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Economic Commission for Africa

ATPC
African Trade Policy Centre

Policy Brief
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New assessment of the economic impacts of the Agreement Establishing the African Continental Free Trade Area on Africa

Key messages

- After full implementation of the Agreement Establishing the African Continental Free Trade Area, African gross domestic product, trade, output and welfare are all expected to increase.

- Most of the gains would be through intra-African trade, for which the Agreement would be a game changer:
  - Successful implementation of the Agreement would result in a major boost to intra-African trade in agrifood, industry and services and a more moderate boost for energy and mining.
  - In agrifood, the subsectors in which there is the greatest potential for an increase in intra-African trade and a positive contribution to African output are milk and dairy products; processed food; cereals and crops; and sugar. In industry, the subsectors with the greatest potential are wood and paper products; chemical, rubber, plastic and pharmaceutical products; vehicles and transport equipment; metals; and other manufactured products. In energy and mining, greatest potential are in the refined oil sub-sector. Lastly, in the services sector, the subsectors with the greatest potential are tourism; and transport.
  - As a result, and considering that intra-African trade is currently dominated by industry, the implementation of the Agreement could facilitate economic transformation in Africa through trade, which could further boost the continent's competitiveness and development.
  - Implementation of the Agreement would also help to reduce the current trade dependence (including for industrial goods) of Africa on its external partners, through a notable improvement in the share of intra-African trade.

- Although the increase in intra-African trade in services would be relatively moderate in absolute terms, it is important to note that the increase in relative terms would be considerable. In the subsectors of the services sector, these relative increases would be greater than in most subsectors of goods. Moreover, findings indicate that the implementation of the Agreement would strengthen production capacities, in particular in industry. Production capacities would also increase for services, which could also benefit from additional trade gains driven by the current trend towards digitalization – an aspect not addressed in this assessment – which could facilitate the development of many services.

- » The decline in Africa's tariff revenues would be gradual under the Agreement and would not have a negative impact on Africa's welfare, thanks in particular to the benefits of the expected expansion of intra-African trade; the African Export-Import Bank has also set up the African Continental Free Trade Area Adjustment Facility to help the most vulnerable countries with any adjustment costs.
- » If, in addition to trade liberalization, non-tariff measures were effectively addressed in the context of the Agreement, the trade gains for Africa could be two to four times higher, depending on how ambitious the reductions in actionable non-tariff measures were. More ambitious cuts in non-tariff measures would increase the possibilities for Africa to industrialize through trade.
- » The Agreement Establishing the African Continental Free Trade Area would not hinder African countries from meeting their unconditional climate commitments under the Paris Agreement.

I. Introduction, methodology and analysed reforms

Trading under the Agreement Establishing the African Continental Free Trade Area officially began on 1 January 2021. As at 27 July 2021, 54 of the 55 member States of the African Union had signed the Agreement[1] and 40 had ratified it. States parties will not be able to effectively trade under the agreed preferential terms until the rules of origin and tariff concession schedules have been officially finalized. Similarly, States parties still need to complete their schedules of specific commitments on the five identified priority services (communication, transport, tourism, financial services and business services) and submit them to the African Union. It is expected that all outstanding issues from the first phase of negotiations on trade in goods and services will be concluded before the end of 2021. The second phase (on investment, intellectual property rights and competition policy) and the third phase (on e-commence) of negotiations might only be concluded in 2022.

It is against this backdrop that the Economic Commission for Africa and the Centre for International Research and Economic Modelling of the *Centre d'Etudes Prospectives et d'Informations Internationales* undertook a new comprehensive assessment of what the economic implications of the ongoing implementation of the Agreement would be. The analysis relies on computable general equilibrium modelling.[2] Implementation of the Agreement would liberalize trade in goods, in line with agreed modalities of the African Continental Free Trade Area; cut by 50 per cent actionable trade barriers[3] in health and education services and in the five priority service sectors that have received greater attention owing to the coronavirus disease (COVID-19) crisis; and cut actionable non-tariff barriers by 50 per

1 Only Eritrea has not yet signed the Agreement.

2 Based on the latest MIRAGE-e computable general equilibrium model (**http://www.cepii.fr/PDF_PUB/wp/2013/wp2013-39.pdf**), the GTAP 10.1 database (**https://www.gtap.agecon.purdue.edu/databases/v10/index.aspx**) and the latest Market Access Map database on bilateral protection information for the year 2014, defined in the Harmonized Commodity Description and Coding System for products at the 6-digit level (MAcMap-HS6; **http://www.cepii.fr/cepii/en/bdd_modele/presentation.asp?id=12**).

