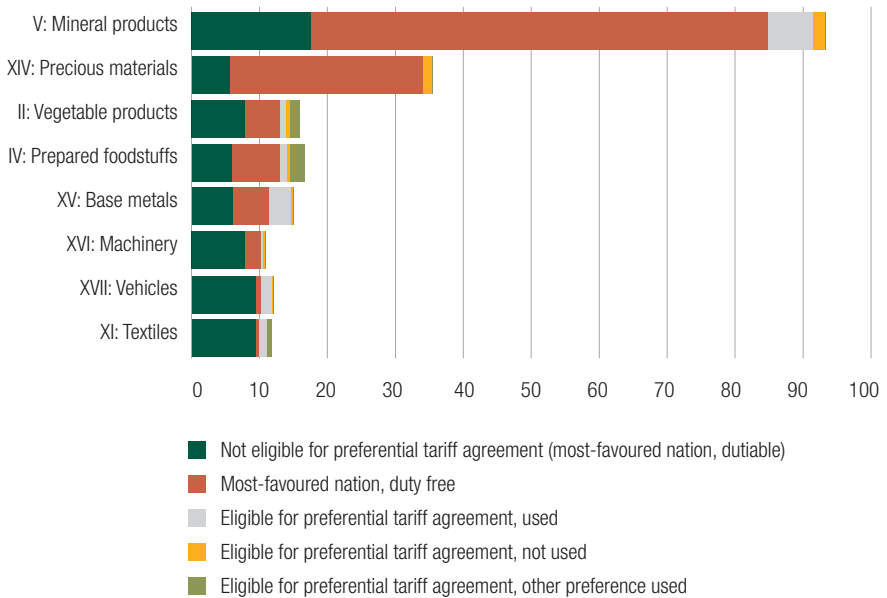
Table 4 shows, for some of the aforementioned external trading partners, the three Harmonized System sections with the highest values of unused preferences. The sections with unused preferences are highest for exports from Africa to India, the United States and the European Union, and include mineral products, precious materials, vegetable products, machinery, prepared foodstuffs and chemicals. India has the highest value of unused preferences at \$1.26 billion, namely, on imports of precious materials, as none of its imports of precious materials from Africa makes use of preferential treatment. The United States imports \$1.11 billion of mineral products from Africa without using preferences, amounting to 15 per cent of the total eligible trade in that category. Several of the products with high values of unused preferences are manufactures and may have rules of origin that are complex to fulfil, but the list also includes products based on

primary commodities for which rules of origin tend to be easier to comply with, since they are, or large shares of them are, wholly obtained. A direct link with rules of origin can only be established if the analysis is made at the most disaggregated level.

Figure 18

Types of tariffs applicable to imports from Africa, selected external partners, by sector, 2016

(Billions of dollars)



Source: UNCTAD calculations, based on the Eurostat database.

Table 4

Imports of African goods by extracontinental trading partners: Harmonized System sections with three highest values of unused preferences, 2016

IMPORTER	HARMONIZED SYSTEM SECTION	ELIGIBLE FOR PREFERENTIAL TRADE AGREEMENT BUT NOT USED (MILLIONS OF DOLLARS)	ELIGIBLE FOR PREFERENTIAL TRADE AGREEMENT BUT NOT USED (PERCENTAGE OF TOTAL ELIGIBLE TRADE)
Australia	XI: Textiles	3.1	50
	XVIII: Precision instruments	2.7	100
	XVI: Machinery	1.7	98
Canada	IV: Prepared foodstuffs	13.4	61
	XI: Textiles	7.8	21
	XII: Shoes, headgear, umbrellas	1.2	42
Chile	IV: Prepared foodstuffs	0.9	50
	III: Animal or vegetable fats	0.7	51
	II: Vegetable products	0.7	100
India	XIV: Precious materials	1 261.8	100
	V: Mineral products	596	91
	II: Vegetable products	421.1	69
Japan	I: Animal products	75.7	30
	II: Vegetable products	16.3	35
	XI: Textiles	7.1	66
Norway	II: Vegetable products	5.9	16
	XI: Textiles	1.8	62
	IV: Prepared foodstuffs	0.2	5
Republic of Korea	II: Vegetable products	8.8	15
	XV: Base metals	7.3	1
	IV: Prepared foodstuffs	5.2	8
Switzerland	XIV: Precious materials	102.5	100
	II: Vegetable products	22.8	96
	XI: Textiles	14.9	90
United States	V: Mineral products	1 113.3	15
	XVI: Machinery	73.3	31
	IV: Prepared foodstuffs	55.5	17
European Union	XVI: Machinery	254.4	100
	IV: Prepared foodstuffs	201.6	21
	VI: Chemicals	163.5	99

Source: UNCTAD calculations, based on the Tariff Analysis Online database of WTO.

Underutilization of trade preferences offered by Africa's main trading partners*

TOP 3 UNUSED PREFERENCES IN 2016



Mineral products

\$ 2.3 billion



Precious materials

\$ 1.4 billion



Vegetable products

\$ 0.6 billion

*Australia, Canada, Chile, India, Japan, Norway, the Republic of Korea, Switzerland, the United States, Taiwan Province of China and the European Union (as included in the WTO Tariff Analysis Online database). Figures are expressed in terms of value.

2.5 Conclusion

Rules of origin are an integral part of international trade agreements and define the conditions under which products are eligible for preferential treatment.

The main objective of rules of origin is to prevent trade deflection or the arbitrage of external tariff differences in free trade and preferential trade agreements. However, rules of origin are also widely used for more developmental objectives, including fostering more integrated manufacturing activities and regional trade. Whether they can deliver on these objectives depends largely on the capacity to source products from within the region. Cadot and De Melo (2008) state that rules of origin have gone vastly beyond the role of preventing trade deflection by mandating that sufficient processing take place in a preferential zone, and have become akin to technical barriers to trade.

The design of rules of origin matters for how trade creating or trade diverting they are and the degree to which trade preferences are used. With ever more fragmented

production structures, firms need to be able to source intermediates from abroad and rules of origin need to be designed to support this need. This differs substantially from the period of vertical integration of industrial sectors that benefited from strict rules of origin. The experiences in East Asia suggest that there are fewer incentives for restrictive rules of origin in areas with integrated regional value chains and global value chains (Cadot and Ing, 2016).

Rules of origin requirements tend to be particularly daunting for smaller firms, which is a concern as the private sector in Africa is mainly comprised of SMEs and informal enterprises. Similar challenges are faced by customs authorities, in particular in LDCs, in which administering rules of origin may divert scarce customs resources from other tasks, such as trade facilitation or tax collection (Brenton and Imagawa, 2004).

The preference utilization rates of European Union preferential trade agreements are high, and this suggests that their rules of origin requirements may be more easily met. The analysis of preference margins and capacity to source from within Africa and regional economic communities and export to other countries in Africa provides some evidence that trading with external partners may be easier with and supported by less restrictive rules of origin.

Current rules of origin regimes in Africa are at the regional economic community level and therefore regulate intra-regional economic community trade. This chapter argues that it would be desirable to achieve some regulatory convergence of rules of origin in regional economic communities and the African Continental Free Trade Area, to make better use of intra-African trade opportunities compared with intra-regional economic community trade. Intra-African trade would also benefit if rules of origin were not overly restrictive, as this would enable all countries to benefit from the Agreement. It is widely acknowledged that rules of origin are context-specific. At the same time, there is consensus that rules of origin should be simple, transparent, predictable, trade-facilitating and development friendly (Estevadeordal and Suominen, 2005; Kommerskollegium, 2012).

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

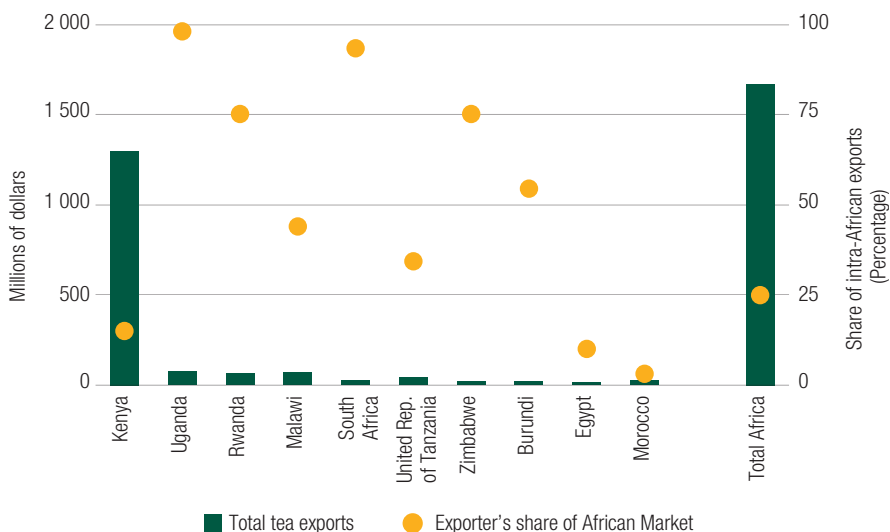
different outcome in terms of broader developmental gains.

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

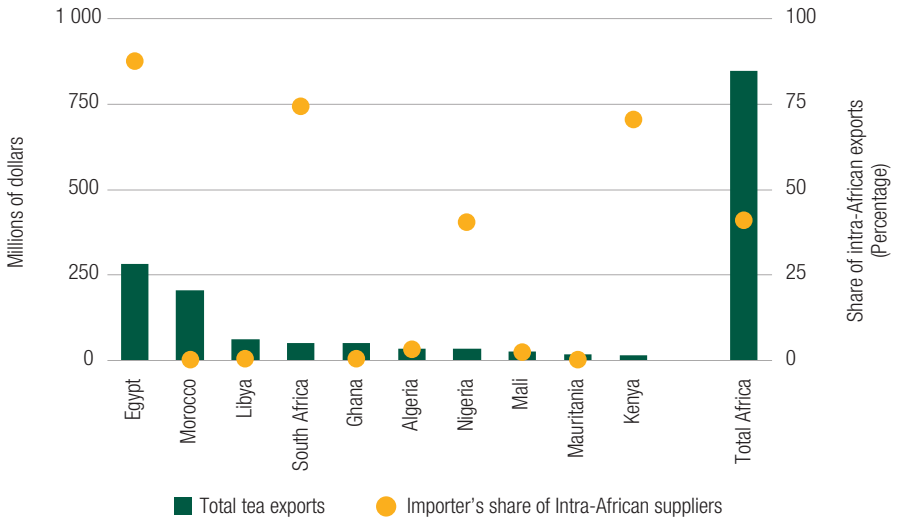
Top 10 African tea exporters (Harmonized System code 0902), 2015–2017



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.

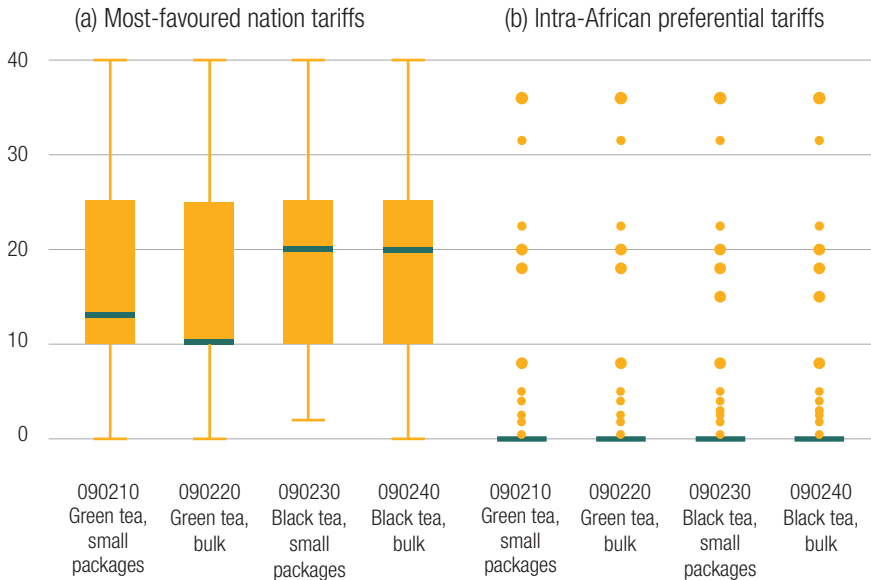
Two main observations can be drawn from figure 21. First, apart from a few countries such as Egypt and South Africa, it appears that most-favoured nation tariffs remain substantial in the African context, even for a product that is not particularly sensitive, such as tea. This is especially relevant 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 to 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 non-originating 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 with 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).

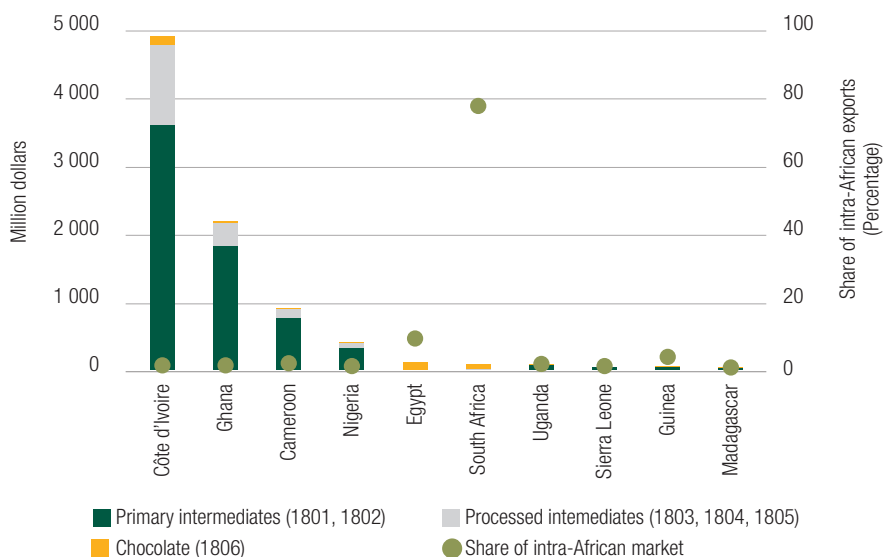
²⁷ Côte d’Ivoire and Ghana, in particular, have successfully put in place incentives to attract investors in cocoa processing, thereby becoming major grinders of cocoa beans. Their diverse experiences show how support for domestic value addition can be provided under different policy frameworks, ranging 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.

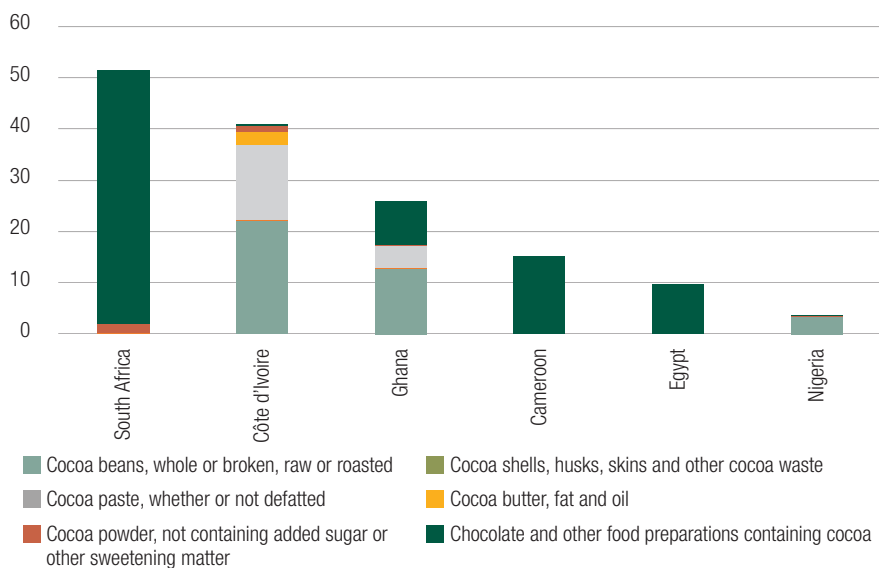
²⁸ See www.whoowinswhom.co.za/store/info/3296 (accessed 15 January 2019).

