Regional Trade Arrangements in Africa

Yongzheng Yang
Sanjeev Gupta

International Monetary Fund

Regional Trade Arrangements in Africa

Yongzheng Yang and Sanjeev Gupta

International Monetary Fund
Washington, DC

©International Monetary Fund. Not for Redistribution

©2005 International Monetary Fund

Production: IMF Multimedia Services Division
Typesetting: Alicia Etchebarne-Bourdin
Cover Design: Martine Rossignol-Winner
Photo Credit: Andrew Burke/Lonely Planet Images

Cataloging-in-Publication Data

Yang, Yongzheng.
Regional trade arrangements in Africa / Yongzheng Yang and Sanjeev Gupta—[Washington, D.C.]: International Monetary Fund, 2005.

p. cm.

Includes bibliographical references.
ISBN 1-58906-439-9

1. International trade—Africa. 2. International Monetary Fund. I. Gupta, Sanjeev.
HF3874.Y35 2005

Disclaimer: The views expressed in this work are those of the authors and do not necessarily represent those of the IMF or IMF policy. The IMF has not edited this publication. Some documents cited in this work may not be available publicly.

Price: $25.00

Please send orders to:
International Monetary Fund, Publication Services
700 19th Street, NW, Washington, DC 20431, U.S.A.
Telephone: (202) 623-7430 Telefax: (202) 623-7201
Internet: www.imf.org

©International Monetary Fund. Not for Redistribution

Abbreviations

ACP	Africa, Caribbean, and Pacific
AEC	African Economic Community
AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
ASEAN	Association of Southeast Asian Nations
ATC	Agreement on Textiles and Clothing
CEAO	West Africa Economic Community
CEMAC	Central African Economic and Monetary Community (formerly UDEAC)
CET	Common external tariff
CMS	Constant market share
COMESA	Common Market for Eastern and Southern Africa
CU	Customs union
EAC	East African Community/Cooperation
EBA	Everything but Arms (EU)
ECA	Economic Commission for Africa (UN)
ECCAS	Economic Community for Central African States
ECOWAS	Economic Community of Western African States
EEC	European Economic Community
EFTA	European Free Trade Association
EPA	Economic Partnership Agreement (EU)
EU	European Union
FDI	Foreign direct investment
FTA	Free trade agreement/area
GATT	General Agreement on Tariffs and Trade
GSP	Generalized system of preferences
Mercosur	Common Market of the South
MFN	Most favored nation
NAFTA	North American Free Trade Agreement
NEPAD	New Partnership for Africa's Development
NTBs	Nontariff barriers
OAU	Organization of African Unity
PRGF	Poverty Reduction and Growth Facility
Quad	Canada, the EU, Japan, and the United States
ROO	Rule of origin
RTA	Regional trade arrangement
SACU	Southern African Customs Union
SADC	Southern African Development Community
TIM	Trade Integration Mechanism
UDEAC	Central African Customs and Economic Union

©International Monetary Fund. Not for Redistribution

VAT	Value-added tax
WAEMU	West African Economic and Monetary Union
WTO	World Trade Organization

©International Monetary Fund. Not for Redistribution

Preface

Trade policy is a critical component of an effective strategy for reducing poverty and boosting growth in Africa. In recent years, however, African policymakers have increasingly resorted to regional trade arrangements (RTAs) as a substitute for broad-based trade liberalization. This trend has long-term implications for the effectiveness of trade policy as a tool for poverty reduction and growth.

This Special Issues paper examines the record of African RTAs in promoting trade and investment and explores policy measures that may help improve the RTAs' performance. The paper concludes that African RTAs have been generally ineffective in promoting trade and foreign direct investment. Relatively high external trade barriers and low resource complementarity between member countries limit both intra- and extraregional trade. Small market size, poor transport facilities, and high trading costs make it difficult for African countries to reap the potential benefits of RTAs. To increase regional trade and investment, African countries need to undertake more broad-based liberalization and streamline existing RTAs, supported by improvements in infrastructure and trade facilitation. Early action to strengthen the domestic revenue base would help address concerns over revenue losses from trade liberalization.

This paper was originally prepared, with input from Alexei Kireyev and Paolo Dudine, for an IMF Seminar on Trade and Regional Integration in Africa, held in Dakar, Senegal, December 6, 2004. The authors wish to thank the following for their helpful comments: Luis de Azcarate, Bergljot Barkbu, Anupam Basu, Ndiame Diop, Anne-Marie Gulde, Paul Heytens, Lawrence Hinkle, Chris Hoveka, Michael Keen, Padamja Khandelwal, Hans Peter Lankes, Arnold McIntyre, Jan Mikkelsen, Koffie Nassar, Michael Nowak, Arvind Panagariya, Gonzalo Pastor, Catherine Pattillo, Delpin Rwegasira, Liliana Schumacher, Arnim Schwidrowski, Chad Steinberg, and Stephen Tokarick. Vera Da Luz, Elisa Diehl, and Suresh Gulati provided excellent research and editorial assistance. Archana Kumar of the External Relations Department coordinated the production of this publication.

©International Monetary Fund. Not for Redistribution

This page intentionally left blank

©International Monetary Fund. Not for Redistribution

CHAPTER

1 Introduction

Africa is home to some 30 regional trade arrangements (RTAs), many of which are part of deeper regional integration schemes.[1] On average, each African country belongs to four RTAs (World Bank, 2004). There has been a renewed push in recent years for broader and deeper preferential trade arrangements in Africa. Some of the previously defunct regional arrangements (e.g., the East African Community) have been revived, while continental institutions—namely, the African Economic Community (AEC), the African Union, and the New Partnership for Africa's Development (NEPAD)—have been launched under the auspices of the Organization of African Unity (OAU). In addition, African countries are preparing to negotiate FTAs with the European Union (EU) under the Economic Partnership Agreements (EPAs). The Southern African Customs Union (SACU) is negotiating an FTA with the United States. South Africa, the largest African economy, has already signed an FTA with the EU.[2]

The push for RTAs in Africa has occurred against the backdrop of increasing regionalism worldwide and the ongoing Doha Round of multilateral trade negotiations. The EU is poised to expand further (e.g., with Bulgaria and Romania's prospective accession) after admitting 10 new members from Central and Eastern Europe in May 2004, while countries in the Americas have been negotiating a hemisphere-wide FTA that would include all democracies in the

[1]The RTAs discussed in this paper include both free trade agreements (FTAs) and customs unions (CUs). Many regional integration schemes in Africa have monetary and economic union dimensions (i.e., monetary union, common market, and economic union)—the so-called deep integration, which involves not only the removal of traditional trade barriers (e.g., tariffs) but also the elimination of other barriers to the free movement of goods, services, and factors and the harmonization of economic policies and regulatory regimes. This paper focuses exclusively on the trade aspects of African regional integration schemes. The term "regionalism" is used to refer to both multicountry and bilateral RTAs.

[2]The South Africa–EU FTA applies de facto to all members of SACU by modifying SACU's common external tariff to establish preferential tariffs for imports from the EU. The modification enabled South Africa to sign the FTA with the EU while being a member of SACU.

©International Monetary Fund. Not for Redistribution

region. In Asia, regionalism has finally gathered momentum, with the major countries in that region (e.g., Japan, China, India, and Korea) rigorously pursuing preferential trade arrangements, which may eventually lead to an Asia-wide trade bloc. On the multilateral front, the Doha Round has moved slowly. Despite the framework agreement reached in August 2004, it will be difficult to conclude the round by the end of 2005, as originally scheduled.

A key challenge facing Africa is to determine the priorities in its trade policy among competing demands on the unilateral, regional, and multilateral fronts. The preferred course of action will have to be based on both past experiences of RTAs in Africa and elsewhere and an examination of the pros and cons of the various options in moving forward. In this regard, this paper intends to accomplish three tasks. First, it discusses the global trend toward regionalism, the challenges it poses for African trade policy, and the salient features of African RTAs (Chapter 2). The paper then goes on to analyze the effectiveness of the arrangements in achieving their stated objectives (Chapter 3) and explore trade policy priorities and strategies for trade promotion (Chapter 4). This is followed by a discussion of the role of the IMF in helping African countries set these priorities and accelerate trade growth (Chapter 5). The paper offers conclusions in Chapter 6.

©International Monetary Fund. Not for Redistribution

CHAPTER

2 Regional Trade Arrangements in Africa

A. Global Background

RTAs have been proliferating exponentially throughout the world. Nearly all countries now participate in at least one RTA, and approximately 300 RTAs, both bilateral and plurilateral, are now in force.[3] A sequence of events—the failure to launch a round of multilateral trade talks in Seattle in 1999, their short-lived recovery after the Doha ministerial meeting in 2001, and an impulsive breakdown in Cancún in 2003—has sparked a renewed enthusiasm for preferential arrangements.

More fundamentally, the surge in regionalism reflects changes in the trade strategies of key members of the WTO. The United States, traditionally a champion of the multilateral trade system, has led the current wave of regionalism as it catches up with (and challenges) the EU—the front-runner in regionalism. The U.S. policy shift has resulted in an acceleration of regionalism around the world, including in East Asia, which had, until recently, relied on the multilateral system to support its export-oriented growth. These changes may have set future global trade liberalization on an uncertain path.

[3]The departure of RTAs from the General Agreement on Tariffs and Trade (GATT)/World Trade Organization (WTO) principle of nondiscrimination (the most-favored-nation—MFN—clause) is sanctioned by GATT Article XXIV and the Enabling Clause. However, Article XXIV requires that an RTA must (1) not "on the whole" raise protection against nonmembers; (2) reduce internal tariffs to zero and remove "other restrictive regulations of commerce" other than those justified by other GATT articles; and (3) cover "substantially all trade." The Enabling Clause relaxes the conditions for RTAs among developing countries. For example, it drops the conditions on the coverage of trade and allows developing countries to reduce tariffs on mutual trade in any way they wish. See World Bank (2000) for a more detailed description of the WTO rules on RTAs.

©International Monetary Fund. Not for Redistribution

Two opposing views describe RTAs as either building blocks for, or stumbling blocks to, further trade liberalization.[4] From a global, static point of view, the multilateral approach to trade liberalization is considered superior to the regional approach primarily because RTAs, which are discriminatory, can lead to both trade diversion and trade creation and, thus, reduce welfare when trade diversion is greater than trade creation. However, proponents of regionalism argue that the trade diversion effect of RTAs tends to be smaller than their trade creation effect. They also contend that the multilateral system is unwieldy and that proliferating RTAs can accelerate global trade liberalization. In contrast, opponents of regionalism argue that RTAs produce limited benefits or even losses for their participants and are likely to undermine the multilateral trade system and, ultimately, slow global trade liberalization. They further contend that the overlapping "hub-and-spoke" structure[5] of major trade blocs increases the complexity of the world trade system and might suck investment and production into the hub and impose administrative costs on trade, especially for the "spokes." The debate over how regionalism affects global trade liberalization is unlikely to be resolved in the near future, if at all.

B. Challenges of Regionalism for Africa

Regionalism may distract Africa from its focus on the core objective of its trade policy—creating a liberal trade regime to support its poverty reduction and growth strategies. In a world of proliferating RTAs, African countries, like many in other parts of the world, have responded instinctively to global regionalism by creating more RTAs on the continent and strengthening the existing ones. However, the pursuit of a defensive strategy to counter regionalism in other parts of the world may not be in Africa's best interest. In particular, as argued below, RTAs aimed at helping local industries through import substitution in Africa are unlikely to expand the continent's overall trade—even intraregional trade—given the low complementarity of natural endowments, the region's small markets, and administrative capacity constraints.

In this context, African policymakers need to build political support to make the continent's existing RTAs more open to the rest of the world through nondiscriminatory liberalization. Opening the RTAs, however, will be a difficult task because of the resistance from highly protected industries—some from pre-independence days—and the ideology of "self-centered development," which

[4]See Bhagwati and Panagariya (1996), Baldwin and Venables (1996), and Panagariya (2000) for comprehensive surveys of the theoretical literature on preferential trade agreements. World Bank (2000, 2004) and Schiff and Winters (2003) provide extensive surveys of the empirical literature from a development perspective.

[5]A "hub-and-spoke" structure refers to a set of trade relationships in which a dominant (hub) country simultaneously has separate RTAs with individual smaller countries (spokes), which do not normally form RTAs between themselves—analogous to a hub-and-spoke system in air transportation.

©International Monetary Fund. Not for Redistribution

inspired, among others, the Lagos Plan of Action and, generally, import substitution policies. In addition, the RTAs have inevitably created some vested interests that are opposed to broad-based liberalization. Exporters who have benefited from regional preferential market access will want to keep their niche markets. Local producers who have benefited from rules of origin will resist reductions in external trade barriers and efforts to make the rules more transparent and less restrictive. In the case of a customs union, there is a danger that once a country joins it, its trade policy cannot be altered without the consent of its partners. If the initial common external tariff is high and consensus on its reduction is difficult to reach, an RTA member is locked into a restrictive trade regime unless it is willing to withdraw from the union.

