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The African Continental Free Trade Area

Perspectives for Africa, Policy Choices for Europe

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The Agreement Establishing the African Continental Free Trade Area (AfCFTA) came into force in May 2019. Ultimately the AfCFTA is designed to create a comprehensive African market; what is does at this stage is set in motion a set of complex and foreseeably very lengthy negotiations. The outcome of that process will not yet be full free trade in Africa, but it will bring about a reduction in tariffs with the potential to stimulate production and trade and boost regional value chains. It is, however, too early to be discussing modifying the European Union's trade policy towards Africa, or for this to be an issue for the upcoming German Council Presidency. Nevertheless, Germany and the European Union should continue to follow and support the process of establishing the AfCFTA, which is an important political process with significant long-term economic potential for Africa.

Fifty-four African states have signed the Agreement Establishing the AfCFTA, of which twenty-eight have also ratified (as of October 2019). In essence, the point of the AfCFTA is to abolish tariffs on 90 percent of goods tariff lines. For the most sensitive 7 percent of products the process will be phased over a period of ten to fifteen years; 3 percent of tariff lines (not exceeding 10 percent of the value of imports) will enjoy permanent protection. The AfCFTA will create a market encompassing 1.2 billion people and a combined GDP of about $2.5 trillion.

AfCFTA Issues

The objectives of market opening are laid out in the agreement, but how they are to be achieved remains unclear. Important prerequisites for an actual liberalisation of trade have yet to be negotiated; these include for example specific agreement on the products for which tariffs are to be lowered, how far to reduce and when to do so (so-called liberalisation lists), as well as rules of origin. The latter form an essential part of any free trade agreement, in order to prevent third-country producers from exploiting the arrangement. Rules of origin define the extent to which a product must have been processed in the partner country in order to qualify for the tariff reduction.

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These provisions are still missing from the AfCFTA agreement. In other words, now that it has entered into force its significance is that negotiations continue, while economic impacts will have to wait.

Incidentally, the concept of the AfCFTA agreement "coming into force" has created misunderstanding in Europe, where it is understood rather differently. When a European free trade agreement (FTA) "comes into force" tariffs are lowered immediately and the economic effects are felt directly.

The AfCFTA is supposed to liberalise trade in services as well as goods. But the talks on services are also only just beginning, so the shape of the outcome and potential effects are not yet foreseeable. African states and regional organisations have even less experience with negotiations on services than they do with those on opening trade in goods, and the challenges are correspondingly large. Although the negotiations are based on the WTO's multilateral General Agreement on Trade in Services (GATS), Africa's existing regional economic communities (RECs) have to date pursued different approaches and accrued different experiences as far as liberalisation of services is concerned. The current impact of the AfCFTA in the sphere of services is simply that a common approach has been agreed. As experience at the regional level demonstrates, the talks will require time. For example in the Southern African Development Community (SADC) the discussion about internal market opening for six service sectors continued for six years.

With the AfCFTA treaty the African states are seeking a comprehensive modern agreement that covers trade in goods and services but also addresses new issues. Arrangements on freedom of movement strive for extensive mobility and the abolition of visas. But given that any country may impose any type of restriction under Article 34, the real value of the agreement remains to be seen. In a second phase of negotiations, it is planned to prepare a set of rules for investment, competition policy and intellectual property. The proposed schedule for this (early 2020) has already been missed. In terms of the new issues, it is unlikely that the partners will go any further than WTO rules and existing regional cooperation arrangements.

More Regional Agreements

It is not yet entirely clear how the ongoing negotiating process will proceed. While the objective of establishing a single African Free Trade Area under the auspices of the African Union might create the impression that the outcome will be one *single* African liberalisation instrument, within which each country presents its liberalisation offer to all other members of the African Union before a *single* agreement is negotiated on that basis. That would correspond to the approach taken in the WTO. But it is already becoming apparent that this is not how the process is going to unfold.

