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Ratification of the African Union Continental Free Trade Area Agreement

Submitted to the

Committee on National Economy, Trade and Labour Matters

By the

Zambia Institute for Policy Analysis and Research (ZIPAR)

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1. Introduction

The objective of this memorandum is to provide the Parliamentary Committee on National Economy, Trade and Labour Matters, ZIPAR's analytical comments on the ratification of the African Continental Free Trade Area (AfCFTA). In this regard, this memorandum provides an analysis of the benefits and challenges of acceding to the AfCFTA and recommends a way forward. Specifically, the memorandum covers the following:

i. The background to regional integration in Africa, objectives of the AfCFTA and the status quo of ratification;
ii. The benefits of acceding to the AfCFTA;
iii. The challenges of acceding to the AfCFTA; and
iv. Recommendation on the way forward.

2. Background to Regional Integration in Africa

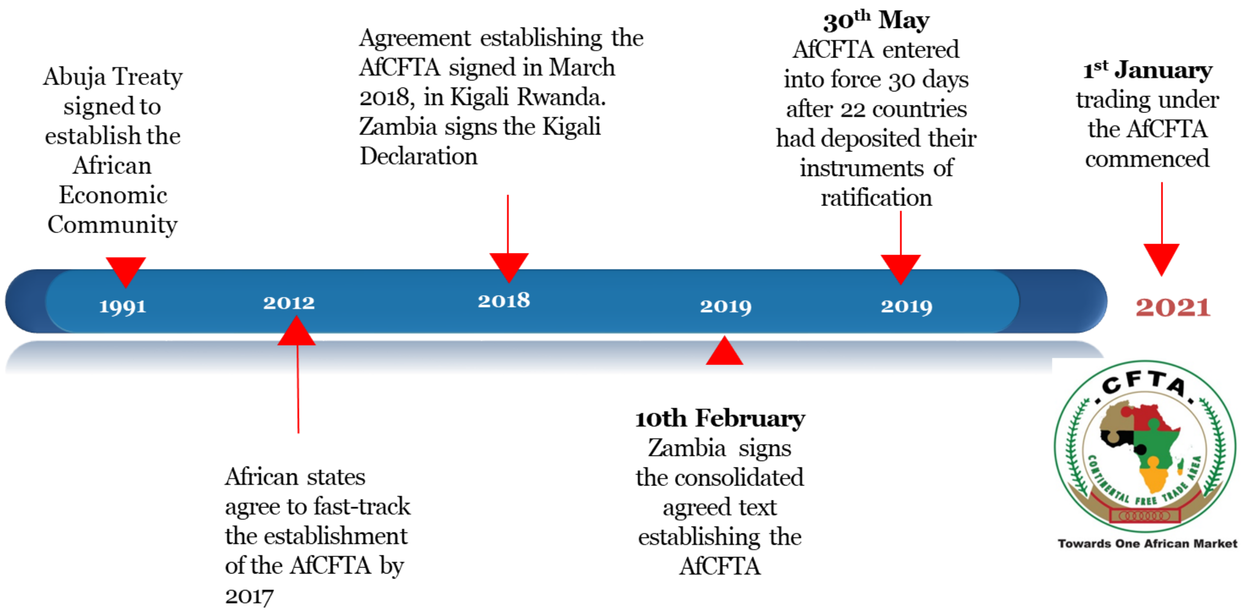
The desire for a deeper level of integration within Africa can be traced back to the signing of the Abuja Treaty in 1991. This Treaty lays out the blueprint for African states to create new regional economic communities (RECs) to augment existing ones and to act as building blocks for the ultimate creation of the African Economic Community (AEC) – an African community that is completely integrated in economic, monetary, political, social and cultural terms[1]. While the Abuja Treaty outlined six sequential stages for Africa's integration, these stages have not been followed to the letter. Initially, it was envisaged that each REC would have established, a free trade area (FTA) and customs union by 2017[2]. The customs unions would then harmonise and amalgamate into a continental customs union, followed by a common market and subsequently, the AEC with an economic and monetary union and a Pan-African Parliament. But progress in the eight RECs recognised as the building blocks for the AEC has been varied with the majority progressing at very slow pace[3].