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-exporting 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).

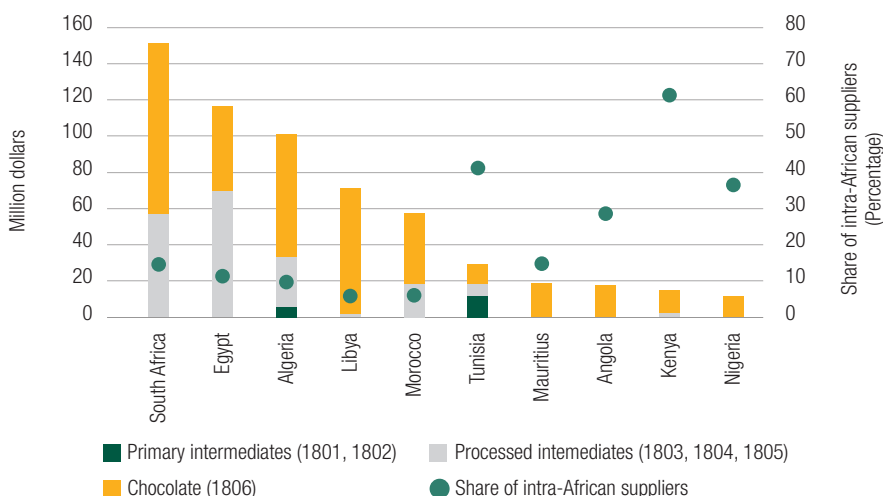
The main importers of cocoa and related products in the region are South Africa and Northern African economies (Egypt, Algeria, Libya, Morocco and Tunisia), followed by

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.

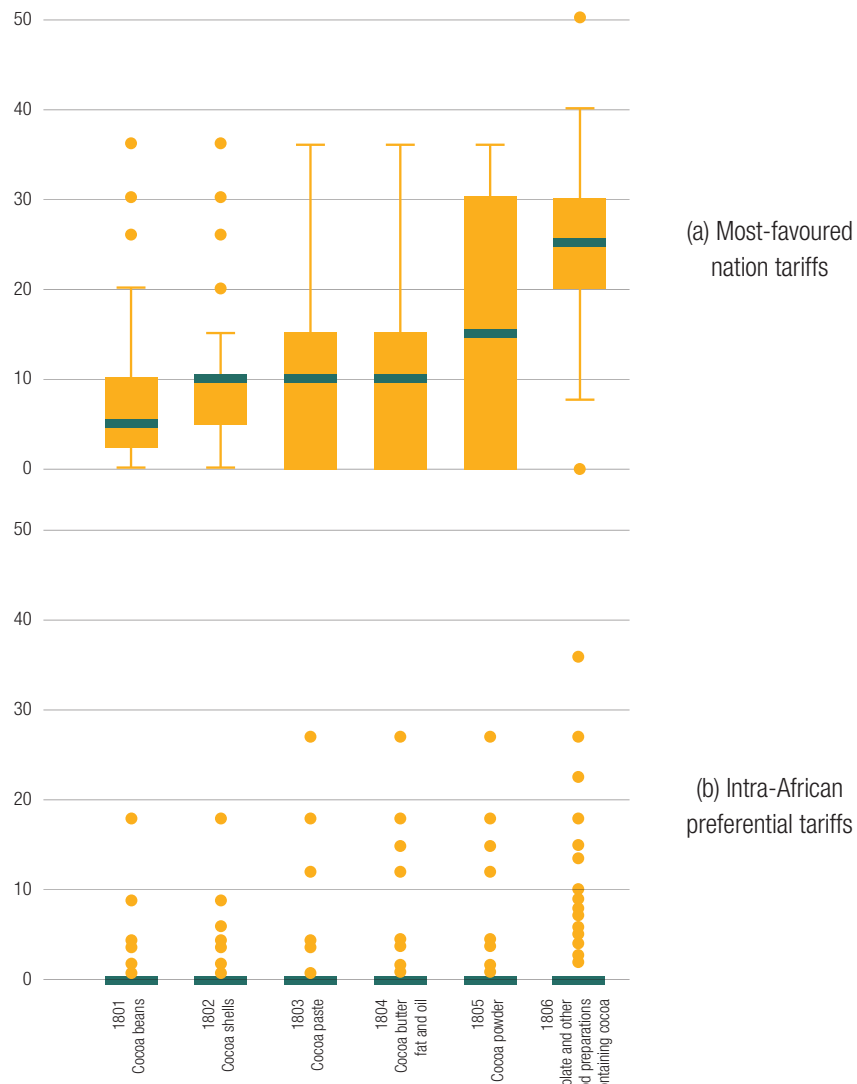
As a result, not only is processing capacity in African countries much lower than cocoa production, but few countries are currently engaged in those downstream activities in chocolate and confectionery production, which appear to generate wider employment gains. Such an outcome represents a missed opportunity 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

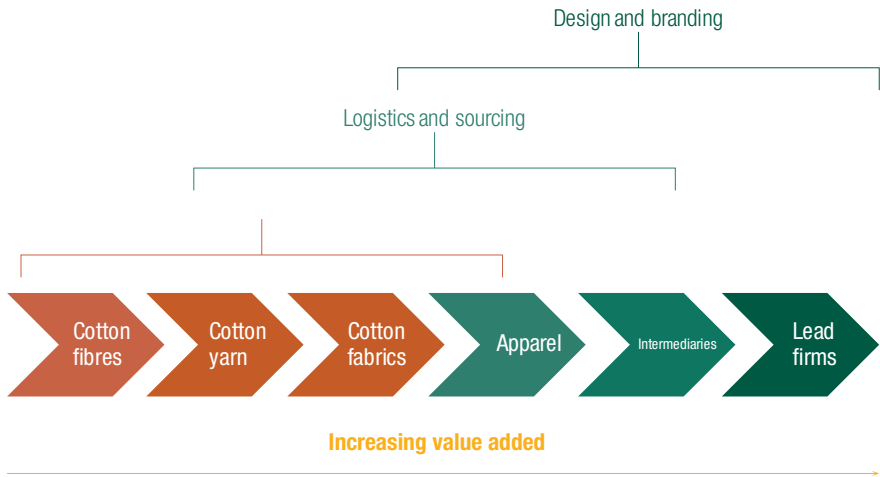
Since the industrial revolution, the textiles and clothing sector has been regarded as the first rung in the light-manufacturing ladder, deserving particular attention because of its labour-intensive nature, which creates scope for the reallocation of mainly unskilled labour across sectors, as well as 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 warrants careful consideration. 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 billion 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.

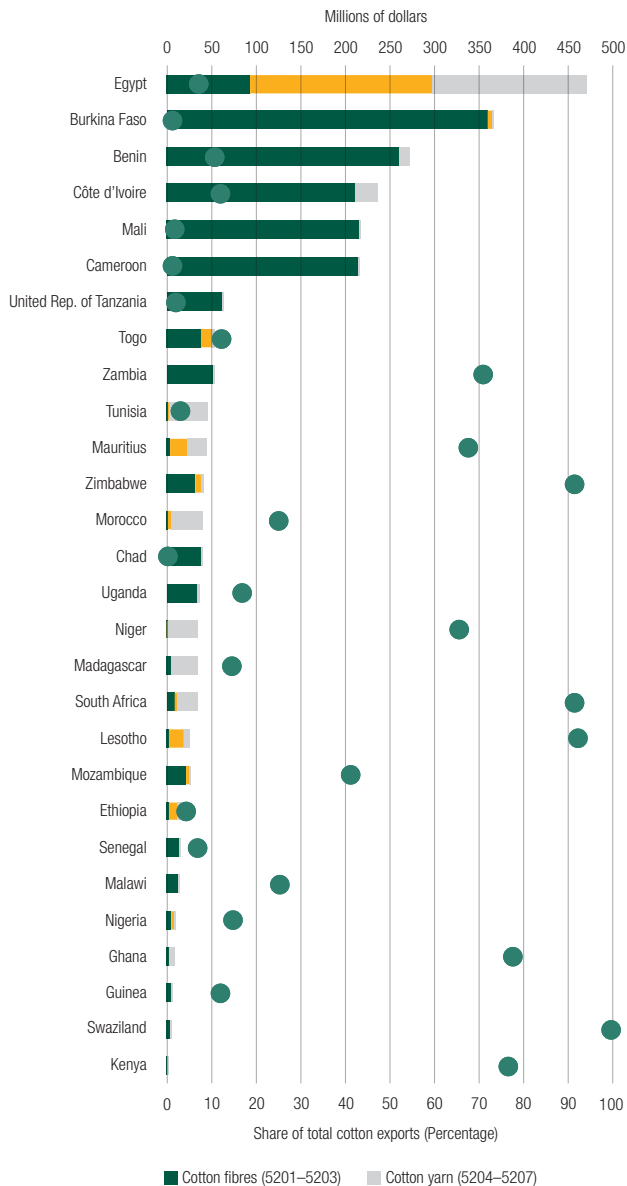
Apart from Egypt, the largest cotton exporters in Africa are generally confined to the production of cotton fibres, as are most of the smaller exporters (figure 27). The integration of Africa in the cotton global value chain is thus driven by forward integration – exports of intermediate inputs – mainly 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

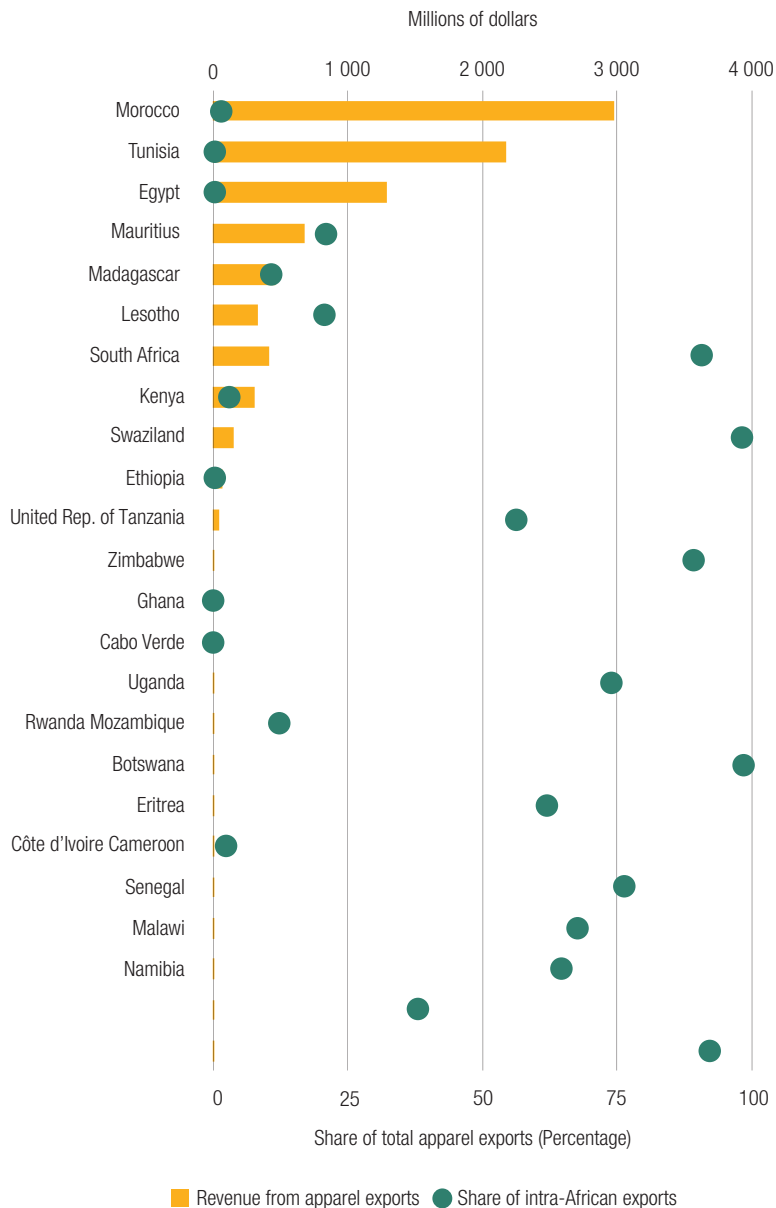


Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

Note: Figures in the legend refer to HS codes.

Figure 29

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



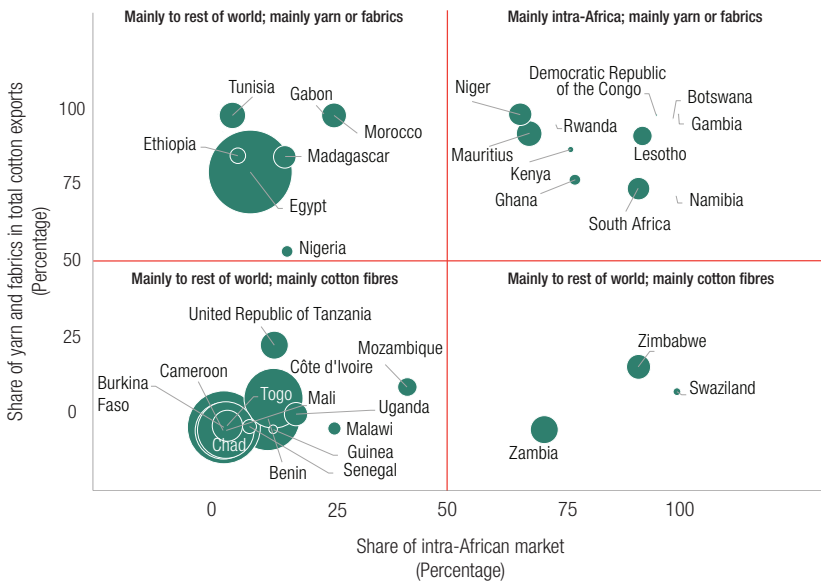
Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed September 2018).

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.

