



African Development Perspectives



Yearbook 2015/16

AFRICA'S PROGRESS IN REGIONAL AND GLOBAL ECONOMIC INTEGRATION - TOWARDS TRANSFORMATIVE REGIONAL INTEGRATION

ACHIM GUTOWSKI, TOBIAS KNEDLIK, PATRICK N. OSAKWE,
ISABELLE RAMDOO, KARL WOHLMUTH (EDS.)

LIT

Achim Gutowski, Tobias Knedlik, Patrick N. Osakwe,
Isabelle Ramdoo, Karl Wohlmuth (Eds.)

**Africa's Progress in Regional and Global
Economic Integration –
Towards Transformative Regional Integration**

African Development Perspectives Yearbook

Edited by the

Research Group on African Development Perspectives Bremen:
Achim Gutowski, Tobias Knedlik, Patrick N. Osakwe,
Isabelle Ramdoo, Karl Wohlmuth

Vol. XVIII

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The Research Group on African Development Perspectives Bremen

The aggravating social, political and economic crisis of the African continent forces institutions, organisations, researchers, development practitioners, ad hoc working groups and networks on Africa, and all others involved in African development affairs to intensify the analytical and conceptional work on alternative development visions and designs for Africa. There exist a growing number of plans and programmes, strategy conceptions, researches, and ideas for policy action and projects being published worldwide and focussing on the peculiarity of the African crisis, Africa's recent growth dynamics, the chances for structural adjustment and transformation, the issue of planning development beyond mere adjustment, and on the necessary responses to the globalisation trend. The discussion referring to Africa's development problems and perspectives is widening. However, it is difficult to get an overall view of the different approaches and proposals and, subsequently, to make the discussion useful for the programming and co-ordinating of development policies. So there is a need for a comprehensive publication that compiles, evaluates, and analyzes the scattered material and the often not easily available sources.

To fill this gap, the *Research Group on African Development Perspectives Bremen*, established at the University of Bremen, is presenting the African Development Perspectives Yearbook, being published since Volume 1 in 1989. Research activities of the group members comprised over the years country case studies and comparative country analyses; studies on macroeconomic policies and strategies, aspects of labour market policies and informal sector activities, human development policies and strategies, agriculture and food security policies; studies on natural resources development and environmental policies, but also researches on the promotion of small-scale industries, private sector development policies, entrepreneurship development, and assessments of sector and structural adjustment policies, trade and regional integration policies, as well as reviews of economic diversification options.

The *African Development Perspectives Yearbook* is the first English-speaking periodical published in Germany relating to development problems and perspectives in Africa. African, European and North-American experts from universities, international and regional organisations, and from non-governmental and donor organisations are reporting on problems and on possible solutions, on new political and economic approaches, on specific

economic programmes, and on visions for alternative African development paths.

Africa's future will depend on both, on its economic and political connections with the international community at the Pan-African, sub-regional, national, provincial and sectoral levels, and on local projects and development efforts at the micro level. Most important are own African development visions, programmes, strategies and policies. The *African Development Perspectives Yearbook* contains information and analyses with regard to these various dimensions. Global analyses, regional and country studies, sectoral studies and individual project evaluations are published in the *African Development Perspectives Yearbook*, as well as statements and declarations on Africa submitted as the result of international conferences, important documents of African regional organisations and of individual African states, and important programmes of African civil society organisations and African self-help groups.

Beside the analytical, comparative and documentary character of the *African Development Perspectives Yearbook*, the editors successfully established an extensive network for the exchange of news and information and are so relating and connecting development organisations and research institutions that are working in and for Africa. The members of the *Research Group on African Development Perspectives* are interested to deepen the contacts with partners in and outside of Africa who are sharing similar objectives.

The *African Development Perspectives Yearbook* is targeted to decision-makers and research personnel in development policy institutions and to experts and staff in project consultancies, media, research and development, donor and aid institutions, and to all others that are interested in Africa's development. It offers comprehensive analyses and information about recent developments with regard to the African continent. Main focus is on development perspectives. Thus, the African Development Perspectives Yearbook is reporting on

- visions and conceptions with regard to long-term development strategies for Africa;
- strategies that emphasise a longer-run planning process that goes beyond conventional structural adjustment policies;
- successful projects and programmes concerning countries, regions, institutions, or specific sectors of African economies, by analysing the conditions of their success;
- resourceful and creative activities of socio-economic interest groups, local development initiatives and NGOs, which could serve as models for other regions;

- innovative strategies for and prospects of regional integration in Africa; and on
- economic, social, and political trends in Africa's sub-regions, nation-states, provinces, towns and local communities.

The *African Development Perspectives Yearbook* takes into account sources and information from all relevant levels of action, planning, discussion, and research, i.e. from international, regional, and national organisations and institutions, committees, working groups, and NGOs, but with particular emphasis given to those ideas and approaches originating from Africa.

