The African Continental Free Trade Area: Economic and Distributional Effects

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Overview

The African Continental Free Trade Area (AfCFTA) agreement will create the largest free trade area in the world—connecting 54 countries and 1.3 billion people.

First study to cover poverty and employment and wages of female and male workers

Part 1. State of play

Part 2. Economic and Distributional Effects

Part 3. Conclusions

State of Play

What is the AfCFTA?

- **Once completed, AfCFTA will be the largest free trade area in the world—comprising 55 nations, 1.3 billion people and an economic area with a GDP valued at $3.4 trillion**

- **Opportunity to be milestone in the process of insertion of Africa in the international economy**
  - Visualization of the continent as a whole
  - Shift from trade & investment patterns focused on natural resources towards diversification via regional and global value chains
  - Conception of trade not limited to trade in goods, but also services, investment, intellectual property and competition

- **Opportunity for new political economy dynamics on regional integration**
  - Interaction among governments from different subregions
  - Pressure for deep trade & investment public/private dialogue, both in countries and within the region
  - Discussing competitiveness agenda with an sustainable and inclusive approach
  - Linking traders and investors
  - Improved visibility and positioning of the region in the international markets

AfCFTA state of play

- AfCFTA Treaty entered into force in May 2019. To date 28 countries have ratified the agreement (all other AU Member States have signed except Eritrea)
- In July 2019, Niamey Declaration launched the Operational Phase of AfCFTA: Permanent AfCFTA Secretariat will be in Ghana, to be established in first half of 2020
- Negotiation of Annexes to Protocols on Trade in Goods scheduled to conclude this semester to start trading under AfCFTA on July 1, 2020
- Negotiations on Trade in Services still pending and scheduled to conclude by December 2020
- Phase II of Negotiations (Investment, Competition Policy and Intellectual Property Rights) scheduled to start this semester to be completed by June 2021

AFCFTA MEMBERSHIP STATUS

Source: TRALAC, https://www.tralac.org/resources/by-region/cfta.html

Progress so far…

Negotiation on Trade in Goods:

- **Tariffs:** Countries to agree on which tariff lines fall in each category by the next AU Summit in February 2020 with a view to start trading under the AfCFTA regime by July 1, 2020.
- **Rules of origin:** Most rules of origin have been negotiated (under a product specific approach). Agreement is still pending in four sectors: Textiles and apparel, edible oils, sugar products, and auto and auto parts.

AfCFTA: Tariff Liberalization Negotiation Modalities

Country classification	Tariff reductions		
	For non-sensitive products (no less than 90% of all products)	For sensitive products (up to 7% of all products)	For excluded products (up to 3% of all products)
Non-least developed countries	Fully liberalized over 5 years (linear cut)	Fully liberalized over 10 years (linear cut)	No cut
Least developed countries	Fully liberalized over 10 years (linear cut)	Fully liberalized over 13 years (linear cut)	No cut
Groups of Seven (Djibouti, Ethiopia, Madagascar, Malawi, Sudan, Zambia, Zimbabwe)	85% fully liberalized over 10 years (linear cut); additional 5% liberalized over 15 years (linear cut)	Fully liberalized over 13 years (linear cut)	No cut

Source: UNECA

Progress so far...

Negotiation on Trade in Services: Two objectives

- Foster progressive liberalization based on "WTO plus" positive lists and exchange of offers by Member States.
- Develop sectoral disciplines in all services sectors, based on best practice in the RECs, starting with five key priority ones.

Exchange of offers is in its initial phase, and should conclude by December 2020

5 Priority Services Sectors:

(i) Business
(ii) Communication
(iii) Financial
(iv) Transport
(v) Tourism

The World Bank is providing support in all stages of the AfCFTA process

Analysis

- Assess potential economic and distributional impacts
- Regulatory benchmarking and good practices on negotiation of trade in goods, services investment, competition policy and intellectual property rights

Negotiation support

- Build capacity within the AU and Member States to negotiate Phase I (goods and services) and Phase II (investment, competition and IPRs)

Implementation support

- Monitor and support effective implementation of AfCFTA on the ground
- Help members use trade liberalization to diversify and upgrade to increase trade and investment, generate quality jobs and reduce poverty

Economic and Distributional Effects

Methodology

- AfCFTA economic impact using ENVISAGE Global dynamic computable general equilibrium model (CGE).
- AfCFTA distributional impact combining CGE with microsimulations based on household surveys (GIDD, Global Income Distribution Dynamics).
- Analysis of revenues using partial equilibrium model (TRIST, Tariff Reform Impact Simulation Tool).

- Core data: GTAP database 2014
  - 141 regions aggregated into 37 (24 individual AfCFTA members).
  - 65 sectors aggregated into 21.
  - GTAP's tariff rates are replaced with most recent data.
- Employment volume and remunerations, gender and skill
  - New data on employment and wages by skill and gender constructed.
  - Projections for the working age population by gender and education attainment.
- Tariffs statutory rates and applied rates where available from countries.