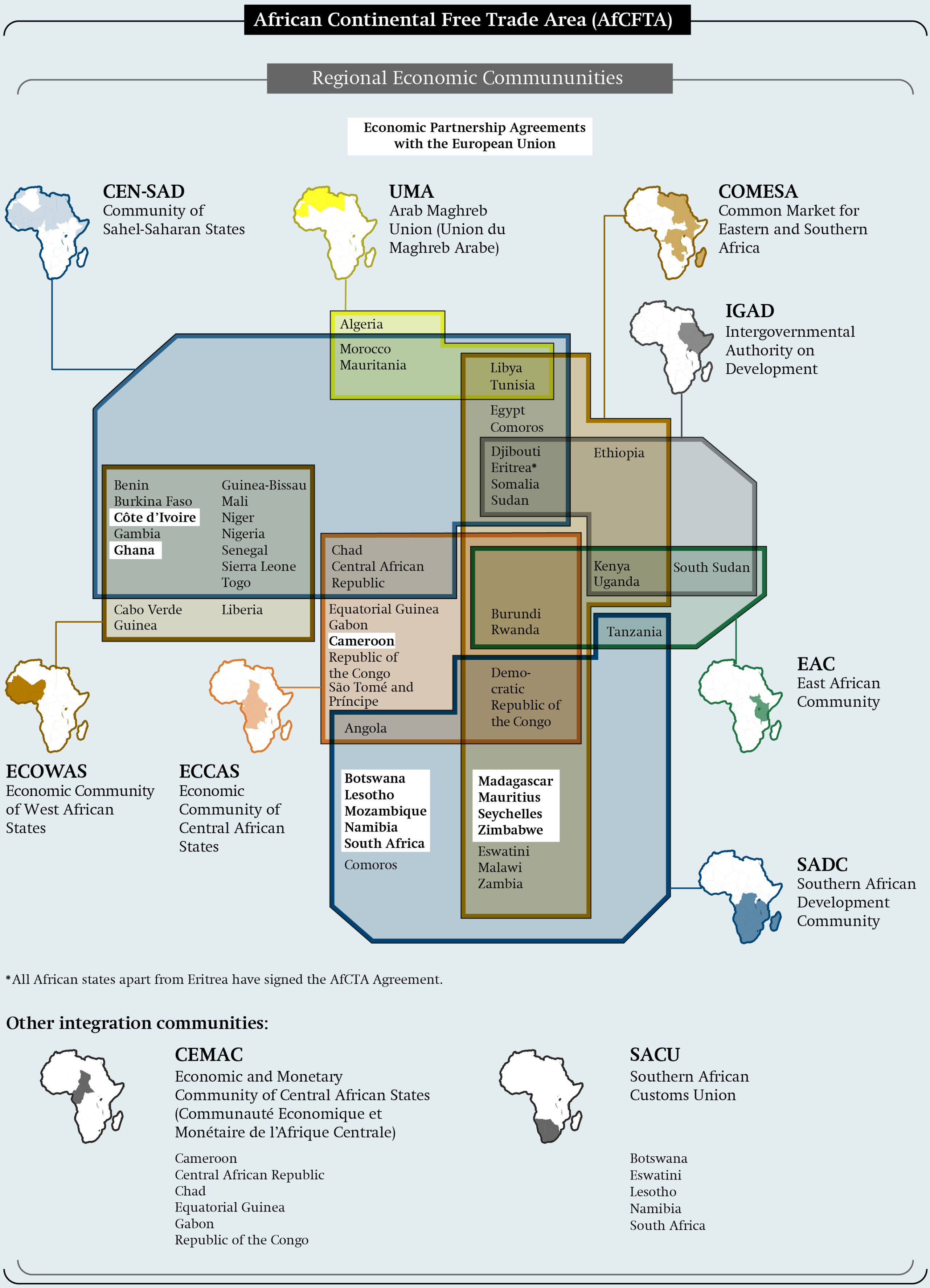
The preamble to the AfCFTA agreement identifies eight RECs as "building blocks" for the AfCFTA (see figure on page 3). Any liberalisation of trade under the AfCFTA (over and above that within the RECs) will initially occur between African countries and regions that do not as yet have FTAs, for example between the East African Community (EAC) and the Economic Community of West African States (ECOWAS). The annex to the report on the AfCFTA for the African Union Summit on 10/11 February 2019 describes the next steps; the number of intra-African economic communities will in fact initially increase until the AfCFTA has been implemented.

