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Opinion beyondbrics

Can Africa's continental free trade area overcome its high risks?

A large pool of adjustment funds to offset dislocation costs must be integral to the AfCFTA



Dock workers at Mombasa port, Kenya © Bloomberg

Harry G. Broadman September 20, 2109

African policymakers have long sought mechanisms to increase international trade, as a means to integrate the region into the world economy, as a pathway to sustained growth and to make a permanent dent in poverty. As a highly fragmented continent comprised of numerous small countries, many of which are landlocked, this goal has been largely elusive. However, Africa's leaders are now on the verge of an economic game-changer.

This year, 54 of the 55 countries in Africa became signatories of the African Continental Free Trade Agreement (AfCFTA), an unprecedented initiative to generate vast economies of scale on an intra-continental basis, principally by eliminating 90 per cent of tariffs on goods and significantly reducing non-tariff barriers (NTBs) on merchandise and services, such as differences in licensing regimes and regulatory standards.

The AfCFTA aims to integrate the entire region into a unified market that could embody a combined GDP of \$2.5tn and a population of over 1bn, 60 per cent of whom are below the age of 25.

To say the AfCFTA was a heroic undertaking would be an understatement. At the same time, it is hard to argue with its intent and goals. The IMF estimates that the AfCFTA will produce an increase in economic welfare for the continent as a whole of between 2 and 4 per cent, depending on how extensively and quickly its reforms are implemented. Those are hardly inconsequential gains — if they can be realised.

But the AfCFTA's success will depend on the extent to which it incorporates from the outset a robust, sufficiently financed and continent-wide integrated programme to alleviate the significant transitions and dislocations among firms and workers that trade liberalisation policies induce everywhere around the globe, while also facilitating the entry of new businesses and members of the workforce.

If Africa's leaders look to the advanced countries to model such a programme, they will fail. In advanced economies, adjustment mechanisms are generally ill designed. They are often enshrined in policies external to trade agreements and are cynically, but sometimes accurately, viewed as an afterthought. The size and duration of financing for such assistance is the responsibility of each signatory, rather than a collective enterprise among all jurisdictions. The ineffectiveness of the standalone US Trade Adjustment Assistance programme in ameliorating the effects within the US of the North American Free Trade Agreement (Nafta) is one example of such problems.

Whereas a wealthy country like the US has wiggle room to rectify such design flaws, in Africa, home to half of the world's extreme poor, the stakes for easing into a regime of trade liberalisation, especially one as ambitious as the AfCFTA, are a great deal higher.

Thankfully, social safety nets in Africa have greatly enlarged over the past decade and a half (albeit, of course, from a low base). However, there is appreciable variance in their scale across countries. Few are designed or nearly large enough to deal with existing unemployment and underemployment, weather-related calamities or external macroeconomic turbulence such as a global downturn in commodity prices, let alone the additional socio-economic impacts of significant trade liberalisation. Structuring, arranging the financing for, and implementing a continent-wide social safety net able to meet these needs must be an immediate priority for Africa's leaders before the execution of the AfCFTA.

One cannot overstate the magnitude of meeting such a challenge. This is not only because Africa is generally comprised of low-income countries, but also because the elimination of tariffs under the AfCFTA will necessarily reduce African governments' fiscal resources. All other things equal, this means there will be diminished public funds available for trade adjustment assistance. Unctad has estimated that this reduction will be more than \$4bn annually continent-wide.

Needless to say, truly innovative approaches to meet such financing needs are called for, beyond the routine method of securing loans from multilateral financial institutions. One such approach might be the formation of a continental public-private partnership, in which African businesses that will profit from the expansion of trade under AfCFTA would be major financiers.

There is an equally critical issue that must be confronted by the continent's leadership before the AfCFTA becomes effective. Unlike other regions' pursuit of regional integration, Africa's existing pattern of trade suffers from a pernicious structural problem: less than one-fifth of the average African country's exports are bought by customers located in other African states. Put differently, more than 85 per cent of exports from African economies are sold outside the continent. Africa's pattern of low intraregional trade is almost the opposite of what occurs in most other parts of the world.

This anomalous condition stems largely from the fact that not only are the vast majority of African businesses locally based small and medium-sized enterprises, but also that there is a daunting lack of cost-effective infrastructure to get goods and services to market at competitive rates. Indeed, there are instances where, because of variation in railway gauges across some African countries, it is necessary to offload shipments at a border and put them either on different rail cars or on trucks to get them to their final destination. The cost of shipping a product from, say, Johannesburg to Kigali can be a multiple of that of shipping the same good from Johannesburg to Beijing.

The consensus of projections of the effects of the AfCFTA is that once fully implemented it could increase intra-African trade of goods and services by as much as a third, with most of the near-term growth in trade taking place in manufacturing. Indeed, Africa's manufacturing sector is thought to be able to double in size and create 13m to 16m new jobs under the AfCFTA. This would help shift the composition of Africa's exports to the rest of the world away from undue dependence on raw commodities.

Nevertheless, for such gains to be realised, the longstanding and well-known continent-wide infrastructure gap, which exists not only within but also across Africa's countries, must be addressed. Closing this gap is arguably the largest public good for which the requisite financing needs to be incorporated within AfCFTA from day one. It is the other critical area where a continental public-private partnership should be sought by Africa's leaders without delay.

Much is at stake for a successful AfCFTA. If there ever was an economic growth opportunity for the African continent to act in unison as well as to show other parts of the world how to design integrated trade reform, this is it.

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