In cognizance of the importance of economic integration for Africa's development, in January 2012, African states decided to fast track the establishment of the African Continental Free Trade Area (AfCFTA) by 2017 as the prelude to the continental customs union. The AfCFTA is one of 14 flagship projects for realising Africa's long-term vision for inclusive growth and sustainable development known as 'Agenda 2063: The Africa We Want'. Agenda 2063 aspires for a single continental market that allows the free movement of goods, services, persons and capital. This is recognized to be "… crucial for deepening economic integration, and promoting agricultural development, food security, industrialization and structural economic transformation."[4] Notably, the 2017 deadline was not met. However, traction was made in 2018 when African states – Zambia included – signed the Kigali

[1] OAU. 1991. Treaty Establishing the African Economic Union. Abuja: African Union
[2] UNECA, AU, and AfDB. 2017. Assessing Regional Integration in Africa VIII: Bringing the Continental Free Trade Area About
[3] Ibid; AfDB. 2019. African Economic Outlook 2019. African Development Bank, African Development Bank.
[4] AU. 2018. Agreement Establishing the African Continental Free Trade Area, p1.

declaration to establish the AfCFTA. A year later in 2019, the AfCFTA entered into force 30 days after the required number of countries (22) deposited their instruments of ratification with the Chairperson of the AU Commission. And in December 2020, African Union adopted the decision to commence trading under the AfCFTA Agreement on 1 January 2021.

Figure 2.1: Timeline of Africa's Push towards a Single African Market



Source: Author's construction

2.1. Objectives of the AfCFTA

The overarching objective of the AfCFTA is to deepen economic integration in Africa in line with the continent's Pan African vision of achieving "an integrated, prosperous and peaceful Africa driven by its own citizens, representing a dynamic force in the international arena." The AfCFTA takes cognizance of the disparities in levels of development among state parties and aims to provide flexible, special and differential treatment and technical assistance to states with special needs. The general objectives of the AfCFTA agreement are summarized as follows:

i) To create a single continental market for goods and services with the free movement of persons and capital;

ii) To expand intra-African trade (trade between African states) through better harmonization and coordination of trade, implementation of trade facilitation measures and cooperation in infrastructure;

iii) To enhance competitiveness at industry and enterprise level by exploiting opportunities for economies of scale, continental market access and an efficient allocation of resources;

iv) To promote and attain sustainable and inclusive socio-economic development, gender equality and structural transformation of member states;

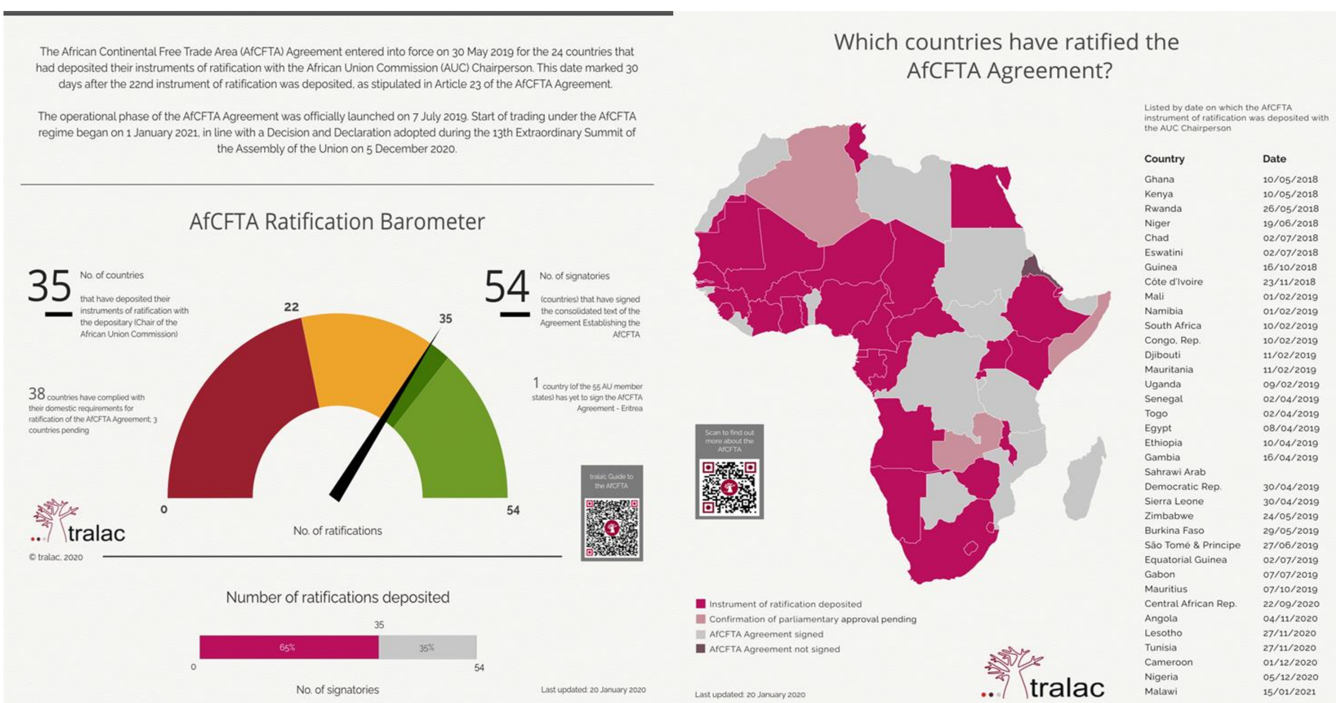
v) To promote industrial development through diversification and regional value chain development, agricultural development and food security; and