Many African policymakers also fear that open trade with the rest of the world would permanently damage Africa's infant manufacturing base. RTAs are viewed as a training ground to prepare local industries for broad-based liberalization in the future, although few African RTAs intend to liberalize subsequently on an MFN basis. There are, however, some factors that are favorable for further opening up of African RTAs. There is now greater recognition that openness promotes growth—no country has been able to grow fast without opening its economy to international trade.[6] The limitations of intra-African RTAs have become more widely acknowledged, leading some to change their views of RTAs. They see them now as a tool to integrate into the world economy by liberalizing intraregional trade first. Nevertheless, it remains to be seen whether the various political forces will result in more broad-based trade liberalization in Africa.

The global trend toward regionalism tends to disadvantage African countries. Regionalism has created "hub-and-spoke" trade relationships among countries, with large economies being the "hub" and small ones being the "spokes." Ongoing competitive (or "additive") regionalism further strengthens such relationships, which tend to benefit the hub disproportionately more than the spokes because of differing rules of origin, product exclusions, nontrade issues, and trade and investment diversion (World Bank, 2004). Because their economies are small, African countries have always been the spokes in their trade relations with industrial countries, especially those in Western Europe. The same World Bank study shows that if *all* developing countries sign a bilateral FTA (on merchandise trade only) with all the major hubs—the Quad (Canada, the EU, Japan, and the United States) plus Australia and New Zealand, sub-Saharan Africa would lose over $3 billion (in 2001 prices) in 2015, or 0.7 percent of the

[6]For the growing body of empirical literature on trade, growth, and poverty, see Sachs and Warner (1995), Dollar and Kraay (2001), Berg and Krueger (2003), Baldwin (2003), and Panagariya (2004). For a critique of the literature, see Rodriguez and Rodrik (2001). The thrust of this literature is that growth is essential for reducing poverty and that trade and growth are positively related. However, the role of trade policy in the trade-growth-poverty link is still a subject of debate.

©International Monetary Fund. Not for Redistribution

region's income (1.2 percent for non-SACU countries). In fact, African countries are likely to lose even more in such a race to bilateralism. First, not all large economies want, at this stage, to establish RTAs with Africa (at least not if agriculture is included and/or antidumping is on the agenda for negotiation). Second, even if Africa can establish RTAs with all the large economies, it is not the same as multilateral free trade. Rules of origin can be and have been used to restrict market access (Krueger, 1999b; Flatters, 2002). Finally, small countries in Africa would face enormous capacity constraints in trying to negotiate and implement multiple RTAs. In contrast, the hubs can essentially replicate rules of origin each time they negotiate a new RTA and are able to access all the spokes' markets. The hubs would have more access to inputs that are available without duties than any spoke would have (Krueger, 1999a).

The proposed EPAs could increase the benefits of regionalism but need to be carefully designed.[7] Key reasons for the failures of intra-African RTAs include the lack of complementarity in trade structure, their narrow focus on intraregional tariff reductions, weak capacity for policy implementation, and a lack of policy credibility. FTAs with the EU as envisaged under the EPAs would, in principle, overcome many of these problems by taking advantage of the EU's large market size, institutional capacity, and policy credibility. More important, the FTAs would cover more than tariffs and would include liberalization of trade in services and measures designed to foster cooperation on "behind the border" issues (such as trade facilitation and investment climate) and strengthen domestic institutions. To reap the potential benefits of the EPAs, however, these agreements will have to be truly development-oriented, and the EU will have to forgo seeking the "first mover" advantage over other countries outside Africa. This is especially important since the EPAs would essentially treat African countries (and other Africa, Caribbean, and Pacific (ACP) partners) as more equal commercial partners, via reciprocity agreements, rather than as preference beneficiaries, as is the case under the current Cotonou Agreement.

While EPA negotiations will inevitably continue, African countries should consider making MFN reduction of their external tariffs an integral part of the EPA design and implementation. There are, of course, concerns that across-the-board liberalization could entail substantial adjustment costs in the short run. The costs may justify gradual MFN liberalization rather than discriminatory liberalization. Indeed, trade liberalization can be, and often is, phased in over extended periods. If African countries want to use external commitments to facilitate trade reforms and strengthen domestic institutions, the WTO can also serve as a useful multilateral commitment mechanism. In fact, most African countries have yet to commit to more comprehensive tariff bindings under the WTO that are reasonably close to their applied tariff rates.

[7]See Panagariya (2002) and Hinkle and Schiff (2004) for a detailed discussion of key issues concerning African EPAs with the EU.

©International Monetary Fund. Not for Redistribution

Preference erosion as a result of proliferating RTAs in other parts of the world reduces Africa's international competitiveness. The main threat of preference erosion comes from multilateral liberalization and MFN reductions of trade barriers in Africa's major trading partners, particularly the EU's reform of its sugar regime and the removal of quotas on textile exports from developing countries.[8] However, even without MFN liberalization, continued dependence on preferential schemes—such as the generalized system of preferences (GSP), the African Growth and Opportunity Act (AGOA), and the "Everything But Arms" (EBA) initiative—becomes a risky strategy for Africa as the Quad countries continue to forge RTAs with other developing countries. African countries need to make the necessary structural adjustments to maintain their international competitiveness, a daunting challenge given their heavy dependence on primary commodity exports and weak manufacturing base.

C. The Web of Africa's Trade Arrangements

Africa has been a pioneer of regional integration. From the SACU established in 1910, through the historic Pan African Congresses, to the first regional federations, African trade integration has included numerous arrangements at regional and subregional levels. The Lagos Plan of Action, followed by the 1991 Abuja Treaty, established the AEC with subregional economic communities envisaged as the building blocks for the AEC.[9]

African RTAs have largely been motivated by the continent's desire to promote growth through regional cooperation. Many African countries are landlocked small economies with inadequate infrastructure.[10] Of the 53 African countries, 39 have fewer than 15 million people, and 21 have fewer than 5 million (ECA, 2004). Although Africa has 12 percent of the world's population, it produces just 2 percent of the world's output because its productivity is low. In 2003, sub-Saharan Africa's GDP was 17 percent lower than Australia's; when South Africa is excluded, Africa's GDP is about the same as Austria's. RTAs, by creating larger markets, are thought to enable African countries to exploit economies of scale and enhance domestic competition as well as to raise returns on investment and, hence, attract more foreign direct investment (FDI).[11] Africa

[8]Under the Uruguay Round Agreement on Textiles and Clothing (ATC), all quotas on textile and clothing exports from developing countries were phased out at the beginning of 2005. However, pressure has been mounting in the United States and EU to curb Chinese exports.

[9]Most African RTAs have yet to be recognized by the WTO (United Nations Economic Commission for Africa (ECA), 2004). For those that have been notified to the WTO, they were mostly reported under the Enabling Clause. No WTO members have requested examination of any of these RTAs for consistency with WTO rules.

[10]There are 15 landlocked countries in Africa: Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Lesotho, Malawi, Mali, Niger, Rwanda, Swaziland, Uganda, Zambia, and Zimbabwe.

[11]However, there is little evidence that RTAs among very small countries promote growth.

©International Monetary Fund. Not for Redistribution

could realize most, if not all, of such benefits by liberalizing unilaterally and/or by participating in multilateral liberalization sponsored by the WTO (Oyejide, 1997). African leaders also believe that RTAs would increase their bargaining power in international trade negotiations and that trade integration would help reduce regional conflict.

RTAs can be viewed as particularly beneficial to Africa's landlocked countries. A CU with coastal countries, for example, may effectively connect landlocked countries to the ocean. Most of Africa's landlocked countries and their coastal neighbors are members of RTAs, sharing long-standing trade routes and port facilities. The share of regional trade in total trade, especially on the import side, also tends to be higher for landlocked countries than for other countries. Nevertheless, these countries stand to gain most from reductions in the region's trade barriers vis-à-vis the rest of the world, because the marginal cost of imports from the region is generally higher. In addition, past experience suggests that RTAs have not generated the expected benefits for landlocked African countries because coastal countries have more often than not created obstacles, administrative (customs procedures) or physical (roadblocks), resulting in excessively high costs of transit or even double taxation at entry.

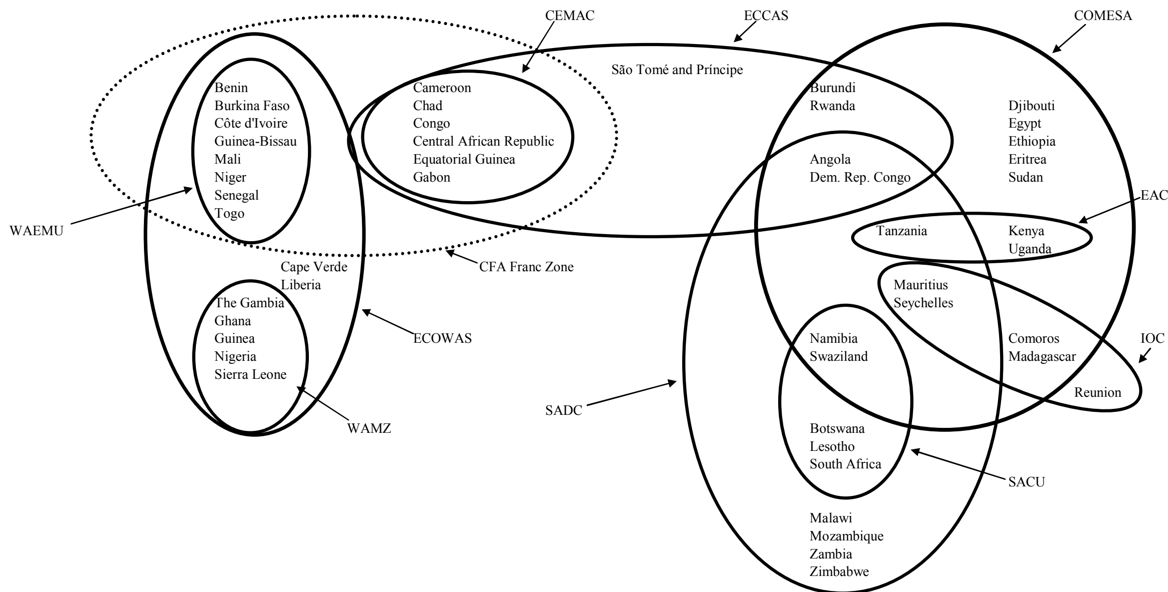
Africa is now a dense web of RTAs and a classic example of a variable geometry in integration (Figure 1). Most African countries have multiple RTA memberships. There are four major RTAs, with 24 member countries, at different stages of development toward a CU: the West African Economic and Monetary Union (WAEMU), the Central African Economic and Monetary Community (CEMAC), SACU, and the East African Cooperation (EAC, successor to the defunct East African Community). The first two are simultaneously monetary unions with a common currency—the CFA franc. Within SACU there is a smaller common monetary area. Four additional large groups of countries are FTAs with long-term goals of becoming CUs, monetary/economic unions, or common markets: the Economic Community for Central African States (ECCAS), which includes all CEMAC members; the Economic Community of Western African States (ECOWAS), which includes all WAEMU members; the Common Market for Eastern and Southern Africa (COMESA), and the Southern African Development Community (SADC), which includes all SACU members and overlaps with COMESA. Most other arrangements are cooperation agreements and have a limited economic impact.

In this enormous diversity, some common features of African RTAs stand out.

- *The goals are usually ambitious*. These usually include promoting economic prosperity through regional integration and enhancing growth by exploring economies of scale; enlarging local markets and encouraging investment; facilitating trade liberalization; harmonizing economic policies; enhancing economic convergence; and accelerating economic diversification. As previously noted, many African RTAs are part of

©International Monetary Fund. Not for Redistribution

Figure 1. The African Galaxy



ACRONYMS

CEMAC	Economic and Monetary Community of Central Africa
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ECCAS	Economic Community of Central African States
ECOWAS	Economic Community of Western African States
IOC	Indian Ocean Commission
SACU	Southern African Customs Union
SADC	Southern African Development Community
WAEMU	West African Economic and Monetary Union
WAMZ	West African Monetary Zone

Source: Authors' compilation.

deeper regional integration schemes. These goals are legitimate and reflect the aspirations of the African people. Nevertheless, they are long-term development objectives and can be achieved only through sustained effort at both the regional and national levels. Moreover, they require a strong political commitment, which does not seem to have been sustained in the past, judging from the long delays and reversals of policy changes.

