



United Nations Conference on Trade and Development

Distr.: General
22 July 2019

Original: English

Trade and Development Board

Sixty-eighth executive session
Geneva, 30 September–4 October 2019
Item 4 of the provisional agenda

Economic development in Africa: Made in Africa – rules of origin for enhanced intra-African trade*

Overview

Executive summary

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 African 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. Yet, under the African Continental Free Trade Area, it is rules of origin, which establish the nationality of products produced in Africa, that will determine whether preferential trade liberalization can be a game changer for Africa's industrialization.

The *Economic Development in Africa Report 2019: Made in Africa – Rules of Origin for Enhanced Intra-African Trade* of UNCTAD argues that it is critical that rules of origin be appropriately designed and can be enforced to support preferential trade liberalization. This requires that they be simple, flexible, transparent, business-friendly and predictable.

How rules of origin 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 future regional value chains on the continent. How lenient, flexible, easy to use and understand and accessible rules of origin are will also 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 the continent's countries when enforcing rules of origin. Policies are needed to build the institutional capacities of customs authorities, and new and emerging technologies must also be leveraged to lower compliance costs for the private sector.

* The present document is based on UNCTAD, 2019, *Economic Development in Africa Report 2019: Made in Africa – Rules of Origin for Enhanced Intra-African Trade* (United Nations publication, Sales No. E.19.II.D.7, New York and Geneva).



I. Introduction

1. 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.¹ As such, it carries tremendous hope for decent job creation, poverty reduction and prosperity for the continent.

2. 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. Consequently, the African Continental Free Trade Area entered into force in May 2019. 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.² Phase II has the Protocol on Investment, the Protocol on Competition and the Protocol on Intellectual Property Rights. Furthermore, 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. Though 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 free trade area.

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

3. The Agreement Establishing the African Continental Free Trade Area 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 are to be liberalized over 10 years in non-least developed countries and over a period of 13 years in the least developed countries. Despite this, 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.

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

5. 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

¹ African Union, 2015, *Agenda 2063: The Africa We Want*, African Union Commission, Addis Ababa.

² African Union, 2018, 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.

of goods. As such, they represent one of the elements that may determine the answer to the question above.

6. 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.³

7. The agricultural sector and associated value chains are among the leading sectors in Africa with regard to investment attraction.⁴ 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.⁵ Processing capacity is still limited in most African countries. Additionally, the volatility of revenues from the commodity sector and rampant macroeconomic instability have stopped most commodity-dependent developing countries from reaching substantial levels of industrialization.

8. In Africa, commodity-dependent developing countries are less industrialized than even the least developed countries.⁶ As some case studies of selected sectors show,⁷ 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.

B. Strategic elements of the African Continental Free Trade Area

9. More than 25 years after the Abuja Treaty, Africa has taken a historic step towards finalizing negotiations for one of the milestones of regional integration envisaged by its pan-Africanist founding fathers.

10. 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.⁸

11. 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.⁹ Moreover, in the current context of

³ On the harmful macroeconomic and microeconomic impact of commodity dependence, see UNCTAD and the Food and Agriculture Organization of the United Nations, 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).

⁴ Pricewaterhouse Coopers, 2015, *Food Security in Africa: Water on Oil*, London.

⁵ Hallward-Driemeier M and Nayyar G, 2017, *Trouble in the Making? The Future of Manufacturing-Led Development*, World Bank, Washington, D.C.

⁶ See TD/B/C.I/MEM.2/37, on commodity dependence and the Sustainable Development Goals.

⁷ See UNCTAD, 2019.

⁸ 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.

⁹ 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>.

globalization and potential trade tensions,¹⁰ 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.

12. Against a background of uneven progress of African regional economic communities towards regional integration and consolidation,¹¹ 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.

13. 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.¹²

(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 tensions.¹³

(c) In the current context of potential trade tensions, revived nationalism and disenchantment with the multilateral trading system,¹⁴ 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.

¹⁰ 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).

¹¹ 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; 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>.

¹² 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); Harvard University, 2018, Atlas of Economic Complexity, Centre for International Development, available at <http://atlas.cid.harvard.edu/> (accessed 30 November 2018).

¹³ United Nations, Economic Commission for Africa, 2015, *Industrializing through Trade: Economic Report on Africa*, No. 2015, Addis Ababa; 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>.

¹⁴ Nicita A, Olarreaga M and Silva P, 2018, Cooperation in WTO's [the World Trade Organization's] tariff waters? *Journal of Political Economy*, 126(3):1302–1338; 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); Coke-Hamilton, 2019.