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Foreword and Acknowledgements

This Volume 18 of the *African Development Perspectives Yearbook* with the title “*Africa’s Progress in Regional and Global Economic Integration – Towards Transformative Regional Integration*” has again benefited from many contributions, from various inputs and from important institutional support. The great number of contributions to this volume was made possible because of the continuing support from African and international organisations, from numerous research and development institutions, and from many individual experts cooperating continuously with us on Africa. A great number of international and regional organisations, universities and research institutes have supported this project, such as: UNECA (United Nations Economic Commission for Africa) and its Sub-Regional Office in Kigali, Rwanda; the FAO (Food and Agriculture Organization) in Rome, Italy; UNCTAD (United Nations Conference on Trade and Development, especially the Trade and Poverty Branch) in Geneva, Switzerland; the Botswana Institute for Development Policy Analysis (BIDPA), Gaborone, Botswana; the Arab Planning Institute (API) in Kuwait City, Kuwait; the European Centre for Development Policy Management (ECDPM) in Maastricht, the Netherlands; the Department of Economics, University of Khartoum, Sudan; the National and Kapodistrian University of Athens, Athens, Greece; TRALAC, the Trade Law Centre in Stellenbosch, South Africa; the Institute of Statistical, Social and Economic Research (ISSER), University of Ghana, Legon, Accra, Ghana; and many others. All these partners have directly supported the Yearbook project and this volume on “*Africa’s Progress in Regional and Global Economic Integration – Towards Transformative Regional Integration*”, with contributions, expertise and suggestions.

Institutional support is welcomed. Many organisations in Africa, like the African Development Bank (AfDB) Group, the United Nations Economic Commission for Africa (UNECA), the African Union (AU), and the NEPAD (New Partnership for Africa’s Development) Secretariat have contributed with information and encouragement. Also the OECD (Organization for Economic Cooperation and Development) Development Centre and the World Bank (with various offices at headquarters and in Africa) have given advice and information. We, as the Editors of the Yearbook, are always interested in and reliant on their advice and guidance so as to structure the future work on the *African Development Perspectives Yearbook*.

For Volume 18 of the *African Development Perspectives Yearbook* the Editors took up the issue of a much needed more “transformative regional integration” process in Africa as proposed by Patrick N. Osakwe, Head of the

Trade and Poverty Branch of UNCTAD. Based on his key contribution to Unit 1 of this volume we were guided through the whole volume to emphasize this new approach so as to stimulate regional integration in Africa more effectively. In this Volume 18 of the *African Development Perspectives Yearbook* with the title “*Africa’s Progress in Regional and Global Economic Integration – Towards Transformative Regional Integration*” major strategic and policy issues are analysed. The guiding issue is how to make the regional integration process in Africa more transformative in terms of structural change and structural transformation. So far the regional integration process in Africa was based on a conventional (linear) model, starting from preference zones and then moving to free trade areas, customs unions, monetary and economic zones, etc. The disappointing results so far in intra-regional trade, investments, technology diffusion, skilled labour migration, enterprise-to-enterprise cooperation, etc. within and between the regional economic communities (RECs) in Africa request a completely new approach.

In this volume such a new approach is elaborated. Based on Africa’s deep rooted structural problems the key aspect of a transformative regional integration strategy is how to promote structural transformation by adapted strategies and policies in the RECs and then for the whole region. In this context the African regional economic communities (RECs), but also projects like the Tripartite Free Trade Area (TFTA) and the Continental Free Trade Area (CFTA) are evaluated. Basic issues are elaborated in Unit 1.

In Unit 1 the core issues are: first, the concepts of a more “transformative regional integration” process and how to translate these concepts into new development strategies and industrial policies; second, the comparative analysis of regional integration in Africa and in other world regions (ASEAN and MERCOSUR), so as to learn more about the deficiencies in Africa from analysing how regional integration works in other developing regions; and third, the potential of the TFTA and of a CFTA for a more transformative regional integration process in Africa, and what all this means for individual participating countries because of their limited institutional capacities to negotiate.

In Unit 2 special policy issues are discussed. Specific problems of a more transformative regional integration agenda are analysed: first, how to reach a higher degree of food security and a more dynamic development of agriculture and agro-industries through a transformative regional integration process; second, how to speed up industry development, enterprise growth, and the transition to a more competitive environment; and third, how to reach more developmental agreements with extra-regional partners, like the European Union did in the context of the Economic Partnership Agreements (EPAs) in its negotiations with ECOWAS in Western Africa and ECA in Eastern Africa. These three issues are interrelated as a more dynamic intra-

regional and extra-regional integration process requests holistic policy responses.

In Unit 3 the analysis was extended to the role of global value chains for a transformation in the RECs, in specific countries and in sub-regions of these countries. The discussion about global value chains (GVCs) has led to a new development paradigm and it is possible and useful to merge the agendas from the “transformative regional integration paradigm” with the “GVC development paradigm”. Therefore, the state of global value chains (GVCs) in Africa is of particular interest, as basic capabilities and key preconditions matter for their functioning. The potential for economic and social upgrading through GVCs is considered as great, and the transmission channels for this to happen are many, but there are many binding constraints in Africa. Three case studies of global value chains (diamonds in Botswana, shea butter in Ghana, and sesame in Sudan) are analysed and related to their regional and sub-regional impacts. The potential contribution of the GVCs to local and national development and to a more transformative regional integration process is discussed.