- *Intraregional tariff reduction is generally the primary focus.* A noticeable exception is the SADC, which has devoted considerable resources to regional sectoral projects (e.g., energy and infrastructure) since its inception. Starting with an FTA, most functioning RTAs are gradually reducing intraregional tariffs while preserving their individual tariffs vis-à-vis third

©International Monetary Fund. Not for Redistribution

Table 1. Official Checkpoints on Selected Routes of Western African Highways, December 2000

Highway	Distance (Kilometers)	Number of Checkpoints	Number of Checkpoints per 100 Kilometers
Lagos, Nigeria, to Abidjan, Côte d'Ivoire	992	69	7
Lome, Togo, to Ouagadougou, Burkina Faso	989	34	4
Niamey, Niger, to Ouagadougou, Burkina Faso	529	20	4
Abidjan, Côte d'Ivoire, to Ouagadougou, Burkina Faso	1,122	37	3
Cotonou, Benin, to Niamey, Niger	1,036	34	3
Accra, Ghana, to Ouagadougou, Burkina Faso	972	15	2

Source: COMESA Secretariat (2001), cited in ECA (2004).

countries. Tariff reduction targets have been implemented to various degrees but, in most cases, are behind schedule. Tariffs are not usually reduced on sensitive commodities. With the exception of SACU, none of the RTAs has reached the point of making all regional trade tariff-free. Some RTAs also stipulate the elimination of nontariff barriers (NTBs), but have made only limited progress toward that goal. Quantitative restrictions, import bans, roadblocks, and administrative charges are still in place in COMESA. There is also evidence that new NTBs are being erected (ECA, 2004); in Western Africa, for example, they include unofficial fees at border crossings, administrative delays at ports, cumbersome customs formalities, and multiple interstate checkpoints and roadblocks (Table 1). The narrow focus on intraregional tariff reduction and failures to eliminate NTBs have limited the economic benefits of RTAs.

- *The rules of origin (ROOs) differ among the RTAs, and some of them are restrictive.* SACU is the only African RTA that has achieved relatively free intraregional trade. Internal trade within all other RTAs, including FTAs and CUs that are expected to become effective in later years, is subject to ROOs. In the case of SADC, the initially proposed ROOs were relatively simple and uniform across products: they involved a change of tariff heading, a minimum of 35 percent of the value added within the region, or a maximum import content of 60 percent of the value of total inputs. However, these rules were subsequently revised and became more restrictive—not only did they become product-specific, but they also required detailed technical processes (Flatters, 2002; Flatters and Kirk, 2004). ROOs can be costly to enforce because they require

©International Monetary Fund. Not for Redistribution

documents to prove origin and verification procedures at border crossings. Estimates of such costs for African RTAs are not available, but evidence elsewhere suggests that they can be considerable.[12]

- *External trade barriers remain relatively high.* Much progress has been made to reduce external tariffs in Africa, especially in the context of IMF- and World Bank–supported programs. Nevertheless, the simple average of applied MFN tariffs in Africa is higher than that in other developing regions of the world (Table 2). As in other regions, the average tariffs in Africa often mask large variations between countries and products. While some African countries have reasonably low average tariffs (e.g., 9 percent in Eritrea and 11 percent in Mozambique), others have high tariffs (e.g., 39 percent in the Comoros and 37 percent in Nigeria) that could lead to large trade diversion under the RTAs. NTBs against non-RTA members remain significant, even though information documenting them is lacking (ECA, 2004).

  Among the three formal customs unions, SACU has a common revenue pool and redistribution system among members, but it has maintained high levels of protection against the rest of the world. WAEMU has made headway in reducing tariffs vis-à-vis the rest of the world, but it still has to deal with official and unofficial internal trade barriers (including ROOs). CEMAC has functioned poorly, making little progress in reducing its tariffs against the rest of the world. Similarly, the record of the African FTAs on reducing trade barriers against nonpartner countries is mixed.

- *Revenue losses are important concerns in RTA design and implementation*. Trade taxes[13] generate almost one-third of all government revenues in African countries (Agbeyegbe, Stotsky, and WoldeMariam, 2004). It is not surprising, then, that a discussion on trade liberalization—whether in the context of multilateral, regional, or bilateral arrangements—also provokes a discussion of its potential consequences for government revenues.[14] Since the 1980s, the revenue-to-GDP ratio in sub-Saharan

[12]A study undertaken by the European Free Trade Association (EFTA) estimated that the cost to EFTA members of documenting origin to receive duty-free entry into the EU averaged 3–5 percent of the export price (Herin, 1986, cited in Krueger, 1999a, p. 112). On the other hand, it is worth noting that ROOs may help reduce the potentially negative welfare effect of an FTA when these rules prevent or reduce costly trade diversion. See Krishna and Krueger (1995) for details.

[13]Trade taxes include border taxes on trade only (excluding the VAT and excise on imports).

[14]Ebrill, Stotsky, and Gropp (1999) find that trade tax revenues tend to fall with tariff levels whenever the latter—measured as the ratio of trade tax revenue to import value—are below 20 percent, whereas Khattry and Rao (2002) estimate this threshold to be around 40 percent. Ancharaz (2003) finds that fiscal dependence on trade taxes makes trade reform less likely to happen.

©International Monetary Fund. Not for Redistribution

Table 2. Simple Average of Applied MFN Tariffs, 1997 and 2004
(In percent)

	1997	2004
Africa	21.6	17.2
CEMAC	19.9	19.4
COMESA	23.6	18.5
ECOWAS	20.0	16.8
WAEMU	22.6	17.8
SADC	20.0	15.9
Other developing countries	14.4	11.6
Asia Pacific	16.1	12.1
Europe	11.2	9.7
Middle East and Central Asia	16.9	12.2
Western Hemisphere	13.2	12.2
Industrial countries	8.7	5.7

Source: IMF staff estimates.

Africa has remained virtually stagnant, while the resource needs for the provision of public services and infrastructure have increased sharply. Potential revenue losses from RTAs are generally small because intraregional trade in most RTAs typically accounts for about 10 percent of total trade. In cases where intraregional trade is important and the CET is also reduced when a customs union is formed, revenue losses can be significant.[15] Because members of most RTAs trade mainly with the rest of the world, concerns over revenue losses have been a key obstacle to broader trade liberalization in Africa.

- *The desired level of regional integration is high*. The five major RTAs (ECOWAS, WAEMU, COMESA, CEMAC, and SADC) aim to establish a customs/economic union and a common market. CEMAC is nominally already a customs union, while the other four are at various stages of forming an FTA—an interim step for deeper integration. While the WAEMU member states of ECOWAS have established a customs union with a CET, similar progress has not yet been achieved for the ECOWAS countries as a group. By aiming for deep integration, African countries are seeking to maximize the benefits of regional integration, but

[15]The World Bank (2003c) estimates that the planned CU among members of the EAC could result in a revenue loss of 5.2 percent for the region (5.9 percent for Kenya, 3 percent for Uganda, and 2 percent for Tanzania). The prospective FTAs with the EU would result in more significant revenue losses, given that the EU accounts for a larger share of total African imports (about 40 percent).

©International Monetary Fund. Not for Redistribution

they are also imposing on themselves a substantial demand for administrative capacity and a high degree of economic convergence among themselves. The prospect of surrendering trade policy to CU authorities and accepting the resulting redistribution of customs revenue has often aroused concerns and tensions. Although the push for a high degree of integration is not entirely responsible for the poor record of RTA implementation, it may have exceeded the limit of regional capacity and political will, leading to delays in implementation. Diverse national interests have led to the establishment of a large number of RTAs on the African continent, often with overlapping membership and conflicting commitments, which further complicate implementation.

©International Monetary Fund. Not for Redistribution

CHAPTER

3 Effects of African Trade Arrangements

A. Have RTAs Helped Increase Intraregional Trade?

Time-series data show that the impact of the RTAs on intra-African trade seems to have been small or insignificant. As a share of the continent's global trade, intra-African trade declined over much of the 1970s before it recovered in the 1980s and the first half of the 1990s. It was not until the early 1990s that intra-African trade recovered to its early 1970s levels (Figure 2). Since the mid-1990s, however, it has stagnated at about 10 percent of total African trade despite intensified efforts to integrate regionally. Trade among the countries in the major RTAs (SADC, COMESA, ECOWAS, WAEMU, and CEMAC) has also grown erratically relative to their trade with the rest of the world, often showing no obvious trend over time—except perhaps WAEMU, whose intraregional trade has increased in recent years because of the improved performance of the CU (Table 3). For many RTAs, intra-arrangement trade as a share of their total external trade remains below intra-African trade as a share of total African external trade.

Trade ties within Africa look much stronger when they are normalized with Africa's share in world trade (Figure 3). Although intraregional trade in Africa is lower than in other parts of the world, trade intensity is considerably higher among African countries than between African countries and a typical country outside the continent.[16] This regional concentration in trade is largely due to

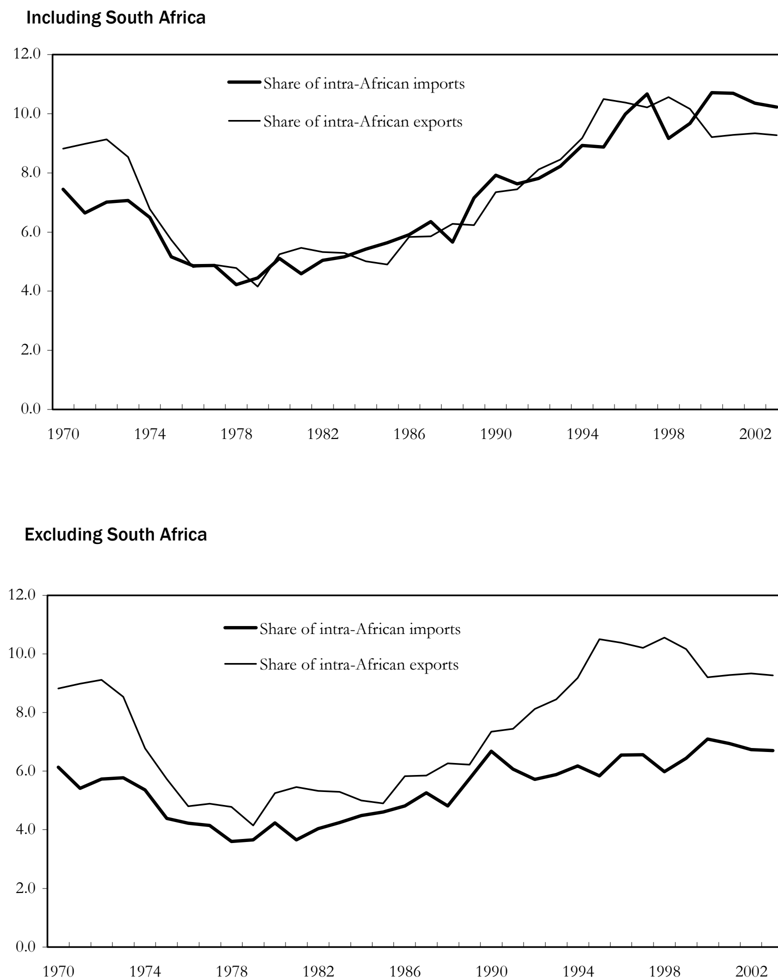
[16]The trade intensity index used here is the same as the one used by Frankel, Stein, and Wei (1997) and similar to the one developed by Drysdale and Garnaut (1982):

$$I = \frac{T_I}{T_A} \bigg/ \frac{T_A}{T_W},$$

where I is the trade intensity index, T_I is intraregional trade, T_A is the region's total (global) trade, and T_W is world trade. If the index is lower (higher) than unity, intraregional trade is less (more) intense than extraregional trade.

©International Monetary Fund. Not for Redistribution

Figure 2. Intra-African Trade in Total African Trade, 1970–2003
(In percent)



Source: IMF, *Direction of Trade Statistics.*

Africa's marginalization in the world market (Figure 4) rather than to the performance of intraregional trade.