Further complicating the negotiations, the degree of integration differs within the individual RECs. Not all of Africa's RECs are yet free trade areas with fully liberalised internal trade: the Union du Maghreb Arabe (UMA) is practically insignificant for example, whereas the SADC has already liberalised 90 percent of its internal trade.

There are also overlaps between the various RECs (see figure). Most African states belong to multiple free trade areas, which may have different tariffs, rules of origin

The African Continental Free Trade Area and its eight building blocks

Africa's overlapping regional integration communities and their Economic Partnership Agreements



and standards. The image of a "spaghetti bowl" is frequently used to describe this situation. How these problems are to be solved and how quickly a further market opening moving towards an AfCFTA can occur thus depends on the political will and engagement of governments and regional communities, and on the progress they make. The role of the African Union here is to drive and possibly facilitate the process.

Concern over Competition Hindering Integration

One of the trickiest problems for the process of developing the AfCFTA is the smaller countries' worries about competition from larger countries with stronger export sectors. The International Monetary Fund points out that intra-African trade flows are dominated by a handful of "hubs": Côte d'Ivoire, Kenya, Senegal and South Africa. These enjoy a head start in the AfCFTA and can expect first and foremost to increase their exports.

The IMF therefore believes that taking the concerns of the weaker nations seriously is crucial for progress in the further negotiations. But these countries are especially likely to adopt protectionist stances and to hesitate to open their own markets, partly because they fear growing competition within a free trade area. Attempts have been made to address these worries in the talks with "special and differential treatment" for weaker countries. The least developed countries in the AfCFTA have already been granted the concession of phasing in their tariff reductions over a period of thirteen years rather than ten. But special treatment in the sense of exemptions from market opening will not apply automatically; interested countries will have to demonstrate their eligibility on the basis of specific criteria. This raises the risk that countries with weak administrative and financial capacities will find it difficult to apply for and retain their special treatment, and will instead simply neglect to fulfil their commitments to open their markets.

Perspectives Going Forward

With the negotiation and ratification of the AfCFTA agreement, the AU Commission has injected new dynamism into the regional integration process. The step from talks — and even negotiated outcomes — to concrete economic effects is large, however. Criticisms of the African Union's pressure to deliver rapid results have also been heard from government circles, for example in Southern Africa. They also point out a difficulty: a timeframe may have been agreed but there is still a danger of foot-dragging on implementation. It is therefore likely that integration will proceed (more) dynamically in those regions that are already committed to a more open trade policy. In this vein, the talks in Southern Africa between the Southern African Customs Union (SACU) and the EAC are said to be going well, while the process of opening between countries that pursue a more protectionist approach, such as Nigeria or Zimbabwe, continues to proceed at a crawl.

On top of this, the stimulating effect of tariff reductions on internal trade differs between regions. This is because other factors often restrict trade more than tariffs — for example high trade costs through quotas and licences, sanitary and phytosanitary measures, technical standards, and bureaucratic procedures. Another problem is the lack of export diversification in many African countries. States with more extensive product diversification are more strongly integrated in regional trade. As a result, the relative importance of regional trade for individual countries has risen rapidly after tariff reductions in certain regions, for example in the SADC, but not in others such as the Communauté Economique et Monétaire de l'Afrique Centrale (CEMAC).

Even if the AfCFTA has yet to produce economic outcomes, significant steps have been achieved: The shared commitment to an objective of a 90-percent market opening within Africa represents an important consensus. But the really significant aspect of the AfCFTA is that it has outlined liberalisation procedures that serve as a "template", in the sense of the structure of the liberalisation schedules that are required for subsequent bilateral and regional negotiations. Once they have been used by a country or region, all subsequent talks with African partners become easier. Namibia for example has reportedly already used the AfCFTA templates for its negotiations within the tripartite of EAC, SADC and COMESA (Common Market for Eastern and Southern Africa).