Scenario Assumptions

- Baseline scenario: continuation of past trends simulated over 2014-2035
- Tariff liberalization scenario in line with AfCFTA modalities starting in 2020-2035

	Non-LDCs	LDCs
Non-sensitive products (90% of tariff lines)	Linear cut, years 1-5	Linear cut, years 1-10
Sensitive Products (7% of tariff lines)	Linear cut, years 6-10	Linear cut, years 6-13
Exclusion List (3% of tariff lines accounting for up to 10 % of imports from African countries)	No cut	No cut

- Non-Tariff Barriers (NTBs)—on both goods and services—are reduced on a most favored nation (MFN) basis by 50 percent.
- Implementation of trade facilitation measures in line with the Trade Facilitation Agreement (TFA) leading to halving of trade costs.

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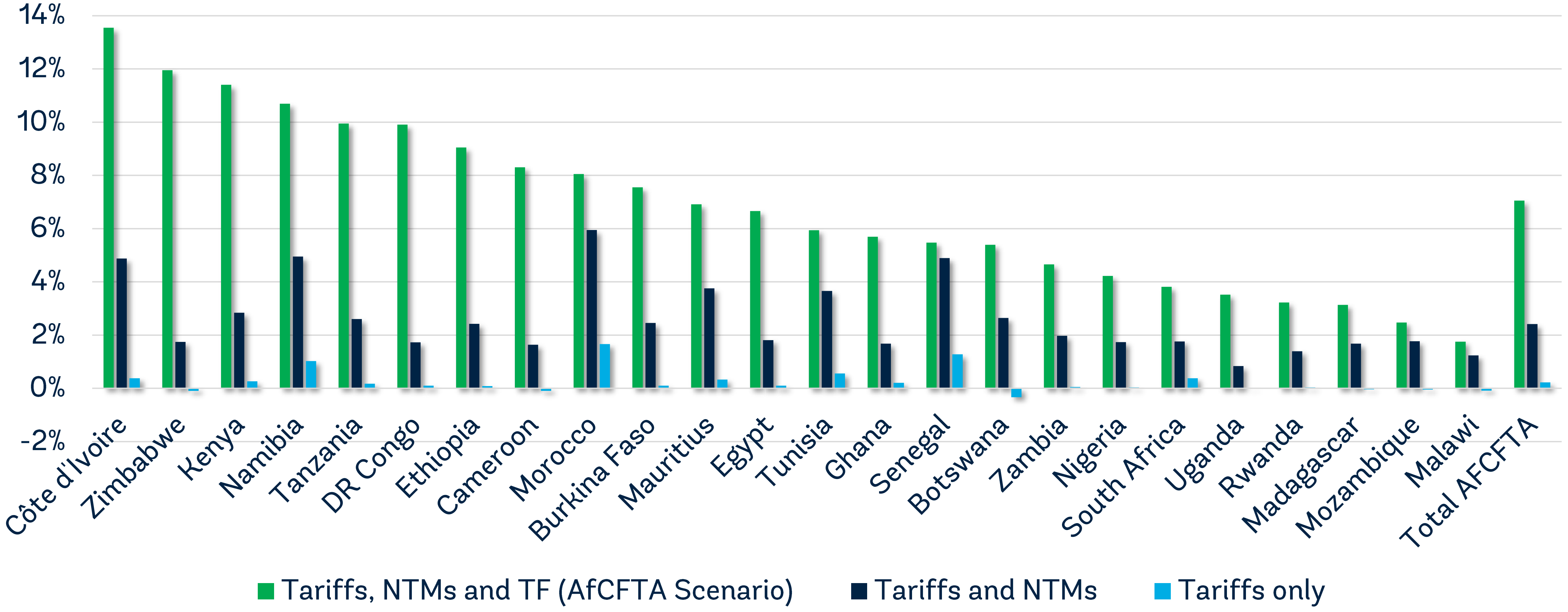
The real income in Africa could increase by 7%, biggest gains from reduction in trade costs (TF and NTBs)