The econometric evidence of the effectiveness of RTAs in promoting intra-African trade is mixed. The slow long-term growth of trade within Africa over the past few decades could result from something other than the ineffectiveness of the RTAs. The econometric technique commonly used to isolate the RTA

©International Monetary Fund. Not for Redistribution

Table 3. Intra-Arrangement Trade in Africa
(Percent of total trade)

	1970	1980	1990	1998	2003
Exports					
CEMAC	4.9	1.6	2.3	2.3	1.4
COMESA	9.7	9.1	8.1	8.9	8.6
ECOWAS	3.1	10.6	8.9	11.1	10.1
WAEMU	7.9	12.6	15.3	13.0	16.2
SADC	9.4	2.7	6.9	6.0	6.0
Africa	8.8	5.2	7.3	10.5	9.3
Imports					
CEMAC	5.0	3.7	3.6	3.9	2.9
COMESA	6.7	2.8	3.4	3.9	5.8
ECOWAS	3.3	10.2	14.9	12.9	11.5
WAEMU	6.4	7.6	14.8	9.8	13.3
SADC	4.9	3.8	6.0	6.1	6.3
Africa	7.4	5.1	7.9	9.2	10.2

Source: IMF, *Direction of Trade Statistics,* various years.

effects on intraregional trade from those of other factors is the gravity model.[17] Using this technique, Elbadawi (1997) finds that, during 1980–84, the presence of African RTAs increased intraregional imports by about 31 percent on average (the effect ranged from nonexistent to substantial) without causing trade diversion. However, these arrangements performed worse in the second half of the 1980s—most of them led to substantial trade diversion and even reductions in intra-arrangement and external overall trade. Carrere (2004) offers a more positive assessment of the African RTAs. She finds that during 1962–96 RTAs generated a significant increase in intra-RTA trade, although initially often through trade diversion. She also finds that CUs in the two CFA franc zone arrangements (CEMAC and WAEMU) have reinforced the positive effect of the

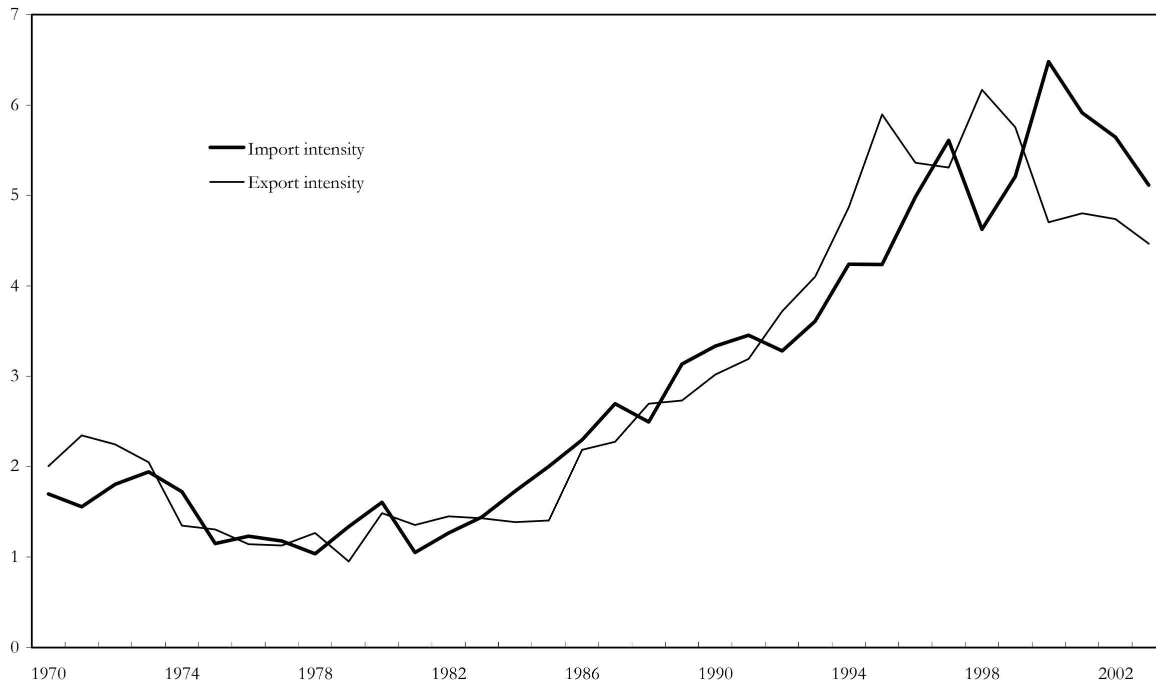
[17]The typical gravity model for testing the trade effect of RTAs has the following general specification:

$$X_{ijt} = \alpha + \beta_{jt} C_{ijt} + \delta_{jt} D_{ijt} + \mu ,$$

where X_{ijt} stands for exports from country *i* to country *j* in time *t;* C_{ijt} represents a set of variables that control for the effect on bilateral trade; D_{ijt} is a set of (binary) dummy variables that are designed to capture the incremental effect of the RTAs in question; μ is the error term; and α, β, and δ are coefficients to be estimated. A less widely used approach is to estimate the trade diversion and trade creation effects using quantity and price data at the detailed commodity level, together with demand and supply elasticities that are needed in partial equilibrium analysis. See, for example, Krueger (1999c), Clausing (2001), and Romalis (2004).

©International Monetary Fund. Not for Redistribution

Figure 3. Intraregional Trade Intensity in Africa, 1970–2003



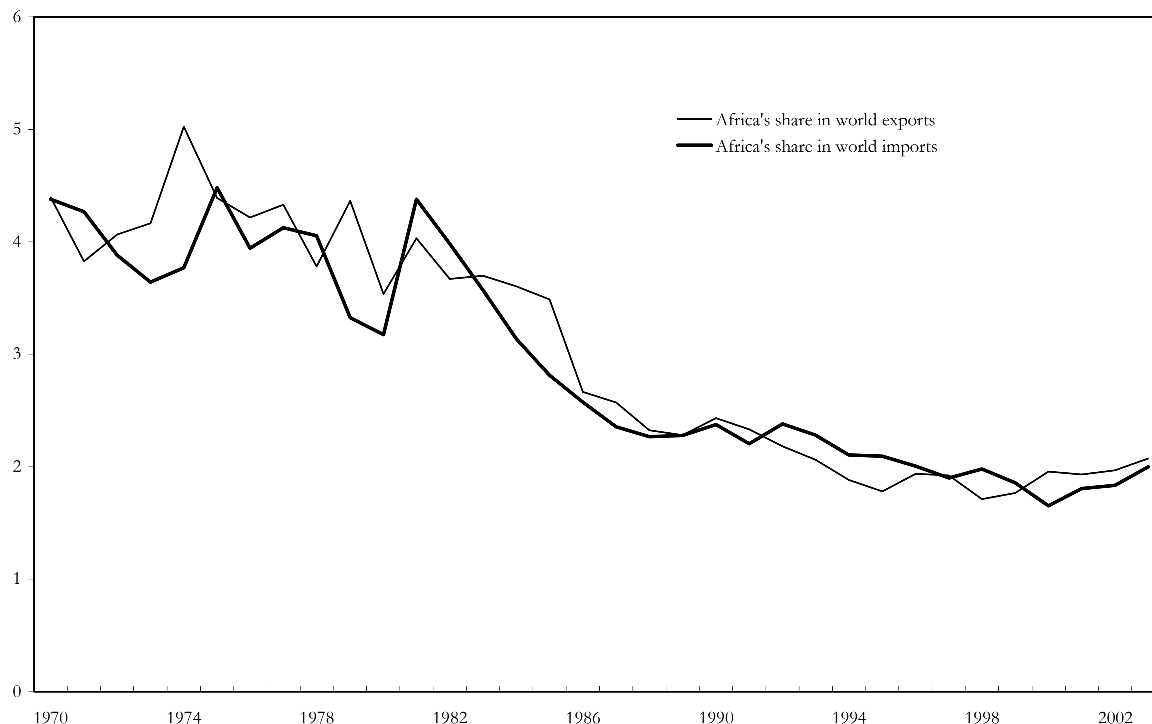
Source: IMF, *Direction of Trade Statistics,* various years.

corresponding trade agreements on intraregional trade while dampening their trade diversion effect. Other studies (Kasekende and Ng'eno, 1995; Lyakurwa, 1996; Robson, 1998) conclude that African RTAs have little or no effect on intraregional trade.

Thus, the RTAs may have had a positive but uneven effect on intraregional trade, although, over the long run, the effect seems to have been small or insignificant. The RTAs also appear to have caused some trade diversion, which may explain part of the decline over time in Africa's share in world trade. Given the small share of intraregional trade in Africa's total trade, the direct contribution of any trade diversion to overall trade performance is likely to be limited; any significant impact would have to come from the overall trade policy environment that RTAs have helped to create. It is difficult to establish that RTAs have resulted in a worse trade regime than there would have been otherwise.

©International Monetary Fund. Not for Redistribution

Figure 4. Africa's Share in World Trade, 1970–2003
(In percent)



Source: IMF, *Direction of Trade Statistics*, various years.

The econometric results should be interpreted with caution. The greatest difficulty in interpreting these results is to identify a counterfactual with which the actual outcome can be compared. The implicitly assumed counterfactual in the gravity model is an outcome determined by control variables. As O'Connell (1997) points out, however, trade policies (including those governing RTAs) in Africa are often endogenous: they are largely influenced by macroeconomic variables (e.g., the balance of payments and the exchange rate) and, in turn, affect countries' macroeconomic policy positions. Apart from the endogeneity problem, specification errors in the gravity model could lead to large margins of error in capturing the residual effect of RTAs. This problem may be compounded by the inaccuracy of African trade data.[18]

[18]Yeats (1998) provides a detailed discussion of the deficiencies of African trade data, which, as reported to the United Nations (UN) COMTRADE system, are often incomplete, out of date, missing, or even contradictory. On the other hand, data reported in the IMF's *Direction of Trade Statistics* on Africa are up-to-date but contain data on aggregate trade only.

©International Monetary Fund. Not for Redistribution

B. Have RTAs Helped Improve Regional Competitiveness?

RTAs do not yet seem to have had a significant impact on Africa's export performance in the world market. The continent's share in global trade has declined from about 4 percent in the 1970s to about 2 percent at present. The trend is similar when oil exports are excluded. Perhaps the clearest sign of Africa's weak competitiveness is its poor performance in manufactured exports. During 1970–2003, Africa's share in global manufactured exports (about 0.5 percent) hardly changed. Its exports of textiles and clothing, often the spearhead of export growth as countries industrialize, also failed to gain global market share. Several studies (Foroutan and Pritchett, 1993; Coe and Hoffmaister, 1999; Rodrik, 1999; Subramanian and Tamirisa, 2003) find that the declining share of Africa's products in global trade can be explained largely by its income growth, population size, geography, and economic policy.[19] This evidence supports the argument that Africa's marginalization in world trade cannot be attributed to external forces (Ng and Yeats, 2000).

A further analysis of Africa's non-oil export growth indicates that Africa's competitiveness has declined over the past three decades (Table 4). Results from the constant market share (CMS) analysis show that, during 1970–80, declining competitiveness, together with an unfavorable export composition, was the dominant contributor to the continent's poor non-oil export performance.[20] This finding is consistent with that by Ng and Yeats (2002), who argue that Africa must diversify away from traditional exports or continue to suffer from a secular decline in the terms of trade and slow growth of demand for these exports. Africa's competitiveness declined sharply during the 1980s before this deterioration slowed in the 1990s. Of course, the CMS analysis cannot reveal the causes of Africa's declining export competitiveness, but it does show that RTAs have not been able to halt this decline.

There is little econometric research linking African export competitiveness with RTAs. However, available evidence on the relationship between African exports/trade liberalization and productivity growth helps shed some light on the impact of African RTAs on export competitiveness. Based on firm-level panel

[19]Subramanian and Tamirisa (2003) also find that francophone Africa, in particular, is an undertrader and that its undertrading, especially with industrial countries, has increased over time. The authors suggest that trade-related costs and the currency arrangements in the CFA zone may be responsible.

[20]The CMS analysis decomposes a country's export growth into four components that are attributed to (1) global market growth, (2) the effect of export composition, (3) the effect of market distribution, and (4) changes in the country's competitiveness (the residual). The analysis here identifies four regions (Africa, the North American Free Trade Agreement (NAFTA) countries, the EU, and the rest of the world) and uses commodity data at the Standard International Trade Classification (SITC) (Rev. 1) one-digit level. For details of the CMS model, see Leamer and Stern (1970).

©International Monetary Fund. Not for Redistribution

Table 4. Decomposition of African Non-Oil Export Growth, 1970–2000

	1970–80	1980–90	1990–2000
Total change in trade (in percent of total)	100	100	100
Contribution of:			
Global demand growth	157	1,337	154
Export composition	–29	–504	–62
Market distribution	–4	–2	11
Residual competitiveness	–4	–731	–4
Memorandum item:			
Change in total exports (US$ billion)	25	3	22

Source: IMF staff estimates based on UN COMTRADE data, extracted from the World Bank World Integrated Trade Solution (WITS) database.

data from three African economies (Ghana, Kenya, and Ethiopia), Mengistae and Pattillo (2004) find that exporting manufacturers have a total factor productivity premium of 11–28 percent. Jonsson and Subramanian (2000) find that trade liberalization has contributed significantly to growth through higher productivity in South Africa. To the extent that RTAs have not been effective in promoting overall African exports, it is unlikely that they have increased Africa's export competitiveness (through productivity gains) vis-à-vis the rest of the world. Indeed, the RTAs may have reduced Africa's international competitiveness because they divert trade toward RTA partners. In many ways, the effects of African RTAs are similar to those of an import substitution policy (albeit on a regional, rather than a national, scale), which protects local industries and reduces incentives to export to world markets. In fact, the primary motive for the establishment of the early (and not so early) African RTAs was industrialization through regional import substitution (Foroutan, 1993; Oyejide, 1997; François and Subramanian, 1998).

Africa's poor record in attracting FDI also seems to indicate that RTAs have not significantly improved the region's competitiveness. One rationale for the premise that RTAs would increase Africa's external competitiveness was that enlarged regional markets would generate higher returns to capital and hence attract more FDI, which would then increase the region's ability to export. At the aggregate level, FDI inflows in Africa as a percentage of total low- and middle-income country FDI have declined sharply over time (Figure 5). In addition, the inflows are heavily skewed toward the mining industries (including the petroleum industry) and highly concentrated in just a few countries (e.g., South Africa, Nigeria, and Angola). FDI from South Africa to other countries in the region is, however, more diversified across industries. Elbadawi and Mwega (1998) find that, unlike some trade agreements in other parts of the world (e.g., the

©International Monetary Fund. Not for Redistribution

Figure 5. Foreign Direct Investment: Net Inflows in Africa, 1970–2001

(In percent of the low- and middle-income countries, total)

Source: World Bank, *World Development Finance*, various years.

