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Made in Africa

Rules of origin for enhanced
intra-African trade



Economic Development in Africa Report 2019

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



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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.