Complementary to Volume 18 is Volume 19 with the title “*Africa’s Progress in Regional and Global Economic Integration – Towards New Trade and Investment Policies*”. Two major issues are discussed – first, in Unit 1 the role of “New Trade Policies in Africa for Structural Change” and second, in Unit 2 the role of “New Investment Policies in Africa for Structural Change”. The contribution of these two policy areas for a more transformative regional integration process in Africa is discussed. Various case studies highlight the transition to more dynamic development and regional integration processes. In Volume 19 there is found also a large Book Review and Book Notes section. This Unit 3 presents major new publications, discussion papers and documents related to the issues of the two volumes 18 and 19.

Many institutions contribute with news about countries and regions, information about new research projects, publications about policies and strategies, documents about declarations and agreements, and research papers, also at their early stage. Many regional and international organisations, like the African Development Bank (AfDB), the African Union (AU), the UNECA (United Nations Economic Commission for Africa), the World Bank, UNCTAD (United Nations Conference on Trade and Development), UNDP (United Nations Development Programme), IMF (International Monetary Fund), UNIDO (United Nations Industrial Development Organization), and ILO (International Labour Organization), continue to support our scientific effort by sending us and making available - always timely - new strategy documents and drafts of their researches for our publication and/or for review. Also UNU-WIDER (United Nations University - World Institute for Development Economics Research) as an institution of global importance for

development has continuously supported our work with most recent research papers, publications and information about important scientific events. Furthermore, we would like to thank all these institutions by informing so many others in the development field about our work for Africa when publishing the *African Development Perspectives Yearbook*.

We would also like to express our gratitude to Patrick N. Osakwe, Head of the Trade and Poverty Branch, United Nations Conference on Trade and Development (UNCTAD) and to Isabelle Ramdoo, Deputy Head of the Economic Transformation and Trade Programme at the European Centre for Development Policy Management (ECDPM) in Maastricht. For Unit 1 Patrick N. Osakwe has brought in the important aspect of a more transformative regional integration agenda. Isabelle Ramdoo has contributed a lot to the Unit 2 of this volume. Both have accepted the task of becoming Unit and Volume Editors and were committed in their work. We also have to thank Andrew Mold from UNECA for his continuous encouragement; beside of being an author in several of our volumes he always pushes us to present the new yearbook volumes at the offices of the main African regional organisations in Addis Ababa and Abidjan, and elsewhere in Africa. We plan to do this with this new volume.

Professor Dr. Tobias Knedlik, the Managing Editor of the *African Development Perspectives Yearbook*, and Professor Karl Wohlmuth, the Director of the *Research Group on African Development Perspectives Bremen* and Volume Editor, are also thankful to Professor Dr. Achim Gutowski for his continuous work as the Book Review/Book Notes Editor of the *African Development Perspectives Yearbook*; he is preparing the Unit 3 with Book Reviews and Book Notes for Volume 19.

We have to thank all the contributors and supporters of the *African Development Perspectives Yearbook* for their hard work, their steady encouragement and their continuous assistance. The valuable inputs from leading African research institutions and their experts have contributed over the years to the success of the *African Development Perspectives Yearbook* as an outstanding publication on and for Africa. In 2014 the project celebrated its 25th birthday as the first volume appeared in 1989. The readers of the various Yearbook volumes have contributed with critical comments and encouragement so that over time a valuable network between readers, contributors and editors was created.

Various institutions have made over the years donations and have funded specific allocations to the *African Development Perspectives Yearbook* project, but the support of the University of Bremen, Bremen, Germany is of invaluable importance. The University of Bremen was awarded by the German scientific research community in June 2012 the title “Excellence Univer-

sity”, and the *Research Group on African Development Perspectives Bremen* is very proud about this distinction.

These donations, supports and research grants to the project have helped us to do research on African development issues, to distribute the various volumes of the Yearbook to African partner universities and to major African research institutions, and to invite research scholars from leading African research institutions to work with us in Bremen. Institutions like the Volkswagen Foundation and the Humboldt Foundation have generously financed the stay of senior researchers at IWIM (Institute for World Economics and International Management) in Bremen. Also the African Economic Research Consortium (AERC) is financing research of our staff since years for their contributions to the Yearbook volumes.

Africa Research Workshops are regularly held in Bremen at the University to discuss the draft papers which are intended for publication. These Africa Research Workshops serve as forums for the intensive discussion of the draft papers and related research topics. The Editors also have to thank the many reviewers of draft contributions for their committed work. By this input the *African Development Perspectives Yearbook* has become over the years a fully refereed publication.

Many persons have given support, advice, and encouragement; others have helped with frank and critical assessments. However, the responsibility for the final product remains with the editorial team of the *Research Group on African Development Perspectives Bremen*. While Volume 18 and the companion Volume 19 are released in the years 2015/16 and 2017, the *Research Group on African Development Perspectives* now starts its work on Volume 20 with the title “*Science, Technology and Innovation Policies for Inclusive Growth in Africa*”. The theme is related to important research and cooperation programmes of the *Research Group on African Development Perspectives Bremen* at IWIM (Institute for World Economics and International Management), University of Bremen.