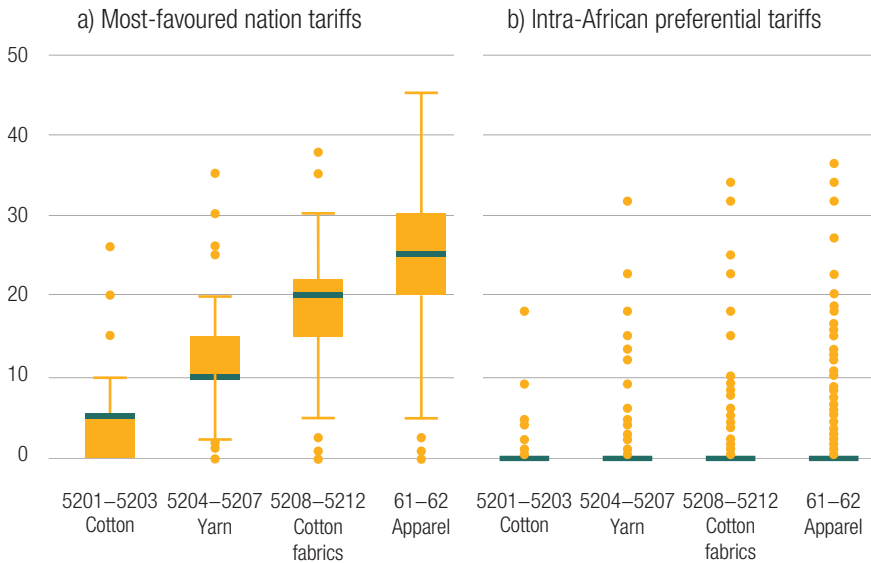
Against this backdrop, the scope for substantial margins of preference at the continental level suggests that rules of origin provisions inevitably warrant special consideration in the context of negotiations relating to the Continental Free Trade Area, since the incentive for trade deflection is likely 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

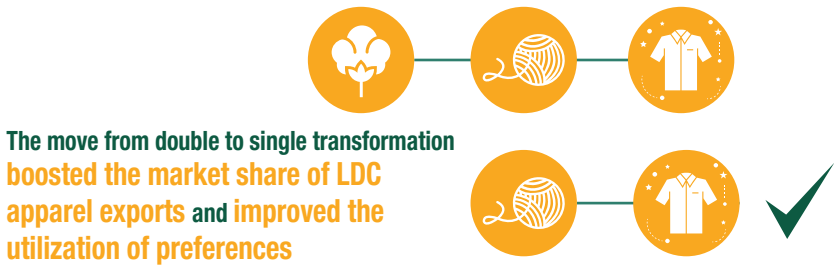
(Percentage)



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).

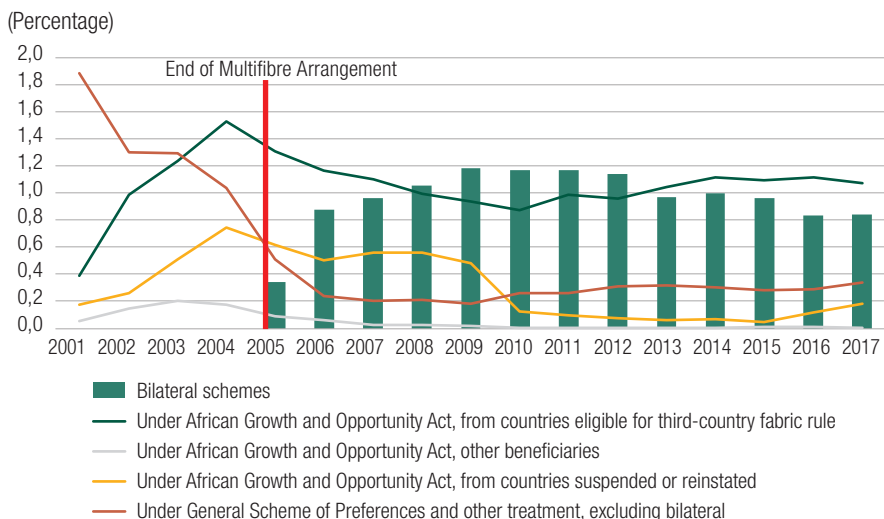
³⁷ Beneficiary countries of the African Growth and Opportunity Act that were suspended or reinstated are reported separately to avoid conflating the often strong impact of these policy decisions with issues related to rules of origin.

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



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

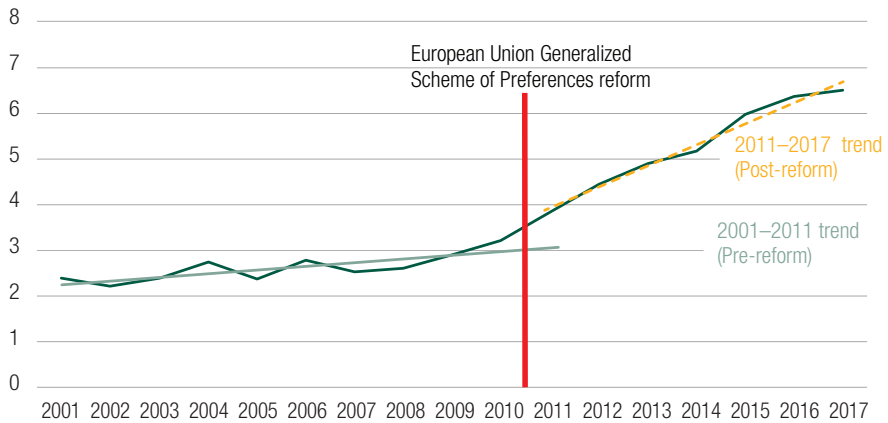
⁴⁰ This example is drawn from complaints No. NTB-000-676, reported through the online Tripartite mechanism for reporting, monitoring and eliminating non-tariff barriers (www.tradebarriers.org/about, accessed 15 February 2019).

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.

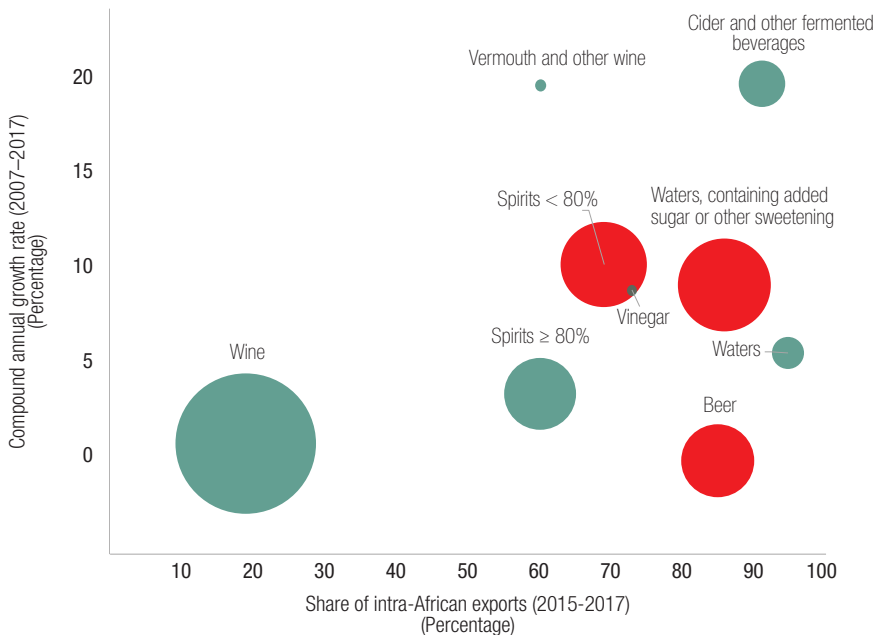
The growth of the low-cost beer segment has led to an increase in the production of commodities such as sorghum, millet and cassava. Such commodities have replaced barley malt, which is sourced from abroad, thus helping to reduce costs. Firms in the value chain have generated backward linkages by sourcing 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

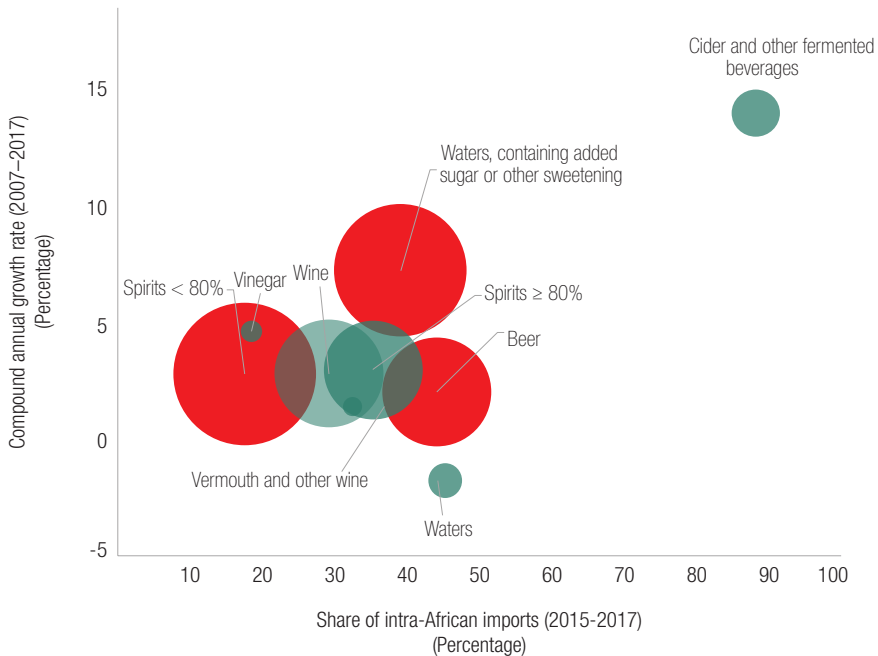


Source: UNCTAD secretariat calculations, based on data from the International Trade Centre Trade Map database (accessed December 2018).

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 per year, 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.

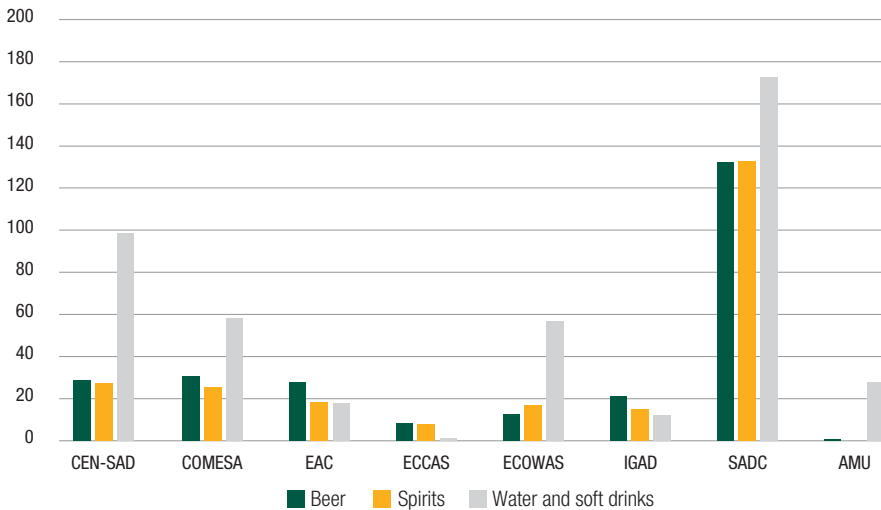
Among the African regional economic communities, the prominence of SADC as a leading space for trade in beverages is unrivalled (figure 36). This position pivots around the role of South Africa as a key exporter of spirits intraregionally to Botswana, Zambia and Zimbabwe, and outside of SADC to Kenya, 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.

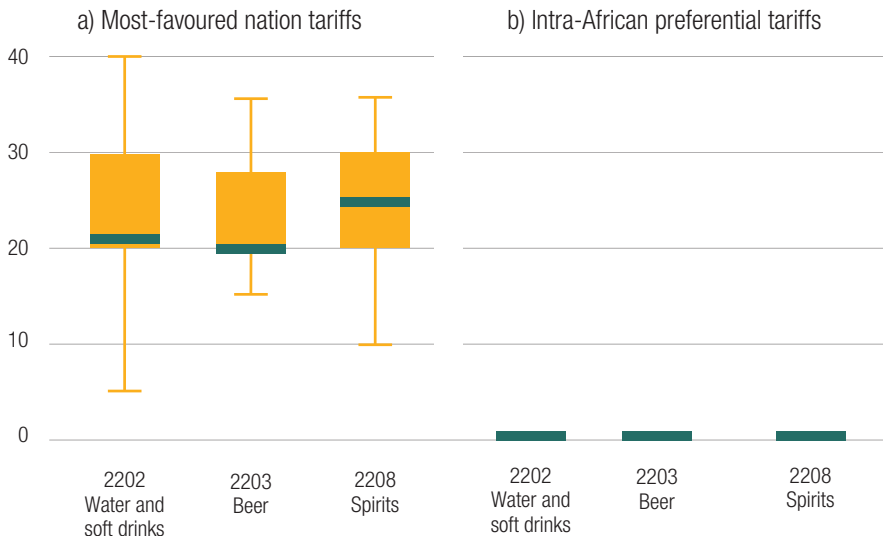
With regard to rules of origin, the way in which the regional economic communities have disciplined beverages displays a broad variety of approaches to products partially obtained from non-originating materials. ECCAS and ECOWAS, for instance, foresee an ad valorem percentage criterion based on value 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 by truck 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 to match 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).

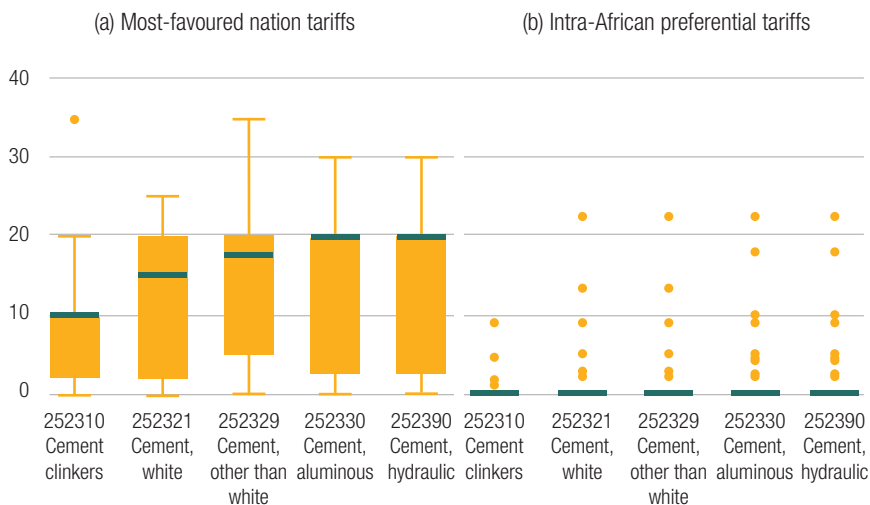
This discussion highlights the complexity of the cement industry in Africa, as well as the political economy trade-offs that need to be considered in the context of trade liberalization discussions. Given the dynamism of cement demand in the region, as well as the generally high prices compared with 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; lentreprenariat.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; lentreprenariat.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, 2018).

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).