3 In practice, not all restrictions on services and non-tariff measures can be removed. Some are legitimate or justified, while others are impossible or challenging to remove. In the literature, it is calculated that about 50 per cent of all non-tariff measures are actionable (see Peter A. Petri and Michael G. Plummer, "The economic effects of the Trans-Pacific Partnership: new estimates", Peterson Institute for International Economics, Working Paper Series, WP 16-2 (January 2016).

cent. Improvements to trade facilitation measures are not included in the modelling exercise, since the substantial implementation costs cannot be well assessed in such an analysis.

Unless stated otherwise, the results in the analysis refer to differences in relative or absolute terms, in the year 2045, between the core Agreement scenario (as described above) and a baseline scenario without the Agreement in place. The results are presented for 2045 because the reform is to be rolled out gradually, between 2021 and 2035, and to give enough time for all the variables in the model to be adjusted dynamically, once reforms under the Agreement have been fully implemented.

The following three alternative scenarios are also analysed: (a) liberalization of trade in goods only; (b) liberalization of trade in goods plus a 50 per cent reduction in actionable trade barriers in the five priority services sectors and in health and education services; and (c) liberalization of trade in goods plus a 100 per cent reduction in actionable trade barriers in the five priority services sectors and in health and education services, as well as a 100 per cent reduction in actionable non-tariff measures. The scenarios were designed and simulated to obtain a better understanding of the expected costs and benefits of liberalizing trade in goods, reducing trade barriers for services and reducing non-tariff measures as part of the implementation of the Agreement. In the policy brief, detailed results are presented only for the core Agreement, but overviews of results under various alternative scenarios are included at the end of the brief to provide additional insights, in particular on the importance of addressing illegitimate non-tariff measures within Africa.

The results are based on all 55 African Union member States having signed and ratified the Agreement. The true costs and benefits of implementation of the Agreement would therefore probably be lower than reported in the brief if not all African Union member States sign and ratify the Agreement. The absence of some member States from the parties to the Agreement would be detrimental to members and non-members alike, since all would lose out on some of the economic opportunities that implementation of the Agreement would generate. In other words, the larger the unified African market is, the greater the benefits would be for the parties to the Agreement.

It should be noted that the Economic Commission for Africa and the Centre for International Research and Economic Modelling are still jointly performing modelling to determine the impact that the Agreement would have on the environment and on regional value chains. The modelling tools and relevant data are being improved. It is hoped that schedules of tariff concessions and services commitments will also be taken into consideration once they have been finalized. The findings presented in the policy brief and, in particular, the absolute and relative changes calculated are therefore expected to slightly change.

II. Findings

The implementation of the Agreement would be expected to have a moderate positive impact on overall gross domestic product, trade, output and welfare in Africa.

The results suggest that if the Agreement were to be implemented, gross domestic product (GDP) in Africa in 2045 would be 0.5 per cent (around \$55 billion) higher than under a baseline scenario without the Agreement in place. The results also show that exports would be 5.1 per cent (\$110 billion) higher, imports 4.7 per cent (\$110 billion) higher, output 0.3 per cent (\$55 billion) higher and welfare 0.4 per cent (\$3 billion) higher than under the baseline scenario (see figure I).

Figure I: Percentage improvements in key macroeconomic indicators in 2045 under the Agreement compared with the baseline scenario

Source: Economic Commission for Africa and Centre for International Research and Economic Modelling, calculated using the MIRAGE-e computable general equilibrium model.

