

Preliminary Draft

AFRICAN REGIONAL INTEGRATION:
ISSUES AND CHALLENGES

by

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Introduction

Following the failed ministerial conference of the World Trade Organization (WTO) in November 1999, global multilateralism has faced an increasing number of vocal and active opposition from around the world. The Seattle conference failed because by expanding to 130 members, it became more difficult for the WTO to reach consensus on different issues. Secondly, developing countries both grew in membership and also became more active participants in voicing their concerns than they had done under the General Agreement of Tariffs and Trade (GATT). The cry is that freer trade and globalization are not in poor countries' interest and that it will cost already poor people dearly (McCalla, 2001). Therefore, as the push for freer trade at the multilateral level has become more and more contentious, governments have been focusing on negotiating regional pacts as means to enhancing policy credibility and accelerating trade and investment liberalization in the hopes of spurring production and export growth.

Africa is faced with just such a challenge in announcing creation of the African Union. The guidelines for the Union are provided by the Abuja Treaty of 1991, which is articulated around the concepts of solidarity and collective self-reliance; a self-sustained and endogenous development strategy; and a policy of self-sufficiency in basic needs. Its major goals include the integration of African productive capacities and infrastructure facilities; the eradication of poverty and ignorance; the building of genuine African-centered institutions; and the establishment of new relationships between Africa and the rest of the world (African Development Report, 2000). The Abuja model of integration provides a marked departure from previous models in that it is no longer a narrow trade agreement; it conceives of a long-term development strategy, aims to integrate economic and non-economic sectors, builds new institutions consistent with a self-reliant development process, upholds democratic principles, and fosters new social and cultural values.

The issue of gaining market access for African countries attracted much attention during the Uruguay Round of multilateral negotiations. Currently, virtually all African countries have entered into contractual preference arrangements with the European Union (EU) as part of the African, Caribbean and Pacific countries (ACP)-European Union (EU) Partnership Agreement. Because of historical colonial ties, the EU accounts for greater than two-thirds of total African trade. African countries also enjoy preferential treatment for certain export products to major markets, such as the U.S. and Japan, under the General System of Preference (GSP).

The option of promoting trade and investment integration on a regional basis was implemented in the 1990s by many WTO members in various regions of the world. Most regional trade agreements (RTAs) involve discriminatory trade liberalization by member countries against the rest of the world. Over 200 RTAs have been notified to the GATT or WTO over time; currently over 150 agreements are in force. Since 1995, over 100 agreements covering trade in goods or services, or both, have been notified to the WTO. Therefore, currently, almost all countries are members of at least one RTA and more than one third of world trade is supported by RTAs. Existing RTAs include the North American Free Trade Agreement (NAFTA), the EU, the Central American Common Market (CACM), Association of South East Asian Nations (ASEAN), Southern Cone Common Market of Latin America (MERCOSUR), etc. In Africa alone, there are at present about thirteen different sub-regional trade agreements. In Central Africa, they include the Central African Monetary and Economic Community (CEMAC - formerly known as the Central African Customs and Economic Union - UDEAC), the

Economic Community of the Countries of the Great Lakes (CEPGL), and the Economic Community of Central African States (ECCAS). In North Africa is the Arab Maghreb Union (AMU). In Southern and Eastern Africa are the Southern African Customs Union (SACU), the Common Monetary Area (CMA), the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), and the East African Cooperation/Community (EAC). In West Africa are the Economic Community of West African States (ECOWAS), the West African Economic and Monetary Union (WAEMU), and the Mano River Union (MRU).

Invariably, consolidation and enlargement of a regional agreement are not intended to close borders but to increase the competitiveness of firms within the region. But all regional agreements do not have the same goals. For example, integration in Europe offers a political option that brings with it economic benefits and security interests. However, regionalism in the Americas does not share the same motivation. The latter is defined around the trade interests of the U.S.

In this paper, we provide comments on emerging trade policy issues and challenges facing Africa as it embarks on its experimentation in forming a regional economic and political union. Implications from potential lessons are derived for Africa's emerging challenge in seeking to create an RTA. The paper borrows substantial information from a previous paper by Amponsah (2002).