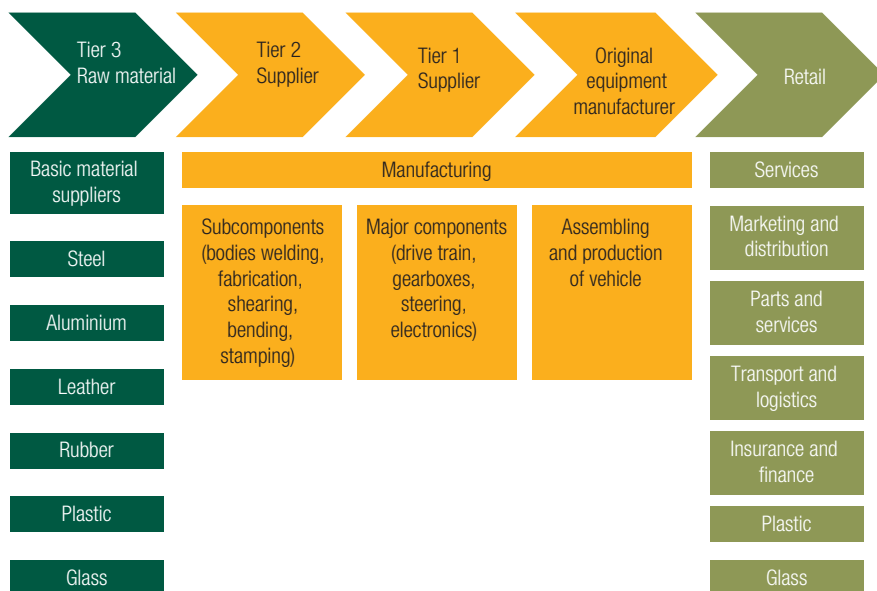
In line with the complexity of the value chain, a broad range of factors informs location and sourcing choices of the lead firms. Given the capital-intensive and long-term nature of their investments, location decisions tend to favour stable countries with low political risk, access to a large domestic 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).

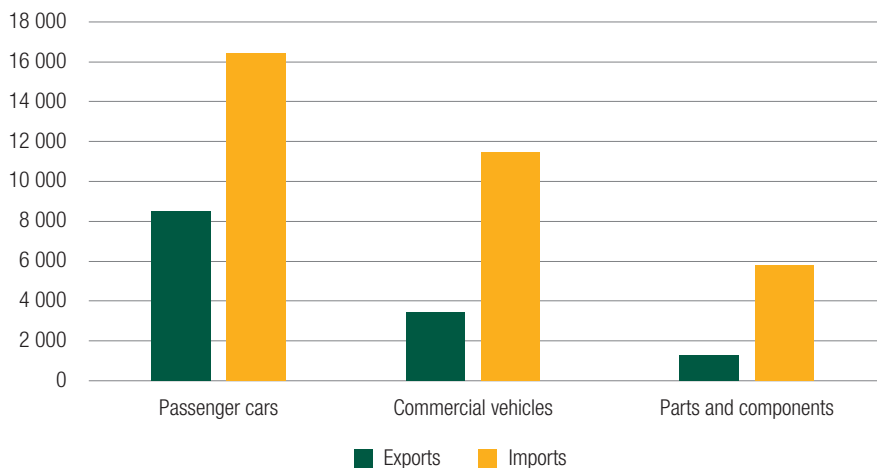
⁴⁸ For the purpose of this case study, trade figures related to the automotive industry are classified as follows: passenger cars, HS heading 8703; commercial vehicles, HS headings 8701, 8702, 8704, 8705 and 8709; and parts and components, HS headings 8706, 8707 and 8708.

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).

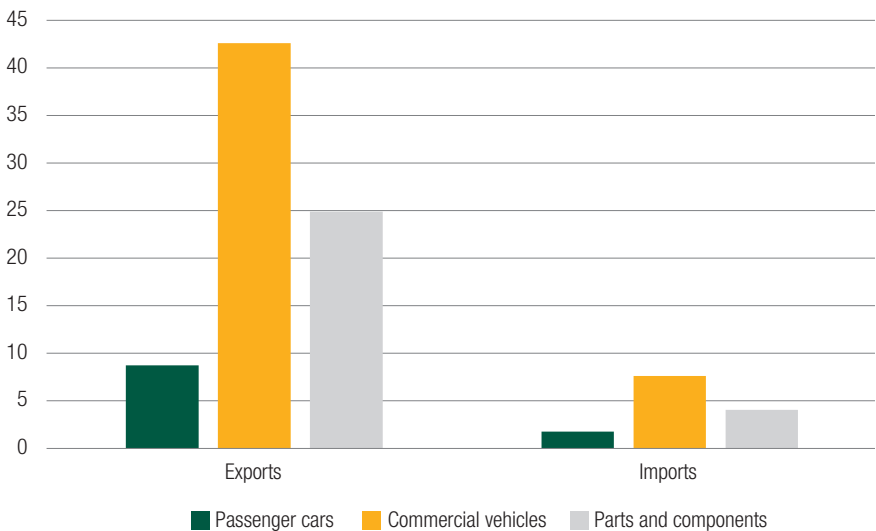
With prospects of creating an integrated regional market of over one billion people, the Continental Free Trade Area could be a game changer for the automotive sector in Africa, given its heavy reliance on economies of scale and its potential for creating strong regional supply networks (Erwin, 2016; 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.

Chapter 4

The rules of the game: Implementation of rules of origin

4.1 The African Continental Free Trade Area and the implementation of its rules of origin

This chapter builds on the previous chapters, which focus on the main issues relating to the economic dimension of preferential rules of origin in Africa and specific case studies on how distinct rules of origin provisions affect the working of selected regional value chains. There are both benefits and costs to having rules of origin. The rules of the game are based on cost–benefit analysis and are likely to vary across countries and sectors. Some of these have been illustrated in the case studies presented in chapter 3, which also highlights elements of the complex political economy of designing rules of origin (Draper et al., 2016). Moreover, there is evidence that the outcome is mixed with regard to regional value chains, even when beneficiaries utilize preferences (Boffa et al., 2018).

EFFECTIVE IMPLEMENTATION OF RULES OF ORIGIN REQUIRES:

1

Easing **documentary
procedures**



Establishing **committee(s)
on rules of origin**

2

3

Ensuring **transparency**



Setting up **dispute-
settlement mechanisms**

4

There is a risk that varied commercial interests may enter into the framing of rules of origin. Trade policy is complex, technical, detailed and often associated with domestic competition between firms. This is why the negotiation of trade agreements is invariably driven by national economic interests, market dynamics and domestic policy. In other words, priority sectors, market opportunities and the balancing of offensive and defensive priorities are important considerations in the political economy of trade (White and Case, 2016). The design of rules of origin in the Continental Free Trade Area might awaken lobbying campaigns that mostly elude public attention. The domestic constituents generally most favourable to free trade agreements differ in their preferences of rules of origin. For example, industries with large returns to scale tend to favour strict rules of origin to gain economies of scale in a free trade agreement, while industries with multinational supply chains tend to prefer lenient rules of origin to accommodate offshore procurement. Chase (2008) finds that the more restrictive rules of origin, the higher the external trade protection and the larger the potential returns to scale. In contrast, the more lenient the rules of origin, the greater the involvement in foreign sourcing. Highly protected industries are more likely to favour more restrictive rules of origin to alleviate adjustment costs from trade liberalization in a free trade agreement. Industries with large returns to scale tend to prefer stringent rules of origin to deter competition and a fragmenting of a free trade agreement by foreign firms, hindering cost reduction. On the other hand, industries dependent on offshore procurement tend to prefer lenient rules of origin to facilitate the sourcing of foreign inputs (Chase, 2008; White and Case, 2016). To the extent that conflicting national preferences are traded off in international and interregional economic community negotiations, industry lobbying at home may have less influence on the terms of the Agreement Establishing the Continental Free Trade Area. Nonetheless, rules of origin are critical to building domestic coalitions for the Continental Free Trade Area, and industry preferences concerning rules of origin may have important political implications for the ratification and implementation of the Agreement.

This chapter discusses the implementation of rules of origin. The following key elements should be addressed: the need to expand cumulation to facilitate compliance with origin requirements and to improve documentary requirements, the functioning of committees on rules of origin, transparency and dispute-settlement mechanisms.

The Agreement Establishing the African Continental Free Trade Area has been signed by most African countries, but the rules of origin have not yet been finalized. Rules of origin, together with the tariff reduction schedules of the signatories, should enable Africa to eliminate most tariff barriers in intra-African trade. Under the Agreement, the member

States reaffirm their rights and obligations under other trade agreements to which they are parties. Similarly, two of the principles outlined in article 5 of the Agreement refer to the free trade areas of the regional economic communities as building blocks for the Continental Free Trade Area and recognize best practices in these communities. The text of the Agreement goes even further to guarantee the “acquis” obtained in the regional economic communities. Thus, the Agreement is not intended to be a substitute for the regional agreements that are in place or under negotiation (i.e. agreements establishing the Tripartite Free Trade Area).

4.1.1 State of play of rules of origin implementation within the African Continental Free Trade Area and status of negotiations

The Agreement Establishing the African Continental Free Trade Area consists of the protocols on trade in goods, trade in services, investment, intellectual property rights, competition policy, and rules and procedures on the settlement of disputes and their associated annexes and appendices. Rules of origin are covered in annex 2 of the Protocol on Trade in Goods. Phase I negotiations on the Protocol on Trade in Goods, the Protocol on Services and the Protocol on Rules and Procedures of the Settlement of Disputes have been under way since March 2018. The five agreed priority sectors for trade in services are transport, communications, tourism, finance and business. In December 2018, African Union Ministers of Trade met in Cairo to finalize the modalities of tariff liberalization and the draft negotiating guidelines for schedules of specific commitments and regulatory frameworks for trade in services. Schedules of tariff concessions were to be finalized and approved by member States by December 2019. The Ministers of Trade took note of progress made towards the development of appendix IV to annex 2 on rules of origin and instructed senior trade officials to finalize outstanding work on rules of origin by the end of June 2019. This includes drafting hybrid rules and regulations for goods produced under special economic arrangements or zones. Phase II negotiations on competition policy, investment, intellectual property rights and draft protocols are due for submission to the African Union Assembly for adoption in January 2020.

In the Agreement, the member States reaffirm their rights and obligations under other trade agreements to which they are parties. Table 6 summarizes the status of regional economic integration in each of the eight regional economic communities recognized by the African Union. The communities are progressing at different speeds across the various components of the Abuja treaty; EAC has made the most progress.

Table 6
Progress towards economic integration in Africa

REGIONAL ECONOMIC COMMUNITIES	DATE ESTABLISHED	FREE TRADE AGREEMENT	CUSTOMS UNION	SINGLE MARKET	MONETARY UNION	POLITICAL FEDERATION
AMU	1989					
CEN-SAD	1998					
COMESA	1994					
EAC	2000					
ECCAS	1983					
ECOWAS	1975					
IGAD	1996					
SADC	1992					



Source: United Nations Economic Commission for Africa et al., 2017.

Governments agreed to build-upon the “acquis” of the regional economic communities. Consequently, African exporters would be able to choose which agreement to use, depending on the concessions and rules of origin they need to comply with. Zambian exporters for instance could either use the rules of origin of COMESA, SADC, the Tripartite Free Trade Area or the African Continental Free Trade Area, depending on the final destination of the products. This raises two key considerations. On the one hand, the assurance to other Members that they can retain their regional agreement is an incentive to making the Agreement Establishing the African Continental Free Trade Area acceptable. On the other hand, this assurance depends on whether the negotiated rules of origin enable or hinder preferential trade across Africa.

The Continental Free Trade Area must prove that it can complement – not threaten – the regional economic communities or become an empty shell. This will facilitate its implementation. The Continental Free Trade Area will have to ensure that it is the main alternative, above all in countries that are part of a regional economic community, while also enabling trade with other countries that are not in the same regional economic community. Thus, the Continental Free Trade Area can also benefit from established experience in the regional economic communities, as many private sector operators have already learned how to work within free trade agreements and regional trade agreements.

Regional economic community secretariats may also be helpful in implementing the Agreement. With additional skilled labour, the Continental Free Trade Area could create a focal point in each regional economic community secretariat to help build the necessary national capacities of member States. This would ensure that the instruments of the Agreement are implemented and work more effectively with the regional economic communities and other regional entities.

The WTO Agreement on Trade Facilitation and the establishment of national committees on trade facilitation should help facilitate trade among all members, as with the national implementation committees that would be formed under the Agreement Establishing the African Continental Free Trade Area. It could be argued that national committees on trade facilitation and national implementation committees could be grouped together or merged to fully exploit synergies, enabling focused discussions among the same stakeholders in a country, as well as to harmonize inputs and outputs, and target such stakeholders with more effectively coordinated technical assistance.

4.2 Expanding cumulation to facilitate compliance with origin requirements

4.2.1 Cumulation of origin, cross-cumulation and principle of territoriality

Cumulation may present the main opportunity for African countries to use African inputs. Regional agreements per se allow for cumulation with inputs from the same regional grouping and consider such goods as produced in the last country of manufacture (mostly, going beyond a minimal operation). A distinction can be made between bilateral and full cumulation. An additional option for cumulation could be explored. For example, the Protocol on the COMESA Rules of Origin⁵⁴ could be revised to consider cross-cumulation options, meaning the incorporation of materials from other non-African trade partners, if the specific trade pacts exist. This could allow for the integration of materials from, for example, the European Union, EAC or SADC.

The use of materials from EAC and SADC may be partially covered by the Tripartite Free Trade Area, which brings together COMESA, EAC and SADC. However, rules of origin negotiations have yet to be concluded. The main idea behind cross-cumulation is to allow for the use of materials in the production of goods that are not covered by the

⁵⁴ Rules of Origin for Products to be Traded between the Member States of the Common Market for Eastern and Southern Africa.

COMESA Agreement, but would nonetheless be granted duty-free treatment if they were shipped directly from another partner country. For instance, the new 2015 EAC rules of origin allow for cross-cumulation with inputs from COMESA and SADC. Further, EAC allows for cumulation with European Union inputs, as countries of the Community have concluded economic partnership agreements with the European Union. The advantage of having cross-cumulation in the Protocol on the COMESA Rules of Origin means that producers do not need to wait for the conclusion of the rules of origin negotiations under the Tripartite Free Trade Area. Further, within COMESA, there is no need to have longer negotiation rounds with other parties, should the rules require modification.

Introducing the concept of cross-cumulation also solves another problem – the need to fully align rules of origin in all agreements. Through the protocol on the rules of origin, agreements can be linked more easily and provide producers with an ample choice of competitive inputs, to enhance regional integration and trade. Several economic partnership agreements concluded between the European Union and African, Caribbean and Pacific countries also have comprehensive accumulation and cumulation possibilities for the promotion of regional integration.

The implementation of the Agreement Establishing the African Continental Free Trade is important, but once implemented, the rules of origin should be applied in realistic conditions. The impact of the Agreement depends on how the general rules of origin for Africa are drafted, whether they allow for full cumulation or not. Theoretically, the Agreement does not require cumulation options, as it includes all African nations to form the biggest regional agreement to date. However, high overland transport costs may be a barrier to intra-African trade along the value chain and may therefore inhibit the scope for cumulation.

The rules of origin will not be the same as those of other regional agreements, and this raises the question of how best to deal with potential inconsistencies in the determination of origin. Firms will apply, wherever more favourable, the more liberal rules of origin or better cumulation rules applicable, in regional agreements such as those of COMESA, ECOWAS and SADC.

Cross-cumulation should be compatible with article XXIV, paragraph 4 of the General Agreement on Tariffs and Trade (1947), which states that a customs union or a free trade area should contribute to the facilitation of trade between the constituent territories and not raise barriers to trade with other countries. Critics such as Weiler et al. (2016) argue that cumulation schemes extend preferences of individual preferential arrangements to non-participating parties without any legal basis and in this way, may discriminate

against third parties. Nevertheless, such criticism has not led to a legal dispute at WTO.

