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African Continental Free Trade Area: a catalyst for industrial development on the continent

The present policy brief draws primarily on research materials and toolkits prepared by the Economic Commission for Africa (ECA) to highlight the potential for industrial development under the African Continental Free Trade Area, in order for countries to make optimal use of the agreement through critical policies and tailored strategies.

1. African Continental Free Trade Area in brief

The African Continental Free Trade Area is aimed at progressively eliminating tariffs and removing non-tariff barriers on intra-African trade, thus creating opportunities for African businesses throughout the continent. The African market, comprising 55 African Union member States and more than 1.2 billion people, will be the largest free trade area (in terms of the number of economies covered) in the world since the formation of the World Trade Organization in 1994. In addition, the agreement contains elements that will help African countries to implement their developmental and industrialization aspirations. There is a greater opportunity for and incidence of trade in industrialized goods on the continent than in trade with other regions that feature predominantly primary products. Increased levels of industrialization will reduce the exposure of African resource-rich countries to the cyclical shocks associated with a dependence on the trade of primary commodities in the international market.

The African Continental Free Trade Area covers trade in goods and services, investment, intellectual property rights, competition policy and, possibly, e-commerce. Given its wide scope, which moves beyond the requirements of a traditional free trade area that, in general, focuses only on the elimination of tariffs and quotas on trade in goods, the expectation is that the agreement will be a key contributor to the economic integration of Africa. If effectively implemented, it should catalyse Africa's industrial transformation, while boosting trade and investment between countries and regional economic communities, to generate prosperity for citizens, in line with the 2030 Agenda for Sustainable Development and the African Union's Agenda 2063: The Africa We Want.

2. African Continental Free Trade Area: a way to bring about industrialization through an integrated African market

African economies are fragmented and isolated from one another by barriers to trade (e.g., tariffs, cumbersome border procedures and significant infrastructure bottlenecks). These barriers limit the ability of African businesses to achieve economies of scale and build competitive productive capacities for regional and international trade of value-added products, capable of generating the jobs that Africa needs. To date, the contribution of the manufacturing sector (manufacturing value added) to Africa's gross domestic product (GDP) is below 15 per cent,¹ while intra-African trade remains as low as approximately 16 per cent of the continent's total trade.²

The African Continental Free Trade Area contains elements that are aimed at tackling the fragmentation of African economies through the elimination of tariffs and removal of non-tariff barriers. If these elements are implemented, the resulting integrated market will create a favourable environment for efficiency gains from economies of scale and increased competition. This will also enable manufacturers and traders to gain efficiencies in the use of resources, including labour and technology. In addition, promoting the free movement of people and capital will contribute to industrial development through supporting businesses in gaining access to a pool of resources, including finance and labour. This will culminate in greater industrial development on the continent and in the promotion of regional value chains, which, in turn, will contribute to strengthening Africa's position in global value chains, while retaining more value at national and regional levels.

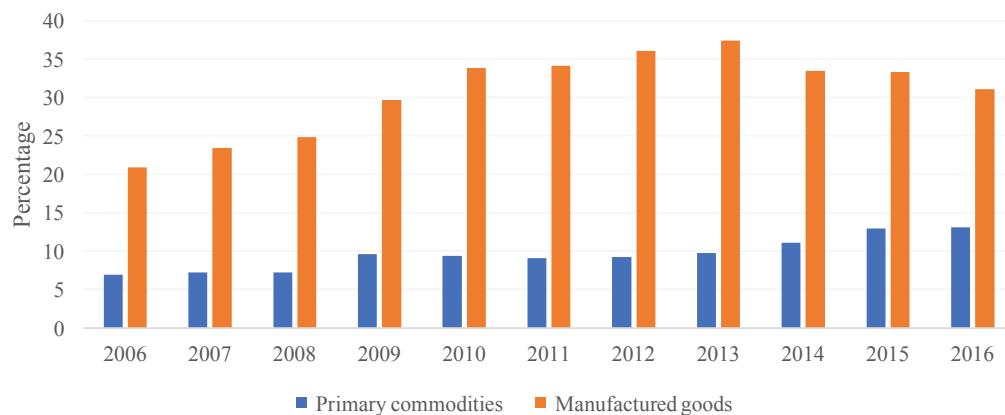
The imperative for the African Continental Free Trade Area to support the industrial development of Africa is evident in the composition of trade between African countries, relative to the trade with the rest of the world, as demonstrated by empirical evidence. For example, while commodities dominate Africa's exports with the rest of the world, intra-African exports are characterized by higher industrial content and value-added products. During the period 2006–2016, Africa exported less than 13 per cent of its primary commodities within Africa, while the equivalent export shares for manufactured goods exceeded 20 per cent (see figure below). Accordingly, Africa's behind-the-border agenda can provide a push for the development of the manufacturing sector. In addition, preliminary estimates by ECA on the potential impacts that the free trade agreement can have on trade suggest that, with the sole removal of tariffs on goods, the value of intra-African trade would increase between approximately 15 and 25 per cent, depending on the ambition of the liberalization (i.e., the more ambitious the trade liberalization, the greater the expansion of intra-African trade), compared with a situation without the agreement in place. The gains would be most pronounced in industrial sectors, thereby offering invaluable opportunities to industrialize through trade.³

¹ Based on data from the World Bank (world development indicators) for GDP data and the United Nations Industrial Development Organization databases for manufacturing value added data.