Africa's Trade Policy Challenges

Recent experiences demonstrate that countries that have pursued open-economy, export-oriented growth and development strategies have almost always done well (a very good example is the "East Asian Miracle" prior to the global financial crisis of the late 1990s). Rapid growth in many Latin American countries in the late 1980s and 1990s also came about with domestic policy liberalization and open-economy models, which reduced trade barriers. On the other hand, the popularly held notion is that most African nations have persisted with inward-looking, protectionist models and have done poorly. The negative consequences of many African countries' highly interventionist and protectionist trade regimes have become unraveled through the Uruguay Round of the GATT and WTO deliberations to date.

At the end of the 1980s, researchers began focusing on the concept of conditional convergence. According to this concept, a country's long-run level of income and its growth rate are determined by factors such as macroeconomic and structural policies, as well as by how poor the country is relative to the rest of the world (Amponsah et al., 1999). The uneven economic performance across countries and uneven rewards within them are frequently linked to the phenomenon of globalization (International Monetary Fund, 1997). The critical issue arising from recent lessons learnt about economic growth is that policy regimes make a difference in whether a developing country converges toward high income levels.

In fact in the 1980s, many African countries unilaterally embarked on the painful process of rationalizing and liberalizing their trade regimes through structural adjustment programs with the assistance of the World Bank and International Monetary Fund (IMF). Although reforms have been uneven, there is clear evidence that protection of import substitutes with tariffs and non-tariff barriers in Sub-Sahara Africa has declined (Nash, 1993). Quantitative restrictions have generally been

replaced with lower tariff levels that average between 15 and 20 percent (with the highest rates at 35-40 percent). These rates still remain quite high by comparison with other developing regions, such as Asia and Latin America. According to Nash, there has been little progress by individual countries in establishing efficient systems and institutions that would provide exporters with access to inputs at internationally competitive prices. Yet, mainly because of policy reversals and lack of sustainability, many African countries suffer from credibility problems at the multilateral level. Additionally, unlike most developing countries that started trade liberalization experiments earlier, many African countries are highly dependent on trade taxes for fiscal revenue.

Therefore, to date compared to other regions of the world, Africa is generally characterized by low economic growth (see Figure 1), although many more countries have achieved positive growth in the 1990s in particular. Moreover, Africa is still far from reaching its targeted goal of an annual growth rate above 7 percent a year so as to achieve economic convergence with other developing countries and to maintain similar quality of life. Sharer (2001) documents that Africa's non-oil exports in 2000 came to about \$69 billion, and that if Africa had retained its share of non-oil exports at 1980 levels, exports in 2000 would have been \$161 billion, or \$92 billion more than their actual level. In contrast, the total cost of the Heavily Indebted Poor Countries Initiative is about \$30 billion (to be delivered over more than 20 years). In addition, the most recent replenishment of the World Bank's concessional lending arm, the International Development Association, totaled \$22 billion for a three-year period.

Extensive research and analysis usually highlight the following causes for Africa's economic problems: adverse geographic and demographic conditions, low rates of domestic savings, endemic poverty, excessive dependence on a few agricultural commodities, lack of institutional transparency, lack of market openness and liberalization, terms of trade and other external shocks, macroeconomic policy weaknesses, structural policy failures, weaknesses in governance, political instability and conflicts. Sub-Sahara Africa's average GDP per head is anywhere around \$509 (\$297 if we exclude South Africa) and it has hardly changed over the past three decades. Additionally, the region has experienced declining shares in nearly all sub-sectors of world trade, and there is a tendency for its exports to be concentrated in primary products whose share of world trade has been declining.

Although the slow pace of Africa's global integration shielded her from global financial crisis of the late 1990s, it has also meant that real prosperity eludes many countries in the region. Therefore, it is usually conjectured that Africa may not continue in its present course of economic development if it wishes to exploit the benefits of globalization, namely, increasing its available resources for productive investment, enhancing efficiency of their uses, and facilitating transfer of appropriate technology to enhance its production processes and to reduce poverty.

Consequently, many economic development analysts have proposed that because of the forces of globalization, African countries (just as most developing countries) have little choice but to integrate into global markets, or risk being further marginalized. The suggested approach is to integrate regionally so as to facilitate wider integration into the global economy so as to gain access to greater flows of trade, finance, technology, and ideas for economic growth and human welfare. In other words, whereas it is alright for these countries to be a part of the global network of multilateral arrangements and need to submit to the rules and regulation of the WTO, Africa must first learn to deal

laterally with its neighbors and other developing countries in the South as partners in trade and development. Conventional wisdom states that by developing such alliances, African countries will build the necessary blocks in negotiating more effectively at the WTO level. Ajayi (2001) suggests that integration must be achieved through trade, capital flows, human migration, and advances in telecommunications and transportation.