4.2.2 Certificate of non-manipulation, direct transport, drawback and tolerance rules

To enhance pan-African trade, rules of origin could allow for the trans-shipment of originating goods, even though producing and exporting countries might not be the same. Therefore, it should be possible, for example, for a Nigerian trader to export duty free not only Nigerian goods but goods from other African countries as well.

The system would then work along the lines of the diagonal cumulation provisions in place in Europe. Diagonal cumulation eliminates the need for direct transport, and all countries of the Pan-Euro-Mediterranean Convention grant each other preferential treatment, even where goods are not exported from the country of manufacture. This makes the Pan-Euro-Mediterranean Area a single market. However, two conditions pertain: there must be an uninterrupted chain of proofs of origin, and the preferential treatment granted upon importation is still based on the original tariff-dismantling commitments.

To facilitate re-export and trade, countries should allow for drawback of the customs duties upon re-export of third-country components integrated into the final product. Also, if finished goods are traded, and the exporting country has not fully implemented the tariff liberalization system, drawback should be allowed on the preferential duties paid.

Further liberalization could be allowed, in connection with the change in tariff classification rule. Indeed, most origin systems contain a tolerance or *de minimis* rule, allowing for a certain percentage of the product not meeting the change in tariff classification rule. This gives firms and producers some needed flexibility where the Harmonized System might classify inputs and final products under the same heading.

4.3 Documentary requirements and compliance costs

4.3.1 Certificate of origin and electronic versions

Electronic certification enables exporters to submit their applications electronically for the issuance of certificates of origin. It implies that the exporter also submits the relevant documentation (for example, import and manufacturer declarations, certificates of origin of inputs used) or will deposit them during the initial stage of application to obtain the authorization to acquire an electronic certification facility. In advanced and interlinked management systems, both the application and issuance of certificates of origin could be completed electronically.

The COMESA electronic certificate of origin system prototype was designed and developed in line with the COMESA Treaty, customs management regulations and the Protocol on the COMESA Rules of Origin with a view to establishing a standardized regional electronic certificate of origin system. The system consists of the following:

- End-to-end procedures for exporter registration and renewal
- Application and issuance of certificates of origin
- Checking and verification of certificates of origin
- Registration and circulation of designated issuing authorities and their authorized signatories
- Other relevant information.

The electronic certificate of origin system is a web-based system that is accessible through web browsers; the layout is practical and follows the necessary steps. The content has been carefully adapted to meet the requirements of the Protocol on Rules of Origin and ordinary certification processing, which, in the electronic version, is highly detailed. The first-time registration process for exporters appears to be cumbersome, involving the sharing of much information (from business operations to tax registration, and so forth). However, once registered, the exporter can simply complete the application form and submit the export documentation in electronic form.

Electronic certification provides good security and traceability; customs administrations, mostly in charge of imports, prefer such a method over self-certification. The electronic certificate of origin system would also make it unnecessary to use paper-based notifications or obtain stamps and signatures from the issuing authorities.

4.3.2 Approved or registered exporter

In general, self-certification describes a simple process whereby an exporter can issue its own proof of origin to allow the importer in another country to claim preferential tariff treatment under a specific trade agreement. Self-certification reduces the documentation burden of traders when claiming preferential tariff treatment and should help improve the utilization of tariff concessions. Under this scheme, the primary responsibility of origin certification is carried out by the traders themselves – manufacturers and exporters – including SMEs participating in regional trade. Certified or approved exporters are allowed to declare that their products have satisfied the specific origin criteria and are thus originating in a country that is party to a specific agreement on free trade or on regional trade. The declaration will be completed by an approved exporter on a commercial invoice or, in the event that the invoice is not available to the importer at the time of exportation, on any other commercial document such as a billing statement, delivery order or packing list. Therefore, chambers of commerce and industry, customs authorities, ministries of trade or related agencies, producers and/or exporters will be able to fully comply from their own offices, which will facilitate the issuance of a proof of origin document.

European Union trade agreements usually provide for a system that allows exporters to establish the proofs of origin (invoice declaration) themselves. The European Union Generalized System of Preferences launched the next level of authorization with the introduction of the registered exporter system in 2017. This system employs a central database, administered by the European Union Commission in Brussels. To register, beneficiary countries log into the database and upload relevant information. If exporters fail to comply, such authorization is not granted.

To ensure uniformity of the respective Generalized System of Preferences, and in respect of bilateral agreements, Norway and Switzerland also accept the registered exporter system of the European Union Generalized System of Preferences as sole proof of origin in their respective Generalized System of Preferences. Such an approach will also be applied in the context of bilateral trade agreements between the European Union and its partner countries. The Comprehensive Economic and Trade Agreement, a free trade agreement concluded between Canada and the European Union, will be the first such agreement to implement a system similar to the registered exporter system. Another positive factor for firms is that while the Generalized System of Preferences certificates of origin Form A is usually sold at a low price, electronic registration in the registered exporter system of the European Union is free of charge.

Tripartite Free Trade Area provisions, similarly to SADC rules of origin, already propose that registration should not be required for the issuance of an invoice declaration concerning amounts below \$5,000. Ultimately, this solution facilitates trade but does not relieve the exporter of the obligation to verify compliance with the relevant rules of origin. A pan-African registered exporter system could greatly reduce documentary burdens. If rules of origin were aligned with the European Union Generalized System of Preferences for instance, rules of origin of the African Continental Free Trade Area might directly link to the registered exporter system of the European Union Generalized System of Preferences and/or accept such statements of origin under the African Continental Free Trade Area.

4.3.3 Verification

Administrative requirements are key to implementation, and certification goes together with the verification of origin. Businesses must be aware that the option to claim preferential tariff treatment abroad comes with administrative obligations. Upon application for certificates of origin or electronic certificates of rules of origin, as well as for obtaining approved exporter or registered exporter status, exporters must submit an array of documentation to ensure that the exported goods comply with the respective rules of origin.

In the importing country, customs administrations or any other competent authorities, trust that the exporting country has fulfilled its duties and verified the originating status of the goods covered by the certificates of origin. In case of doubt, importing countries might also request verification upon importation or post-verification of certificates of origin or other proofs of origin once consignments have been released into free circulation. Fully integrated electronic systems might allow for efficient and quick online verifications. Some countries also verify first by emailing other competent authorities.

The Automated System for Customs Data of UNCTAD and other customs systems may also allow for electronic verification. For example, the COMESA electronic certification of origin system allows all connected, competent agencies to access its servers to perform self-verification based on the documentation stored in the server. Similarly, in the registered exporters system of the European Union Generalized System of Preferences, the European Union would first consult the registration details in its own system before submitting a verification request to the exporting country. In this case, electronic means of communication have a major trade-facilitating effect.

4.3.4 Compliance costs

The implementation of the Agreement Establishing the African Continental Free Trade Area will incur costs for Governments, as they will have to provide the institutional framework for establishing and implementing the Agreement, so that the private sector can benefit fully from liberalization. At the same time, much of the literature advancing a private sector perspective points negatively at the compliance costs for administering rules of origin (Cadot and de Melo, 2008; Cadot, Estevadeordal et al., 2006).

In recent years, administrative compliance costs have been lowered, and exporters have become more aware of rules of origin compliance as such systems have spread across the globe. Some African countries are not only party to four regional agreements (excluding the Agreement Establishing the African Continental Free Trade Area), but are also party to economic partnership agreements and free trade agreements with European countries and the United States. Further, despite the administrative burdens, other administrative systems (i.e. the value added tax) and accounting principles may also require greater administrative efforts and capacities. This means keeping records much longer than three years, being able to show import and export documentation at any time and submitting periodic statements and accounts.

Certainly, a well-kept accounting and document management system also helps ensure compliance with any requirements under pertinent rules of origin regimes. However, documentary compliance is only one side of the coin; the other is compliance with the rules of origin themselves. Problems may occur where producers might have to source local, uncompetitive inputs to meet, for instance, a tariff shift or value added criteria, instead of being able to import and use a competitive input from abroad. Thus, compliance costs would include the cost of more expensive inputs and the problem of selling a product at a less competitive price. For example, some countries would like to see wholly obtained rules for certain products, i.e. cigarettes or cigars. Naturally, raw materials producers prefer wholly obtained rules of origin, as cigarette producers may eventually be obliged to use local tobacco. However, as consumers are sensitive to changes in taste, most mainstream brands mix tobaccos to obtain a uniform, consistent product. Thus, wholly obtained rules of origin automatically rule out any preference for such products. Under such circumstances, producers might simply choose to ignore the rules of origin of the African Continental Free Trade Area and pay most-favoured nation duties. The second choice would be to use an alternative preferential agreement that would not have such restrictive rules of origin.

Mizuno and Takauchi (2013) estimated compliance costs and found that if exporters faced too many uncertain production costs, through restrictive rules of origin, non-compliance might become the cheaper alternative. Too many barriers in the framework would trigger non-compliance as the safest and cheapest solution for producers and exporters.

Governments should consult with the private sector to deal with constraints in observing proposed rules of origin, especially as raw materials are often not available in Africa at competitive prices because of high transportation costs. In this sense, COMESA provides a good approach to addressing constraints in production patterns by allowing members to ask for more liberal rules of origin for specific products. For example, it might allow members to use a 25 per cent value added rule, if economic interests are substantiated.

The African Continental Free Trade Area should consider a similar rule, as well as the instruction of the change-in-tariff-subheading rule, upon request, as it is virtually impossible to deal with all existing and upcoming production patterns in the current negotiations. A rule of origin upon request might at least allow for additional flexibility in the future. This flexibility might be agreed upon by the competent committee concerned and would not need to go through parliamentary approval and ratification in all member States; a normal amendment of the Agreement would suffice.

Not all compliance costs stem from rules of origin; some costs arise from customs procedures, laws and requirements relating to import or export. In this sense, the implementation of trade facilitation commitments as mandated by the Agreement on Trade Facilitation and the Agreement Establishing the African Continental Free Trade Area, can contribute substantially to lowering compliance costs and thus raise the utilization rate of the future agreement.

4.3.5 Origin fraud

Origin fraud is also an issue to be addressed, above all in trade environments with high tariffs. Regional economic communities in Africa usually combat fraud prevention with cumbersome documentary requirements for applying for a proof of origin certificate, as mentioned previously. Also, importing countries tend to have onerous requirements for granting preferential treatment. Fear of fraud has led many African Governments to refrain from applying potentially efficient solutions that make use of information and communications technology for rules of origin certification, for example, electronic certification. This may be due partly to a lack of familiarity with electronic certification tools, inadequate technological infrastructure and the initial costs of implementing such a system.

Fraud may be prevented by implementing risk-assessment schemes based on risk criteria, statistical information or verification requests from a trading partner. Addressing origin fraud through risk assessment might include the following steps:

- Introduction of a clearance programme with inspection options (red, orange or green channels) upon import
- Verification at a later stage based on national statistical analysis and inspection results
- Introduction of new verification tools such as scanning equipment.

Origin fraud could also be tackled by monitoring company websites and examining annual reports, information on competitors and publications that might contain helpful information and background data. Other points to explore would be the relationships between buyers and sellers, accounting systems (electronic or on paper), production data on the sector concerned and statistics.

However, fraud can be prevented a priori, by educating private sector operators about the benefits and administrative aspects of operating within the African Continental Free Trade Area, highlighting the need to comply with rules of origin. Also, customs administrations and related agencies should strengthen mutual cooperation – outside diplomatic channels – and share their knowledge within the framework of the African Continental Free Trade Area and beyond. This has also been highlighted in discussions within the framework of the Agreement on Trade Facilitation and on illicit financial flows. A customs academy to be set up by the African Continental Free Trade Area could also be considered.

Origin fraud can be reduced by:

1

Adopting rules of origin that are **simple and transparent**

2

Enhancing cooperation and trust between the **private sector** and **relevant government agencies**



Simplifying rules of origin would also help prevent fraud. Some countries introduce mandatory origin and customs procedures training courses for exporters seeking to become approved economic operators. The whole concept of the approved exporters of the Pan-Euro-Mediterranean Convention for origin purposes relies on mutual trust and the exporters' ability to correctly apply rules of origin schemes. Enhanced cooperation and trust between the private sector and competent government agencies are necessary to reduce fraud.

4.4 Institutional set-up, transparency and dispute-settlement mechanisms

4.4.1 Implementation prerogatives

Several regional economic communities have made great advances in implementing rules of origin through electronic processing and customs procedures (i.e. Automated System for Customs Data). Further, the COMESA agreement and other regional agreements experiment with electronic certification and verification of origin systems, which could provide guidelines for the rules of origin of the African Continental Free Trade Area that seek to introduce electronic certificates of origin systems and eventually, self-certification systems.

African negotiators have amassed considerable knowledge through discussions on the European Union Generalized System of Preferences, negotiations on the Cotonou Agreements and economic partnership agreements, the African Growth and Opportunity Act, regional agreements in different set-ups and the introduction of customs unions (EAC, Southern African Customs Union).

Negotiators should consider regional and country-specific sensitivities and will have to foster cooperation to find solutions. Countries should be provided with several options for tariff-dismantling schedules and deadlines to accommodate their needs. LDCs benefit from longer periods of dismantling tariffs and a longer list of sensitive products; LDC specificity should be part of the ongoing negotiations.

Widely consulted and well-balanced rules of origin are the most likely to be implemented. The whole protocol, including certification and verification, should be able to stand the test of time to avoid cumbersome renegotiations and updates that may confuse Governments and private sector operators. Care should also be taken to ensure that

the translation of the legal texts of rules of origin into different languages is consistent across regional economic communities, so that the interpretation of the rules is likewise consistent across countries.

4.4.2 Notification, harmonizing and monitoring role of the secretariat of the African Continental Free Trade Area

Part III of the Agreement Establishing the African Continental Free Trade Area outlines the main rules relating to administration and organization. The secretariat is the administrative organ tasked with coordinating the implementation of the Agreement. It will work autonomously within the African Union system but will be supervised by the Chair of the African Union Commission and will receive funding from the African Union budget. The Committee of Senior Trade Officials is a high-level working group consisting of principal secretaries or other officials designated by each Member State. It is responsible for the development of programmes and action plans for the implementation of the Agreement. All issues pertaining to rules of origin under the African Continental Free Trade Area will be addressed by a specifically designated committee on rules of origin.

4.4.3 Transparency and dispute resolution

Similar to other agreements, and in line with WTO principles, part IV of the Agreement Establishing the African Continental Free Trade Area sets out transparency rules. This includes the obligation of the parties to adopt domestic procedures to enhance transparency in promulgating and notifying laws, regulations and administrative practices, including notification of such to the secretariat. As a guideline, COMESA and EAC now implement systems to systematically tackle problems in cross-border trade. The COMESA notification system and EAC time-bound programme represent a mechanism for the identification, reporting, resolution, monitoring and elimination of non-tariff barriers. To facilitate notifications, COMESA recently introduced a text-messaging notifications option, thus allowing more users to notify in real time problems in cross-border trade.

The Agreement could enhance its visibility, transparency and implementation by further developing the following lines of action:

- Members should inform the Committee on Rules of Origin of the measures being taken to implement the rules of origin provisions.
- Members should provide import data annually.