It should not be surprising or a cause for concern that the gains in relative terms are rather modest. A free trade area is not expected to have a substantial impact on overall GDP. Free trade areas do, however, usually tend to have more of an impact on net trade than GDP. However, a large impact on net trade should not be expected in Africa, since most of its trade (around 85 per cent) is currently with partners outside the continent. Nevertheless, implementation of the Agreement is expected to create new trade within Africa, at the expense of some of the trade between Africa and the rest of the world.

The composition of intra-African trade is very different from trade between Africa and the rest of the world. Energy and mining products with low value added account for half of all African exports to the rest of the world, while imports from the rest of the world consist mostly of industrial goods (around 60 per cent of the total), reflecting the fact that Africa relies heavily on external partners for its industrial needs. Intra-African trade, however, tends to be more balanced, with industrial goods accounting for about 45 per cent and energy, mining and agrifood products accounting for smaller, but still substantial, shares.

The gains might be underestimated in the analysis, since it ignores informal trade, which is believed to contribute a significant share to intra-African trade. A non-negligible expected added benefit of implementation of the Agreement is that informal traders might move into the formal sector as it becomes cheaper and less cumbersome to trade across borders.

Another positive expected outcome of implementation of the Agreement is that it would increase the continent's overall output. It should come as no surprise that the expected increase would be modest in relative terms, since Africa currently exports only about 15 per cent of its total output, which is why one of the objectives of the Agreement is to boost intra-African trade, which accounts for a relatively small proportion of total African trade.

Lastly, welfare would also grow, despite the potential costs, even taking into account the expected revenue loss for African Governments owing to tariff liberalization, which is discussed later in the brief.

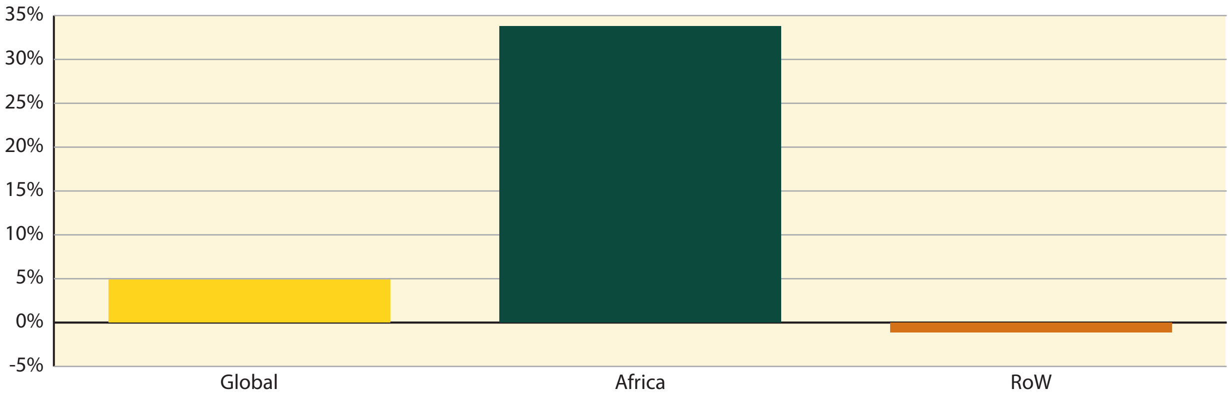
Nonetheless, the assessment of welfare should be treated with caution, since there are other likely costs not captured in the assessment, such as those associated with environmental externalities.

Overall, despite the rather limited overall gains in relative terms, the Agreement offers Africa an opportunity to reduce its current dependence on trade with partners from outside the continent and a credible basis for the economic diversification and industrialization of Africa, which are much needed for its development.

Gains under the Agreement would be for intra-African trade

Results from the empirical analysis confirm that most of the benefit of the full implementation of the Agreement would be in intra-African trade. As illustrated in figure II, although net global trade in 2045 would be only 4.9 per cent higher than without the Agreement, average intra-African trade[4] would be some 33.8 per cent higher. Average trade with the rest of the world would be 1.1 per cent lower than under the baseline scenario, with exports to the rest of the world 0.9 per cent lower and imports from the rest of the world of 1.3 per cent lower. In absolute terms, the net effect on African trade would be positive, with intra-African trade $130 billion higher than under the baseline scenario and trade with the rest of the world around $20 billion lower.