In the name of the Editorial Team:

Professor Dr. Tobias Knedlik, Fulda University of Applied Sciences and IWH Halle, Managing Editor, and Professor Dr. Karl Wohlmuth, Bremen University, Director of the Research Group on African Development Perspectives Bremen at IWIM, Volume Editor

List of Abbreviations and Acronyms

AAACP	All ACP Agricultural Commodities Programme
AAK	Aarhus Karlshamns
ABM	African Business Magazine
ABS	Agricultural Bank of Sudan
ACBF	Africa Capacity Building Foundation
ACBGs	African Central Bank Governors
ACDEP	Association of Church Development Projects
ACDI	Agricultural Cooperative Development International
ACET	African Center for Economic Transformation
ACP	African, Caribbean and Pacific (group of countries)
ACTESA	Alliance for Commodity Trade in Eastern and Southern Africa
ADB	Asian Development Bank
AEC	African Economic Community
AERC	African Economic Research Consortium
AfDB	African Development Bank
AFE	Action for Enterprise
AfT	Aid for Trade
AFTA	ASEAN Free Trade Area
AGOA	Africa Growth and Opportunity Act
AIDA	Accelerated Industrial Development of Africa
AISs	Agricultural Innovation Systems
ALDP	Arable Lands Development Programme
Als	Actor Linkages
AMU	Arab Maghreb Union
AMV	Africa Mining Vision
AO	Aarhus Olie
APCI	African Productive Capacities Initiative
APRM	African Peer Review Mechanism (in NEPAD)
ARAP	Advanced Rain-fed Arable Programme
ARB	Association of Rural Banks
ARP	Agricultural Revival Program
ASBI	American Shea Butter Institute
ASEAN	Association of South East Asian Nations
ATPAF-ESA	Agricultural Trade Policy Advisory Forum for East and Southern Africa
ATPC	Africa Trade Policy Centre (at UNECA)
AU	African Union
AUC	African Union Commission
BAIS	Botswana AIDS Impact Survey

BDC	Botswana Development Corporation Limited
BEDIA	Botswana Export Development and Investment Agency
BIAT	Boosting Intra-African Trade
BIDPA	Botswana Institute for Development Policy Analysis
BIS	Bank for International Settlements
BITC	Botswana Investment Trade Centre
BLNS	Botswana, Lesotho, Namibia, Swaziland
BMC	Botswana Meat Commission
BNPC	Botswana National Productivity Centre
BoB	Bank of Botswana
BOTA	Botswana Training Authority
BP	Bridge Press
BPC	Botswana Power Corporation
BRICS	Brazil-Russia-India-China-South Africa (group of countries)
BTAs	Bilateral Trade Arrangements
BTCL	Botswana Telecommunications Corporation Limited
CAADP	Comprehensive African Agricultural Development Program
CAD	Computer Aided Design
CAGR	Compound Annual Growth Rate
CARICOM	Caribbean Community and Common Market
CBE	Cocoa Butter Equivalent
CBK	Central Bank of Kenya
CBoS	Central Bank of Sudan
CBS	Central Bureau of Statistics
CDEP's	Association of Church Development Projects
CEDA	Citizen Entrepreneurial Development Agency
CEDEAO	Communauté Economique des États de l'Afrique de l'Ouest
CEMAC	Central African Economic and Monetary Community
CEN-SAD	Community of Sahel-Saharan States
CEO	Chief Executive Officer
CEPGL	Economic Community of Great Lakes Countries
CEPII	Recherche Et Expertise Sur L'Economie Mondiale
CEPII	Centre d'Etudes Prospectives et d'Informations Internationales
CEPR	Centre for Economic Policy Research (in London, UK)
CEs	Commodity Exchanges
CET	Common External Tariff
CFTA	Continental Free Trade Area
CFTA	Continental Free Trade Agreement

CGAP	Consultative Group to Assist the Poor
CGD	Commission On Growth And Development
CGGC	Center on Globalization, Governance & Competitiveness, Duke University
CIA	Central Intelligent Agency
CIAs	Common Investment Areas
CIP	Competitive Industrial Performance Index
CM	Common Market
CNC	Computer Numerical Control
CNCM	Computer Numerically Controlled Machines
CO	Competitiveness Observatory
CoEs	Chamber of Exporters
COMESA	Common Market of Eastern and Southern Africa
COMTRADE	United Nation's Commodity Trade Statistics
CRP	Common Revenue Pool
CTG	Capturing The Gains (project)
CTTTFP	Comprehensive Tripartite Trade and Transport Facilitation Programme
CU	Customs Union
DBGSS	De Beers Global Sightholder Sales's
DBR	Deutsche Bank Research
DEA	Department of Energy Affairs
DFID	Department For International Development (UK)
DFID-TERP	DFID-Trade and Enterprise Research Programme
DFQF	Duty Free Quota Free
DG	Directorate General (of EC)
DMC	Debswana Mining Company
DNA	Development Network Africa
DOTS	Direction of International Trade Statistics (of IMF)
DRC	Democratic Republic of Congo
DSM	Dispute Settlement Mechanism
DTC	Diamond Trading Company
DTIS	Diagnostic Trade Integration Study (instrument of WTO)
DTP	Diamond Technology Park
EABL	East African Breweries Limited
EAC	East African Community
EACCU	Eastern African Community Customs Union
EAGC	Eastern Africa Grains Council EU – European Union
EBA	Everything But Arms
EC	European Commission
ECA	Economic Commission for Africa
ECCAS	Economic Community of Central African States