©International Monetary Fund. Not for Redistribution

Association of Southeast Asian Nations (ASEAN)), African RTAs other than the SADC did not significantly increase FDI. However, an earlier study by de Melo, Panagariya, and Rodrik (1993) finds significant investment effects for the Central African Customs and Economic Union (UDEAC), predecessor of the Central African Economic and Monetary Community (CEMAC), and the West Africa Economic Community (CEAO), predecessor of WAEMU. Nevertheless, if investment increases under an RTA because of higher returns from activities related to trade diversion, then the investment will have been diverted from more productive uses.[21]

C. Have RTAs Benefited Africa?

Even if RTAs have increased intra-Africa trade, they may not have improved welfare. The conventional approach to the analysis of the impact on economic welfare of regional trade arrangements is based on Viner's concepts of the trade creation and trade diversion effects of CUs. If African RTAs have not significantly increased intraregional trade over extraregional trade, then they are unlikely to have led to any trade creation or trade diversion. Nevertheless, real resource costs are involved in negotiating and implementing these arrangements, irrespective of the outcome. If the regional arrangements have also diverted attention away from unilateral and multilateral trade liberalization and other domestic reform agendas, then the cost could be larger.[22]

The available econometric results suggest that RTAs are unlikely to have increased Africa's overall trade or its economic welfare. Take the example of the relatively positive assessment by Carrere (2004), which shows that the SADC increased intraregional trade by two and a half times and reduced extraregional trade by only 35 percent during 1962–96.[23] Since intra-SADC trade was less than one-tenth of total SADC external trade, this implies that total SADC trade (intra-SADC plus SADC external) declined by about 7 percent as a result of this regional arrangement. In fact, even if trade creation exactly offsets trade

[21]Krueger (1999b) explains this possibility in the context of FTA rules of origin that tend to be "protectionist." An exporter selling within an FTA could switch the sourcing of inputs to a higher-cost partner country from a lower-cost country outside the FTA because it has to meet the rules of origin in order to gain duty-free entry of final goods exports to the partner country. Similarly, an investor could be induced to invest in a factory within an FTA that would otherwise not be viable.

[22]The counterfactual for evaluating the effect of RTAs is difficult to establish. One could compare the observed outcome with an equilibrium extrapolated from the trend prior to the establishment of the arrangement, or with an equilibrium in which a different outcome might have emerged as a result of an alternative path of multilateral or unilateral liberalization.

[23]It is not clear whether and to what extent the increase in intra-SADC trade resulted from South Africa's accession to the SADC.

©International Monetary Fund. Not for Redistribution

diversion (and assuming domestic production does not change), the arrangement must have *reduced* welfare—the loss of tariff revenue from intraregional trade is greater than consumer benefits.[24]

Of course, RTAs may have some dynamic effects that could, in theory, dominate the static welfare effects outlined above. Such benefits could result from increased competition and learning by doing. They could also come from the increased imports of capital goods, which may embody more advanced technology. But if African RTAs have not been able to increase the region's overall trade and have often led to fewer imports from the rest of the world, it is unlikely that they have yielded any dynamic gains. A study cited earlier (de Melo, Panagariya, and Rodrik, 1993) finds no growth effects for the UDEAC or CEAO. Robson (1998) draws the broader conclusion that most RTAs in Africa have contributed little or nothing to economic development.

D. Have RTAs Achieved Their Noneconomic Objectives?

Like RTAs in other parts of the world, African arrangements also have several noneconomic objectives, of which the most important is conflict prevention and resolution. It is widely believed that close trade ties would make conflicts between countries economically more costly and hence less likely to happen. If conflicts do arise, the incentives for external intervention are stronger because the stakes are higher. Close trade ties, however, do not always reduce risks of conflict. In fact, they can aggravate tensions between countries if they lead to an uneven (real or perceived) distribution of benefits (and losses) arising from RTAs (World Bank, 2000). For instance, trade integration among members of the Eastern African Community (Kenya, Tanzania, and Uganda) led to the concentration of manufacturing activities in Kenya and eventually caused the demise of the EAC. On balance, however, anecdotal evidence seems to suggest that more recent RTAs that are part of deeper regional integration arrangements (e.g., the EU and the African Union) may have contributed to regional stability and security. One prominent African example often cited as a success is the intervention by ECOWAS in the civil conflicts in Sierra Leone, where ECOWAS troops, together with UN and British troops, played an important role in disarming the rebels against the government and eventually led to peaceful democratic elections in 2003.

[24]Popular press and academic analysis often equate net *trade* creation (increase in intraregional trade plus decrease in extraregional trade) with net *welfare* creation. Obviously, even if net trade creation is positive, there could be a net welfare loss depending on the cost structure of domestic production and the level of the external tariffs against nonmember countries. The ultimate criterion for judging the welfare effect of a regional arrangement is whether consumer gains outweigh government revenue and producer losses.

©International Monetary Fund. Not for Redistribution

However, the role of RTAs in preventing and resolving conflicts in Africa should not be exaggerated. First, even if closer trade ties do increase incentives for regional intervention in the event of a conflict, RTAs that do not increase intraregional trade will not make such intervention more likely. In fact, in Africa, regional cooperation arrangements that address the management of cross-border resource issues (such as water) are more effective in reducing military conflicts than trade-based RTAs (World Bank, 2004). Second, effective regional intervention requires regional arrangements that go beyond trade. This finding suggests that some regional political and cooperation arrangements can be just as effective as trade arrangements in preventing and resolving conflict. Furthermore, regional intervention may not be effective without the broad support of the wider international community. An RTA that diverts trade away from the rest of the world could hardly help attract attention from the rest of the world.

Another largely noneconomic objective of African RTAs is to increase regional bargaining power in multilateral and other forums for trade negotiations. Collective efforts would increase Africa's bargaining power only if the African countries formed a common position, in terms of both what concessions they seek from their trading partners and what they are willing to offer to them. In many areas, African countries do have a common position, such as greater market access in industrial countries. Another common interest is to make the Doha Round more development-oriented. However, when it comes to specific trade issues, African countries do not always have a common interest or position. For example, African countries have not presented a common tariff offer during the Doha Round negotiations. Another such example is quota restrictions on textile imports in the United States and the EU. For cotton-exporting countries in Western Africa (i.e., Benin, Burkina Faso, Chad, and Mali), the removal of textile quotas would increase world demand for their cotton, a vital industry for their economies. In contrast, some other African countries—Kenya, Lesotho, Madagascar, Mauritius, Namibia, South Africa, and Swaziland—are expected to lose from the removal of the quotas. So far in the WTO, Mauritius and Madagascar have aligned themselves with some other developing countries that are expected to lose from the quota removal in an effort to extend the quota restrictions, against the interests of the cotton-exporting African countries.

©International Monetary Fund. Not for Redistribution

CHAPTER

4 Policy Implications

The generally disappointing record of African RTAs warrants a reexamination of the underlying assumptions. Is the record disappointing because no preconditions were established to make the RTAs beneficial, dooming them to failure before they even began? Or is this record the result of poor design and/or implementation? What can we learn from the successes of regional trade integration in other parts of the world as well as from Africa's failures?

The evidence presented in the literature suggests that most African RTAs lacked initial conditions for success because of limited intraregional trade, weak complementarity in resource endowments, and inadequate transport infrastructure and local capacity. The design is generally poor, particularly with respect to external tariffs, nontariff barriers, and trade facilitation—although in some cases (e.g., WAEMU) the early involvement of international financial institutions and some donor governments helped improve the design. For virtually all African RTAs, implementation has been weak, often with delays, which partly results from overlapping membership. Thus, to improve the performance of African RTAs, a broad approach is required to tackle a whole range of design and implementation problems as well as to create necessary preconditions for successful regional trade integration.[25] Overall, the following policy messages have emerged from the literature:

- African countries should reduce their trade barriers against non-RTA members when pursuing RTAs. As Jebuni (1997) points out, MFN liberalization, either unilaterally or multilaterally, is even more important in the presence of RTAs. Lower external trade barriers reduce the risk of trade and investment diversion. Compared with unilateral liberalization, multilateral liberalization can mitigate the potential terms of trade effects on

[25]The approach proposed here is similar to that advocated by the World Bank in the Regional Assistance Strategy papers—for example, World Bank (2001, 2003b).

©International Monetary Fund. Not for Redistribution

liberalizing countries if they are large economies. Because African economies are small and hence have no market power, unilateral tariff reductions will be welfare-improving as long as supporting policies are put in place to ensure that resources dislocated by liberalization are reemployed. Tariff reductions will also reduce the tariff-induced bias against exports. Subramanian and others (2000) find that, for Africa, a 1 percentage point reduction in trade taxes leads to an increase in trade of between 0.7 and 1.1 percentage points.

More generally, MFN liberalization is found to be more conducive for growth and trade than discriminatory liberalization. Using time-series data for 1950–92, Vamvakidis (1998) shows that economies grew faster after broad-based liberalization, in both the short and long run, but slower after participating in an RTA. He also finds that economies had higher investment shares after broad-based liberalization, but lower shares after joining an RTA. A recent World Bank (2004) study finds that MFN liberalization tends to increase intraregional trade most rapidly and efficiently. Nowhere is this more evident than in East Asia, where there have been very few RTAs until recently, and yet intraregional trade has exploded following broad-based, nondiscriminatory trade liberalization in the region (Box 1). With the rapid growth of trade comes a finer division of labor within the region and intraindustry trade, which, in turn, reinforces regional trade ties. There are some encouraging signs in Africa, too. For example, when the WAEMU customs union was established in 2000, the average external tariff in its member countries was reduced substantially, fostering both extra- and intraregional trade (World Bank, 2003a).

The success of the European Union, notwithstanding its continued high protection of agriculture, is largely due to the steady reduction of its external trade barriers against non-EU members under successive rounds of GATT/WTO trade liberalization (Box 1). The experience of EU trade integration suggests that MFN liberalization can be effectively pursued by RTA members despite likely resistance to liberalization from vested interests. To overcome such resistance, policymakers in RTA members must show a strong commitment to effective implementation of reforms, as demonstrated by the EU members over the past decades. It is only through sustained efforts and a willingness to be bound by both multilateral and regional commitments that RTAs can foster intraregional as well as extraregional trade.

- African countries should avoid the pitfall of import substitution in their RTAs. One of the key reasons that many African RTAs have failed to promote trade is their inward orientation, as seen in an import substitution

©International Monetary Fund. Not for Redistribution

Box 1. Regional Trade Integration With and Without RTAs: The EU and East Asia

Regional trade integration in the EU and East Asia represents two success stories. The two regions have, however, taken different paths to success: EU integration has been driven by formal institutional arrangements, whereas East Asian integration has been a result of "natural" market forces. But both stories highlight the importance of initial economic conditions and sustained MFN reductions on external trade barriers.

The European Union, successor to the European Economic Community (EEC) created in 1957, has consistently pursued not only the elimination of trade barriers between its member countries, but also the reduction of barriers against nonmembers. Before the EEC was established, tariffs in its original members were high, and nontariff barriers were prevalent. Through successive rounds of multilateral trade liberalization under the auspices of the GATT and its successor, the WTO, the average MFN tariff on manufactures has been brought down to about 4 percent, although tariffs on agriculture remain high (22 percent). In 1957, intra-EEC trade was already about 30 percent of its total trade. The formation of the EEC led to sharp increases in intraregional trade, and, by the early 1970s, intra-EEC trade had reached 60 percent of total EEC trade. While intraregional trade has increased, trade with the rest of the world has also increased, albeit less rapidly. Beginning with trade, the EU has successfully moved to deeper economic and political integration and extended its membership over time. Successful economic integration has also contributed to greater regional stability.

Formal regional trade schemes are a recent phenomenon only in East Asia,[1] which has pursued trade liberalization largely on an MFN basis. The region's first integration arrangement, ASEAN, established in 1967, largely for the purpose of regional security , was designed only to facilitate trade. Nevertheless, with the shift from an inward-looking to an outward-looking growth strategy in the late 1950s (Japan began after World War II and China in the late 1970s), the region has consistently opened its markets to the rest of the world. Trade has since expanded rapidly. In 1956, the year for which data are available for all countries except China and Malaysia, total East Asian exports were only 4.6 percent of world exports, of which 2.6 percent was contributed by Japan. By 2003, the region accounted for more than 23 percent of world exports. At the same time, the share of intra–East Asian exports in the region's total exports rose from 23 percent to 47 percent. Rapid export growth to industrial country markets has generated demand for imports within the region, and income and resource diversity among the countries has enabled them to specialize according to their *global* comparative advantage. Thus, East Asia's trade integration has succeeded without much trade diversion.

---

[1]For the discussion here, East Asia includes China, Hong Kong SAR, Indonesia, Japan, Republic of Korea, Malaysia, the Philippines, Singapore, Taiwan Province of China, and Thailand.