Figure II: Changes in African trade (i.e. global vs. with Africa vs. with the rest of the world) in 2045 under the Agreement compared with the baseline scenario



Source: Economic Commission for Africa and Centre for International Research and Economic Modelling, calculated using the MIRAGE-e computable general equilibrium model.

The implementation of the Agreement would greatly boost intra-African trade in agrifood, industry and services and provide a strong basis for economic transformation

The results for intra-African trade alone show that the successful implementation of the Agreement would be a game changer for the continent. Even without the Agreement, intra-African trade would be expected to continue growing, with the industrial sector remaining dominant. But implementation of the Agreement would accelerate and amplify this promising trend for development and competitiveness in Africa.

The Agreement would result in additional trade, in relative and absolute terms, for all major sectors, although not all of them would benefit equally. Figure III indicates that trade in agrifood, industry and

4 Expressed as the average between intra-African exports and intra-African imports.

services would all be about 40 per cent higher if the Agreement were implemented than under the baseline scenario. Trade in energy and mining would also be higher, albeit only by about 16 per cent. This is a clear indication that implementation of the Agreement would help African countries to diversify away from energy and mining products, which tend to have low value added and often rely on finite natural resources.

As shown in figure IV, the shift from energy and mining towards other sectors, especially industry, is even more apparent when the results are presented in absolute terms. Nearly two thirds of the increase in intra-African trade would be in the industry sector alone. Agrifood would account for about 21 per cent of the gains, energy and mining for about 11 per cent and services for only about 3 per cent.

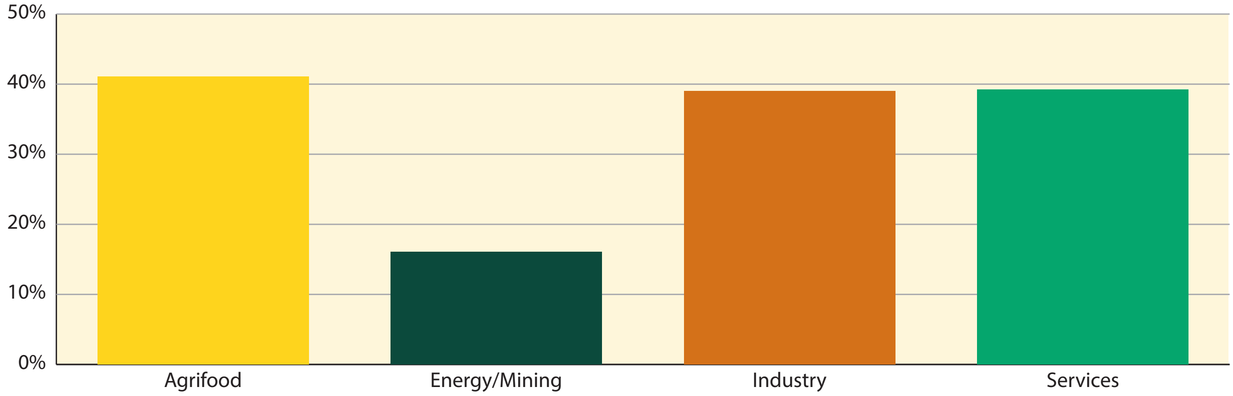
The relatively moderate shares of absolute intra-African trade gains expected for the agrifood and services sectors are consistent with the fact that industrial goods already dominate intra-African trade, accounting for about 45 per cent of the total. However, this does not mean that the agrifood and services sectors would not be important to the development of African economies following the implementation of the Agreement. The expected relative increases in those sectors (as shown in figure III) should therefore not be overlooked. For instance, whereas services made up nearly 50 per cent of total output in Africa in 2020, they represented less than 3 per cent of the value of intra-African trade. It should also be noted that, in the same year, only about 3 per cent of total exports of services by African countries were to other African countries; the remaining 97 per cent were to other regions.[5] Consequently, even if implementation of the Agreement led to strong relative growth in intra-African trade in services, which is important, it would not translate into a large increase in absolute terms. In addition, it is likely that the current data vastly underestimate intra-African trade in services and, therefore, that the figure given in this assessment for the expected gains from the liberalization of services is also vastly underestimated. Moreover, the current trend towards digitalization, which is not considered in this assessment, could facilitate the development of many services in Africa, thereby amplifying the gains in intra-African trade in services. Lastly, it is worth noting that services would contribute a substantially larger share to gains in African output than to gains in intra-African trade (see figure IV). This is very significant, as it shows that not only would intra-African trade gains translate into output gains for all major sectors, but also production capacities would be strengthened, in particular in industry and services, both of which have larger shares in output than in intra-African trade gains. Further discussion of the impact that implementation of the Agreement would have on specific subsectors within the services sector is provided later in the brief.