vi) To resolve the challenges of multiple and overlapping memberships and expedite the regional and continental integration processes.

2.2. Status of Ratification

The AfCFTA has received unprecedented political support and commitment. Following signing of the agreement to establish the AfCFTA in March 2018, in just under 14 months, several countries had already signed and ratified the agreement. By 30 May 2019, the AfCFTA had entered into force for the countries that has deposited their instruments of ratification. As at 15 January 2021, 54 out of 55 countries had signed the agreement and 35 countries had deposited their instruments of ratification. Countries that have ratified the agreement include: Ghana, Kenya, Rwanda, Niger, Chad, Eswatini, Guinea, Côte d'Ivoire, Mali, Namibia, South Africa, Congo, Rep., Djibouti, Mauritania, Uganda, Senegal, Togo, Egypt, Ethiopia, Gambia, Sahrawi Arab Democratic Rep., Sierra Leone, Zimbabwe, Burkina Faso, São Tomé & Príncipe, Equatorial Guinea, Gabon, Mauritius, Central African Rep., Angola, Lesotho, Tunisia, Cameroon, Nigeria and Malawi. Interestingly, only Eritrea is yet to sign the AfCFTA agreement. Notably, trading under the AfCFTA was delayed by 6 months owing to the COVID-19 pandemic.

Figure 2.2: Status of AfCFTA Ratification



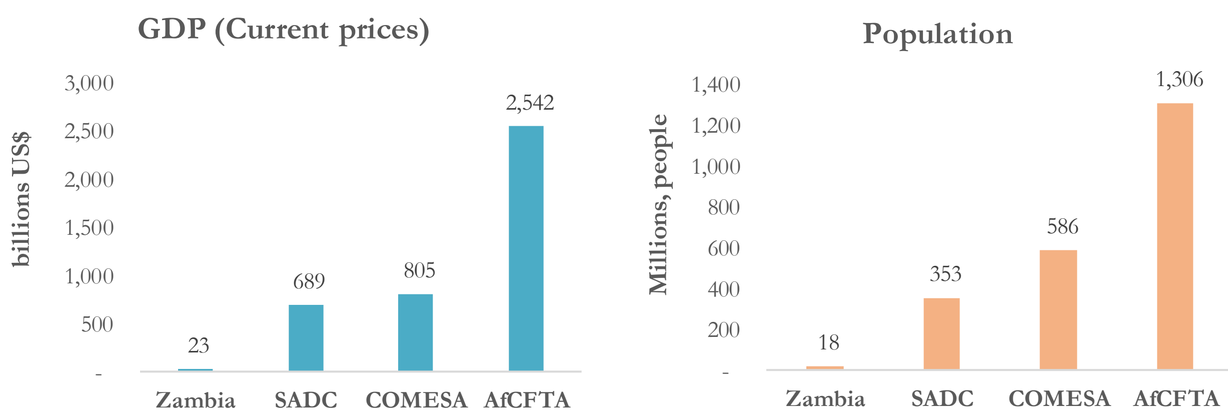
Source: Tralac, https://www.tralac.org/resources/infographic/13795-status-of-afcfta-ratification