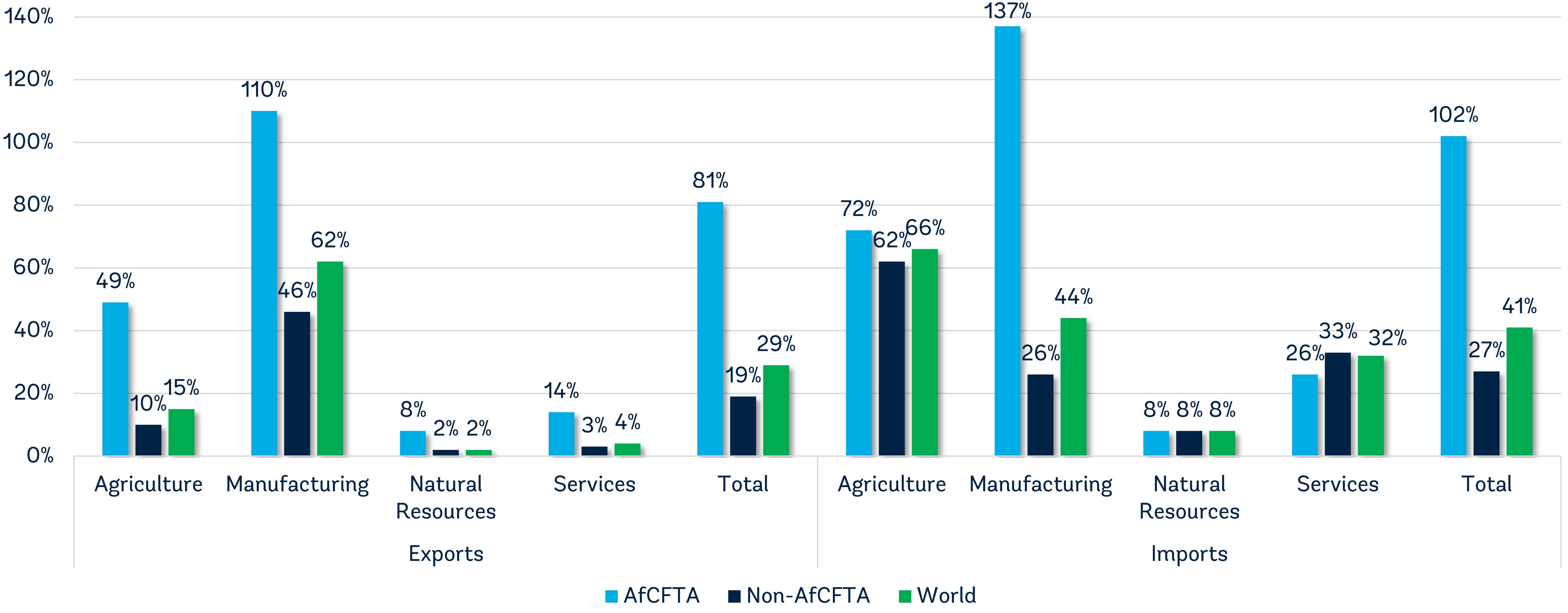
Real income (welfare) implications (2035, % relative to the baseline)



Source: World Bank estimates

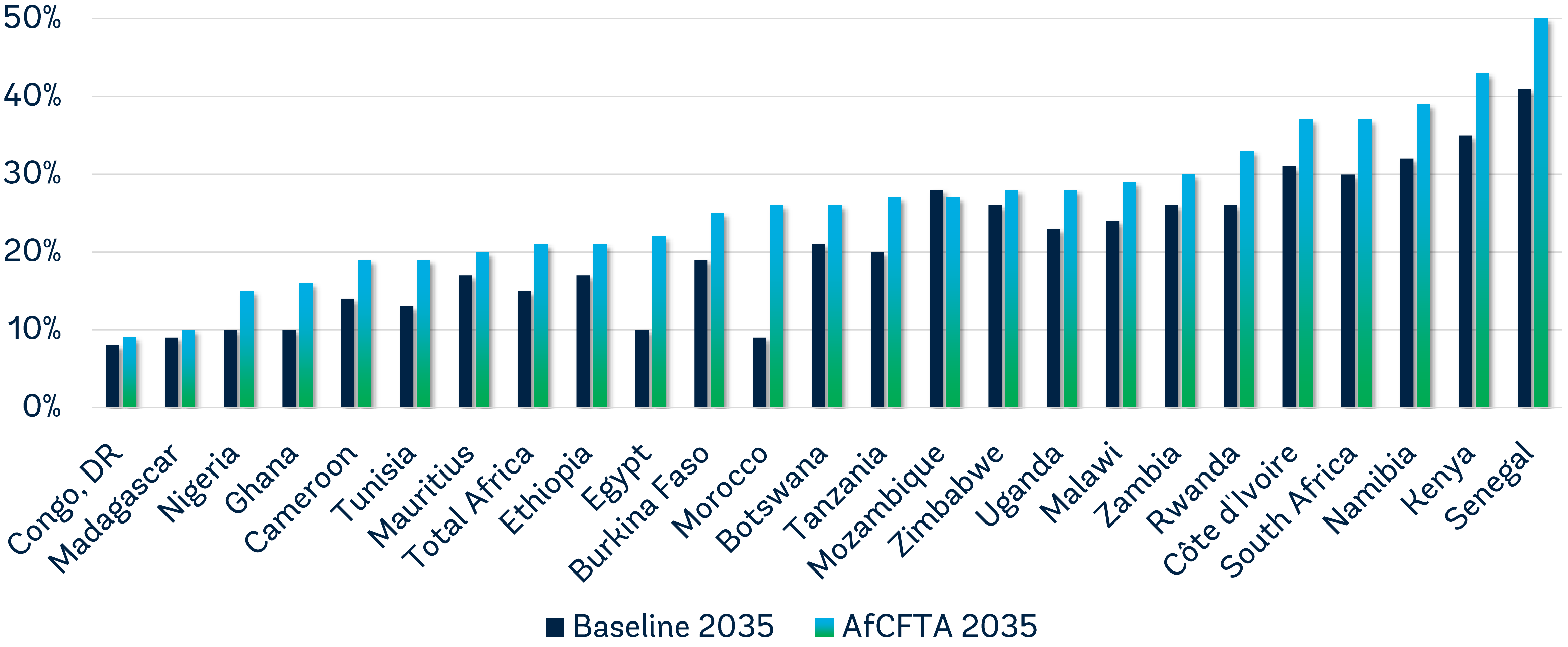
African trade will significantly increase, especially intra-regional trade in manufacturing