©International Monetary Fund. Not for Redistribution

policy.[26] RTAs have often been designed to increase incentives to export to regional markets at the expense of exports to the world market (Foroutan, 1993). In addition, since local firms have to pay external duties, they are unable to access the most efficient sources of supplies and production equipment, thereby reducing Africa's ability to compete internationally.

Most African RTAs, even if successfully implemented, would have only limited potential to expand intraregional trade because countries in the region can meet only a very small share of regional import demands (Yeats, 1998; African Development Bank, 2000). For example, machinery and transport equipment account for approximately three-fourths of total (global) African imports, but they account for less than 4 percent of intra-African trade (Yeats, 1998). Similarly, Khandelwal (2004) finds that with low product complementarity among African countries, even three of the largest, most diversified economies in the region—Egypt, Kenya, and South Africa—might not function as growth poles in COMESA and SADC. While low intra-African trade flows point to great growth potential in the long run, it also suggests that the greatest boost to African trade in the short to medium term must come from policies promoting trade with the rest of the world. The African market is too small to sustain high export growth.

- African countries need to strengthen their domestic supply response to take advantage of unprecedented opportunities to export to world markets. African countries typically face very low protection in industrial countries, either because MFN tariffs (except on agricultural products) are already low (about 2–6 percent on manufactures and 16–49 percent on agricultural products) or because extensive preference is granted to African goods under the GSP, the EBA, AGOA, and Japan and Canada's zero-rated tariff schemes.[27] Any of these markets is much larger than Africa, and, when combined, they provide far greater potential to exploit economies of scale.[28] To increase domestic supply response, African countries need to continue to undertake structural reforms as well as MFN trade liberalization. They must also improve infrastructure and upgrade workers' skills.

[26]If RTAs are designed to provide local industries with a learning-by-doing period before exposing them to full-scale international competition, a clear, finite transition period could be set to avoid prolonged protection.

[27]The preferential market access is subject to ROOs, which reduce African exporters' ability to take full advantage of the preferential treatment. In addition, technical standards and sanitary and phytosanitary measures in industrial countries may impose substantial compliance costs on African exporters.

[28]GDP in sub-Saharan Africa is about one-tenth of that in Japan. In 2000, the EU, the United States, China, and Japan accounted for more than three-fourths of total African exports.

©International Monetary Fund. Not for Redistribution

- To exploit economies of scale and enhance domestic competition through RTAs, African countries need to reduce transport costs within the region.[29] It is difficult to take advantage of economies of scale in Africa when shipping a car from Japan to Abidjan, Côte d'Ivoire, costs $1,500 while the same car costs $5,000 to ship from Addis Ababa, Ethiopia, to Abidjan (ECA, 2004). The high transport costs and other barriers to intra-African trade are reflected in the fact that such trade is often "cross-border" and that "geographically distant" African countries trade very little with each other despite extensive regional trade arrangements (Yeats, 1998). Hummel (2001) finds that, in general, each additional day a shipment is in transit is equivalent to an extra 0.8 percentage point increase in applied tariffs. For historical reasons, infrastructure in Africa has been oriented toward facilitating trade with former colonial powers in Europe. To facilitate regional integration, Africa needs to devote resources to regional infrastructure. Such investment is also necessary to enhance domestic competition. With a more integrated regional market, MFN liberalization could then effectively substitute for a competition policy, given the small size of individual African markets.

- African countries should focus on cross-border, sectoral cooperation in areas of common interest. Customs administration, which is weak in most African countries, impedes trade within the region as well as with the rest of the world. Crossing a border in Africa can be equivalent to the cost of more than 1,000 miles of inland transportation, while in Europe the cost is equivalent to 100 miles. According to the World Bank (2004), delays at the main border crossing between South Africa and Zimbabwe (Beit Bridge) amounted to six days in February 2003, leading to an estimated loss of earnings per vehicle of $1,750—equivalent to the costs of a shipment from Durban to the United States. African countries could also cooperate on a range of other areas, such as energy, water resources, research and education, environment management, and regional conflict prevention and resolution. The relative success of SADC is perhaps partly due to its efforts to facilitate regional cooperation in various projects that bring tangible benefits to member countries.[30] Unlike the promotion of intraregional trade through preferential trade agreements, cooperation in such projects does not lead to trade diversion.

[29]There is an issue whether African countries should give priority to investment in infrastructure that reduces transport cost for intraregional trade or in infrastructure that helps extraregional trade. On efficiency grounds, the decision should be based on a cost-benefit analysis. However, if the promotion of intraregional trade is the objective, then there is a second-best argument for transport investment in favor of intraregional trade.

[30]Sectoral cooperation in Africa has its own shortcomings, as documented in Kritzinger-van Niekerk and Moreira (2002). Ineffective coordination of sectoral activities and institutions could lead to failures to take advantage of synergies of various sectoral activities, resulting in slow regional integration.

©International Monetary Fund. Not for Redistribution

- African countries should participate more actively in multilateral trade liberalization. Numerous studies indicate that Africa stands to gain substantially from multilateral trade liberalization. The World Bank (2004), for example, estimates that Africa would gain as much as $24 billion from global merchandise trade reform. Such benefits do not come without any costs, of course. Both Africa and other parts of the world would have to reduce their trade barriers and undertake structural adjustment. The Uruguay Round was a missed opportunity for Africa. Only a little over 2 percent of tariff lines in Africa are bound, often at levels well above the applied rates (Oyejide, 1997). Binding African tariffs at levels close to the applied rates would increase the credibility of Africa's trade policy. A recent study by Kowalski (2004) finds that binding tariffs closer to the applied rate could significantly increase trade.

  The current Doha Round of multilateral trade negotiations can bring substantial benefits for African countries. The long-term dynamic gains from a successful Doha Round are likely to be much larger than typical estimates (such as the number cited above) from general equilibrium models. In agriculture, for example, eliminating trade distortions (export and domestic subsidies and high tariffs) around the world could boost world agricultural prices by 12 percent according to the U.S. Department of Agriculture (2001), thus increasing the returns on agricultural investment and productivity growth in Africa.[31] Reductions in industrial tariffs in Africa would increase domestic competition and provide much needed incentives for exports in Africa. Liberalization of trade in services in Africa would reduce the production cost for other sectors, as well as increase competition and hence efficiency of the domestic services sector. Many of these and other gains (such as those from improved trade facilitation, which is also part of the Doha Round agenda) are difficult to quantify using standard general equilibrium models. However, if the prosperity of some developing economies (e.g., Hong Kong SAR, Korea, Singapore, and Taiwan Province of China) over the past decades is any indication that multilateral liberalization can help poor countries achieve, Africa has a much higher stake in a successful Doha Round than a mercantilist approach to trade liberalization would suggest.

- African countries should take early action to bolster domestic tax mobilization. As noted earlier, trade taxes remain an important source of government revenue in most African countries despite tariff reductions in recent years. At an average tariff level of 17 percent at present, any further tariff cut can result in revenue losses. The need for early mobilization of domestic taxes has become more urgent because of the ongoing negotiations

[31]Some net food-importing African countries could, of course, suffer terms of trade losses.

©International Monetary Fund. Not for Redistribution

on multilateral trade liberalization in the WTO and on the FTAs with the EU. For countries that plan to undertake unilateral liberalization, domestic tax mobilization should be part of the reform program to safeguard government revenue.

- Preferential trade arrangements between African countries and outside countries are likely to bring greater benefits. Although such arrangements are inferior to MFN liberalization, as noted earlier, they provide several advantages over RTAs among African countries alone and could serve as a second-best policy when MFN liberalization is not feasible. Empirical studies show that trading partners matter. Trade ties with fast-growing partners bring more benefits, and trade with high-income countries is also more beneficial (Arora and Vamvakidis, 2004). A key weakness of RTAs in Africa is that the region as a whole has been growing more slowly than the rest of the world. Preferential trade agreements with industrial countries could help reduce policy reversals by acting as an "agency of restraint" when commitments under the multilateral system do not exist (Collier, 1991). Furthermore, trade agreements with industrial countries are more likely to have broader product and policy coverage. Properly balanced, such coverage—such as trade in services, trade facilitation, investment protection, institution building, and regulatory reforms—can yield more benefits. But there is the risk that trade agreements with industrial countries are skewed toward areas that are more in the interest of industrial countries than of developing countries. For example, financial services are often covered in North-South agreements, whereas temporary movement of labor is not. Also, such agreements often introduce labor and environmental standards that may not be appropriate for Africa, given its current level of economic development.

- African countries should streamline RTAs with overlapping membership. Most African countries have multiple commitments arising from different agreements, and the commitments are not always consistent. For example, some Eastern African countries (Burundi, Kenya, and Uganda) are involved in two *planned* customs unions (COMESA and EAC). As long as the CETs are different (or even if their final levels are the same but have different schedules of transition), these countries would face the impossible task of implementing multiple tariff commitments. In the case of FTAs, the implementation is further complicated by the different ROOs that these countries have to administer. In addition to the administrative costs, these rules give customs officials more discretion and are therefore vulnerable to rent seeking by domestic interest groups. Despite the recognition of these problems, little progress has been made in addressing them.[32] The current negotiations on FTAs with the EU represent an opportunity to begin

[32]For some countries, multiple memberships reflect their desire to pick and choose various options offered by competing RTAs—in terms of the level of integration and the extent of commitments (e.g., the exchange rate regime).

©International Monetary Fund. Not for Redistribution

streamlining the arrangements. For example, some countries could reduce their multiple memberships to a single one; small and unsuccessful RTAs could be absorbed by the large ones that have been designated to represent groups of African countries in negotiating FTAs with the EU. Given the number of RTAs involved and the rivalries between them, any such process will be a long and difficult one.[33]

[33]According to the current plan, four regional EPA negotiating groups will be formed in Africa to negotiate FTAs with the EU (Hinkle and Schiff, 2004). ECOWAS has been designated the negotiating bloc for Western Africa; The CEAMC plus São Tomé and Príncipe grouping has been chosen by the Central African states; 16 countries, including most of the COMESA members, will form an Eastern and Southern Africa group; and SACU members and three neighboring countries are forming a Southern African negotiating group.

©International Monetary Fund. Not for Redistribution

CHAPTER

5 Role of the IMF

The discussion so far highlights the need to take a broad perspective in thinking about how to make African RTAs work better. Careful design and sustained implementation are necessary to make any RTA deliver, but the more fundamental determinants of RTA performance seem to be policies and conditions that affect the overall environment for trade. In this context, MFN liberalization, improvements in regional infrastructure (particularly transport), and reductions in trading costs at borders are critical. These are all conventional development issues but nonetheless pose difficult challenges for African policymakers. African countries need to protect their revenue base in undertaking MFN tariff reductions, and, when such tariff cuts are implemented in their trading partners, they need to address the consequence of preference erosion.[34] Efforts to improve infrastructure and reduce trading costs will require adequate local capacity of implementation, in addition to financial resources. In all these areas, the IMF can lend its support to African countries, beyond its core expertise area of macroeconomic management, which is also essential to create a conducive environment for trade.

A. Establishing Sound Macroeconomic Frameworks

The IMF plays a central role in helping its African members promote trade by establishing sound macroeconomic frameworks. Macroeconomic stability is a key precondition for trade growth. Low inflation and financial stability create an enabling environment for trade growth. Prudent fiscal policies not only help

[34]If trade preferences in favor of African countries have not worked in the first place, then there is no risk of preference erosion from MFN liberalization. The ability of African countries to utilize trade preferences seems to vary. For example, in the case of textile and garment exports to the United States under the AGOA, several African countries—namely, Kenya, Lesotho, Madagascar, Mauritius, Namibia, and Swaziland—have been able to increase their exports substantially, while many others have not demonstrated such a capacity.

©International Monetary Fund. Not for Redistribution

keep inflation low, but also leave more resources to the private sector to increase their productive capacity. Appropriate exchange rates help maintain external balance and competitiveness. They also help reduce resistance to trade liberalization. African experience has shown that overvalued exchange rates often lead to pressure for policy reversals even if reforms have been undertaken in the first place (O'Connell, 1997). Many African countries have made progress toward macroeconomic stability in recent years. Inflation has moderated and public finance is on a more sustainable path. Many countries have a stronger balance of payments position thanks to more flexible exchange rates and higher foreign reserves. Still, much more needs to be done.

B. Managing Revenue Losses from Trade Reform

Trade liberalization does not necessarily lead to revenue losses. In the initial stages of liberalization, revenues may even increase, especially when certain nontariff barriers are converted into tariffs, high tariffs are lowered, and certain exemptions on the payment of duties are eliminated (Ebrill, Stotsky, and Gropp, 1999).[35] In the subsequent stages of liberalization, it is possible to recover revenue losses by strengthening domestic indirect taxes, provided that the country has the administrative capacity to do so (Keen and Ligthart, 2001).[36] To some extent, revenues from domestic taxes are likely to increase in the aftermath of trade liberalization because of higher domestic consumption arising from lower prices of tradables and because of higher growth resulting from the improved allocation of resources in the economy. However, the size and timing of such dynamic effects on revenues are highly uncertain. The experience in Africa shows that only half of the countries where trade tax revenue declined from the early 1980s to the late 1990s managed to recover tax revenues from domestic sources. In general, empirical research shows that revenue losses from trade liberalization vary considerably across countries (Box 2).