3. Benefits of Acceding to the AfCFTA for Zambia

Considerable Economic Size

The AfCFTA has been heralded as a potential game change for African countries. It is the largest trade bloc in the world by number of member countries and offers a sizable market of more than 1.3 billion people with a combined income (GDP) of more than US$2.5 trillion dollars. This collective market size is quite considerable compared to the market size of the small economies and surpasses the market potential of RECs such as SADC and COMESA (see Figure 3.1). For instance, on its own, Zambia's domestic market is relatively small – estimated at about 17.8 million people with income [GDP] of only US$23 billion in 2019. This small market size does not provide sufficient demand required to exploit economies of scale and become low-cost competitive producers. Further, Zambia's market limits the country's potential to attract substantial investments required to sustain economic growth, create employment and reduce poverty. In 2019, Zambia's GDP ranking by the World Bank was 111 out of 203 economies. But, as a collective with other African states, ranks 8th out of 203 economies.

Figure 3.1: AfCFTA versus Zambia, SADC and COMESA Market Potential



Source: Author's construction based on data from UNCTADStat and World Bank World Development Indicators

A large market size provides new market opportunities for businesses which can act as a stimulus for increased domestic or foreign investments, income growth and economic transformation. Recent simulations by the World Bank (2020) predict that the AfCFTA would increase Africa's real income by 7% and Zambia's income by 5% by 2035. Further, simulations indicate the implementing the AfCFTA could lift 30 million people out of extreme poverty (those living below US$1.90/day); and 68 million people out of moderate poverty (those living below US$5.50/day).

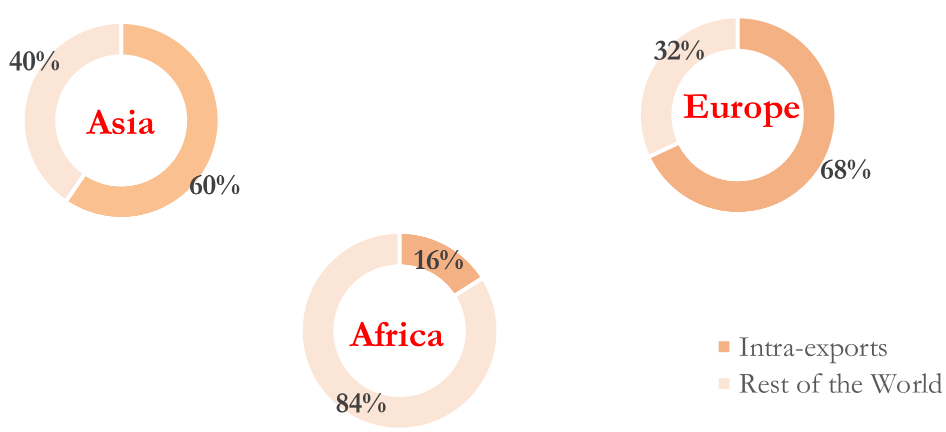
Resolve Challenges of Overlapping Memberships

Since the 1980s, Zambia has been a member of COMESA and SADC albeit these RECs were preferential trading areas in their earlier form that have now become free trading areas. In 2020, the country acceded to the tripartite free trade area between COMESA, SADC and the East African Community (EAC). This brings the total number of free trade agreements that the country belongs to, to three. Zambia's overlapping membership to these RECs has the potential to impede trade and slowdown regional integration efforts. This is referred to the **spaghetti bowl effect** – a slowdown in trade owing to increased trade procedures, regulations and rules of origin that invariably increase business and administration costs.[5] For instance, the rules of origin used to determine the national source of a product and thus preferential treatment, are different under SADC and COMESA and this potentially complicates trade for businesses. In addition, for the country, multiple membership implies higher costs associated with membership subscriptions and other operational costs. One of the key objectives of the AfCFTA is to resolve some of these challenges posed by having multiple and overlapping memberships to various RECs. However, how this will be achieved is still uncertain since the RECs will continue to operate alongside the AfCFTA. The AfCFTA is most likely to consolidate, harmonize and streamline the rules of origin and trade procedures obtaining in various RECs.