Finally, the founding of the AfCFTA channels private-sector interest more strongly to the African market. Niger's president regards the positive outcomes of the Intra-African Trade Fair in Cairo in December 2018 as a first result of the AfCFTA. At the event contracts worth more than $30 billion were concluded between the 1,086 exhibitors.

The Economic Potential of the AfCFTA

There are many good reasons to complete the AfCFTA. Especially in smaller African economies, such as Namibia with a population of about 2.5 million, expanding the market in the context of a free trade area would allow industry to realise economies of scale. These are potentiated by the constellation of an expanding middle class within a rapidly growing population. According to UN estimates, Africa's population is expected to double to about 2.6 billion by 2050.

The figure for intra-African imports as a proportion of total African imports has almost tripled over the past two decades to reach approximately 13 percent ($73.6 billion). But this welcome development conceals widely diverging trends in different sub-regions. While South Africa alone is the source of 35 percent of intra-African exports and receives 15.5 percent of intra-African imports, other major countries are poorly integrated. Algeria, Egypt and Nigeria together account for half of Africa's GDP but are only marginally involved in intra-African trade, which accounts for just 11 percent of their imports and exports. The SADC, on the other hand, is highly integrated with its members conducting a significant share of their trade with each other (20 percent). Most intra-African trade — about three-quarters — occurs within the most important regional organisations, above all in Eastern and Southern Africa.

Intra-African trade offers great potential to establish regional value chains and boost both growth and development. This is because more manufactured goods are traded within Africa than African states export to third countries. Products with high added value such as vehicles and cosmetics represent about 40 percent of intra-African trade (raw materials 44 percent, agricultural products about 16 percent). Exports to countries outside Africa on the other hand are still largely dominated by raw materials (approx. 75 percent).

To what extent might the AfCFTA now contribute to intra-African trade? As already laid out above, it will be a very long time before the economic effects are felt. According to the IMF, liberalisation of 90 percent of trade within the AfCFTA would lead to a comparatively modest 16 percent increase in trade. The reason for this is that 90 percent liberalisation may sound impressive but is not in fact very ambitious. In most countries most imports are already tariff-free; in Namibia for example the figure is about 60 percent. So if 10 percent of products are excluded from tariff reductions, this allows the most dynamic categories to be excluded. The economists Peter Draper and Andreas Freytag go as far as concluding that this lack of ambition will prevent the AfCFTA from achieving any really meaningful liberalisation.

The negotiations and the launch of the AfCFTA have generated a certain dynamism and expectation — both within and outside Africa — to actually achieve economic results. But, especially in view of the sobering balance of liberalisation efforts to date in certain regions, two real dangers must be noted. Firstly, decisions to reduce tariffs may not necessarily be implemented. Secondly, the definitions and obligations could be so unambitious that even implementation leads to little change in real trade, for example if the rules of origin are very strict or the exemptions very generous. Great effort expended on meagre results would be the worst outcome, and would dissipate the drive for further liberalisation.

Little Effect on Agreements with Third States

African states and regions already have various agreements with counterparts *outside* Africa. The most important of these are the economic partnership agreements (EPAs) with the European Union; there are also free trade agreements and preferential agreements (the latter covering only a selection of sectors) with other countries and regions such as the European Free Trade Association (EFTA) or Mercosur. Other FTAs are currently being negotiated, for example with the United Kingdom, between the SACU and India, and soon also with the United States.

FTAs with countries and regions outside Africa remain possible under Article 4 of the AfCFTA Protocol on Trade in Goods, as long as they do not "impede or frustrate the objectives" of the AfCFTA.

What does this mean concretely? Article 4 states unambiguously that the AfCFTA does not affect existing agreements like EPAs, and thus answers a question often asked in Germany: At this stage African trade integration does not necessitate a comprehensive new agreement between the European Union and the African Union to replace the EPAs. Article 4 also confirms that individual countries and regions will retain the ability to conclude new agreements with third countries. This is not a problem because the AfCFTA — unlike a customs union — does not require uniform tariffs vis-à-vis third countries. As a free trade area it liberalises only trade between the participating countries. All participants thus retain the freedom to conclude their own agreements, including different external tariffs.