Putting intra-African trade gains from the Agreement implementation into perspective

A comparison between the expected composition of intra-African trade after the full implementation of the Agreement and the current composition reveals the benefits that implementation would bring. As illustrated in figure V, intra-African trade is currently valued at around $100 billion, of which 44.8 per cent is in industrial goods, 33.0 per cent in energy and mining products, 19.6 per cent in agrifood and 2.6 per cent in services. Even without the Agreement in place, intra-African trade would be expected to grow substantially, by around 270 per cent between 2020 and 2045, with the growth spread across all main sectors. The composition of that trade would change, in particular for industry, which would have a much larger share, and energy and mining, which would have a much smaller share. These trends

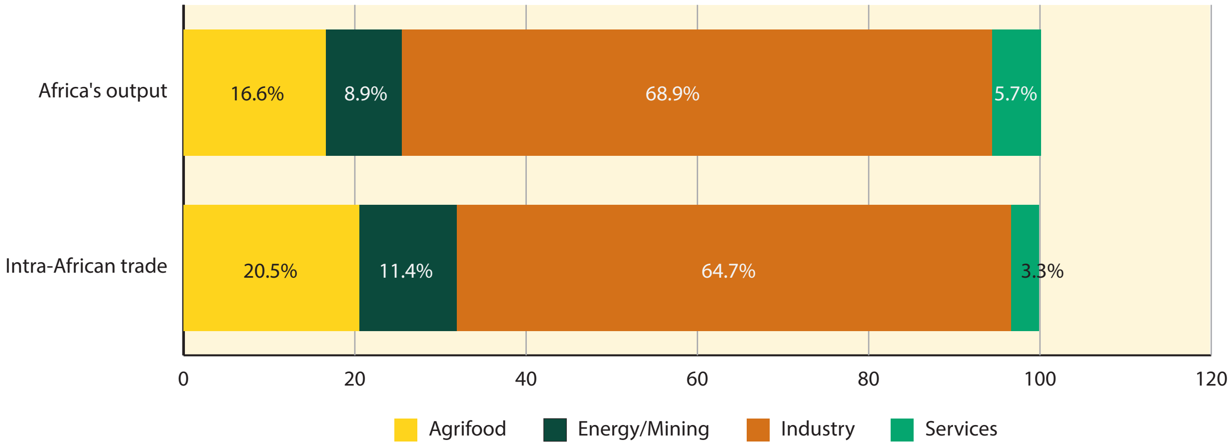
5 All 2020 values are estimated using the MIRAGE-e computable general equilibrium model based on the latest Macroeconometrics of the Global Economy growth model. The MIRAGE-e model is itself calibrated on the year 2014 based on the GTAP 10.1 database developed by the Global Trade Analysis Project.

Figure III: Percentage difference in intra-African trade in 2045, under the Agreement compared with the baseline scenario



Source: Economic Commission for Africa and Centre for International Research and Economic Modelling, calculated using the MIRAGE-e computable general equilibrium model.