Expand Intra-African Trade and in tandem, Zambia Exports to Africa

Intra-African trade (trade between African countries) has remained exceedingly low compared to similar geographical areas. Figure 3.2 depicts the share of intra-exports within Africa, Asia and Europe. In 2019, intra-exports in Africa were 16% of the continent's total exports, compared to 60% for Asia and 68% for Europe. We observe a similar pattern when it comes to intra-imports (Africa – 14%; Asia 62%; and Europe – 66%). This reveals that countries within Europe and Asia trade more with each other while African countries trade more with the rest of the world and not their counterpart African countries. Africa's demand, including its demand for food where the continent arguably has a latent comparative advantage given the land, water and labour resources, is largely met by countries outside of Africa (more than US$67 billion worth in 2017).

Figure 3.2: Share of Intra- and Extra- Exports, 2019

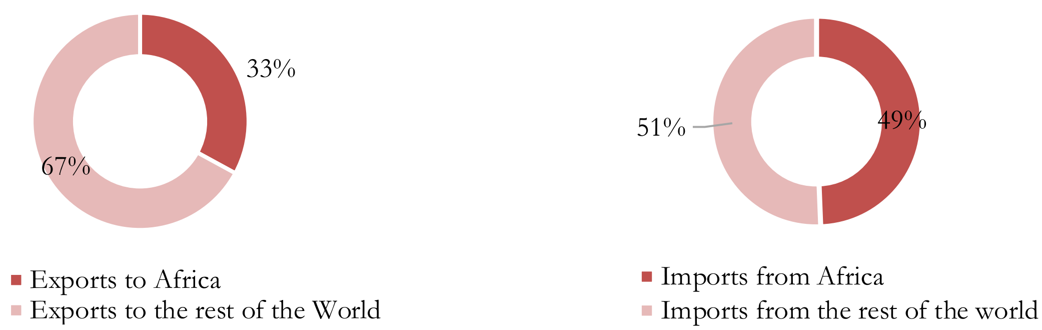


Source: Author's construction based on data from UNCTADStat

[5] Bhagwati, Jagdish, Greenaway, David and Arvind Panagariya. 1998. Trading preferentially: Theory and Policy

In the same vein, Zambia predominantly exports the bulk of its produce to countries outside of Africa. This is largely on account of copper – the country's chief export that is highly demanded by China. In 2019, only one-third of Zambia's exports were to other African countries (see Figure 3.3. below). Notably, Zambia's imports from Africa (largely from South Africa) are more sizable, accounting for 49% of the country's total imports in 2019.

Figure 3.3: Zambia's Trade with Africa – Imports and Exports, 2019



Source: Author's construction based on data from UNCTADStat

Low intra-African trade limits Zambia's and the continent's prospects for achieving sustained rapid economic growth and development associated with trade. Particularly for developing countries such as Zambia, trade remains an important tool for driving high economic and income growth. Various empirical studies have established a positive causal link between trade and productivity, income growth, and structural transformation.[6] Through the progressive elimination of tariffs and non-tariff barriers, and cooperation in infrastructure and trade facilitation measures, the AfCFTA has the potential to expand intra-African trade and by extension, Zambia's trade with Africa.

Initial simulations[7] carried out by the United Nations Economic Commission for Africa (UNECA) and the African Trade Policy Centre (ATPC) project that the AfCFTA would increase intra-African trade in 2040 by between 15% (or US$50 billion) and 25% (or US$70 billion).[8] More recent simulations by the World Bank that take into account liberalisation of trade in services and the removal of non-tariff barriers project an increase in intra-African exports of more than 81% (about US$ 238 billion).[9] But these increases are not expected to raise the share of intra-African significantly. The World Bank (2020) predicts that the overall share of intra-African trade would increase marginally but remain stagnant around 20% in 2035. The gains would also not be evenly distributed, some countries would gain more than others. For example, Cameroon, Egypt, Ghana, Morocco and Tunisia are some of the countries whose exports to other African countries are expected to double or triple. Zambia on the other hand, along with the Democratic Republic of Congo and Mozambique, are countries expected

[6] Teignier, Marc. 2017. The Role of Trade in Structural Transformation.
[7] These simulations only consider liberalisation of tariffs on traded goods.
[8] UNECA and ATPC. 2018. An empirical assessment of the African Continental Free Trade Area Modalities on Goods.
[9] World Bank. 2020. The African Continental Free Trade Area: Economic and Distributional Effects

to record the least increase in exports to other African countries of between 10 to 30%. Although this is a moderate increase, the AfCFTA will still expand Zambia's exports.