Empirical research suggests that appropriate supporting policies mitigate trade revenue loss when it occurs. First, trade liberalization will need to be accompanied by a strengthening of indirect taxes. A two-year period has often been found sufficient for introducing an effective VAT in countries where this tax does not exist. However, for countries where tax administration is weak, like many in Africa, it may take up to five years to introduce an effective VAT. Countries that already have a VAT could moderate revenue losses by improving

[35]Insofar as multilateral tariff reductions focus on bound rates rather than applied rates, the revenue impact of trade liberalization is muted because bound rates in Africa tend to be well above applied rates (Baunsgaard and others, 2003).

[36]It is argued that countries that have already a well-functioning value-added tax (VAT) are best placed to recoup revenues lost through trade reform.

©International Monetary Fund. Not for Redistribution

Box 2. Trade Liberalization and Revenue Losses

The empirical evidence on the revenue effects of RTAs in sub-Saharan Africa is mixed. The World Bank estimates (cited in ECA, 2004, p. 101) that Uganda could lose 9 percent of total government revenue in 1998 as a result of COMESA liberalization. An IMF study of the free trade area between 11 (out of a total of 19) COMESA member states[1] shows that the elimination of intra-COMESA trade flows would not pose significant threat to revenues.[2] Only in the case of Rwanda would the direct loss of import duty be about 4 percent of total revenues. For Uganda, Tanzania, and Mauritius, it would be between 1 and 2 percent of total revenues; in all other countries, it would be below 1 percent. Trade diversion effects could magnify these results in Rwanda, Uganda, and Tanzania, whose imports from Kenya could increase somewhat at the expense of imports from non-COMESA countries.

How well countries can manage revenue losses from trade liberalization depends on the macroeconomic policies they follow and their level of economic development. One recent study (Agbeyegbe, Stotsky, and WoldeMariam, 2004) shows that trade liberalization in sub-Saharan Africa may not have a significant effect on overall revenues if it is accompanied by sound monetary and exchange rate policies. Following trade liberalization, a depreciation of the exchange rate often increases overall tax revenue, with the impact varying across different types of taxes. Another study (Baunsgaard and Keen, 2005), however, provides evidence that is more troubling for low-income countries. Using panel data for 125 countries during 1975–2000, it concludes that following the loss of trade revenues, high-income countries recovered them with ease, middle-income countries recovered only 35–55 percent of revenues, and low-income countries recovered none. The authors were unable to find evidence to support the notion that the presence of a VAT makes it easier to offset revenue losses from trade liberalization. Moreover, Keen and Simone (2004) find that international competition in tax incentives (including those offered to investors in free trade zones) has reduced both the corporate tax rate and base, making it more difficult to recover revenue losses from trade liberalization.

---

[1]The countries studied were Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

[2]These estimates focused only on changes in import duties and therefore ignored the implications of the tariff reduction for excises, VAT, or sales tax. They were derived on the assumption of unchanged behavior.

its design. Second, strengthened income taxes on both individuals and companies can aid in capturing revenues from rising incomes. Third, attention will need to be paid to strengthening the administration of the wider tax system—for example, by establishing large-taxpayer units. Finally, the adoption of sound macroeconomic policies promotes growth, expands the tax base, and, ultimately, raises government revenues. In all these aspects, the IMF has provided, and should continue to provide, assistance to countries in need of mobilizing more government revenue.

©International Monetary Fund. Not for Redistribution

C. Addressing the Impact of Preference Erosion

African countries have expressed concern about preference erosion in the context of multilateral liberalization. As noted earlier, African countries currently enjoy extensive preferential market access in industrial countries and some developing countries. MFN liberalization in Africa's trading partners would reduce its preference margins in these markets and, hence, reduce the competitiveness of African exports. Empirical research indicates that the impact on exports of preference erosion from multilateral liberalization is generally small and highly concentrated in a small number of countries and commodities (Box 3). Preference erosion can also result from the further proliferation of regional trade arrangements. For instance, the EU-Common Market of the South (Mercosur) FTA that is currently under negotiation could reduce the tariff advantage that African countries enjoy in the EU under the EBA. Similarly, a continued U.S. push for FTAs in the Americas, the Middle East, and Asia could reduce the preference margin for African exports in the U.S. market.

The IMF has taken steps to address the problem of preference erosion. In April this year, the Executive Board of the IMF approved the Trade Integration Mechanism (TIM). It is designed to finance balance of payments shortfalls as a result of textile shocks, increases in the prices of food imports, and preference erosion stemming from multilateral liberalization. It is hoped that the TIM will mitigate the apprehension of many developing countries about trade shocks arising from a successful Doha Round. In July 2004, Bangladesh became the first country to be granted TIM support under the umbrella of the country's Poverty Reduction and Growth Facility (PRGF)-supported program. Bangladesh expects a decline in its exports of garments as a result of the scheduled removal of textile quotas at the beginning of 2005. Some African countries (e.g., Lesotho, Madagascar, and Mauritius) face similar shocks.

D. Strengthening Surveillance and Trade-Related Technical Assistance

As RTAs in Africa continue to expand and the Doha Round negotiations make progress, the IMF will need to strengthen its surveillance and trade-related technical assistance. As RTAs and multilateral trade liberalization broaden their coverage to services, especially financial services, the Fund has the important task of helping African countries strengthen their financial systems, through surveillance activities and technical assistance. The IMF may also need to examine regional financial issues and be vigilant about potential vulnerabilities arising from more integrated regional financial markets and from any impediments to the resolution of financial crises that arise. In the context of overlapping RTAs in Africa, tariff reforms have become increasingly

©International Monetary Fund. Not for Redistribution

Box 3. Preference Erosion from Multilateral Liberalization

The impact of preference erosion on African countries is likely to be small and concentrated in a few countries. Subramanian (2003) finds that a 40 percent MFN tariff reduction by the Quad countries (Canada, the EU, Japan, and the United States) would likely lead to a loss of less than 2 percent of exports for least developed countries as a whole. However, the loss would be significant in a few countries, but still small in absolute value and in relation to exports. Only one country (Malawi) may face a loss exceeding 10 percent of exports. Alexandraki and Lankes (2004), focusing their research on the impact on middle-income developing countries, reach a similar conclusion: the preference erosion is heavily concentrated in a subset of preference beneficiaries—primarily small island economies dependent on sugar, bananas, and textiles.

These results must be qualified. First, there is considerable uncertainty about supply elasticities and the elasticities of substitution between imports from preference beneficiaries and those from other countries. Second, although both studies deal only with exports, imports can also be affected by preference erosion (e.g., reduced exports of garments result in fewer imports of textiles). Third, the general equilibrium effects of preference erosion need to be considered, because the exchange rate may well depreciate in response to export losses. More important, multilateral liberalization that leads to preference erosion as a by-product is likely to result in overall welfare gains for current preference beneficiaries, although short-term adjustment costs may occur. And, finally, to the extent that the impact of preference erosion represents a permanent shock that often occurs gradually and can be anticipated, it can be dealt with effectively.

complicated. Working together with other international financial institutions (e.g., the WTO and the World Bank), the Fund should continue to assist African countries in streamlining their tariff structures to enhance transparency and efficiency, and broaden their domestic tax base to safeguard revenues for the budget. The decision by WTO members to negotiate trade facilitation—the sole area of the four so-called Singapore Issues that remains on the Doha agenda[37]—will require the IMF to strengthen its technical assistance in customs administration.[38] As part of surveillance and program work, the Fund will also need to take a more proactive approach to infrastructure development and reductions in trading costs both at and behind the border. Finally, the Fund should strive to strengthen its analysis and assistance in support of Africa's regional integration arrangements.

[37]The other three issues that have been dropped from the Doha Round agenda are investment rules, competition policy, and government procurement.

[38]Other international organizations, such as the International Organization for Standardization, the World Customs Organization, the WTO, and the World Bank will need to help African countries overcome technical barriers to trade and barriers arising from sanitary and phytosanitary measures in importing countries. These barriers are becoming increasingly important as tariff levels fall.

©International Monetary Fund. Not for Redistribution

E. Creating an Enabling Global Environment

The IMF should continue to advocate that multilateral trade liberalization be a top policy priority for its membership. The success of the Doha Round trade negotiations remains vital for maintaining confidence in the multilateral trade system, which has been a cornerstone of global economic prosperity since World War II. Regionalism in its current form is not a substitute for multilateral liberalization. Regionalism also runs the risk of marginalizing small and weak countries outside major trade blocs even if they are WTO members. Overall, the outcome of a global trade system in which multilateralism coexists with proliferating regionalism is uncertain, produces fewer widespread benefits, and may not serve the IMF's objective of facilitating the expansion and balanced growth of international trade, as set out in its Articles of Agreement.

The framework agreements reached at the WTO in August 2004 are welcome and place the Doha Round back on track. What is required now is determination and commitment by all countries to deliver on the goals of the Doha Development Agenda. Both rich and poor countries carry responsibilities for promoting the fuller integration of developing countries into the global trading system. Rich countries should eliminate their agricultural export subsidies as soon as practical and substantially reduce trade-distorting domestic subsidies. They also need to reduce tariff peaks and escalation as well as barriers to manufactured exports (e.g., textiles) that are of special interest to poor countries. At the same time, trade barriers in many developing countries remain high. Poor countries, including those in Africa, should firmly reject the idea of a "round for free" (i.e., no reciprocal liberalization by certain developing countries) and undertake to reduce their own trade barriers while insisting that rich countries make strong commitments to open their markets further.

The IMF should continue to advocate coherence between trade and development assistance. To enable developing countries to reap the benefits of trade liberalization, rich countries have a responsibility to deliver the promised technical assistance to help developing countries build their capacity in trade areas. More generally, industrial countries need to boost their overseas development assistance. Current aid flows are not only insufficient, but are also unpredictable and often uncoordinated among donors. Better aid coordination and multiyear commitments are key steps in making development assistance more effective.

©International Monetary Fund. Not for Redistribution

CHAPTER

6 Conclusions

Over the past decades, African countries have set ambitious goals for their regional trade arrangements, but the results have so far fallen short of expectations. Most African RTAs started with a low level of intraregional trade. Thus, even if the RTAs had been more successfully implemented, the impact of these arrangements on Africa's overall trade would have been small—unless they had created a more favorable environment for overall trade. The potential of the RTAs in exploiting economies of scale and enhancing competition has been limited by the lack of trade complementarity among RTA partners, small market size, poor transport infrastructure, and high trading costs at the border. More important, relatively high barriers against trade with the rest of the world have essentially turned RTAs into an import substitution policy at the regional and subregional levels.

The most critical challenge to improve the performance of African RTAs is to open them up to the rest of the world. Experience from other parts of the world suggests that nondiscriminatory liberalization promotes intraregional trade as well as trade with the rest of the world. To make broad-based trade liberalization work, African countries also need to devote more resources to trade facilitation, with a particular focus on reducing infrastructure bottlenecks and impediments to trade at the borders. Streamlining existing RTAs and closer regional cooperation in sectors of common interest would also help reduce trading costs. In negotiating EPAs with the EU, African countries should ensure that these agreements result in lower external tariffs against the rest of the world to minimize trade diversion. These agreements should also be development-oriented, with a strong focus on comprehensive product coverage, trade facilitation, investment protection, institution building, and regulatory reforms in Africa.

The IMF can play an important role in helping African countries implement such a broad strategy for trade promotion. In addition to continued support in establishing macroeconomic stability, the IMF should strengthen its surveillance and technical assistance in managing shocks arising from trade liberalization and regional integration. The IMF could also, in collaboration with other

©International Monetary Fund. Not for Redistribution

international financial institutions, be more actively involved in the area of trade facilitation, particularly customs administration. Continued IMF support for multilateral trade negotiations in the WTO and greater market access for developing country exports will create a more favorable global environment for Africa's trade. Ultimately, however, African countries themselves need to demonstrate a strong commitment to a program of broad-based trade reform to reverse the region's marginalization in world trade and investment.

©International Monetary Fund. Not for Redistribution

References

African Development Bank, 2000, *African Development Report 2000* (Abidjan).

Agbeyegbe, Terence, Janet G. Stotsky, and Asegedech WoldeMariam, 2004, "Trade Liberalization, Exchange Rate Changes, and Tax Revenue in Sub-Saharan Africa," IMF Working Paper 04/178 (Washington: International Monetary Fund).

Alexandraki, Katerina, and Hans Peter Lankes, 2004, "The Impact of Preference Erosion on Middle-Income Developing Countries," IMF Working Paper 04/169 (Washington: International Monetary Fund).

Ancharaz, Vinaye, 2003, "Determinants of Trade Policy Reform in Sub-Saharan Africa," *Journal of African Economies*, Vol. 12, No. 3, pp. 417–43.

Arora, Vivek, and Athanasios Vamvakidis, 2004, "How Much Do Trading Partners Matter for Economic Growth?" IMF Working Paper 04/26 (Washington: International Monetary Fund).