C. The economics of the African Continental Free Trade Area

14. 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.

15. 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.

16. 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.

17. 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.¹⁵ In this context, some degree of flexibility while avoiding overly restrictive requirements¹⁶ will be important to ensure that economically weaker countries (e.g. the least developed countries) 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

¹⁵ See UNCTAD, 2019.

¹⁶ It should be noted that the need for flexibilities and special and differential treatment, particularly for the least developed countries, 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 the least developed countries 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.

long-debated issue and a question for which it may be difficult to offer an unambiguous, empirical answer.¹⁷ Broadly, the *Economic Development in Africa Report 2019* 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.

D. Beyond trade liberalization

18. 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 implementation of the African Continental Free Trade Area. This approach could contribute to supporting structural transformation and paving the way for the vision enshrined in Agenda 2063.

19. 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.¹⁸ As is generally the case, however, the growth effects of trade liberalization tend to be relatively small in the short to medium term.¹⁹ 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.

20. 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.²⁰ This is the rationale behind the Action Plan for Boosting Intra-African Trade,²¹ 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.

21. 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

¹⁷ 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; De Melo J and Portugal-Pérez A, 2013, Preferential market access design: Evidence and lessons from African apparel exports to the United States [of America] and the European Union, Policy Research Working Paper No. 6357, World Bank, Washington, D.C.

¹⁸ 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; United Nations Economic Commission for Africa et al., 2017.

¹⁹ 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; 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.

²⁰ 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).

²¹ See <https://www.uneca.org/pages/action-plan-boosting-intra-africa-trade> (accessed 19 July 2019).

value chains and, though to a lesser extent, those in regional value chains, have captured a disproportionately high share of these gains.²² 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.²³

22. 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 (through, respectively, special and 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,²⁴ 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 employment²⁵ and on food security.

23. 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 small and medium-sized enterprises, for any given level of restrictiveness agreed upon. This is a critical objective in so far as it could help in maximizing the utilization of the African Continental Free Trade Area.

II. Main messages

24. 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

²² Rodrik D, 2018, New technologies, global value chains and the developing economies, Pathways for Prosperity Commission Background Paper Series No. 1, University of Oxford; 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).

²³ UNCTAD, 2015, 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, 2016b, *Cocoa Industry: Integrating Small Farmers into the Global Value Chain* (United Nations publication, New York and Geneva); UNCTAD, 2018c.

²⁴ United Nations Economic Commission for Africa and Friedrich-Ebert-Stiftung, 2017, *The Continental Free Trade Area (CFTA) in Africa – A Human Rights Perspective*, Germany; 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.

²⁵ UNCTAD, 2018e, *The Djibouti City–Addis Ababa Transit and Transport Corridor: Turning Diagnostics into Action* (United Nations publication, New York and Geneva).

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.

25. 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, as the *Economic Development in Africa Report 2019: Made in Africa – Rules of Origin for Enhanced Intra-African Trade* illustrates, 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. The African Continental Free Trade Area can help address such continental disconnects, which also arise with regard to other primary commodities.

26. An 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.²⁶ 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 African 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.

27. Rules of origin are a necessary instrument to implement preferential trade liberalization. As such, how they are addressed in the African 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 African Continental Free Trade Area.

28. 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.

29. The report findings 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 demonstrated in the *Economic Development in Africa Report 2019* with regard to the automotive value chain, strategic outward orientation, in this instance at the regional level,

²⁶ UNCTAD, 2019.

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.

III. Policy recommendations

30. 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.

31. 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 African Continental Free Trade Area, leading to low utilization rates of trade preferences; getting them right could enhance commercial value under the African Continental Free Trade Area and support structural transformation. Rules of origin are not sufficient in themselves to boost intra-African trade, as 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 UNCTAD, 2019).

32. 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 small and medium-sized enterprises, 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 also the extensive margin (product and market diversification).

33. 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.

34. 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.²⁷

35. 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.

36. 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 the Common Market for Eastern and Southern Africa.²⁸

37. 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.

38. 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.

39. 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.²⁹

40. 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.

41. 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.

42. 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.

²⁷ UNCTAD, 2019.

²⁸ See UNCTAD, 2019.

²⁹ UNCTAD, 2019.

43. 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.

44. 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,³⁰ such a future move is likely to be welcomed by stakeholders in the cotton sector.³¹ 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 Livelihoods³² 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.

³⁰ 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).

³¹ UNCTAD, 2019.

³² African Union, 2014, *Malabo Declaration on Accelerated Agricultural Growth and Transformation for Shared Prosperity and Improved Livelihoods*, Addis Ababa.