Industrialisation and Export Diversification

Perhaps the greatest benefit that Zambia stands to gain from acceding to the AfCFTA is the potential for industrialisation and export diversification. For many years, Zambia has sought to industrialise and transform the structure of its economy with little success. Zambia's economic structure has changed over the years but services have taken a more prominent place in the economy while manufacturing has dwindled and largely remained stagnant. Following trade liberalisation in the 90s, the share of manufacturing and agriculture output in the overall economy declined markedly from 33% of GDP in 1992 and 30% of GDP in 1993 respectively, to 7.8% of GDP and 2.8% of GDP in 2018. In addition, the country's export basket remains dominated by copper which exposes the country to the effects of commodity price shocks.

Arguably, Zambia needs to industrialise, expand and diversify its export base if it is to realise sustained inclusive economic growth, raise income and significantly reduce poverty. The AfCFTA has the potential to catalyse this transformative process by improving productivity and output in agriculture and increasing value addition through regional value chains. According to simulations by UNECA and ATPC (2018), the AfCFTA would increase intra-African trade in industrial products by between 25% (or US$36 billion) and 30% (or US$44 billion) in the year 2040. On the other hand, intra-African trade in agriculture and food products are projected to increase by between 20% (or US$9.5 billion) and 30% (or US$17 billion) while intra-African trade in energy and mining products are projected to increase by between 5% (or US$4.5 billion) and 11% (or US$9 billion).

Key industrial sectors that UNECA and ATPC (2018) predict will see an expansion in trade include: textiles, apparel, leather, wood and paper, vehicle and transport equipment, electronics and metals. In agriculture – sugar, vegetables, fruit, nuts, beverages, tobacco, meat and dairy products would obtain the largest expansion in trade. Furthermore, small least developed countries i.e. Zambia, are also projected to gain the largest growth in intra-African trade of industrial products. The World Bank (2020) similarly predicts that intra-African trade in manufacturing goods would gain the most, expanding by 110%.

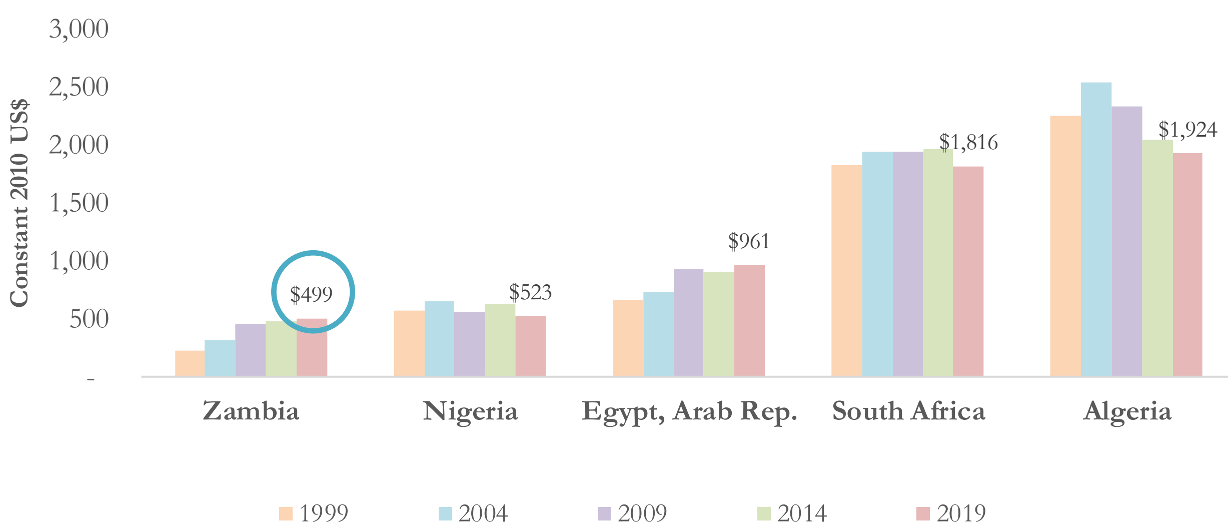
4. Challenges/Risks of Acceding to the AfCFTA for Zambia

Weak Productive Capacity

Zambia's weak productive (and export) capacity limits the country's ability to withstand the fierce competition posed by more industrialised countries such as South Africa. Figure 4.1 below depicts the country's capacity to produce industrial products relative to selected top exporting countries in Africa. Industrial capacity is measured as industry value added per capita, that is, industrial output divided by the country's population size. This adjustment for country size is required to facilitate cross-country comparisons.