ECDPM	European Centre for Development Policy Management (in Maastricht)
ECIPE	European Centre for International Political Economy
ECLAC	Economic Commission for the Latin America and the Caribbean
ECOWAS	Economic Community of West African States
EDD	Economic Diversification Drive
EDF	European Development Fund
EDI	Export Diversification Index
EDPRS	Economic Development and Poverty Reduction Strategy (of Rwanda)
EFTA	European Free Trade Area
EIB	European Investment Bank
EIU	Economist Intelligence Unit (in London, UK)
EJN	Economic Justice Network
EMFTA	Euro-Mediterranean Free Trade Area
EPA	Economic Partnership Agreement (with the EU)
EPRC	Economic Policy Research Centre (at Makerere Business School)
ERI	Economic Research Institute, at Neuchatel University
ERSD	Economic Research and Statistics Division (of WTO)
ESA	Eastern and Southern African (EPA group)
ETGMA	Ethiopian Textile and Garment Manufacturers Association
ETSG	European Trade Study Group
EU	European Union
FAO	Food and Agricultural Organization (of the United Nations)
FAOSTAT	FAO Statistics database
FAP	Financial Assistance Policy
FDI	Foreign Direct Investment
FE	Fixed effects (models)
fed	Feddan
FEM	Fixed Effects Model
FES	Friedrich Ebert Stiftung
FFA	Free Fatty Acid
FLO	Fairtrade Labelling Organisation
FNGOs	Financial Non-Governmental Organisations
FOB	Free on Board
FRA	Food Reserve Agency
FTA	Free Trade Area (Arrangement)
GAP	Good Agricultural Practices
GATS	General Agreement on Trade in Services

GATT	General Agreement on Tariff and Trade
GCB	Ghana Cocoa Board
GCC	Global Commodity Chain
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
GEPC	Ghana Export Promotion Council
GFCF	Gross Fixed Capital Formation
GHC	Ghana Cedi (currency of Ghana)
GIZ	German International Cooperation Corporation
GLSS	Ghana Living Standard Survey
GMS	Greater Mekong Sub-Region (Economic Cooperation Program)
GoB	Government of Botswana
GOG	Government Of Ghana
GSA	Ghana Standards Authority
GSDG	Sudanese Pound (Guinea)
GSP	Generalized System of Preferences
GSS	Ghana Statistical Service
GTA	Grain Traders Association
GTAP	Global Trade Analysis Project
GVC	Global Value Chain
H&M	Hennes & Mauritz Swedish textile trade company
HDI	Human Development Index
HS	Harmonized System (tariff code nomenclature)
IAPRI	Indaba Agricultural Policy Research Institute (in Lusaka, Zambia)
ICA	Infrastructure Consortium for Africa
ICEG	International Center for Economic Growth
ICRISAT	International Crops Research Institute for the Semi-Arid Tropics (Nairobi, Kenya)
ICT	Information and Communication Technology
ICTSD	International Center for Trade and Sustainable Development (in Geneva, Switzerland)
IDDA	Industrial Development Decade for Africa
IDP	Industrial Development Policy
IDRC	International Development Research Center
IDS	Institute for Development Studies (in Sussex, UK)
IF	Integrated Framework (for Trade-Related Technical Assistance to Least Developed Countries)
IF&ATPC	International Food and Agricultural Trade Policy Council
IFAD	International Fund for Agricultural Development

IFC	International Financial Companies
IFIs	International Financial Institutions
IFPRI	International Food Policy Research Institute (in Washington D.C., USA)
IFSC	International Financial Services Centre
IGAD	Inter-Governmental Authority on Development
IJMVSC	International Journal of Managing Value and Supply Chains
IJTLID	International Journal Technological Learning Innovation and Development
ILRI	International Livestock Research Institute
IMF	International Monetary Fund
IOC	Indian Ocean Commission
IOI	Industrial Oxygen Incorporated
IOSA	International Air Transport Association (IATA) Operational Safety Audit
IPR	Intellectual Property Rights
IPRSP	Interim Poverty Reduction Strategy Paper
ISBPT	Improved Shea Butter Processing Technology
ISPAAD	Integrated Support for Arable Agricultural Development
ISSER	Institute of Statistical Social and Economic Research, University of Ghana, Legon
IT	Information Technology
ITC	Information Technology and Communication
IWIM	Institute for World Economics and International Management, Bremen University, Bremen, Germany
IWVWW	Internationale Wissenschaftliche Vereinigung für Weltwirtschaft und Weltpolitik (in Berlin)
JICA	Japan International Cooperation Agency
JPRI	Japan Policy Research Institute
KFC	Kenyan Flower Council
KNBS	Kenya National Bureau of Statistics
KPC	Kimberley Process Certification
KPCS	Kimberley Process Certification Scheme
KPMG	Klynveld, Peat, Marwick und Goerdeler (group of companies)
KWh	kilowatt hour
LDC	Least Developed Country
LEA	Local Enterprise Authority
LEI	Landbouw-Economisch Institut (in Wageningen)
LLDCs	Least Developed Countries
LMIC	Lower-middle income countries