It is important for Africa that tariffs for third countries outside Africa must not be lower than those within Africa. The point of this is to avoid a situation where an agreement — for example with Mercosur — could create trade preferences that disadvantage intra-African trade. Article 4 of the AfCFTA Protocol on Trade in Goods therefore requires that all preferences granted to third countries under FTAs must also be granted to the African partners within the AfCFTA under the principle of reciprocity. The same is also planned for services. If for example the SACU lowers a tariff for India it must also offer the same to its partners in the AfCFTA (for example in future potentially Côte d'Ivoire) *provided* that the African partners are willing to lower their own corresponding tariffs.

The European Union's EPAs already contain such so-called regional integration clauses, even without a requirement of reciprocity. Admittedly these apply only within the respective EPA regions, and not outside them. The regional integration clause in the AfCFTA is therefore a significant expansion that ensures that tariffs for all other African partners (not just those within the respective EPA region) are at least as low as those for the European Union (or partners in other future FTAs). This provision is central, but tends to hamper ongoing negotiations, including the intra-African. This is because the extent to which potential tariff reductions can and must also apply to the African partners in the AfCFTA must always be considered in future (bilateral) negotiations.

Conclusions: Implications for Germany and the European Union

The AfCFTA can only be understood as a very long-term project. Shaping it offers the opportunity to boost value creation and generate new employment via an increase in intra-African trade in finished goods. The European Union should continue to contribute to this process through Aid for Trade (AfT). That means supporting the AU's Commission and negotiating processes, and the implementation by the national governments of the decisions made in the African Union. Advancing integration within the RECs and the trade negotiations between them will remain decisive for quite some time. Because the AfCFTA will be realised via these steps, the RECs are ultimately the "building blocks" of the AfCFTA.

In order to achieve concrete results it will also be necessary to enable the private sector to actually make use of the new market opportunities that arise. That means information about markets, and frequently also work to enhance industrial competitiveness. In order to attract investment — whether local, regional or from third countries — African countries must continue to improve the underlying conditions and realise trade facilitation. The G20 Compact with Africa (CwA) and the European External Investment Plan (under the Africa-Europe Alliance) are frameworks that should be used to such support efforts.

The talks about the successor to the Cotonou Agreement between the European Union and the Africa, Caribbean and Pacific (ACP) states offer space to agree principles for such AfT approaches for promoting regional integration. If not completed beforehand, this task may fall to the German Council Presidency, which would then have an opportunity to set its own priorities. It can be assumed that the issue of AfT promoting regional integration can be handled harmoniously, unlike the "real sticking-points" of the post-Cotonou negotiations such as the question of how to anchor migration in the agreement and its regional pillars.

The question of whether ratification of the AfCFTA agreement means that the European Union should start negotiations with the African Union about an EU-AU trade agreement to supersede the existing EPAs has already been discussed in Germany. Currently such negotiations would be neither possible nor sensible. And the African side has no incentive, because most of the states of Sub-Saharan Africa already enjoy completely free access to the EU's markets. This applies not only to all the countries that participate in EPAs, but also to all the LDCs, which profit from unilateral EU trade preferences. South Africa and the states of North Africa already enjoy extensive tariff-free access for industrial goods. Nevertheless, Jean-Claude Juncker, when he was President of the European Commission, stated that the European Union would be open to trade talks with the African Union once the AfCFTA was completed, if this were desired by the African side. As such the European Union has demonstrated the necessary political willingness, to which Africa may return. But that cannot be expected for the time being.

Finally, the African states will need their energy and capacities for the negotiations on completing the AfCFTA. Especially in view of the current weakness of the multilateral system they also have an interest in free trade agreements with other partners above all in Asia, but also in Latin America, and with the United States. Africa's negotiating power would naturally be greater if African countries were already able to operate jointly as a pan-African customs union. But the first step is to complete the AfCFTA.

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