Lately, a consensus has also emerged that the sub-regional integration arrangements in Africa have failed to date to substantially increase trade (in terms of market access) and economic growth both within the region and in the world. Oyejide (1997) indicates that although virtually all of Africa's sub-regional integration arrangements contain specific trade liberalization commitments, most of them have not been implemented. Therefore, inter-African trade is lower (typically less than 10 percent) than that of any region in the world. Africa's share in global exports fell from 4.5 percent in 1977 to 2 percent in 1997, while developing countries as a whole increased their contribution to world trade. Additionally, Africa's share of total developing country exports dropped from 15.5 percent in 1981 to 9.2 percent in 1997. Africa's share of FDI flows to developing countries fell from 23 percent in 1970 to 4.7 percent in 1997 (African Development Bank, 2000). Lessons learnt from African sub-regional arrangements are that they have major design and implementation flaws, exhibit narrow patterns of trade, depend on primary product exports, involve low levels of inter-country trade, and have low potential complementarities in goods and services.

Summary of Theoretical and Empirical Challenges

In a paper presented during the maiden African Development Forum III to develop consensus on the way forward for the formulation of the African Union, Amponsah (2002) provide comprehensive review of the literature in support of regional trade agreements. The author also draws heavily on reviewed literature to derive potential lessons for Africa's new regionalism. The presentation dwells on theoretical arguments in support of trade creation and diversion, economies of scale in the formation of RTAs, impacts of trade liberalization on economic growth, economic growth through foreign direct investment, and other policies such as promotion of policy credibility, conflict prevention and regional stability, political rapprochement, and the distribution benefits from free trade.

Empirical evidence from global *ex post* and *ex ante* policy studies provide additional lessons for African countries. Again, Amponsah (2002) draws heavily on both OECD (European Community, European Union, NAFTA, etc.,) and non-OECD (ANDEAN, ASEAN, SADC, MERCOSUR, etc.) examples.

From the comprehensive review of literature on the theory and practice of RTAs, the following stylized facts provide lessons for Africa's experiment with regional trade agreement:

- Greater trade policy liberalization may lead to stronger economic growth, notwithstanding the controversies pertaining to trade and development policies, and the mixed results of specific impacts from various studies. A major complement of RTAs is the ability to import knowledge, ideas, investment goods and intermediate inputs (such as technology, skilled management, etc.,) from successful integrating

regions;

- Economic integration stands to improve regional economic performance, to the extent that the necessary environment is enabled for human capacity building, learning by doing, and sustained policy and institutional reforms;
- The fundamentals for achieving sustained growth lie in human resource availability and human resource development, macroeconomic and fiscal stability, and effective institutions (including the rule of law);
- Pursuit of open economic strategies is the key incentive to gaining greater access to markets. Therefore, countries must adopt trading systems that are open, transparent, rules based, and fair. They must also learn to negotiate as a trading bloc;
- By “locking in” uniform trade and investment policies among member countries, an RTA may help promote policy credibility. Group action may influence all members to abide by a common reform agenda. Of course, RTAs do not guarantee equal distribution of benefits to each member. Therefore, unilateral actions by countries to embark on sustained economic and structural reforms are very important in reaping the full benefits from integration;
- RTAs are expected to boost both home grown and foreign investment to spur economic growth. The economic geography literature seems to suggest that industry location within RTAs may reduce transactions costs based on the availability and efficiency of infrastructure. For similar reasons, an RTA that is built around some larger and rapidly growing member country that serves as a “growth-pole” for the region, could have growth enhancing effects for the region. In both the EC and NAFTA cases, there are substantial diversion of FDI by non-members to take advantage of preferential access to the regional market. FDI also seemed to stimulate production in related industries, increase production in neighboring firms and in transferring technology mainly because of the forces of agglomeration;
- RTAs present firms in member countries with the opportunity to exploit economies of scale through access to enlarged and diversified markets. RTAs may also broaden the available market for a member country’s producers and diversity of goods for its consumers;
- The economic benefits from an RTA has been justified in terms of greater trade creation than trade diversion by its members. Net trade creation offer dynamic gains from trade and provide the fundamental argument for free trade and economic growth;
- Intra-bloc trade is usually small at the inception of the RTA for most regions, but grows over time. In many cases, trade among RTA members and the rest of the world tends to be curtailed. In the developing country examples of the MERCOSUR and SADC, trade performance seemed to be explained in large part by currency issues and exchange rate policies rather than instituted trade policy instruments per se;
- The fastest growing products in intra-bloc trade are capital-intensive goods in which MERCOSUR countries did not previously display strong export performance. Therefore, the new patterns of trade of members of an RTA may be at odds with what their historical comparative advantage would predict (what is referred to as the “anti-monde”); and
- RTAs can help prevent conflicts since regional political support is necessary for regional agreements. Therefore, RTAs may promote greater rapprochement,