The data shows that Algeria has the highest industrial capacity followed by South Africa. However, since 2004, Algeria's capacity to produce industrial products has been reducing from US$2,535 in 2004, to US$1,924 in 2019. Likewise, South Africa's industrial capacity has reduced since 2004 but by a very small margin. Notably, Zambia's industrial capacity, though from a low base value, has been improving steadily over the years, increasing from US$229 in 1999 to US$499 in 2019. While this growth is commendable, the country still lags behind countries such as Egypt South Africa and Nigeria that are projected to gain the biggest increase in the value of exports to other African countries under the AfCFTA.[10] Thus, an important risk for Zambia is that countries with stronger productive capacities are likely to gain the most from the AfCFTA.

Figure 4.1: Industry Value Added Per Capita



Source: Author's construction based on World Bank WDI data
Notes: Industry includes manufacturing, mining, construction, electricity, water, and gas.
Value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs.

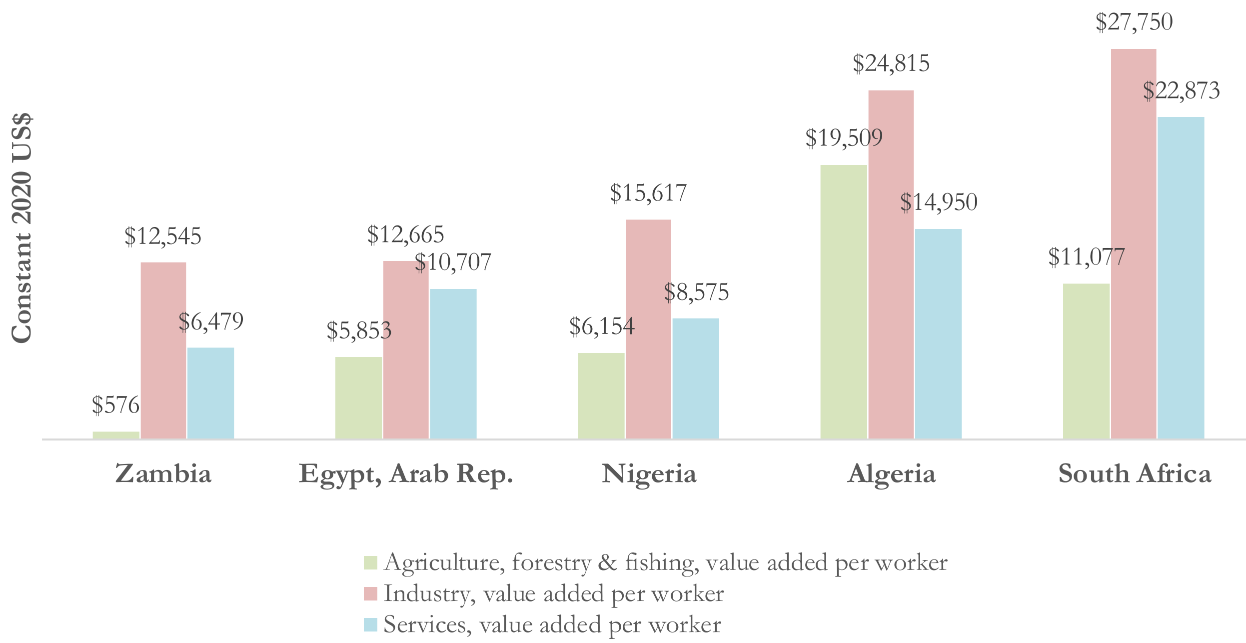
Low Labour Productivity

In addition to weak productive capacities, Zambia is further constrained by low labour productivity particularly in agriculture and service activities which may render the country less competitive in the AfCFTA (see Figure 4.2). Since productivity drives income growth, Zambia's low productivity limits wage growth and perpetuates poverty. The country's labour engaged in agricultural activities is the least productive, producing US$576/worker compared to US$5,853 produced by each worker in Egypt; US$6,154 in Nigeria; US$11,077 in South Africa; and US$19,509 in Algeria. This low labour productivity highlights the long-standing challenges in the agriculture sector namely low mechanisation and modernisation, inadequate irrigation systems, limited diversification, inadequate

[10] World Bank. 2020. The African Continental Free Trade Area: Economic and Distributional Effects

extension services and skills amongst others. Notably, Zambia's productivity in industrial activities is relatively high and almost at par with Egypt and Nigeria.