Impact of AfCFTA on trade, by sector (deviation from the baseline for 2035)



Source: World Bank estimates

Share of intra-AfCFTA exports in total exports



Source: World Bank estimates

By 2035, output could be $212 billion higher than in the baseline

- Aggregate gains in output of $212 billion (in $2014 market prices and exchange rates) or 1.3 percent relative to the baseline in 2035 would result from a reallocation of resources across sectors and countries, which would increase productivity.

- Output would increase the most in natural resources and services at 1.7 percent, with manufacturing seeing a 1.2 percent rise.

- Partly reflecting higher demand for services as the African economy grows, due to limited factors of production, output in agriculture would contract 0.5 percent.

- Vast majority of countries would see their volume of services grow under AfCFTA, while slightly over half of the countries would see growth in the value of their output of agricultural and manufacturing goods.

Impact on tariff revenue is expected to be negative and small in the short-run, but positive in the long-run

- The short-term impact on imports and tax revenues is small for most countries.
- Tariff revenues would decline by less than 1.5 percent for most countries.
- As a result total tax revenues would seldom decline by more than 0.3 percent.

- Increase of tariff revenue 3 percent at the continental level relative to the baseline in 2035
  - The increase in the volume of imports leads to higher tariff revenue collection.
  - Faster economic growth leading to higher level of economic activity are likely to increase the total revenue from other taxes.

AfCFTA will lift an additional 30 million people out of extreme poverty relative to baseline

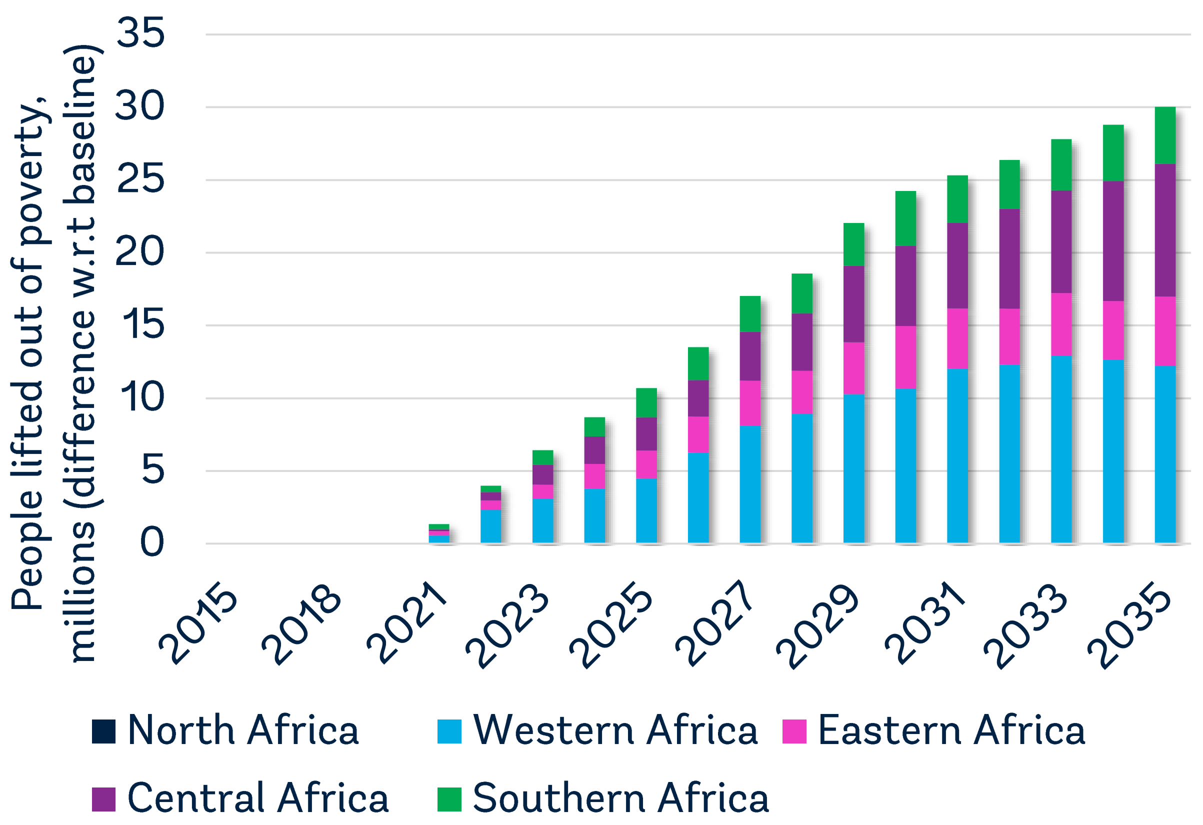
Extreme poverty decline (in million):