- The secretariat of the Committee on Rules of Origin should calculate and publish utilization rates.
- Preferential rules of origin should be notified according to established procedures in the event that members of the African Continental Free Trade Area enter into other free trade area agreements or conclude agreements with third countries.

The Committee on Rules of Origin will annually review the implementation of rules of origin and the transparency provisions and submit reports and recommendations to the Committee of Senior Trade Officials.

Should the Committee on Rules of Origin and the Committee of Senior Trade Officials fail to find a mutually agreed solution in the ordinary committees, the African Continental Free Trade Area would provide for a dispute-settlement mechanism, such as that of WTO.

4.5 Implementation of rules of origin

4.5.1 Government institutions: Negotiation and conclusion of the Agreement Establishing the African Continental Free Trade Area

In most countries, ministries of trade or commerce, in cooperation with other agencies, lead negotiations on chapters relating to trade in goods. For example, they negotiate with the ministry of agriculture on issues relating to agricultural products and with customs authorities and ministries of finance with regard to customs dismantling and rules of origin. The Seventh Meeting of the African Union Ministers of Trade was held in Egypt on 12 and 13 December 2018 to consider progress in negotiating the Agreement. The Ministers of Trade directed the negotiators to finalize annex 2 on rules of origin by the end of June 2019.

In negotiating product-specific rules of origin, Governments should consider implementing a major goal. Thus, rules of origin should be realistic and follow a common pattern, to facilitate implementation and acceptance, not only in their own countries, but also in the investment community, as the realization of the African Continental Free Trade Area will require foreign direct investment in African value chains to be successful. Implementation means not only that the private sector will be empowered to use such

value chains, but that they should also be verifiable, as verification should be part of the implementation process. Administrative burdens should be kept to a bare minimum.

4.5.2 Involvement of the private sector

Lessons learned from negotiations on economic partnership agreements show that the private sector should be involved early on to avoid problems relating to the implementation of the Agreement. Key stakeholders should be involved from the start, i.e. at the negotiation stage, to ensure ownership of the Agreement at the national level. Such problems have already arisen in some countries, as in the case of Nigeria, where business associations opposed the ratification of the Agreement because of claims from the private sector that the private sector had not been adequately consulted or advised that the Agreement could adversely affect Nigerian industries and fuel unemployment (Adekoya, 2018; *The East African*, 2018).

The Agreement contains an obligation for member States to establish national implementation committees that include private sector representatives. Knowledge sharing, capacity-building and needs assessments are required to enable the smooth implementation of rules of origin. In addition, there is a need to do the following:

- Strengthen and support the establishment of national implementation committees in the African Continental Free Trade Area
- Align the establishment of national implementation committees of the African Continental Free Trade Area with that of national trade facilitation committees (WTO) to ensure consistency and uniformity of approach
- Identify and address operational and capacity constraints, awareness-raising and implementation needs assessment in all countries
- Establish focal or inquiry points and help desks in each member State and strengthen existing mechanisms
- Ensure coordination of international donors.

In addition to donor coordination, inter-agency collaboration is essential to ensure more coherent, efficient and coordinated planning and implementation. Continuous awareness raising among stakeholders will be necessary in implementing the Agreement when it comes into force. Implementation, however, can only begin once the rules of origin are agreed.

Addressing all other constraints in Africa should be a priority for all parties to the Agreement, if Africa is to seize the available opportunities. Productive capacities and competitiveness in Africa need to be strengthened. Technical sanitary or phytosanitary standards should be aligned to enable trade and not hinder it. Such trade-facilitation measures are as important as rules of origin. Implementation is vital for rules of origin systems to allow and enable businesses to enjoy the benefits of integrated markets through tariff concessions.

The closer the rules of origin of the African Continental Free Trade Area are to existing systems, the less effort will be required to implement and explain to businesses the new rules of origin. There are many different agreements in Africa but their rules of origin generally share the following characteristics:

- Similar wholly obtained rules of origin
- Some type of cumulation allowed and alignment of general rules of origin
- Product-specific rules of origin generally based on changes in tariff heading and value added concepts.

Further, electronic certification in some regional economic communities, and lessons learned can be replicated in the rules of origin of the African Continental Free Trade Area. Inter-agency cooperation (customs, government ministries, chambers of commerce and industry, customs agents or customs brokers) is standardized in several regional economic communities but needs to be enhanced.

Some African countries already have comprehensive trade portals or one-stop-shops, for investment promotion (usually under investment promotion agencies), export promotion agencies or ministries of commerce or economy.⁵⁵ Customs authorities and the competent import or export agencies also maintain good online tools and information.

In principle, Governments and private sector stakeholders across Africa are already observing regional agreements and should be familiar with the rules of origin and opportunities that could develop through the African Continental Free Trade Area. Capacity-building is necessary for stakeholders to implement the Agreement.

⁵⁵ For an interesting example of a one-stop shop, see www.gobotswana.com/ (accessed 25 February).

4.5.3 Support for small and medium-sized enterprises and the business community: Incidence and evolution of compliance costs over time for exporting firms

Compliance costs are a concern of the private sector, and the more rules of origin regimes they have to navigate, the higher the administrative burden. However, over time, the private sector also learns how to handle regional economic communities and the rules of origin; thus, the African Continental Free Trade Area could create good opportunities for African traders and producers. Rules of origin and procedural requirements should be aligned with best practices from other regional economic communities and economic partnership agreements.

Today, online tools provide more options to minimize compliance costs for exporting firms. The wider business community – chambers of commerce and industry, customs brokers and agents' associations – can also play a role in disseminating best practice and capacity-building.

4.5.4 Need for capacity-building assessment

Donor agencies have been active within Africa in the provision of trade and development cooperation projects and activities. The European Union, for instance, assists African, Caribbean and Pacific countries through TradeCom I and II projects, but also deploys considerable efforts in the implementation of economic partnership agreements.

To attract donor agencies, the African Union and its members should undergo a needs assessment in relation to the overall implementation of the Agreement, including rules of origin. Next, an action and implementation plan should be drawn up with a timetable, providing an opportunity for donors to assist in the implementation process in a coordinated manner, at the public and private sector levels.

Capacity-building must be envisaged for all countries. As some will require more assistance than others, a needs assessment should be conducted in all African countries and the above-mentioned plan established. Capacity-building will cover all sorts of available tools, from awareness raising to printed media and electronic tools, such as online toolboxes, training courses, materials and information. The needs assessment should be carried out in all signatory countries, to coordinate and streamline all implementation efforts, together with national players in each country, whether government entities, think tanks or major business associations.

4.6 Using new technology

The increasingly rapid diffusion of information and communications technology innovations in Africa makes implementation and awareness raising easier. Therefore, increased emphasis should be placed on using modern technology, including online training programmes, information-sharing tools and help desks. In addition to these, Governments should consider providing an online rules of origin toolbox in local languages. There are a few examples of online rules of origin information services that may prove useful to African countries, such as the World Customs Organization, WTO and International Trade Centre rules of origin facilitator (available at <http://findrulesoforigin.org/home/index>; accessed 25 February 2019); various African Union and African Development Bank websites containing legal documentation and rules of origin training materials; and UNCTAD online handbooks on duty-free quota-free market access and rules of origin for LDCs.

Many Africans still have limited or no access to fully fledged Internet services. Therefore, online services might need to be simplified (push messaging, text messaging and unstructured supplementary service data). If many people do not have access to ordinary laptops or computers, the development of special applications could be envisaged, for example, an African Continental Free Trade Area application for smart devices. Clearly, linkages between training tools and online training in member States should be improved, as well as linkages to one-stop-shops, mainly for customs procedures but for export/import information, as well.



4.7 Monitoring

The parties to the Agreement Establishing the African Continental Free Trade Area should develop and implement an effective monitoring and evaluation mechanism to track progress on implementation and ensure that the utilization of preferences is widely available and that the objectives of the Agreement are realized. This extends beyond mere rules of origin and would include all major commitments to be monitored and evaluated on a periodic basis. The African Continental Free Trade Area Committee on Rules of Origin should follow up annually on the implementation of the rules of origin and application modalities. The WTO Technical Committee on Rules of Origin, established under the WTO Agreement on Rules of Origin, has developed a model for the calculation of utilization rates that could serve as a model in Africa. The secretariat of the Continental Free Trade Area should ensure that such information is publicly available. Underutilization of preferences should be investigated at the regional and country levels to determine the root cause of such underutilization. This requires public–private dialogue, consultation processes and portals where the private sector can directly comment and submit complaints.

4.8 Shared goals, different capacities and perspectives

UNCTAD (2015a) advocated a reform agenda for Africa that would cover goods and services, put in place appropriate regulations for integrated markets and build the capacity of institutions that are essential if Africa is to achieve its potential in regional business, in particular cross-border trade.

Efforts to accelerate regional integration hinge on political economy and regional dynamics. Five factors relating to political economy shape and influence the dynamics of regional integration (Byiers et al., 2015):

- Structural factors that are mostly embedded in geography,⁵⁶ history, demographic and economic characteristics of a country or region.
- Institutional capacity to set and monitor the rules of the game. These can be formal, written or codified rules (in legal texts), or open practices associated with norms, beliefs and customs.

⁵⁶ An example is the Moroccan automotive industry, which benefits from the proximity of Morocco to the European Union (chapter 3).

- Factors that support or undermine the reforms of actors or their capacity to act and make choices, mainly according to their economic, political and social power.
- Characteristics, including technical features, of specific sectors that may have political implications such as influencing incentives and accountability measures.
- External factors that affect the domestic political economy, regional dynamics and organizations. Among these are global trade, investment patterns, climate change, consumer preferences and attitudes in affluent markets. External factors can change abruptly.

These factors can influence the incentive environment in which domestic and regional actors operate and the choices they make. They influence ideas, choice of priorities, resource distribution rents and power. They determine the implementation of reforms that streamline trade regulation and processes that improve the business climate and financial management, promote value addition and eliminate non-tariff barriers. Nonetheless, as previously discussed, rules of origin implementation in the African Continental Free Trade Area and the sectors analysed in chapter 3 demonstrate a need to shift the focus from market access-based integration to development-based integration (see chapter 1). Developmental integration involves a greater focus on industrialization and cross-country infrastructural development in the form of roads, rails, airports, seaports and communication facilities.

Effective regional integration is more than mere tariff elimination – it is also about addressing implementation challenges relating to the Agreement on the African Continental Free Trade Area and regional trade agreements and dealing with on-the-ground constraints that disrupt the daily operations of ordinary producers and traders (see chapter 1). It is therefore expedient that mechanisms for harmonizing trade laws within Africa be adopted to realize the objectives of the Continental Free Trade Area and make it more attractive to investors. The private sector is critical in this respect. Regional business associations, including the East African Business Council, COMESA Business Council and SADC Business Forum, represent the voice of the private sector and can influence the pace of regional integration processes. Two bodies of the Continental Free Trade Area, the African Business Council (a continental platform tasked with aggregating and articulating private sector views on continental policy formulation processes) and the African Trade Forum (a pan-African platform for reflection and discussion on the

progress and challenges of continental market integration) play important roles in achieving the following objectives: ensuring trade integration based on the need to improve on trade performance in Africa and consequently, its economic development; supporting the harmonization of business laws in Africa; harmonizing trade legislation and commercial practices that have the potential to distort trade flows; and providing assurances for the protection of businesses against unfair trade practices.

4.9 Conclusion

Rules of origin should remain simple, transparent, predictable and trade-facilitating to enable their implementation. Implementation is essential for rules of origin systems to enable firms to reap the benefits of integrated markets through tariff concessions. The closer the rules of origin of the African Continental Free Trade Area are to existing systems, the less effort will be required to implement and explain to businesses the new rules of origin. Capacity-building, the adoption of new technology and the establishment of an effective monitoring and evaluation mechanism to track progress on rules of origin implementation will be necessary to ensure that preference utilization is high and that the objectives of the African Continental Free Trade Area are realized. Understanding the role played by all stakeholders is also essential to ensure an appropriate continental policy response. These require institutional and implementation mechanisms for collaborative and inclusive continental policymaking in the Continental Free Trade Area.

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.

References

- Abreu MD (2013). Preferential rules of origin in regional trade agreements. Staff Working Paper No. ERSD-2013-05. WTO.
- Adekoya F (2018). MAN [Manufacturers Association of Nigeria] kicks against Nigeria's ratification of African free trade agreement June. Available at <https://guardian.ng/business-services/man-kicks-against-nigerias-ratification-of-african-free-trade-agreement/> (accessed 19 February 2019).
- African Business (2016). Alcohol consumption rising in Africa despite obstacles. Available at. <http://africanbusinessmagazine.com/3x5uv> (accessed 19 February 2019).
- African Centre for Economic Transformation (2014). The Cocoa Agroprocessing Opportunity in Africa.
- African Competition Forum (2013). Competition Dynamics and Regional Trade Flows in the Cement Industry: The Case of Botswana, Kenya, Namibia, South Africa, [United Republic of] Tanzania and Zambia.
- African Union (2006). Declaration of the Abuja Food Security Summit. FS/Decl (I). 7 December. Available at www.fanrpan.org/archive/documents/d00188/AU_Abuja_declaration_Dec2006.pdf.
- African Union (2009). Africa Mining Vision. Addis Ababa.
- African Union (2013). Action plan for boosting intra-African trade. Available at www.au.int/web/sites/default/files/newsevents/pressreleases/26498-pr-action_plan_for_boosting_intra-african_trade_f-english.pdf.
- African Union (2014). Malabo Declaration on Accelerated Agricultural Growth and Transformation for Shared Prosperity and Improved Livelihoods. Addis Ababa.
- African Union (2015). Agenda 2063: The Africa We Want. African Union Commission. Addis Ababa.
- African Union (2018a). Kigali Declaration for the Launch of the African Continental Free Trade Area. Available at <https://www.tralac.org/documents/resources/african-union/1970-kigali-declaration-for-the-launch-of-the-afcfta-21-march-2018-1/file.html> (accessed 1 March 2019).
- African Union (2018b). Agreement Establishing the African Continental Free Trade Area. Available at https://au.int/sites/default/files/treaties/34248-treaty-consolidated_text_on_cfta_-_en.pdf.