Figure 4.2: Industry value added per worker, 2019



Source: Author's construction based on World Bank WDI data

High Trade Costs Exacerbated by Red Tape

Beyond tariff considerations, cumbersome documentation and border procedures increase trade costs thereby rendering Zambian firms uncompetitive in regional markets. For these reasons, tackling non-tariff barriers and implementing trade facilitation measures are key aspects of the AfCFTA agreement that are imperative for maximising the benefits of the continental free trade area. Zambian firms face considerable red tape when it comes to trade. According to the World Bank's Ease of Doing Business – 'Trading across Borders' indicator which records the time and cost associated with the process of exporting and importing goods, Zambia ranked 155 out of 190 economies in 2020.

The country continues to perform poorly on this indicator. The time it takes to comply with export documentation and border procedures takes longer in Zambia compared to the average for Sub-Saharan Africa (see Table 4.1. further below). Similarly, the documentation compliance costs associated with exports are higher in Zambia (US$200) relative to the Sub-Saharan region (US$172).

Table 4.1: World Bank Ease of Doing Business - Trading Across Borders, 2020

	Zambia	Sub-Saharan Africa	OECD High Income
Time to export: Border compliance (hours)	120	97.1	12.7
Cost to export: Border compliance (USD)	370	603.1	136.8
Time to export: Documentary compliance (hours)	96	71.9	2.3
Cost to export: Documentary compliance (USD)	200	172.5	33.4
Time to import: Border compliance (hours)	120	126.2	8.5
Cost to import: Border compliance (USD)	380	690.6	98.1
Time to import: Documentary compliance (hours)	72	96.1	3.4
Cost to import: Documentary compliance (USD)	175	287.2	23.5

Source: Reproduced from the World Bank Doing Business 2020 Zambia country report

Potential Revenue Impacts

The liberalisation of trade entails the progressive elimination of tariffs and thus a loss in tax revenues for governments. UNECA and ATPC (2018) estimate that revenue losses from tariff liberalisation could range between US$8.5 billion and US$13 billion overall. The World Bank's (2020) simulations reveal a small decline in tariff revenues for most countries of less than 1.5% but of 1.6% for Zambia in the short-term. The decline in total tax revenues is expected to be less than 0.3%. For Zambia in particular, the revenue loss is mainly mitigated by the fact that a very small proportion of tariff revenues is derived from imports from African countries that are not already part of SADC or COMESA. Having already eliminated tariffs in SADC and COMESA – Zambia's major source markets for imports – little impact is expected on tariff and overall tax revenues.

Further, revenue sensitive products have been placed on exclusion lists to guard against significant revenue losses.[11] Over the medium-term, import tariff revenues are expected to increase as trade volumes increase. The growth in overall taxes would also be reinforced by economic growth and the expansion in economic activities.

[11] Ibid

5. Way Forward: To Ratify or Not to Ratify?

By and large, the AfCFTA offers considerable benefits for Zambia, particularly, for industrial development. Having weighed the potential gains against the potential risks and losses, we find that the potential benefits outweigh the costs. Therefore, it is our considered view that Zambia **should ratify the African Continental Free Trade Area agreement**.

However, to fully exploit the potential benefits of the AfCFTA, there are a number of structural and fundamental issues inhibiting Zambia's effective participation in trade that need to be addressed. Zambia needs to:

- Build productive capacities through investments in education, skills, research and development, technology and the provision of affordable finance;
- Provide an enabling business and macroeconomic environment by addressing infrastructure constraints, ensuring policy consistency, streamlining trade documentation and border procedures; dismantling arrears owed to domestic suppliers of goods and services, ensuring financial and exchange rate stability; and
- Strategically exclude revenue sensitive products and protect products with the most potential for improving productive capacities, boosting exports and employment creation in line with the provisions under the AfCFTA. These industries should also be supported financially and technically