- West Africa: 12.2m
- Central Africa: 9.1m
- Eastern Africa: 4.8m
- Southern Africa: 3.9m
- North Africa: 0.003m

The AfCFTA will decrease the headcount ratio of extreme poverty to 9.3% (baseline is 10.9%).

Countries with high initial poverty rates will experience the greatest decline (p.p.): Guinea-Bissau (10.2%), Togo (7.2%), Mali (7.6), Sierra Leone (7.2%), Liberia (5.7%), Niger (5.4%), Central Africa Republic (5.1%).

Extreme poverty (at PPP$1.90/day)



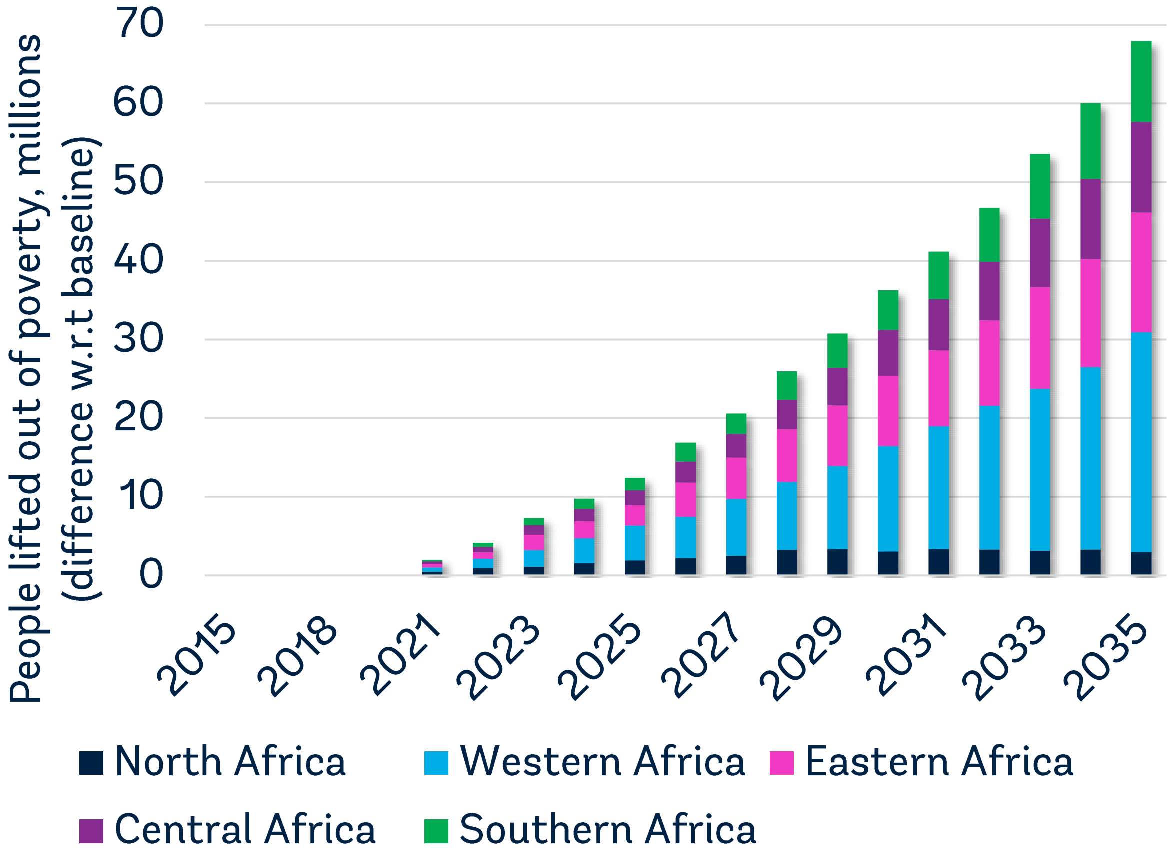
Source: World Bank estimates

67.9 million people could be lifted out of moderate poverty

- A total of 67.9 million people will be lifted out of moderate poverty (at PPP $5.50/day), especially due to the large boost in household consumption expected from trade openness.