diplomacy and stability.

Derived Lessons for Africa

The combined effects of identified factors resulting from an RTA are expected to provide opportunities to expand trade, pool resources for investment, enlarge local markets, and industrialize more efficiently by taking advantage of the scale of production that large markets afford. Since most national markets in Africa are simply too small and/or inadequate to sustain large-scale economic operations, economic integration must be viewed as important for utilizing Africa's human and physical potential, instituting credible policies, and for realizing its prime objectives of accelerating economic growth and reducing poverty.

Invariably, therefore, a regional trade agreement can be a good thing if it leads the member countries further and faster towards greater openness and integration. But trade system reforms, as well as the completion of regional integration agreements represent processes rather than discrete events. The implementation schedules for most reforms must be viewed as ongoing over time. Fortunately, Africa can build on lessons learned from existing sub-regional and bilateral arrangements in order to sustain its emerging regional economic integration. Creating a single regional market can eventually enhance Africa's economic efficiency. Regional trade agreements can help countries build on their comparative advantages, sharpen their industrial efficiency, and act as a springboard to integrate into the world economy. It can also help strengthen the political commitment to an open economy, improve technical, management and negotiation skills and competence, educate the public and more actively engage the business community. This will build credibility for Africa's best reformers in the eyes of the world and, hopefully, reward them with greater access to markets.

Clearly, building closer trading links among African countries will strengthen their capacity to fully participate in the global/multilateral trading system. It will help avoid the usual problems with small domestic markets, since producers and manufacturers will be offered greater economies of scale and regional market infrastructure. Additionally, an integrated African market should provide greater access to regional trade institutions to harness human resources and re-orient policy instruments. For example, common agreements can be reached to harmonize tariff reduction, legal and regulatory reforms, the rationalization of payment systems, reorganization of financial systems, and reforms of labor markets that should enable African countries to assert their economic interests from a stronger and more confident position in global markets. It is also expected that by engaging in learning by doing, this process would influence the countries to implement politically more difficult trade measures that they would otherwise not have the individual political will to undertake, such as lowering tariffs or embarking on extra-institutional reforms. To that end, therefore, there could exist a framework for greater surveillance and dialogue among partner countries to discourage/reduce potential risks of macroeconomic slippage and to create the enabling stable environment for business to flourish.

Just as with most systems, regionally integrated markets entail some costs. Regional integration could encourage trade diversion. There is always the tendency for member countries to divert some of their trade that would otherwise take place between the participants of the agreement with third countries. When countries integrate and reduce or eliminate trade taxes, they eventually

lose potential revenues. The dynamic process of substituting lost revenues with alternative sources of revenue, such as the value-added tax or any such comparable instrument, poses potential risks to small country governments. As in the EU, regional trade integration may encourage member countries to become more inward-looking and protectionist. This phenomenon may create policy reversals and pose a major threat to the goal of an open multilateral regime that is based on non-discriminatory trade. Nevertheless, there is a prevailing view that RTAs enable participants to move more closely and quickly to trade liberalization than it is possible at the multilateral level. Also, if it is trade creating, then RTAs would complement the overall goal of achieving multilateral liberalization.