LPP	Local Procurement Programme
LPS	Local Preference Scheme
LWOs	Local Women Organisations
MAR	Market Access Regulation
MCM	Morupule Coal Mine
MDG	Millennium Development Goal
MED	Mediterranean
MENA	Middle East and North Africa
MERC	MERCOSUR
MERCOSUR	Mercado Común del Sur or Southern Common Market
MFI	Micro Finance Institutions
MFN	Most Favoured Nation (clause of GATT/WTO))
MINECOFIN	Ministry of Finance and Economic Planning (of Rwanda)
MISs	Market Information Systems
ml	million
MLGRD	Ministry of Local Government & Rural Development (Ghana)
MMTZ	Group of Countries (Malawi, Mozambique, Tanzania and Zambia)
MNCs	Multi-national Companies
MoAaI	Ministry of Agriculture and Irrigation
MoAWF	Ministry of Agriculture, Water and Forestry of the Republic of Namibia
MoF	Ministry of Finance
MoFT	Ministry of Foreign Trade (Sudan)
MoT	Ministry of Trade
MoU	Memorandum of Understanding
M-PESA	M is for mobile, pesa is in Swahili for money
MRU	Mano River Union
Mt	Metric ton
MTI	Ministry of Trade and Industry of the Republic of Namibia
MTM Kenya	general merchandize supplies company in Kenya
MU	Monetary Union
MWSS	Ministry of Welfare and Social Security (Sudan)
MYS	Ministry of Youth and Sports (Ghana)
NACC	Namibia Competition Commission
NAFTA	North American Free Trade Area
NBER	National Bureau of Economic Research (Boston, Mass., USA)
NBoT	Namibia Board of Trade
NCP	National Competition Policy
NDB	National Development Bank

NDP	National Development Plan
NEPAD	New Partnership for Africa's Development
NFIDC	Net Food Importing Developing Countries
NGO	Non-governmental Organisation
NIE	New Institutional Economics
NIS	national innovation system
NOGCAF	Northern Ghana Community Action Fund
NPC	Nominal Protection Coefficient
NPLs	Non-performing Loans
NPR	Nominal Protection Rate
NRGP	Northern Rural Growth Programme
NSC	North-South Corridor
NSI	Namibia Standards Institution
NT	network theory
NTB	Non-Tariff Barrier
NTF	Namibia Trade Forum
ODI	Overseas Development Institute (London, UK)
OE	Organic and Ecocert (certification body)
OECD	Organization for Economic Cooperation and Development
OER	Official Exchange Rate
OI	Olam International
P	stands for pooled models
P	Pula (Currency Unit of Botswana)
PAPED	Programme de l'APE pour le developpement (West African EPA Development Programme)
PCB	Productive Capacity Building
PEEPA	Public Enterprise Evaluation and Privatisation Authority
PER	Parallel Exchange Rate
PF	Political Federation
PIDA	Programme for Infrastructure Development in Africa
PNDC	Provisional National Defence Council
PPP	Public Private Partnership
PREM	Poverty Reduction And Economic Management Network (at World Bank)
PSD	Private Sector Development
PTA	Preferential Trade Agreement
qnt	quintal
R&D	Research and Development
RATIN	Regional Agricultural Trade Information Network
RCA	Revealed Comparative Advantage
RCEP	Regional Comprehensive Economic Partnership
RE	Random effects (models)

REC	Regional Economic Community
REM	Random Effects Model
ReSAKSS	Regional Strategic Analysis and Knowledge Support System (by IFPRI and CAADP/NEPAD)
RIAs	Regional Investment Agreements
RIDE	Rural Intervention for Development and Employment
RISDP	Regional Indicative Strategic Development Plan
RoA	Return on Assets
RoO	Rules of Origin
RoW	Rest of the World
RSP	Reserved Sectors Policy
RTA	Regional Trade Agreement
RTFP	Regional Trade Facilitation Programme
RVC	Regional Value Chain
SACU	Southern African Customs Union
SADC	Southern African Development Community
SADCAS	SADC Accreditation Service
SADCC	Southern African Development Coordination Conference
SAFEX	South Africa Futures Exchange
SAIIA	South African Institute of International Affairs
SANE	(South Africa, Algeria, Nigeria, Egypt) group of countries
SAP SE	Systems, Applications & Products in Data Processing (German multinational software company)
SARI	Savannah Agriculture Research Institute
SCF	Standard Conversion Factor
SCM	Supply Chain Management
SDT	Special and differential treatment (clause of WTO)
SeKaf	Senyo and Kafui Company Ltd
SISs	Sector-specific Innovation Systems
SMCA	Standardisation, Metrology Conformity Assessment and Accreditation
SMEs	Small and Medium Enterprises
SMMEs	Small, Medium and Micro Enterprises
SNV	Netherlands Development Organisation/ Foundation of Netherlands Volunteers
SPS	Sanitary and Phytosanitary Standards
SQAM	Standardization, Quality Assurance, Accreditation, and Metrology
SQMT	Standards, Quality, Metrology, Testing
SSA	Sub-Saharan Africa
SSC	South-South Cooperation
SSN	Star Shea Network