- Half of the people lifted from moderate poverty will be from Ethiopia (8.2m), Nigeria (7m), Tanzania (6.3m), Democratic Republic of Congo (4.8m), Kenya (4.4m), and Niger (4.2m).

Moderate poverty (at PPP$5.50/day)



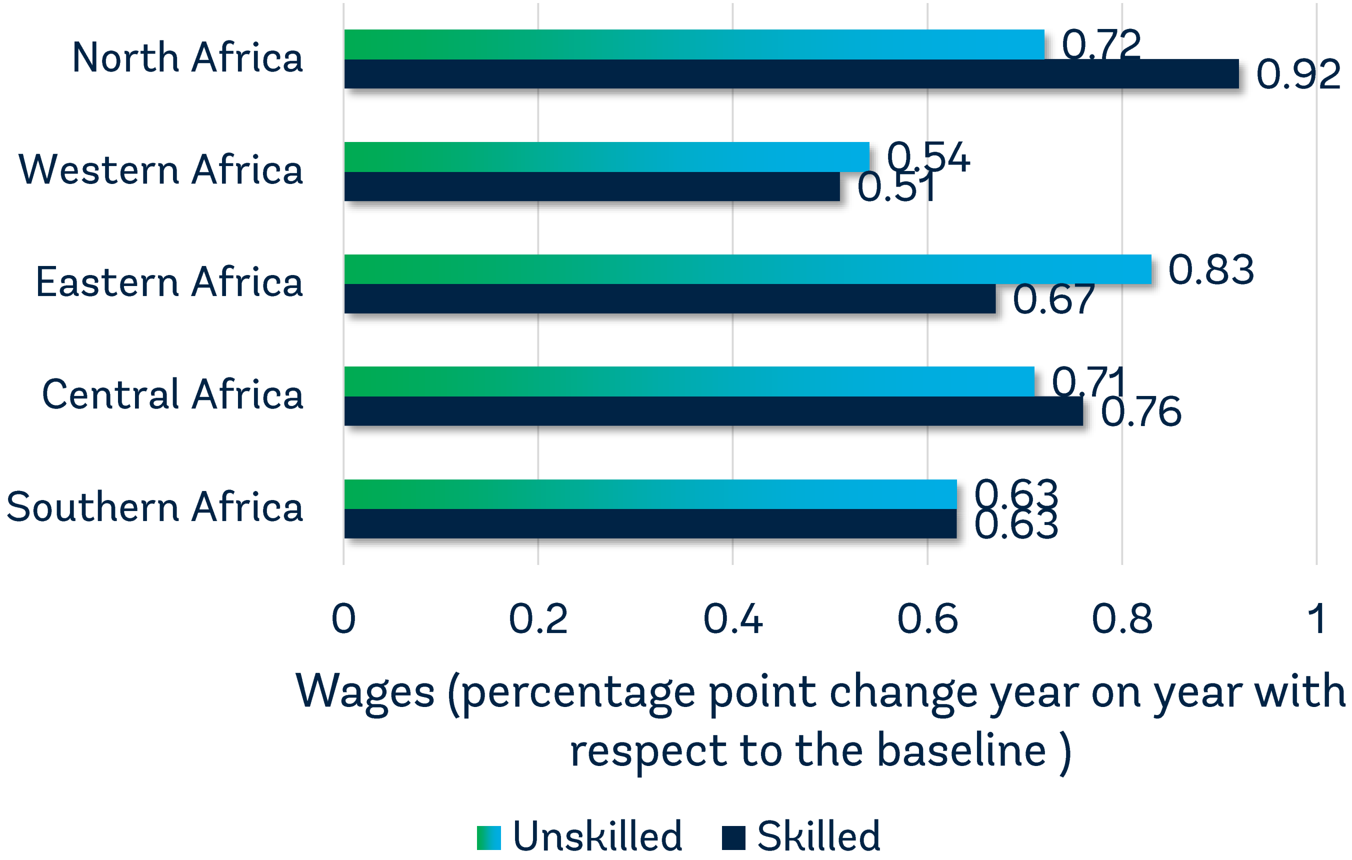
Source: World Bank estimates

There will be better opportunities for unskilled workers

- The proportion of workers in energy intensive manufacturing, trade services, public, and recreational services will increase.

- Wages for unskilled workers will be 10.3 percent higher than the baseline, wages for skilled workers will be 9.8 percent higher than the baseline.