- Afriki Presse (2016). En Côte-d'Ivoire l'importation non réglementée du ciment menace emplois, sécurité et investissements. 4 March.
- Akinyoade A and Uche C (2017). Dangote Cement: The challenges of pan-African expansion. In: Akinyoade A, Dietz T and Uche C, eds. *Entrepreneurship in Africa*. Brill. Leiden, Germany: 279–306.
- Akinyoade A and Uche C (2018). Development built on crony capitalism? The case of Dangote Cement. *Business History*. 60(6):833–858.
- Ambe IM and Badenhorst-Weiss JA (2011). An automotive supply chain model for a demand-driven environment. *Journal of Transport and Supply Chain Management*. 5(1).
- Anga J-M (2016). Internalizing the cocoa value chain in producing countries. Presented at the eighth session of the Multi-year Expert Meeting on Commodities and Development. 21 and 22 April. Geneva. Available at https://unctad.org/meetings/en/Presentation/CI_MEM2_2016_Anga.pdf (accessed 19 February 2019).
- Augier P, Gasiorek M and Tong CL (2005). The impact of rules of origin on trade flows. *Economic Policy*. 20(43): 567–624.
- Ba MN (2016). Strategic agricultural commodity value chains in Africa for increased food: The regional approach for food security. *Agricultural Sciences*. 7:549–585.
- Beverage Industry News (2016). Nigerian Breweries targets 60% local sourcing of raw materials by 2018, says MD [managing director]. 23 May.
- Birshan M, Czigler T, Periwal S and Schulze P (2015). The cement industry at a turning point: A path toward value creation. McKinsey and Company. Available at www.mckinsey.com/industries/chemicals/our-insights/the-cement-industry-at-a-turning-point-a-path-toward-value-creation (accessed 19 February 2019).
- Black A, Barnes J and Monaco L (2018). Structural transformation in the auto sector: Industrial policy, state–business bargaining and supply chain development. Industrial Development Think Tank.
- Bloomberg (2018). South Africa places local content at heart of new autos programme. 23 November. Available at www.bloomberg.com/news/articles/2018-11-23/south-africa-to-unveil-next-car-industry-incentive-plan-bd-says (accessed 19 February 2019).
- Boffa M, Jansen M and Solleder O (2018). Value chain activity in the age of changing trade alliances. Vox Centre for Economic Policy Research Policy Portal. 15 December. Available at <https://voxeu.org/article/value-chain-activity-age-changing-trade-alliances#.XECeVV4YtXU.google> (accessed 25 March 2019).

- Bolaky B (2019). Digitalization, Entrepreneurship and Inclusiveness in Digital Trade and Human Rights. United Nations Economic Commission for Africa. Addis Ababa.
- Brenton P (2011). Preferential rules of origin. In: Chauffour J-P and Maur J-C, eds. *Preferential Trade Agreement Policies for Development: A Handbook*. World Bank. Washington, D.C.: 161–178.
- Brenton P and Imagawa H (2004). Rules of origin, trade and customs. In: De Wulf L and Sokol JB, eds. *Customs Modernization Handbook*. World Bank. Washington, D.C.: 183–214.
- Brenton P and Manchin M (2002). Making EU [European Union] trade agreements work: The role of rules of origin. Scholarly Paper No. 304021. Social Science Research Network.
- Brenton P and Soprano C (2018). Small-scale cross-border trade in Africa: Why it matters and how it should be supported. *Bridges Africa*. 7(4):4–6.
- Brenton P, Flatters F and Kalenga P (2005). Rules of origin and SADC: The case for change in the midterm review of the trade protocol. Africa Region Working Paper Series No. 33609. World Bank.
- Brookings Institution and United Nations Economic Commission for Africa (2013). *The African Growth and Opportunity Act: An Empirical Analysis of the Possibilities Post-2015*. Available at <https://www.brookings.edu/wp-content/uploads/2016/06/130729-AGOA-2013WEBFINAL.pdf>.
- Byiers B, Karaki K and Vanheukelom J (2017). Regional markets, politics and value chains: The case of West African cement. European Centre for Development Policy Management. Discussion Paper No. 216.
- Byiers B, Vanheukelom J and Kingombe CKM (2015). A five lenses framework for analysing the political economy in regional integration. European Centre for Development Policy Management. Discussion Paper No. 178.
- Cadot O and De Melo J (2008). Why Organization for Economic Cooperation and Development countries should reform rules of origin. *World Bank Research Observer*. 23(1):77–105.
- Cadot O and Ing LY (2016). How Restrictive Are ASEAN [the Association of Southeast Asian Nations]’ Rules of Origin? *Asian Economic Papers*. 15(3):115–134.
- Cadot O, Carrere C, De Melo J and Tumurchudur B (2006). Product-specific rules of origin in EU [European Union] and US [United States] preferential trading arrangements: An assessment. *World Trade Review*. 5(2):199–224.

- Cadot O, Estevadeordal A, Suwa-Eisenmann A and Verdier T (2006). *The Origin of Goods: Rules of Origin in Regional Trade Agreements*. Oxford University Press. Oxford.
- Calabrese L and Mendez-Parra M (2016). What are the causes of non-tariff barriers in the East African Community? Overseas Development Institute Briefing.
- Chase K (2008). Protecting free trade: The political economy of rules of origin. *International Organization*. 62(3):507–530.
- Chocolate, Biscuits and Confectionery of Europe (2017). European Union–Japan Economic Partnership Agreement: CAOBISCO concerned about origin rules. 13 December. Available at <http://caobisco.eu/public/images/actualite/caobisco-13122017115549-EAC-Bilaterals-122017-558-763.pdf> (accessed 19 February 2019).
- Chidede T and Sandrey R (2018). Intra-African trade: Focusing on trade within regional economic communities. Trade Law Centre. 17 October.
- Coca-Cola (2018). Coca-Cola in Africa. Available at www.coca-colafrica.com/coca-cola-in-africa (accessed 26 February 2019).
- Coke-Hamilton P (2019). How trade wars pose a threat to the global economy. Available at <https://www.weforum.org/agenda/2019/02/how-trade-war-diverts-the-world-unctad-tariff/> (accessed 10 February 2019).
- Collectif régional pour la coopération Nord–Sud (2015). La “guerre du ciment”. 28 November. Available at <https://revuedepressecorens.wordpress.com/2015/11/28/la-guerre-du-ciment/> (accessed 21 February 2019).
- Conconi P, García-Santana M, Puccio L and Venturini R (2018). From final goods to inputs: The protectionist effect of rules of origin. *American Economic Review*. 108(8):2335–2365.
- Davis S, Williams S and Boundy R (2017). *Transportation Energy Data Book: Edition 36*.
- De Melo J and Portugal-Pérez A (2013). Preferential market access design: Evidence and lessons from African apparel exports to the United States and the European Union. Policy Research Working Paper No. 6357. World Bank. Washington, D.C.
- De Melo J and Tsikata Y (2015). Regional integration in Africa: Challenges and prospects. In: Monga C and Lin J, eds. *The Oxford Handbook of Africa and Economics Volume 2: Policies and Practices*. Oxford University Press. Oxford.
- De Melo J, Laski A and Mancellary A (2014). Preparing for the ECOWAS [common external tariff] CET: Options for Liberia. Working Paper. International Growth Centre.

- De Melo, J, Nouar M and Solleder J-M (2017). Integration along the Abuja road map: A progress report. Working Paper 2017/103. United Nations University World Institute for Development Economics Research. Available at <https://www.wider.unu.edu/sites/default/files/wp2017-103.pdf>.
- Deloitte (2018). Navigating the African Automotive Sector: Ethiopia, Kenya and Nigeria. Johannesburg.
- Depetris Chauvin N, Ramos MP and Porto G (2016). Trade, growth and welfare impacts of the CFTA [Continental Free Trade Area] in Africa. Available at https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=CSAE2017&paper_id=749.
- Diageo (2018). Annual Report 2018. Available at www.diageo.com/en/investors/financial-results-and-presentations/annual-report-2018/ (accessed 21 November 2018).
- Draper P, Chikura C and Krogman H (2016). Can rules of origin in sub-Saharan Africa be harmonized? A political economy exploration. Discussion Paper. German Development Institute.
- EAC (2014). Status of Elimination of Non-tariff Barriers in the East African Community. Volume 7. Arusha.
- Erwin A (2016). Building a value chain for the automotive industry in Africa. Presented at the Trade and Industrial Policy Strategies Development Dialogue Seminar. Pretoria. 2 November. Available at www.tips.org.za/events/development-dialogue-seminar/item/3214-the-automotive-value-chain-in-africa-and-the-motorcycle-industry (accessed 21 February 2019).
- Esho H (2015). Dynamics of the textiles and apparel industries in South-East Asia: A preliminary analysis. *Journal of International Economic Studies*. 29:85–106.
- Estevadeordal A (2000). Negotiating preferential market access: The case of the North American Free Trade Agreement. *Journal of World Trade*. 34(1):141–166.
- Estevadeordal A and Suominen K (2004). Rules of origin in FTAs [free trade agreements] in Europe and in the Americas: Issues and implications for the EU [European Union]–Mercosur [Southern Common Market] interregional association agreement. Discussion Paper 2(1). Mercosur [Southern Common Market] Chair of Sciences Po.
- Estevadeordal A and Suominen K (2005). What are the effects of rules of origin on trade? Available at http://siteresources.worldbank.org/INTRANETTRADE/Resources/WBI-Training/288464-1119888387789/RulesOfOrigin_TradeEffects.pdf.
- Estevadeordal A and Suominen K (2008). Gatekeepers of Global Commerce: Rules of Origin and International Economic Integration. Inter-American Development Bank. Washington, D.C.

- European Commission (2005). Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: The rules of origin in preferential trade arrangements – Orientations for the future. COM(2005) 100 final. Brussels. 16 March.
- European Commission (2007). Impact assessment on rules of origin for the Generalized System of Preferences. Taxud/GSP-RO/IA/1/07. October.
- European Commission (2019). The pan-Euro-Mediterranean cumulation and the PEM Convention. Available at https://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/general-aspects-preferential-origin/arrangements-list/paneuromediterranean-cumulation-pem-convention_en (accessed 29 March 2019).
- FAO (2014). Developing Sustainable Food Value Chains: Guiding Principles. Rome.
- FAO (2018a). Emerging trends in tea consumption: Informing a generic promotion process. 2CCP:TE 18/2. Hangzhou, China. April.
- FAO (2018b). Fostering sustainability in tea production and trade: Assessing the impact of certification schemes on farm income, inclusive rural development and market access. CCP:TE 18/4. Hangzhou, China. April.
- Federation of East African Freight Forwarders Associations (2017). Information Booklet on the 2015 Revised EAC Rules of Origin. Nairobi.
- Financial Times (2017). Multinational brewers look to tap Africa's \$13bn beer market. 18 April.
- Financial Times (2018). Global chocolate sales hit a sweet spot. 11 April.
- Food Business Africa (2016). ZB Lusaka South malting plant to be completed soon: Sekele. 19 September. Available at www.foodbusinessafrica.com/2016/09/19/zb-lusaka-south-malting-plant-to-be-completed-soon-sekele/ (accessed 21 February 2019).
- Food Business Africa (2018). Serengeti Breweries to increase volume of cereals sourced locally by 2020. 23 August. Available at www.foodbusinessafrica.com/2018/08/23/serengeti-breweries-to-increase-volume-of-cereals-sourced-locally-by-2020/ (accessed 21 February 2019).
- François J, Hoekman B and Manchin M (2006). Preference erosion and multilateral trade liberalization. *World Bank Economic Review*. 20(2):197–216.
- French Development Agency and World Bank (2010). Africa's Infrastructure: A Time for Transformation. Africa Development Forum. No. 52102. World Bank. Washington, D.C.

- Freund C and Rocha N (2011). What constrains Africa's exports? *World Bank Economic Review*. 25(3):361–386.
- Fugazza M and McLaren A (2014). Market access, export performance and survival: Evidence from Peruvian firms. *Review of International Economics*. 22(3):599–624.
- Gereffi G, Humphrey J and Sturgeon T (2005). The governance of global value chains. *Review of International Political Economy*. 12(1):78–104.
- Global Agriculture Information Network (2012). International brands celebrate growth in Nigeria's spirits market. *Product Brief*. 13 April.
- Gretton P and Gali J (2005). The restrictiveness of rules of origin in preferential trade agreements. Paper presented at the thirty-fourth Conference of Economists. 26–28 September. Available at www.pc.gov.au/research/supporting/restrictive-rules-of-origin (accessed 23 November 2018).
- Gwilliam K, Foster V, Archondo-Callao R, Briceño-Garmendia C, Nogales A and Sethi K (2008). Africa infrastructure country diagnostic: Roads in sub-Saharan Africa. Working Paper No. 55105. World Bank.
- Hallward-Driemeier M and Nayyar G (2017). *Trouble in the Making? The Future of Manufacturing-Led Development*. World Bank. Washington, D.C.
- Harris JT (2007). Measurement and determination of rules of origin in preferential trade agreements. Available at <https://drum.lib.umd.edu/handle/1903/7180>.
- Harvard University (2018). *Atlas of Economic Complexity*. Centre for International Development. Available at <http://atlas.cid.harvard.edu/> (accessed 30 November 2018).
- Hausmann R and Hidalgo CA (2011). The network structure of economic output. *Journal of Economic Growth*. 16(4):309–342.
- Heineken (2015) Growing together in Africa. Available at www.theheinekencompany.com/about-us/our-global-presence/growing-together-in-africa (accessed 14 February 2019).
- Inama S (2009). *Rules of Origin in International Trade*. Cambridge University Press. Cambridge.
- Inama S (2015). Ex ore tuo te iudico: The value of the WTO ministerial decision on preferential rules of origin for LDCs. *Journal of World Trade*. 49(4):591–617.
- Independent Online (2018). Toyota SA initiative to drive localization and transformation. *Business Report*. 12 August. Available at www.iol.co.za/business-report/companies/toyota-sa-initiative-to-drive-localisation-and-transformation-16700374 (accessed 20 January 2019).

- Independent.ie (2015). Africa produces cocoa but little value added chocolate. 24 April.
- Ing LY (2015). Research Institute of Economy, Trade and Industry, BBL Seminar handout. Presented 20 November. Available at <https://www.rieti.go.jp/en/events/bbl/15112001.pdf>.
- International Cocoa Organization (2018). Quarterly Bulletin of Cocoa Statistics. No. 2. Vol. XLIV. Cocoa year 2017/18.
- International Labour Organization (2014). Social protection global policy trends 2010–2015. From fiscal consolidation to expanding social protection: Key to crisis recovery, inclusive development and social justice. Social Protection Policy Papers, Paper 12. Available at http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_319641.pdf.
- International Trade Centre (2010). Market Access, Transparency and Fairness in Global Trade: Export Impact for Good 2010 (United Nations publication. Sales No. E.11.III.T. Geneva).
- International Trade Centre (2015). The Invisible Barriers to Trade: How Businesses Experience Non-tariff Measures. Geneva.
- International Trade Centre (2017). SMEs [Small and medium-sized enterprises] Competitiveness Outlook 2017: The region – A door to global trade. SME Competitiveness Outlook Series (United Nations publication. Sales No. E.17.III.T.2. Geneva).
- International Trade Centre (n.d.). United Republic of Tanzania Cotton-to-Clothing Strategy 2016–2020. Geneva.
- Kamuganga DN (2012). What drives Africa's export diversification? Available at http://graduateinstitute.ch/files/live/sites/iheid/files/sites/international_economics/shared/international_economics/students/PhD%20Job%20Market%20Candidates/2012/JMP_Dick_Kamuganga.pdf.
- Keck A and Lendle A (2012). New evidence on preference utilization. Staff Working Paper No. ERSD-2012-12. WTO.
- Kommerskollegium (2012). The Impact of Rules of Origin on Trade: A Comparison of the EU [European Union]'s and the US [United States]'s Rules for the Textile and Clothing Sector. Stockholm.
- KPMG (2014). The UK [United Kingdom] Automotive Industry and the EU [European Union]. United Kingdom.
- Lejarraga I, Kozul-Wright R, Primi A, Toselli M and Wermelinger M (2016). Upgrading pathways in the automotive value chain. Background document presented at

the seventh plenary meeting of the Organization for Economic Cooperation and Development Initiative for Policy Dialogue on Global Value Chains, Production Transformation and Development. Mexico City. 10 and 11 November.

lentrepreneuriat.net (2014). CIMENT: Une révolution nommée Dangoté. May. Available at <http://lentrepreneuriat.net/business-news/ciment-une-revolution-nommee-dangote> (accessed 17 January 2019).