STI	Science, Technology and Innovation
STP	Sudan Trade Point
SWOT	Strength/Weakness/Opportunity/Threat (analysis)
TBT	Technical Barriers to Trade
TCC	Trans-Capriivi Corridor
TCIs	Trade Complementarity Indices
TCuC	Trans-Cunene Corridor
TDCA	Trade and Development Cooperation Agreement
TFA	Trade Facilitation Agreement (of the WTO)
TFTA	Tripartite Free Trade Agreement
TFTA	Tripartite Free Trade Area
TGLP	Tribal Grazing Lands Programme
TKC	Trans-Kalahari Corridor
TMEA	TradeMark East Africa/Trade and Markets East Africa
TMSA	TradeMark Southern Africa
TNC	Transnational Corporations
TP (SADC)	Trade Protocol
TPP	Trans-Pacific Partnership
TPR	Trade Policy Review (of the WTO)
TRALAC	Trade Law Centre (in Stellenbosch, South Africa)
TRI	Transformative Regional Integration
TRQ	Tariff Rate Quotas
TS	Tariff Schedule
TSC	Transitional Safeguard Clause
TTF	Tripartite Task Force
TTIP	Transatlantic Trade and Investment Partnership
TTNF	Tripartite Trade Negotiation Forum
UAE	United Arab Emirates
UEMOA	Union Economique et Monétaire Ouest Africaine
UG	University of Ghana
UK	United Kingdom
UMIC	Upper-middle income countries
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNCTAD	United Nations Conference on Trade And Development
UNDESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNECA	UN Economic Commission for Africa
UNIDO	United Nations Industrial Development Organization

UNU-	United Nations University-World Institute for
WIDER	Development Economics Research
UoCoC	Union of Chambers of Commerce (in Sudan)
UoG	University of Gezira
US\$	United States Dollar
USA	United States of America
USAID	United States Agency for International Development
USD	United States Dollar
USDA	United States Department of Agriculture
VAT	Value Added Tax
VC	Value Chain
VOCA	Volunteers in Overseas Cooperative Assistance
VSLA	Village Savings and Loans Association
WAEMU	West African Economic and Monetary Union
WATH	West African Trade Hub
WB	World Bank
WBC	Walvis Bay Corridor
WBES	World Bank Enterprise Surveys
WCO	World Customs Organization
WDI	World Development Indicators
WEF	World Economic Forum
WID	Women in Development
WII	Weather Index Insurance
WITS	World Integrated Trade Solution
WP	Working Paper
WRCs	Warehouse Receipt Certificates
WRS	Warehouse Receipt Systems
WSVC	white sesame value chain
WTO	World Trade Organization
ZAR	South African Rand
ZEF	Zentrum für Entwicklungsforschung, Department Political and Cultural Change

Unit 1: Towards Transformative Regional Integration in Africa

Towards Transformative Regional Integration in Africa - An Introduction

Patrick N. Osakwe¹ and Karl Wohlmuth²

1 The Issues

Drastic Changes are needed in Africa's regional integration agenda

Africa's economic development prospects are undoubtedly bright. The middle class is growing and its purchasing power is also rising. The continent has posted relatively very strong economic growth performance in recent years with an average growth rate of about 5 percent over the past decade. There is also heightened interest by the international community in African development issues and African leaders are increasingly speaking with one voice and are more assertive in discussions on global issues, which have enhanced their ability to protect their national and regional interests in the world economy. These developments have led some analysts to argue that Africa could be the emerging-market story of the next decade. Nevertheless, it should be noted that the prevailing view represents a marked departure from the situation in the 1980s and the 1990s when most analysts described the prospects for the continent as dim and gloom. Despite the current optimistic prognosis of Africa's development prospects, there is an understanding that the continent is yet to realize its full development potential and that fulfilling African leaders' promise of a better life for their people, as enshrined in the New Partnership for Africa's Development (NEPAD), will require a strategic vision coupled with the political will to design and implement policies to unlock the continent's untapped development potential.

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Although Africa accounted for 15 percent of global population over the period 2009-2013, its share of global output was only 2.5 percent. It also accounted for only 3.3 percent of global exports and 3.7 percent of global inward foreign direct investment flows. The continent has vast endowments of natural resources, which could provide the basis for fostering growth and engendering development. For example, Algeria, Angola, Libya and Nigeria have large oil reserves, the Democratic Republic of Congo has significant reserves of cobalt, South Africa, Ghana and Mali are known for their gold reserves, and Zambia is known for its copper reserves (UNCTAD 2012). Notwithstanding these vast natural resources and the recent improvements in growth performance, Africa remains the continent with the highest number of poor people. It is also the continent that has not achieved any of the Millennium Development Goals (MDGs). In this context, one of the key development challenges facing African leaders is how to achieve sustained poverty reduction on the continent. In the medium to long term, this would require transforming the production and export structures of African economies to create decent employment, reduce vulnerability to external shocks, and make growth more inclusive.

