

## Trade Facilitation in the African Continental Free Trade Area

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### Overview of the problem and proposed intervention

The African Continental Free Trade Area (AfCFTA) was signed by 44 African countries in March 2018. To date, 24 countries have ratified this major regional trade agreement (RTA), which entered into force for these countries in May 2019. The AfCFTA seeks to boost intra-regional trade by supporting free cross-border movement of goods and people along regional corridors throughout Africa. Removing barriers to trade is a pre-requisite for realizing Agenda 2063 aspirations for interconnected and sustainable transport infrastructure systems. These will necessitate an additional US\$2 billion each year. With prevailing high transaction costs these investments are unlikely to materialize; if they do, they will have a much lower rate of return than they would have if trade barriers were not substantially removed.

The AfCFTA has prioritized the removal of import tariffs on intra-AfCFTA trade. As important is to dismantle non-tariff measures (NTMs) affecting intra-African trade. Both types of policies increase trade costs by driving a wedge between consumer prices in the importing country and producer prices in the exporting country. Often NTMs are associated with domestic regulation, and trade costs arise due to regulatory heterogeneity. But NTMs may also reflect a policy to protect domestic firms, or rent-seeking behavior by officials at the border. As many NTMs have legitimate social goals the aim cannot be simple elimination as in the case of tariffs. Trade stakeholders must work together to reduce the trade restrictive effects of NTMs. To do so they require information on a broad range of NTMs and mechanisms to determine their effects and

incidence. Transparency is both a critical input and output, needed to determine priorities for action, assess progress in reducing trade costs, and accountability for results (monitoring and evaluation).

This brief argues that simple, low cost interventions to improve collection and use of information on the prevalence, intensity and incidence of trade costs associated with NTMs have the potential to greatly increase the economic gains from the AfCFTA. The premise – based on global experience – is that the extent to which the AfCFTA will be effective to reduce trade costs depends importantly on governments addressing NTMs, including in services markets. Current technologies permit information on the effect of NTMs to be collected from traders – whether firms, farmers, truckers, or day traders. Real time data on NTMs that is fed into/used to inform the activities and deliberations of national and sub-regional trade facilitation institutions will help target actions on trade policy areas that generate the highest trade costs. As the relative importance of different NTMs will change over time as the AfCFTA is implemented, real-time information is also important to ensure high BCR interventions are pursued over time as opposed to a single point in time.

The proposed intervention capitalizes on a new UNCTAD/Africa Union initiative to collect and record data on NTMs using cell phones and an online portal. We propose building on and extending that mechanism to include services, as it is currently limited to goods. In addition, the intervention will support monitoring and evaluation of the CFTA implementation, as well as future developments in the integration of services markets across the continent. We very conservatively assess the BCR of action to measure trade costs from ‘NTMs at work’ and putting in place mechanisms to help traders advocate, discuss and monitor progress in reducing trade costs at 20.<sup>19</sup>

<sup>19</sup> The appendix provides references to some of the recent literature documenting the importance of NTMs and model-based assessments of the

potential welfare benefits of the AfCFTA. The latter generate higher estimates of gains than our assessment, reflecting different methodologies.

## Probable benefits of scaling up efforts to reduce trade costs

The benefits from the proposed intervention include an increase in the return to investments to reduce the infrastructure gap and the impact of implementation of the CFTA on economic transformation. Increased trade will promote economic welfare gains, job creation and contribute to several of the SDGs. Recent global trade modeling has made progress in estimating the trade and economic welfare impacts (measured as real GDP) of RTAs. In previous work, such agreements have typically been assessed using Computable General Equilibrium models. While useful, these models suffer from the limitation that they do not directly include data on NTMs or services barriers, so results in those areas are dependent on strong assumptions as to likely impacts, which then determine overall effects to a large extent. By contrast, ongoing work builds on recent methodological advances and uses a global gravity model to assess the impacts of RTA membership on trade flows and economic welfare, based on analysis of the trade effects of existing trade agreements that have been implemented in the past. There is no assumption, for instance, that all NTMs are reduced with a particular impact on trade costs. Instead, the approach is to estimate an average effect of RTA implementation in addition to tariff liberalization, which is modeled explicitly, and to infer the observed trade effect must be due to reductions of NTMs and services barriers. In a final step, an additional variable captures EU-style ‘deep integration’, where institutions and mechanisms have been explicitly developed to deal with NTMs and services barriers.