McKinsey Global Institute (2016). Lions on the Move II: Realizing the Potential of Africa's Economies. McKinsey and Company. Available at <http://www.mckinsey.com/global-themes/middle-east-and-africa/lions-on-the-move-realizing-the-potential-of-africas-economies>.

Mevel S and Karingi S (2012). Deepening regional integration in Africa: A computable general equilibrium assessment of the establishment of a continental free trade area followed by a continental customs union. Presented at the seventh African Economic Conference. 30 October to 2 November. Kigali.

Mizuno T and Takauchi K (2013). Rules of origin and uncertain cost of compliance. Available at <https://ideas.repec.org/p/pramprapa/44431.html>.

Naumann E (2011). UN [United Nations] LDC IV: Reforming rules of origin in preference-giving countries. Policy Brief No. 2. Trade Law Centre and International Centre for Trade and Sustainable Development.

N'Diaye A (2010). Influence des stratégies locales dans les chaînes globales de valeur: Le cas de Madagascar. *Revue française de gestion*. 201:141–159.

Nicita A, Olarreaga M and Silva P (2018). Cooperation in WTO's tariff waters? *Journal of Political Economy*. 126(3):1302–1338.

Organization for Economic Cooperation and Development (2005). The costs and benefits of trade facilitation. Policy Brief. October.

Portugal-Pérez A (2006). Disentangling the Determinants of Rules of Origin in North–South Preferential Trade Agreements: Evidence for NAFTA [the North American Free Trade Agreement]. University of Geneva.

Portugal-Pérez A and Wilson JS (2012). Export performance and trade facilitation reform: Hard and soft infrastructure. *World Development*. 40(7):1295–1307.

Pricewaterhouse Coopers (2008). Global sourcing: Shifting strategies – A survey of retail and consumer companies.

Pricewaterhouse Coopers (2015). Food Security in Africa: Water on Oil. London.

Pulse Ghana (2016). AGI [Association of Ghana Industries] applauds Spio Gbrah's

- decision to cut cement importation. 4 April. Available at www.pulse.com.gh/news/business/association-of-ghana-industries-agi-applauds-spio-gabrahs-decision-to-cut-cement/dknzfg (accessed 21 February 2019).
- Reuters (2017). Brandy chases whisky in South African spirit wars. 13 October.
- Rodrik D (2018). New technologies, global value chains and the developing economies. Pathways for Prosperity Commission Background Paper Series No. 1. University of Oxford.
- Sommer L, Calabrese L, Mendez-Parra M and Luke D (2017). Smart industrialization through trade in the context of Africa's transformation. Overseas Development Institute Briefing.
- Source Supply (2017). Africa's biggest cement producer Dangote rivalled by Lafarge. 16 August. Available at www.source-supply.com/africas-biggest-cement-producer-dangote-rivalled-by-lafarge/ (accessed 21 February 2019).
- Staritz C, Morris M and Plank L (2016). Clothing global value chains and sub-Saharan Africa: Global exports, regional dynamics and industrial development outcomes. International Trade Working Paper No. 2016/16. Commonwealth Secretariat.
- Suominen K (2003). Selective liberalization in response to globalization: Rules of origin as determinants of market access provisions in PTAs [preferential trade agreements]. *Integration and Trade*. 19(7):153–185.
- Suominen K (2004). Rules of origin in global commerce. Ph.D. Dissertation. University of California at San Diego.
- The East African (2014). Rwanda tax on raw materials to affect price of cement. 5 July. Available at www.theeastafrican.co.ke/business/2560-2372906-od8lvaz/index.html (accessed 21 February 2019).
- The East African (2018). Nigeria's study on AfCFTA [the African Continental Free Trade Area] ready next January. 20 December. Available at www.theeastafrican.co.ke/news/africa/Nigeria-study-on-AfCFTA-ready-in-January/4552902-4903656-hk4p8yz/index.html (accessed 21 February 2019).
- The Star (2017). [East African Breweries Limited] EABL courts sorghum farmers for better gains. 2 September. Available at www.the-star.co.ke/news/2017/09/02/eabl-courts-sorghum-farmers-for-better-gains_c1628138 (accessed 14 February 2019).
- Third World Network (2014). LDCs outline challenges in complying with existing rules of origin. 11 November. Available at www.twn.my/title2/wto.info/2014/ti141103.htm.

- Trade Law Centre (2017). African production and trade of coffee and tea in perspective: What are the implications for continental trade liberalization? Available at www.tralac.org/publications/article/12329-african-production-and-trade-of-coffee-and-tea-in-perspective-what-are-the-implications-for-continental-trade-liberalisation.html (accessed 21 February 2019).
- Trade Law Centre (2018). Egypt: Intra-African trade and tariff profile. Available at www.tralac.org/resources/our-resources/13144-egypt-intra-african-trade-and-tariff-profile.html (accessed 21 February 2019).
- Türkcan K and Saygılı H (2018). Economic integration agreements and the survival of exports. *Journal of Economic Integration*. 33(1):1046–1095.
- UNCTAD (1998). Globalization and the international trading system: Issues relating to rules of origin. Available at <https://unctad.org/en/Docs/poitcdtsbd2.en.pdf>.
- UNCTAD (2008). *Cocoa Study: Industry Structures and Competition* (United Nations publication. Geneva).
- UNCTAD (2009). *Economic Development in Africa Report 2009: Strengthening Regional Economic Integration for Africa's Development* (United Nations publication. Sales No. E.09.II.D.7. New York and Geneva).
- UNCTAD (2013). *Economic Development in Africa Report 2013: Intra-African Trade – Unlocking Private Sector Dynamism* (United Nations publication. Sales No. E.13.II.D.2. New York and Geneva).
- UNCTAD (2014). *Pan-African Cotton Road Map: A Continental Strategy to Strengthen Regional Cotton Value Chains for Poverty Reduction and Food Security* (United Nations publication. New York and Geneva).
- UNCTAD (2015a). *Deep regional integration and non-tariff measures: A methodology for data analysis*. Policy Issues in International Trade and Commodities Research Study Series No. 69.
- UNCTAD (2015b). *Economic Development in Africa Report 2015: Unlocking the Potential of Africa's Services Trade for Growth and Development* (United Nations publication. Sales No. E.15.II.D.2. New York and Geneva).
- UNCTAD (2015c). *Commodities and Development Report 2015: Smallholder Farmers and Sustainable Commodity Development* (United Nations publication. New York and Geneva).
- UNCTAD (2016a). *Sand in the wheels: Non-tariff measures and regional integration in SADC*. Policy Issues in International Trade and Commodities Research Study Series No. 71.

- UNCTAD (2016b). *Cocoa Industry: Integrating Small Farmers into the Global Value Chain* (United Nations publication. New York and Geneva).
- UNCTAD (2016c). *African Continental Free Trade Area: Policy and Negotiation Options for Trade in Goods* (United Nations publication. New York and Geneva).
- UNCTAD (2017). *Commodity dependence and the Sustainable Development Goals*. TD/B/C.I/MEM.2/37. Geneva. 3 August.
- UNCTAD (2018a). *Trade and Development Report 2018: Power, Platforms and the Free Trade Delusion* (United Nations publication. Sales No. E.18.II.D.7. New York and Geneva).
- UNCTAD (2018b). *World Investment Report 2018: Investment and New Industrial Policies* (United Nations publication. Sales No. E.18.II.D.4. New York and Geneva).
- UNCTAD (2018c). *The Least Developed Countries Report 2018: Entrepreneurship for Structural Transformation – Beyond Business as Usual* (United Nations publication. Sales No. E.18.II.D.6. New York and Geneva).
- UNCTAD (2018d). *Economic Development in Africa Report 2018: Migration for Structural Transformation* (United Nations publication. Sales No. E.18.II.D.2. New York and Geneva).
- UNCTAD (2018e). *The Djibouti City–Addis Ababa Transit and Transport Corridor: Turning Diagnostics into Action* (United Nations publication. New York and Geneva).
- UNCTAD (2018f). *African Continental Free Trade Area: Challenges and opportunities of tariff reductions*. Research Paper No. 15.
- UNCTAD (2018g). *Handbook on Duty-Free Quota-Free Market Access and Rules of Origin for Least Developed Countries, Part I* (United Nations publication. New York and Geneva).
- UNCTAD (2018h). *The treatment of goods originating in special economic arrangements/zones in the African Continental Free Trade Area*, Technical Paper. Available at https://unctad.org/meetings/en/SessionalDocuments/aldc2019_AfCFTA_TWGrulesoforigin11_tn_SEZs.pdf (accessed 26 February 2019).
- UNCTAD (2018i). *The methodologies of drafting the ad-valorem percentage criterion*. Presentation made at the seventh session of the Technical Working Group Meeting on Rules of Origin. 30 and 31 July. Geneva.
- UNCTAD and FAO (2017). *Commodities and Development Report 2017: Commodity Markets, Economic Growth and Development* (United Nations and FAO. Sales No. E.17.II.D.1. New York and Geneva).

- United Nations Economic Commission for Africa (2015). *Industrializing through Trade: Economic Report on Africa*. No. 2015. Addis Ababa.
- United Nations Economic Commission for Africa (2018). *An empirical assessment of the African Continental Free Trade Area modalities on goods*. Available at https://www.uneca.org/sites/default/files/PublicationFiles/brief_assessment_of_afcfta_modalities_eng_nov18.pdf.
- United Nations Economic Commission for Africa and African Union Commission (2013). *Economic Report on Africa 2013: Making the Most of Africa's Commodities – Industrializing for Growth, Jobs and Economic Transformation*. Addis Ababa.
- United Nations Economic Commission for Africa and Friedrich-Ebert-Stiftung (2017). *The Continental Free Trade Area (CFTA) in Africa – A Human Rights Perspective*. Germany.
- United Nations Economic Commission for Africa, African Union and African Development Bank (2013). *Assessing Regional Integration in Africa VI: Harmonizing Policies to Transform the Trading Environment*. Addis Ababa.
- United Nations Economic Commission for Africa, African Union and African Development Bank (2016). *Assessing Regional Integration in Africa VII: Innovation, Competitiveness and Regional Integration*. Addis Ababa.
- United Nations Economic Commission for Africa, African Union and African Development Bank (2017). *Assessing Regional Integration in Africa VIII: Bringing the Continental Free Trade Area About*. Addis Ababa.
- United Nations Industrial Development Organization (2003). *The Global Automotive Industry Value Chain: What Prospects for Upgrading by Developing Countries*. Sectorial Studies Series. Vienna.
- United States Agency for International Development and East Africa Trade and Investment Hub (2018). *EAC Common Market Implementation: Impact of Non-Implementation of Revised EAC Rules of Origin 2015 – The Case of Motor Vehicle Assemblers in Kenya*.
- United States Geological Survey (2018). *Mineral commodity summaries 2018*.
- Valensisi G and Karingi S (2017). *From global goals to regional strategies: Towards an African approach to SDGs [the Sustainable Development Goals]*. *African Geographical Review*. 36(1):45–60.
- Valensisi G, Lisinge R and Karingi S (2016). *The trade facilitation agreement and Africa's regional integration*. *Canadian Journal of Development Studies*. 37(2):239–259.

- Vonderembse M and Dobrzykowski D (2009). Understanding the automotive supply chain: The case for Chrysler's Toledo supplier park and its integrated partners – KTPO, Magna, and OMMC. Available at www.wistrans.org/cfire/documents/AutoSupplyChainCase10_30_09%20FINAL.pdf.
- Wambui TW (2015). Tea trade in Kenyan markets: Effects of marketing strategies on sustainable domestic market and return to the smallholder tea enterprise. Proceedings of the First International Conference on Tea Science and Development. Karatina, Kenya.
- Weiler JHH, Cho S, Feichtner I and Arato J (2016). International and Regional Trade Law: The Law of the World Trade Organization. Unit III: Rules of Origin.
- White and Case (2016). The fundamentals of trade deals. 15 August. Available at <https://www.whitecase.com/sites/whitecase/files/files/download/publications/fundamentals-of-trade-deals.pdf>.
- World Bank (2012). Sewing Success? Employment, Wages and Poverty Following the End of the Multifibre Arrangement. Directions in Development. Report No. 67524. Washington, D.C.
- World Bank (2016a). Stitches to Riches? Apparel Employment, Trade and Economic Development in South Asia. Directions in Development. Washington, D.C.
- World Bank (2016b). Breaking down barriers: Unlocking Africa's potential through vigorous competition policy. Working Paper No. 106717. Washington, D.C.
- World Bank and Organization for Economic Cooperation and Development (2016). Inclusive Global Value Chains: Policy Options for Small and Medium Enterprises and Low-Income Countries. World Bank. Washington, D.C.
- World Customs Organization (2012). Rules of origin handbook. Available at <http://www.wcoomd.org/en/topics/origin/overview/origin-handbook.aspx>.
- World Economic Forum, World Bank and African Development Bank (2009). The Africa Competitiveness Report 2009. Geneva.
- WTO (2014). Challenges faced by LDCs in complying with preferential rules of origin under unilateral preference schemes. G/RO/W/148. Geneva. 28 October.
- WTO (2015). World Trade Report 2015: Speeding Up Trade – Benefits and Challenges of Implementing the WTO Trade Facilitation Agreement. Geneva.
- WTO (2018). Utilization rates under preferential trade arrangements for LDCs under the LDC duty scheme. G/RO/W/179. Geneva. 10 October.

The advent of the African Continental Free Trade Area represents a historic opportunity for the continent to boost intra-African trade and accelerate structural transformation. However, this relies on a critical policy instrument – the effective implementation of preferential trade liberalization among the members of the African Continental Free Trade Area. Whether African firms, in practice, will use tariff preferences under the African Continental Free Trade Area depends on a critical factor: rules of origin and the net benefits of complying with them. The *Economic Development in Africa Report 2019* argues for the adoption of lenient and flexible rules of origin and a strengthening of institutional capacities to ensure impartial, transparent and predictable implementation of agreed rules of origin.

unctad.org/Africa/series

“Rules of origin in the African Continental Free Trade Area lie at the core of what it means for goods to be ‘made in Africa’ and for Africa. At the eve of the entry into force of the world’s largest free trade area, this report provides the basis for decision-making over the right set of rules of origin for the development of a selection of African value chains. I am proud to count the report among the contributions of UNCTAD as a strategic partner of the African Union for the African Continental Free Trade Area.”

Mukhisa Kituyi

Secretary-General, United Nations
Conference on Trade and Development

“The UNCTAD *Economic Development in Africa Report 2019* makes a valuable contribution to ongoing discussions on rules of origin, which are an important facilitator of intraregional trade in Africa. Rules of origin are a vital component in all market access agreements undertaken in accordance with World Trade Organization rules. This timely report recognizes the role that context-specific rules of origin can play in contributing to the successful implementation of the African Continental Free Trade Area – which is of importance to us all.”

Roberto Azevêdo

Director-General, World Trade Organization