² Based on 2017 data from UNCTADstat.

³ The figures are based on an ongoing study by ECA using the computable general equilibrium model.

Figure: Intra-African exports – percentage of total exports for primary commodities and manufactured goods (2006-2016)



Source: Based on data from UNCTADstat (<http://unctadstat.unctad.org>). Accessed on 28 August 2018.

For the African Continental Free Trade Area to deliver the expected results, it is important to ensure that the enablers necessary are in place.

3. Essential enablers to maximize the gains of the African Continental Free Trade Area

3.1 Implementation of the African Continental Free Trade Area

Harnessing the benefits of the African Continental Free Trade Area begins with its implementation, and ratification by member States being a prerequisite. Once ratified, however, the benefits will not come overnight. Countries will need to identify areas in which their comparative advantages lie for diversification and value chains (for both goods and services) development under the agreement, which will enable them to design and implement the action necessary to harness these advantages. In addition, they will need to identify the means to deal with any fiscal impact resulting from the agreement. This certainly implies developing tailored national strategies for countries to make optimal use of the agreement. The strategies should be aligned with current policy frameworks at the national, regional and continental levels. These include countries' national development plans and policies and the Boosting Intra-African Trade and the Accelerated Industrial Development for Africa initiatives.

The need for national strategies regarding the African Continental Free Trade Area were recognized and clearly articulated at the Conference of Ministers held in Addis Ababa in May 2018, and reiterated at the African Union Summit in Nouakchott in July 2018. Implementation of the agreement needs to be coupled with tools designed to track the progress in that regard. It is critical to assess, monitor and overcome the constraints faced by businesses if the agreement is to catalyse Africa's industrial development.

3.2 Digitalization of African economies

To maximize the opportunity for industrialization in the African Continental Free Trade Area, it is imperative to consider the opportunities and challenges associated with the fourth industrial revolution, especially the digital economy, which incorporates Internet-based changes leading to advanced robotics and factory automation (i.e., advanced manufacturing), the Internet of things, cloud computing, big data analytics and artificial intelligence.⁴ These developments, which have drastically changed the nature of manufacturing, give African countries the opportunity to reduce costs and increase efficiencies of manufacturing and other industrial operations. Similarly, the competitiveness and employment of Africa's workforce will be enhanced through investment aimed at closing the digital divide, which is manifested in their lower levels of digital skills and not having access to digital technologies. These digital skills and technologies also underpin the use of digital trade and e-commerce platforms, which will enable the trade of industrial goods and services in Africa.

Although Africa has made some progress in digitalization in the past years, it remains the poorest performing continent in terms of information and communications technology (ICT) development. According to the 2017 ICT Development Index published by the International Telecommunication Union, only 6 African countries were among the top 100 in the world in terms of ICT development. The top performing country in Africa, Mauritius, was ranked seventy-second worldwide.⁵ Digital policies⁶ and digital industrial strategies are important to enable the identification of gaps in technology, skills and infrastructure, promote investment in critical areas and support the development of inclusive and coherent policy frameworks that will allow African countries to maximize the opportunities in the digital economy for industrialization.

3.3 Promotion of well-functioning and resilient infrastructure: hard and soft assets

The efficient movement of resources, goods and people needed for operationalizing the African Continental Free Trade Area are critical components of industrialization, underpinned by well-functioning resilient infrastructure assets. The potential of the blue economy, which incorporates a range of productive sectors in trade and maritime services, is presently underutilized.⁷ Approximately 90 per cent of Africa's trade is sea borne, but African-owned ships account for only 1.2 per cent of global shipping and 0.9 per cent of gross tonnage, while African ports handle 6 per cent of global water-borne traffic and 3 per cent of global container traffic.⁸

⁴ See United Nations Conference on Trade and Development, The New Digital Economy and Development (Geneva, 2017).

⁵ See ICT Development Index 2017. Available at www.itu.int/net4/ITU-D/idi/2017/index.html.

⁶ For example, the National E-Commerce Strategy of Egypt and the National ICT Policy of Kenya.