Lessons from the reviewed literature suggest that to be successful, reforms must be adapted to each member country's specific economic and social characteristics, its priorities and its relative level of development. Although the harmonization of trade policy instruments such as tariff reductions and the formation of regional institutions can be undertaken by the collective will of all members of the RTA, unilateral macroeconomic and structural reforms must be undertaken by each sovereign nation's government. These include removing trade barriers, adopting appropriate exchange rate policies, diversifying exports, tax reforms, policies to encourage innovation and economies of scale, infrastructure development, redefining the role of the state, reforming the civil service so as to improve the business climate, instituting mechanisms toward greater transparency in the legal and regulatory framework, liberalizing investment laws, offering fiscal incentives, easing restriction on entry and profit remittances, strengthening banking and financial systems, and enhancing social policies, especially in health and education.

Whereas it is generally agreed that African countries must be held accountable for accomplishing their reforms and development, international organizations and donor groups can complement their efforts. First, markets must be opened to provide free access to African products and services. Removal of trade barriers could contribute to gains in incomes that could make up for declining levels of potential external assistance that are destined for Africa. The present drive towards market openness, though successful to a great extent, has not led to full accessibility to markets. Significant impediments to free trade in goods and services still exist that prevent nations from reaping full benefits from international trade. Markets still do not constitute a level playing field. For example, although many regions such as the EU have drastically reduced tariffs, they still maintain relatively higher protection rates for agricultural commodities that it produces and low to zero tariffs on those it does not produce. Many developed countries also impose non-tariff barriers in the form of price supports, subsidies, and special marketing arrangements that tend to keep out agricultural products from developing countries. Other restrictive policies include product standards and health regulations. Now, although Africa may be accorded preferential treatment, these preferences have not increased African trade. Therefore, it may be in African countries' interests to support broad-based multilateral liberalization in agriculture during future rounds of global trade negotiations. To this end, a two-pronged strategy seems to be in order for members of the African Union. This will involve strengthening integration links within the group, on the one hand, and reinforcing the global multilateral system on the other. It will serve Africa's interest to see the WTO monitoring regional economic groupings, and to seek to moderate differences and resolve potential disputes.

Africa's international partners could also strengthen this regional initiative by promoting flows of capital and FDI to help create new jobs, provide information, raise technological development, and

add value to “made-in-Africa” products that would raise their competitiveness and satisfy global demand. International partners could also commit anew to honoring their contemporary commitments toward debt reduction/eradication so as to assist Africa in reducing its level of poverty.