Initial model results indicate that removal of all tariffs on intra-African trade could boost exports by 1.74%, which would be associated with an increase in real GDP of USD\$4.6 billion, or 0.15%. If, in addition, the agreements were to take action on NTMs and services barriers similar to what is seen on average in extant

trade agreements, the numbers would increase to 2.22% and 0.19%. Going beyond this average effect, in a scenario dealing with NTMs and services as completely as the EU has, would see an export gain of 3.7% and a welfare gain of 0.31% (\$9.8 billion), or more than double the tariffs only gain. These effects are conservative relative to the gains reported by other modeling efforts, so they bias the benefit cost ratio (see below) downwards. The ratio would be higher if we used the findings of Abrego et al. (2019) (who conclude tariff removal plus NTM reduction leads to a 2.1% increase in economic welfare) or Vanzetti et al. (2018) (tariff removal leads to a 1.0% increase in GDP). In assessing projects, we believe it is important to state the likely gains as conservatively as possible.

For cost-benefit estimation purposes, we use the figure of \$5.2 billion (current USD) as the total amount of gains that could be reaped by focusing on NTMs and services barriers in AfCFTA. This is the amount of additionality relative to the core tariff removal obligation already accepted by AfCFTA ratifying countries. This is a very conservative measure of regional integration benefits. It ignores many other potential welfare benefits associated with faster border crossings/fewer checkpoints along transport corridors, such as less corruption and red tape (“social waste”), less scope for harassment of women informal cross-border traders (consistent with SDG 5 on gender equality), and the disproportionate importance of trade cost reduction for small firms, helping to promote economic inclusion (SDG 9). Moreover, it is a static assessment based on a counterfactual simulation, not a forecast. So again, in the interests of being conservative, we allow the total gain to build up over ten years using an exponential decay function with a half-life of five years, on the assumption that in the early years, there will be “low hanging fruit” in terms of NTMs to remove, but that the exercise will become more difficult over time. However, we have, in accordance with CCC practice, assumed that

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Ours is more conservative. Relative to the literature our estimates are similar in magnitude to those of Mevel and Karingi (2012).

the counterfactual gain from our model continues to exist over time.

### Nature of the Intervention

Firms and individuals that benefit from trade barriers often have a significant stake in maintaining it. A key to supporting regional integration efforts is to focus on interventions that change the political economy equation by empowering firms and industries that benefit from trade. A key constraint in mobilizing actors with a stake in regional trade liberalization is that they may be unaware of the policy measures and other practices that increase their trade costs. Similarly, governments may be unaware that particular measures impose economic costs, or the extent of those costs. Transparency is thus an important first step in changing the balance between defenders of status quo rents and reformers.

The proposed intervention in this case is to extend and build on the UNCTAD/African Union crowdsourced regional database on NTMs to include barriers to trade facilitation related services, including temporary cross-border movement of service providers. Building on the existing framework based on cell phones and an online interface, a core team would be responsible for cross checking and cataloging the reported measures, which could serve as the basis for a regular report to governments and the basis of regular interactions between stakeholders (traders) and governments.

The intervention will capitalize on data collection efforts by UNCTAD/African Union, and the CMI, including the Dar es Salaam, Northern and Central Corridors in Eastern Africa, the Borderless Alliance and the Abidjan Lagos Corridor organization in West Africa; the Walvis Bay Corridor Group and the Maputo Corridor in Southern Africa. The project connects with national trade facilitation committees that have the mandate to oversee implementation of the 2013 WTO Trade Facilitation Agreement. One output of the intervention will be to generate comparable data on NTMs and a coherent set of indicators for monitoring and evaluation of AfCFTA implementation from a trade cost reduction perspective. Reports and analysis will be

prepared jointly with the CMIs, be presented at their statutory meetings with trade facilitation stakeholders and disseminated through CMI newsletters and websites.

The intervention will consolidate and expand on extant efforts to collect information on NTMs. A key element/source of added value in addition to generating rich and timely data on trade costs will be the analysis of progress/lack of progress in implementation of trade facilitation elements of the AfCFTA. The analysis will be done in collaboration with local institutions and feed into/be the basis for policy dialogues (e.g. at the annual ministerial meeting of the corridor authorities); this in-built capacity building of local analysts and institutions will ensure progressive transfer of competence and sustainability of the intervention. A specific feature of the proposed intervention will be to focus on multi-country transport corridors and associated gateway ports of entry as these are a primary channel for market integration. The basic concept is to create and support a knowledge platform that provides a repository of trade cost data and related information that can support realization of the CFTA and AU2063 visions by generating analysis and mobilizing dialogue and pressure for reform by stakeholders at the national and regional level.