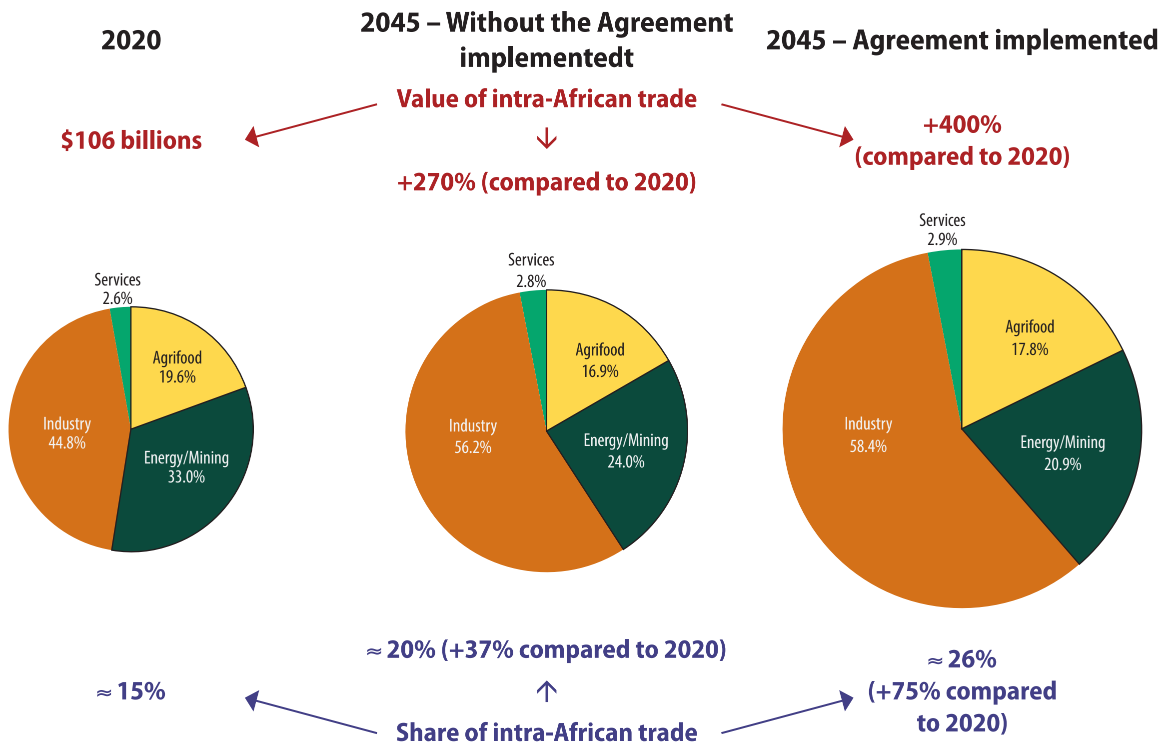
Figure IV: Distribution of absolute gains in intra-African trade and output in 2045, by main sectors, under the Agreement compared with the baseline scenario



Source: Economic Commission for Africa and Centre for International Research and Economic Modelling, calculated using the MIRAGE-e computable general equilibrium model.

would be even more pronounced if the Agreement were in place, in which case intra-African trade would be expected to grow by about 400 per cent during the same period, greatly benefiting all major sectors, while industry's share would grow to about 60 per cent and energy and mining's share would contract to under 21 per cent, only slightly ahead of agrifood's share (about 18 per cent); the share of the services sector in intra-African trade would expand slightly.

Figure V: Intra-African trade (share, value and composition) in 2020 and 2045, with and without the Agreement in place



Source: Economic Commission for Africa and Centre for International Research and Economic Modelling, calculated using the MIRAGE-e computable general equilibrium model.

The expected changes to the composition of intra-African trade following implementation of the Agreement seem to confirm that it would provide invaluable opportunities for industrialization in Africa. The magnitude of those changes suggests that the Agreement would also somewhat reduce the current trade dependence of Africa on its external partners. With the Agreement in place, intra-African trade as a share of total trade would grow by about three quarters, from its current level of about 15 per cent to more than 26 per cent; without the Agreement, the share would increase by only 37 per cent to about 20 per cent of total trade.[6] This growth is indicative that formal intra-African trade would grow faster than Africa's trade with the rest of the world following implementation of the Agreement. With the Agreement in place, African trade would also increase as a share of global trade by about two thirds over the same period (from about 3 per cent in 2020 to nearly 5 per cent in 2045).