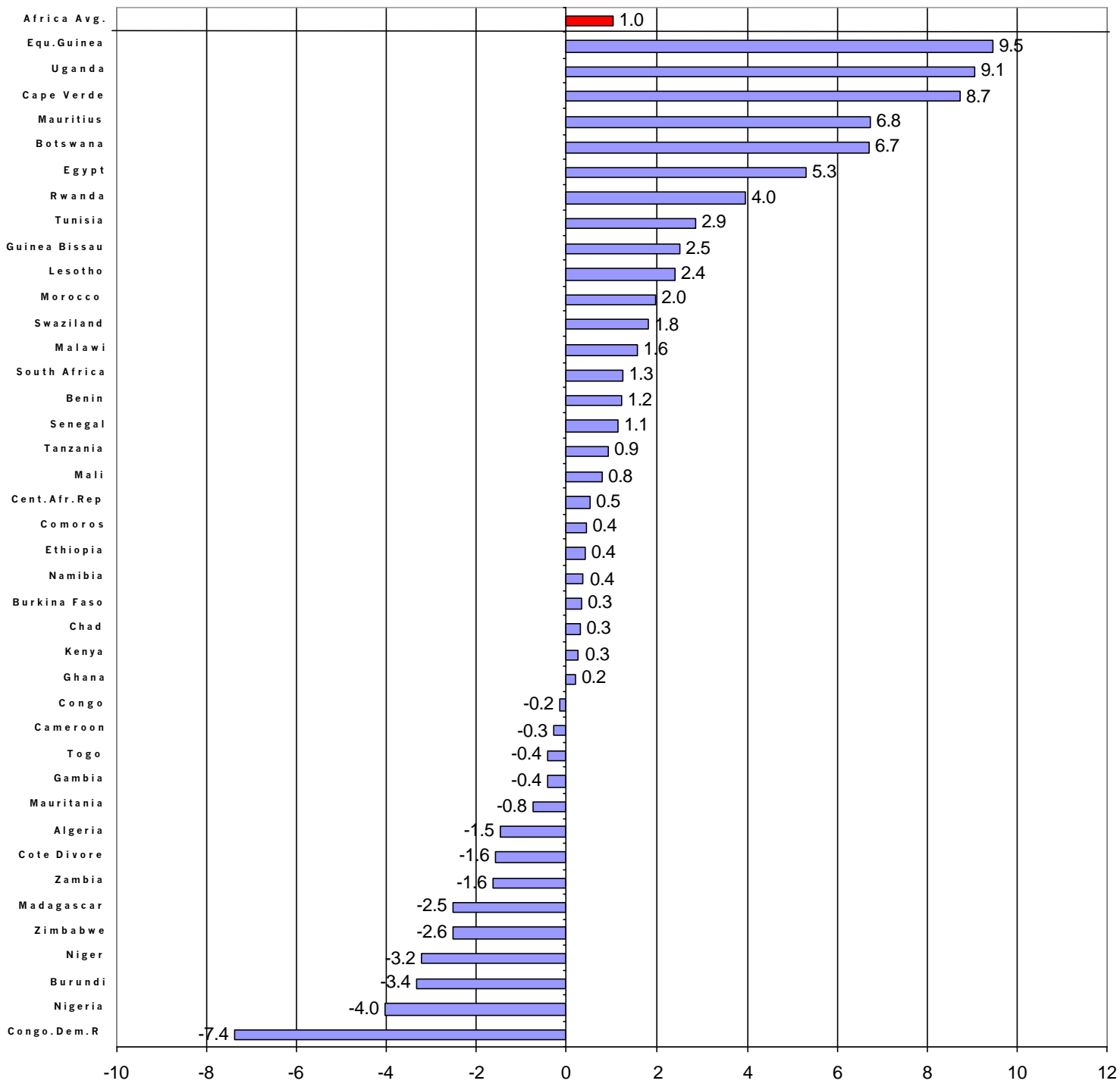
Additionally establishing institutions that can intermediate with global financial and extralegal institutions will be critical. For example, lessons from the recent global financial meltdown (in Southeast Asia and Latin America) seem to suggest that the potential risks from globalization may be very high. Although Africa avoided such risk by not being active players in global finance, in planning to become active players, framers of the African Union must take into consideration establishment of protocols that will enable Africa to achieve sustainable growth without exposure to major external shocks that would contribute to current poverty. African countries must work actively with multilateral institutions, such as the WTO, the World Bank and IMF, to promote convergence through macroeconomic discipline, trade liberalization, reforms of institutions to strengthen the enforcement of market rules and the rule of law that will lead to good governance. But would African countries be willing to cede authority to a supra-national institution?

Finally, a major concern about Africa is that there is a dearth of data to back up negotiations. Let us assume that African countries want to negotiate on the elimination of tariff and non-tariff measures. To reach effective agreement through negotiation would require adequate information to conduct the necessary background research that takes into consideration different assumptions to compare third party tariffs, preferential tariffs and rules of origin for the region. Since adequate information may not be available on measures of support, it is doubtful if negotiations can proceed on a sound basis. Even if some information were available, it is not clear how many countries have the necessary expertise to conduct comprehensive analysis of the existing information without the benefit of expert technical assistance.

Complementary challenges to overcome for the African Union to be realized are: convergence of national trade policies, agreement on the goals and the content of the African Union, and consensus on how to achieve the goals. Consequently, it is important to assess how far (or how near) the countries are from the necessary convergence of their trade policies, how broad are the differences between the countries in their conception of the content of the future African Union, and finally, how much they agree on an approach to getting there. Again, these issues point back to the ability to gather information and to conduct factual research.

Therefore, there is a major role to be played by institutions such as the United Nations Economic Commission for Africa (UNECA) and the African Development Bank by undertaking research that will fill such gaps in trade and investment flows and trade policy related information. Perhaps, a special trade unit could be established to pay special attention to the needs of the participating countries (a majority of them are resource poor), and to work towards a strategy that minimizes their adjustment costs, as well as identifies the implications of integrating economies of different sizes and levels of adjustment. Consequently, UNECA’s Africa Knowledge Networks Forum (AKNF) and the African Development Forum is a major step in seeking consensus of ideas that should solve Africa’s poverty enigma once and for all.

Figure 1 **Average Growth Rate (%)**
1980-1999



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