Baldwin, Richard E., 2003, "Openness and Growth: What Is the Empirical Relationship?" NBER Working Paper No. 9578 (Cambridge, Massachusetts: National Bureau of Economic Research).

———, and Anthony Venables, 1996 "Regional Economic Integration" in *Handbook of International Economics*, Vol. 3, ed. by Gene M. Grossman and Kenneth Rogoff (Amsterdam: North Holland), pp. 1597–1644.

Baunsgaard, Thomas, Anne-Marie Geourjon, Michael Keen, and Jesus Seade, 2003, "Liberalizing Trade and Safeguarding Public Revenues," note prepared for the WTO (WT/TF/COH/14), January.

Baunsgaard, Thomas, and Michael Keen, 2005, "Trade Revenue and (or?) Trade Liberalization," IMF Working Paper 05/112 (Washington: International Monetary Fund).

Berg, Andrew, and Anne O. Krueger, 2003, "Trade, Growth, and Poverty: A Selective Survey," IMF Working Paper 03/30 (Washington: International Monetary Fund).

Bhagwati, Jagdish, and Arvind Panagariya, 1996, *The Economics of Preferential Trading Arrangements* (Washington: American Enterprise Institute).

Carrere, Celine, 2004, "African Regional Agreements: Impact on Trade With or Without Currency Unions," *Journal of African Economies*, Vol. 13, No. 2, pp. 199–239.

Clausing, Kimberly A., 2001, "Trade Creation and Trade Diversion in the Canada-United States Free Trade Agreement," *Canadian Journal of Economics*, Vol. 34, No. 3, pp. 677–96.

©International Monetary Fund. Not for Redistribution

Coe, David T., and Alexander W. Hoffmaister, 1999, "North-South Trade: Is Africa Unusual?" *Journal of African Economies*, Vol. 8, No. 2, pp. 228–56.

Collier, Paul, 1991, "Africa's External Economic Relations: 1960–90," *African Affairs*, Vol. 90, No. 360, pp. 339–56.

COMESA Secretariat, 2001, *Annual Report*, Ref. COM/TCM/CT/NTB/1/3 and COM/TCM/NTB/1/4 (Lusaka, Zambia).

De Melo, Jaime, Arvind Panagariya, and Dani Rodrik, 1993, "The New Regionalism: A Country Perspective," in *New Dimensions in Regional Integration*, ed. by Jaime de Melo and Arvind Panagariya (Cambridge, U.K.: Cambridge University Press).

Dollar, David, and Aart Kraay, 2001, "Trade, Growth, and Poverty," Policy Research Working Paper Series 2615 (Washington: World Bank).

Drysdale, Peter, and Ross Garnaut, 1982, "Trade Intensities and the Analysis of Bilateral Trade Flows in a Many-Country World," *Hitotsubashi Journal of Economic*s, Vol. 22, pp. 62–84.

Ebrill, Liam, Janet Stotsky, and Reint Gropp, 1999, *Revenue Implications of Trade Liberalization*, Occasional Paper No. 180 (Washington: International Monetary Fund).

Elbadawi, Ibrahim A., 1997, "The Impact of Regional Trade and Monetary Schemes on Intra-Sub-Saharan Africa Trade," in *Regional Integration and Trade Liberalization in Sub-Saharan Africa,* ed. by Ademola Oyejide, Ibrahim Elbadawi, and Paul Collier (London: Macmillan Press Ltd.).

———, and Francis M. Mwega, 1998, "Regional Integration, Trade, and Foreign Direct Investment in Sub-Saharan Africa," in *Trade Reform and Regional Integration in Africa*, ed. by Zubair Iqbal and Moshin S. Khan (Washington: International Monetary Fund).

Flatters, Frank, 2002, "SADC Rules of Origin: Undermining Regional Free Trade." Available via the Internet: http://qed.econ.queensu.ca/faculty/flatters/main/writings.html.

———, and Robert Kirk, 2004, "Rules of Origin as Tools of Development? Some Lessons from SADC," Trade Policy and Economic Development (Arlington, Virginia: The Services Group (TSG)).

Foroutan, Faezeh, 1993, "Regional Integration in Sub-Saharan Africa: Past Experience and Future Prospects," in *New Dimensions in Regional Integration*, ed. by James de Melo and Arvind Panagariya (Cambridge, U.K.: Cambridge University Press).

———, and Lant Pritchett, 1993, "Intra-Sub-Saharan African Trade: Is It Too Little?" *Journal of African Economies*, Vol. 2 (May), pp. 74–105.

François, Christian A., and Arvind Subramanian, 1998, "Beyond Trade: Regional Trade Arrangements as a Window on Globalization," in *Trade Reform and*

©International Monetary Fund. Not for Redistribution

Regional Integration in Africa, ed. by Zubair Iqbal and Mohsin S. Khan (Washington: International Monetary Fund).

Frankel, Jeffrey A., Ernesto Stein, and Shang-Jin Wei, 1997, *Regional Trading Blocs in the World Economic System* (Washington: Institute for International Economics).

Herin, Jan, 1986, "Rules of Origin and Differences Between Tariff Levels in EFTA and in the EU," EFTA Occasional Paper No. 13 (Geneva: European Free Trade Association).

Hinkle, Lawrence E., and Maurice Schiff, 2004, "Economic Partnership Between Sub-Saharan Africa and the EU: A Development Perspective," *The World Economy*, Vol. 27, No. 9, pp. 1321–33.

Hummel, David, 2001, "Time as a Trade Barrier" (West Lafayette, Indiana: Purdue University).

Jebuni, Charles D., 1997, "Trade Liberalization and Regional Integration in Africa," in *Regional Integration and Trade Liberalization in Sub-Saharan Africa,* ed. by Ademola Oyejide, Ibrahim Elbadawi, and Paul Collier (London: Macmillan Press Ltd.).

Jonsson, Gunnar, and Arvind Subramanian, 2000, "Dynamic Gains from Trade Evidence from South Africa," IMF Working Paper 00/45 (Washington: International Monetary Fund).

Kasekende, L., and N. Ng'eno, 1995, *Regional Integration and Economic Liberalization in East and Southern Africa* (Nairobi: African Economic Research Consortium).

Keen, Michael, and Jenny Ligthart, 2001, "Coordinating Tariff Reductions and Domestic Tax Reform," *Journal of International Economics*, Vol. 56, pp. 407–25.

Keen, Michael, and Alejandro Simone, 2004, "Tax Policy In Developing Countries: Some Lessons from the 1990s and Some Challenges Ahead," in *Helping Countries Develop: The Role of Fiscal Policy,* ed. by Sanjeev Gupta, Benedict Clements, and Gabriela Inchauste (Washington: International Monetary Fund).

Khandelwal, Padamja, 2004, "COMESA and SADC: Prospects and Challenges for Regional Integration," IMF Working Paper 04/227 (Washington: International Monetary Fund).

Khattry, Barsha, and Mohan Rao, 2002, "Fiscal Faux Pas? An Analysis of the Revenue Implications of Trade Liberalization," *World Development*, Vol. 30, pp. 1431–44.

Kowalski, P., 2004, *Impact of Changes in Tariffs on Developing Countries' Government Revenue*, TD/TC/WP(2004)29/Rev1, work in progress (Paris: Organization for Economic Cooperation and Development).

©International Monetary Fund. Not for Redistribution

Krishna, Kala, and Anne O. Krueger, 1995, "Implementing Free Trade Areas: Rules of Origin and Hidden Protection," NBER Working Paper No. 4983 (Cambridge, Massachusetts: National Bureau of Economic Research).

Kritzinger-van Niekerk, Lolette, and Emmanuel Pinto Moreira, 2002, "Regional Integration in Southern Africa: Overview of Recent Developments," Discussion Paper (Washington: World Bank).

Krueger, Anne O., 1999a, "Are Preferential Trading Arrangements Trade-Liberalizing or Protectionist?" *Journal of Economic Perspectives*, Vol. 13, No. 4, pp. 105–24.

———, 1999b, "Free Trade Agreements as Protectionist Devices: Rules of Origin," NBER Working Paper No. 4352 (Cambridge, Massachusetts: National Bureau of Economic Research).

———, 1999c, "Trade Creation and Trade Diversion under NAFTA," NBER Working Paper No. 7429 (Cambridge, Massachusetts: National Bureau of Economic Research).

Leamer, Edward, and Robert Stern, 1970, *Quantitative International Economics* (Boston: Allyn and Bacon).

Lyakurwa, W.M., 1996, "Trade and Investment Integration in Sub-Saharan Africa," paper presented at a FONDAD Conference on Regional Integration in Africa, The Hague.

Mengistae, Taye, and Catherine Pattillo, 2004, "Export Orientation and Productivity in Sub-Saharan Africa," *IMF Staff Papers*, Vol. 51, No. 2, pp. 327–53.

Ng, Francis, and Alexander Yeats, 2000, "On the Recent Trade Performance of Sub-Saharan African Countries: Cause for Hope or More of the Same?" Africa Region Working Paper Series No. 26, June (Washington: World Bank).

———, 2002, "What Can Africa Expect from Its Traditional Exports?" Africa Region Working Paper Series No. 26, February (Washington: World Bank).

O'Connell, Stephen A., 1997, "Macroeconomic Harmonization, Trade Reform, and Regional Trade in Sub-Saharan Africa," in *Regional Integration and Trade Liberalization in Sub-Saharan Africa,* ed. by Ademola Oyejide, Ibrahim Elbadawi, and Paul Collier (London: Macmillan Press Ltd.).

Oyejide, T. Ademola, 1997, "Regional Integration and Trade Liberalization in Sub-Saharan Africa," Special Paper No. 28 (Nairobi: African Economic Research Consortium).

©International Monetary Fund. Not for Redistribution

Panagariya, Arvind, 2000, "Preferential Trade Liberalization: The Traditional Theory and New Developments," *Journal of Economic Literature*, Vol. 38 (June), pp. 287–331.

———, 2002, "EU Preferential Trade Arrangements and Developing Countries," *World Economy*, Vol. 25, No. 10, pp. 1415–32.

———, 2004, "Miracles and Debacles: In Defense of Trade Openness," *World Economy*, Vol. 27, No. 8, pp. 1149–71.

Robson, P., 1998, *Economic Integration in Africa* (London: Allen and Unwin).

Rodriguez, Francisco, and Dani Rodrik, 2001, "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence," in *NBER Macroeconomics Annual 2000,* ed. by Ben Nernanke and Kenneth Rogoff (Cambridge, Massachusetts: MIT Press).

Rodrik, Dani, 1999, *The New Global Economy and Developing Countries: Making Openness Work* (London: Overseas Development Institute).

Romalis, Johan, 2004, "NAFTA's and CUSFTA's Impact on International Trade" (Chicago: University of Chicago).

Sachs, Jeffrey, and Andrew Warner, 1995, "Economic Reform and the Process of Global Integration," *Brookings Papers on Economic Activity*: 1, Brookings Institution.

Schiff, Maurice, and L. Alan Winters, 2003, *Regional Integration and Development* (Washington: World Bank and Oxford University Press).

Subramanian, Arvind, 2003, "Financing of Losses from Preference Erosion," note prepared for the WTO (WT/TF/COH/14), January.

Subramanian, Arvind, Enrique Gelbard, Richard Harmsen, Katrin Elborgh-Woytek, and Piroska Nagy, 2000, *Trade and Trade Policy in Eastern and Southern Africa*, Occasional Paper No. 196 (Washington: International Monetary Fund).

Subramanian, Arvind, and Natalia Tamirisa, 2003, "Is Africa Integrated in the Global Economy?" *IMF Staff Papers*, Vol. 50, No. 3, pp. 352–72.

United Nations Economic Commission for Africa (ECA), 2004, *Assessing Regional Integration in Africa (*Addis Ababa, Ethiopia).

United States Department of Agriculture, 2001, *Agricultural Policy Reform in the WTO: The Road Ahead*, Economic Research Service (Washington).

Vamvakidis, Athanasios, 1998, "Regional Trade Agreements Versus Broad Liberalization: Which Path Leads to Faster Growth? Time Series Evidence," IMF Working Paper 98/40 (Washington: International Monetary Fund).

World Bank, 2000, *Trade Blocs* (Washington: World Bank).

©International Monetary Fund. Not for Redistribution

———, 2001, “Memorandum of the President of the International Development Association to the Executive Directors on a Regional Integration Assistance Strategy for West Africa,” July 11 (Washington).

———, 2003a, “Africa Regional Trade Progress Note,” June (Washington).

———, 2003b, “Memorandum of the President of the International Development Association to the Executive Directors on a Regional Integration Assistance Strategy for Central Africa,” January 10 (Washington).

———, 2003c, “Regional Trade Integration in East Africa—Revenue Impacts of the Planned Customs Union,” December (Washington).

———, 2004, *Global Economic Prospects 2005* (Washington: World Bank).

Yeats, Alexander J., 1998, “What Can Be Expected from African Regional Trade Agreements: Some Empirical Evidence,” World Bank Policy Research Working Paper No. 2004 (Washington: World Bank).

©International Monetary Fund. Not for Redistribution