AfCFTA's effect on wages, by skill



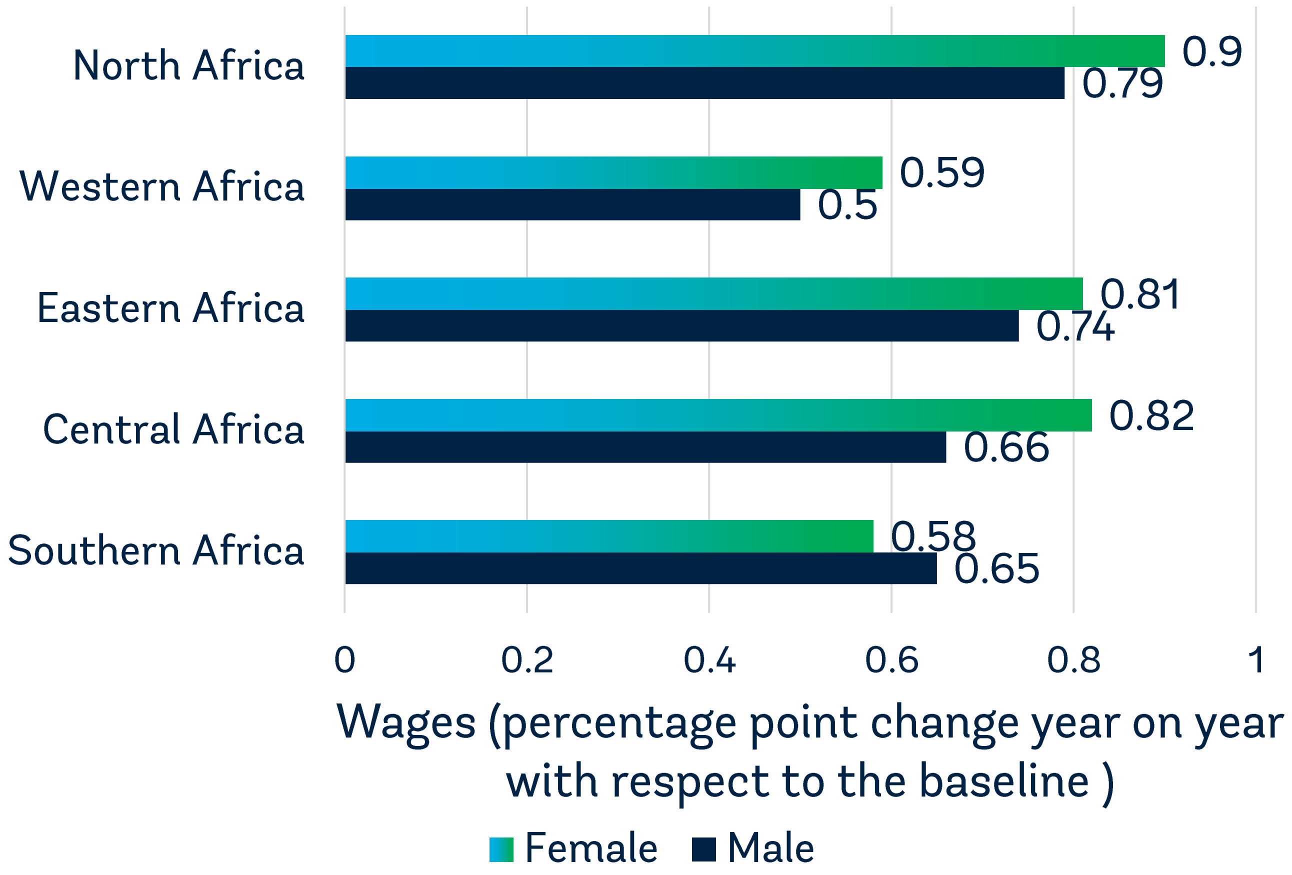
Source: World Bank estimates

Wages will grow faster for women

- 10.5 percent increase in wages for women relative to baseline and 9.9 percent for men