⁷ The blue economy in Africa covers aquatic and marine spaces, including oceans, seas, coasts, lakes, rivers and underground water, and comprises a range of productive sectors, such as fisheries, aquaculture, tourism, transport, shipbuilding, energy, bio-prospecting, underwater mining and other related activities. See Economic Commission for Africa, Africa's Blue Economy: A Policy Handbook (Addis Ababa, 2016).

⁸ See African Union, 2050 Africa's Integrated Maritime Strategy (Addis Ababa, 2012).

Africa's long-lasting infrastructure shortcomings are being tackled through a number of high-level programmes and projects at the national, regional and continental levels. The Programme for Infrastructure Development in Africa covers a range of projects from transport, water and sanitation to energy and ICT. Examples of infrastructure programmes and projects with high potential to accelerate regional integration include the North-South Corridor Programme, the Abidjan-Lagos Highway Development Programme, the Walvis Bay Corridor, the Addis Ababa-Djibouti Railway, the Africa Clean Energy Corridor, the Grand Ethiopian Renaissance Dam and the Grand Inga Dam. These regional projects have national components that need to be embedded into countries' national infrastructure development plans. The establishment of integrated economic zones, including industrial parks, special economic zones and technology parks with efficient infrastructure assets, are critical to circumvent infrastructure deficits throughout Africa. Countries such as Egypt, Ethiopia, Gabon, Kenya, and South Africa have developed well-integrated economic zones that are supporting the development of vibrant manufacturing sectors.

The development of regional value chains under the African Continental Free Trade Area also implies the promotion of quality infrastructure systems, from metrology and standardization to quality management and conformity assessment. These systems create opportunities for African producers to successfully (re-)position themselves in specific (i.e., niche) markets of certified products that ensure premiums, while promoting environmental sustainability and the traceability of goods and services. There are cases in which a number of quality infrastructure systems are found with overlapping schemes that make the certification process confusing and costly for producers. This suggests the need for schemes to be harmonized in order to make them an opportunity under the agreement, rather than a trade barrier. In addition, it is important to promote other soft infrastructure needed for trade facilitation, including the simplification, harmonization and automation of intraregional trade procedures.

3.4 Building strong capacities at all levels

The lack of financial and human capacity has been a key impediment to Africa's industrial development, in particular for small and medium-sized enterprises. Skills gaps and skills mismatches are recurrent in Africa in part because institutions are not providing enough skilled human resources to meet the market demand. For example, skills gap throughout the continent include 4.3 million engineers and 1.6 million agricultural scientists and researchers.⁹ Accordingly, there is a need to tailor national education systems to support industrial development and for more effective insertion into value chains under the African Continental Free Trade Area. Issues relating to finance and investment include the high cost of finance and low investment (for both intra-African and external investment) in factors that support productive capacities and value addition. Creating a favourable environment to channel such investment into the high value added sectors should be incentivized

⁹ See African Capacity-Building Foundation, African Critical Technical Skills: Key Capacity Dimensions Needed for the First 10 Years of Agenda 2063 (Harare, 2016).

at all levels, including the national and continental levels. Whenever possible, the creation of funds to support small and medium-sized enterprises should be encouraged.

Key recommendations

In the light of the issues discussed, the following actions will need immediate attention to ensure that the African Continental Free Trade Area serves as a catalyst to Africa's industrial development:

- **Develop national strategies to support the effective implementation of the African Continental Free Trade Area so as to harness its potential gains in terms of industrial development.** The national strategies should ensure that countries review export performance, identify key industrial and trade opportunities and identify constraints to target sectors and strategic action for boosting target sectors in the continental market. In addition, countries should develop and incorporate digital industrial strategies into their national strategies to enhance productivity and competitiveness. These strategies should account for the technology, infrastructure and skills capacities necessary to improve efficiencies and reduce the costs of manufacturing.
- **Foster the emergence of digital platforms for trade in industrial goods at regional and continental levels.** These platforms to provide market information and create market opportunities for producers should also include certification and quality assurance systems to increase levels of trade in industrial goods on the continent.
- **Resolve infrastructure bottlenecks in order to make the African Continental Free Trade Area a catalyst for industrial development through integrated markets.** African countries should urgently invest in all types of resilient infrastructure assets, promote integrated economic zones for industrial development and implement trade facilitation measures, all of which are required to improve competitiveness.
- **Develop the skills required by businesses to promote value addition on the continent.** It is advised to tailor education systems to the needs of industries, including those to be prioritized under the African Continental Free Trade Area. This implies fostering technology-focused incubation programmes; increasing participation rates at tertiary-level education in science, technology, engineering and mathematics; and improving the means for young people to have access to high-quality technical and vocational education and training programmes.
- **Foster access to finance and channel investment into productive activities.** Countries, in collaboration with development partners and financial institutions, should create an environment that makes it easier for businesses to have access to finance (e.g., creation of funds for small and medium-sized enterprises) and to channel investment into high value-added activities.



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