The intervention will be designed to complement efforts by the AUC African Trade Observatory, which has a continental focus, the UNECA, which works with regional economic communities in Africa, and ongoing trade facilitation initiatives supported by donor organizations such as UNCTAD, ITC, TradeMark and USAID. It will add value because extant efforts do not focus on transaction-level sources of trade costs and do not seek to build a unified trade cost reporting and tracking system. A key piece of value added is that it would cover trade in services, including movements of people, in addition to NTMs affecting trade in goods. As such, it would help build a case in the public domain for moving forward in integrating African services markets.

## Benefit Cost Ratio

The benefit side of the calculation comes from the global gravity model referred to above. The total change in real GDP associated with tariffs only integration is subtracted from the total change in real GDP associated with EU-style integration that makes real progress on NTMs, trade facilitation, and services. The result, as noted above, is \$5.2bn for the continent as a whole. For the Northern Corridor, the corresponding figure is \$0.4bn. For the Southern Maputo Corridor, it is \$1.0bn. For the Abidjan-Lagos Corridor (ALCO) in West Africa, it is \$0.9bn. The differences in these figures are driven by the distinct economic size of each sub-region, as well as their pre-intervention level of trade integration (barriers). The corridor figures do not cover all the examples listed above for analytical clarity as we want to avoid double counting of potential benefits. As noted above, we assume that it takes ten years to fully realize the benefits of the intervention, and so apportion the gains according to an exponential decay function with a half-life of five years, assuming the GDP effects remain in line with CCC practice. In an additional effort to be conservative, we have assumed that only 50% of the estimated gains would in fact be realized. This assumption is arbitrary, and not based on an empirical assessment of experience with other trade agreements, but is made in light of past difficulties that have characterized regional integration efforts in Africa.

For the cost side of the calculation, it is important to distinguish one off investment costs from ongoing operating costs. The main up-front cost, namely development of a reporting system, has already been engaged by UNCTAD and the African Union. This intervention would extend the system to cover services policies, which would be significantly less costly than the initial development. Development along with requisite oversight and inputs by a team of analysts comprise some \$0.4m. Ongoing operating costs include training programs for transport operators and traders, a core team of professionals to curate the database and produce regular reports for stakeholders, and a budget for dissemination

and regular engagement with CMLs, chambers of commerce/business associations and government bodies responsible for trade and investment promotion. This recurring cost is estimated at \$0.2m per year per sub-region, on the basis that part of the total cost would be absorbed by UNCTAD and the African Union. On a ten-year basis total costs for 5 sub-regions would be some \$10.4m.

A final consideration relates to adjustment costs associated with reallocation of capital and labor following trade liberalization. In the case of tariff removal such costs can be substantial relative to the benefits. The economics of our proposal is different. NTMs typically create a pure loss of economic resources without any accompanying revenue gain for the government. Part of the resource loss are absorbed as rents by “gatekeepers” including border officials, but the largest share constitutes pure economic waste. The effect is to inflate consumer prices and deflate producer prices relative to a no NTM equilibrium. The reforms supported by our program would reduce the size of that wedge, thereby adding to GDP without bringing about major reallocations across sectors of the type that cause adjustment costs following tariff liberalization. We therefore believe adjustment costs would be much smaller in this case. However, in line with CCC practice, we err on the side of conservatism by assuming that adjustment costs amount to 25% of benefits in the first year, 20% in the second year, 15% in the third year, 10% in the fourth year, and 5% in the fifth year. These figures are based on an UNCTAD analysis of *tariff* reductions, which, as noted, are fundamentally different in terms of impacts from the reforms that are the focus here. As a sensitivity exercise, if adjustment costs were thought to be significantly lower, e.g., 5% of the benefits in the first five years, the BCR would more than double.

Based on the assumption of high adjustment costs, the continent-wide BCR is 20; under the sensitivity assumption on adjustment costs just discussed, it is 50. Even if rollout were to be limited to a single corridor in one sub-region only, with full absorption of the initial investment cost by that corridor alone, the BCR remains approximately 20 for all corridor

examples, as the cost side of the equation is fundamentally driven by the assumption on adjustment costs. As a result, if the intervention was to be rolled out on a trial basis to a single corridor, it would still represent good development 'value'.

## Risks and challenges

The success of the intervention depends upon the effective mobilization and empowerment of relevant regional trade stakeholders through the proposed deliberation and dialogue mechanisms, informed by the data that will be collected. The data collection and analysis effort is designed to complement current corridor performance monitoring programs of CMLs. The sustainability of CMLs, which are envisaged to play a significant role in policy dialogue around trade costs, are generally tied to externally funded infrastructure projects and thus may have a time bound nature. A trend towards providing CMLs with multi-year funding attenuates this risk. A precondition for the cost estimate costs is that it will be possible to coordinate the intervention with the recently announced UNCTAD and AU initiative to develop a mobile app-based reporting system.

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