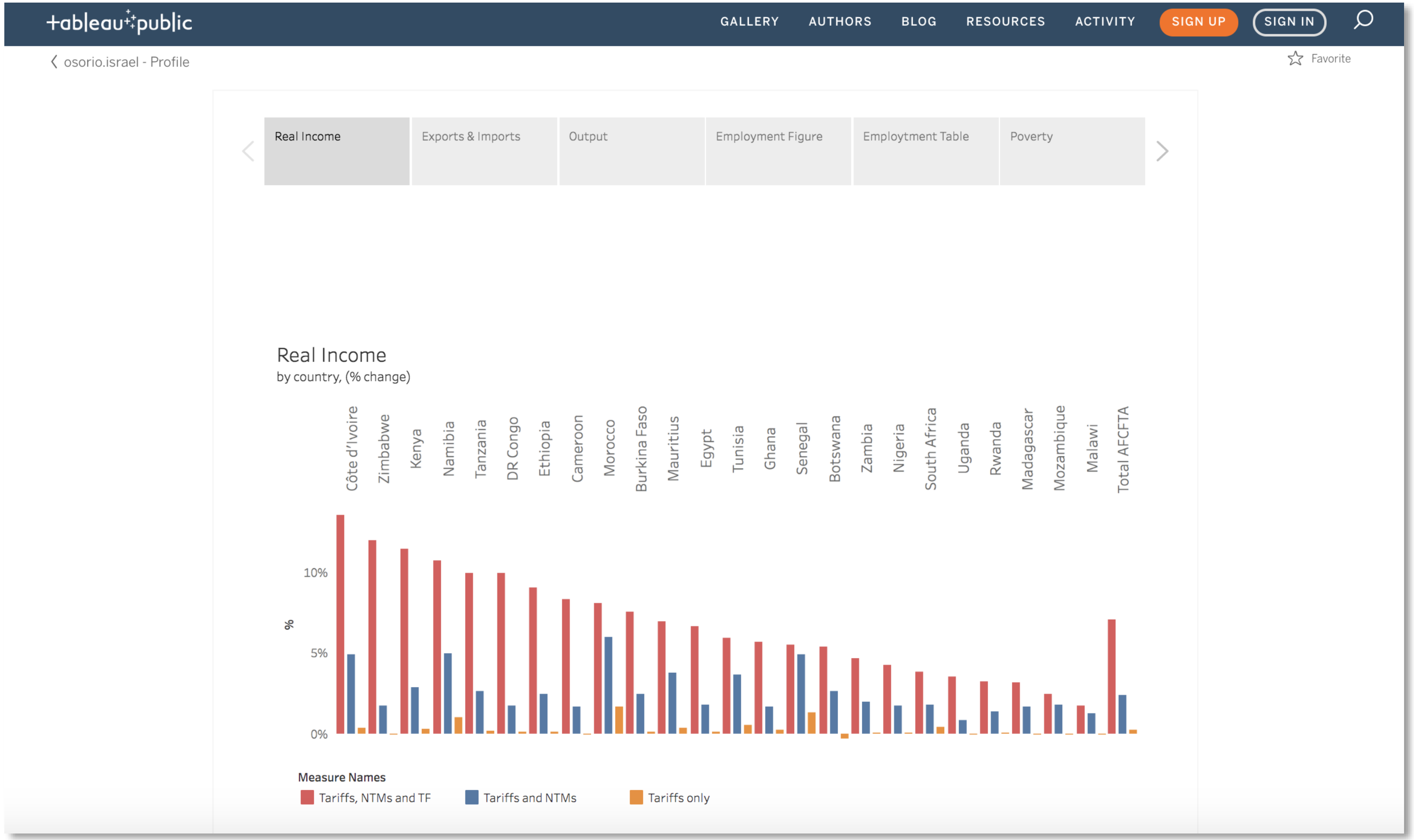
- As a result of an expansion of output in female-labor intensive industries, female wages would grow faster in all regions, except for Southern Africa

AfCFTA's effect on wages, by gender



Source: World Bank estimates

Results – Tableau



Caveats

- **The results might overestimate the impacts as the analysis does not capture**
  1) the costs of lowering the non-tariff barriers and the trade facilitation measures;
  2) the transitional costs associated with trade-related structural change such as employment shifts and potentially stranded assets, such as capital.

- **The results on distributional impacts are based on a new data set of gender disaggregated employment and wages, which requires further vetting by country experts.**

- **The results might underestimate the impacts as the analysis does not capture**
  1) informal trade flows nor new trade flows in sectors and countries that are not trading in the baseline;
  2) dynamic gains from trade (productivity increases, economies of scale, learning by doing);
  3) FDI: improving market conditions, competitiveness, and business sentiment will likely induce FDI in Africa increasing the gains substantially.

Conclusions

Conclusions

- Global economy is slowing, and commodity prices are likely to remain stable. In this context, the creation of the AfCFTA vast regional market is a major opportunity to help member countries diversify their exports, grow faster and attract FDI.

- Benefits in terms of poverty reduction and higher wages would be significant, especially for low-skilled workers and women.

- Real income gains from tariffs liberalization under AfCFTA would be significant, but the main gains would come from the reduction of NTBs and trade facilitation measures. This is a critical agenda.

- Achieving AfCFTA's full potential depends on agreeing and implementing an ambitious tariffs liberalization, strong reduction in NTBs and aggressive trade facilitation measures. Partial implementation within and across countries would lead to smaller impacts.

- Potential income gains through FDI (not captured in this study) could be very significant and a game-changer for the continent, but only if the AfCFTA is ambitious and implemented consistently across countries creating a large market with transparent and predictable set of rules for investors.