Regional integration can foster structural transformation in Africa

Transforming the structure of African economies will necessitate shifting factors of production and other resources from low to high productivity activities across the agriculture, industry and service sectors of an economy. Regional integration can contribute to this transformation agenda in several ways. Given the small and fragmented size of African economies, the domestic manufacturing enterprises cannot exploit the advantages of scale and this has a negative impact on their ability to compete in global markets. Through facilitating the reduction of intra-African trade barriers, regional integration can increase market size and allow domestic manufacturing entrepreneurs to benefit from scale economies, thereby enhancing their competitiveness and survival rates. In addition, regional integration is critical to developing cross-border infrastructure which will reduce trade costs and make export activities more competitive. Another channel through which regional integration can contribute to structural transformation is fostering peace and security, which is a necessary condition for enterprises to flourish. Recent research also suggests that the composition of intra-African trade is skewed towards manufacturing (UNCTAD 2013), indicating that strengthening regional integration is likely to have a positive impact on manufacturing development in the continent.

Regional integration is of strategic importance for Africa. But it also presents challenges for African governments. In particular, although African

leaders are interested in strengthening regional integration, they are also mindful of the need for the continent to better integrate into the global economy. In this context, it is important that African governments see regional integration as a stepping-stone towards integration into the global economy and not as a substitute. Another challenge that regional integration presents for African governments is that while policies are designed and agreed to at the regional and continental levels, implementation is generally at the national level and often there is lack of effective coordination and exchange of information between regional institutions and relevant ministries at the national level. Also, competition among countries for external development finance often leads to a race-to-the-bottom, thereby jeopardising the achievement of regional goals. These facts underscore the importance of a continent-wide African integration strategy to ensure that national policies are consistent with regional goals and also to reduce competition among African countries, particularly for aid and foreign direct investment.

A change is needed from conventional to transformative regionalism

Regional integration is not a new phenomenon in Africa. Since independence in the 1960s African leaders have made political commitments to strengthen regional integration and have also embarked on various initiatives and projects to promote it. The setting up of the Regional Economic Communities (RECs), the adoption of the Lagos Plan of Action, the Abuja Treaty, the Constitutive Act of the African Union, and the Tripartite Free Trade Area are some of the initiatives that African leaders have established to foster regional integration. Some progress has been made as a result of these efforts. For example, the Economic Community of West African States (ECOWAS) and the East African Community (EAC) are adopting common passports which will facilitate the free movement of people across borders. In 2012, African Heads of State and Government adopted the Programme for Infrastructure Development in Africa as the continental framework for addressing the infrastructure challenge on the continent. Regional institutions are also increasingly playing a crucial role in conflict prevention, management and resolution. Furthermore, several RECs are in the process of establishing monetary unions to facilitate regional trade and some (for example the Common Market for Eastern and Southern Africa (COMESA)) have also established regional payments systems. Despite these positive developments, it is clear that Africa's overall performance in terms of promoting regional integration has been modest at best. For instance, the continent has not made much progress in boosting intra-Africa trade, which over the past decade accounted for only 12 percent of Africa's total trade.

Several explanations have been provided for Africa's weak performance on regional integration, ranging from lack of structural transformation and poor infrastructure to low stakeholder involvement, overlapping memberships of regional organisations, and over-concentration on the processes and institutions of integration. What is clear however is that the current (or conventional) approach to regional integration in Africa has not delivered the outcomes expected by African leaders and has to be changed. The conventional integration approach focuses so much on the text-book model of integration which involves establishing a free trade area, a customs union, a common market and eventually a monetary and economic union. While this approach may have worked for some continental groups in the past, it is not the appropriate approach to integration for countries in Africa with very poor infrastructure, similar export structures and low productive capacities. In addition, the global environment within which regional policies will be implemented has changed since the 1960s. There is now increasing emphasis on the impact of trade and investment on climate change and these developments have to be taken into account in the integration process. There have also been significant changes in production processes, with increasing fragmentation of production and emphasis on trade in tasks. Furthermore, new multilateral trade rules limit the policy instruments available to governments for promoting regional integration and development. These developments underscore the need for a new approach to regional integration that is appropriate for the 21st century in the sense that it permits countries to respond to current challenges facing the continent. It is well-known that one of the key development challenges facing Africa is how to reduce the poverty rate as well as the absolute number of poor people on the continent on a sustained basis. Recent research suggests that structural transformation is necessary to achieve this objective and so there is the need for regional integration to be geared more towards inducing structural transformation for better development outcomes in Africa. Against this backdrop, making regional integration work for Africa would require a shift in emphasis from the current approach to integration—which focuses on processes and institutions of integration—to an approach based on transformative regionalism, in which regional integration promotes and ensures progress in achieving structural transformation and building productive capacities.

Africa can learn from experiences of other developing regions

Regional integration groups, such as the Association of South East Asian Nations (ASEAN) and the Greater Mekong Sub-Region (GMS) Economic Cooperation Program, have been effective in using regional integration to promote and support economic development. For example, since the

establishment of the GMS in 1992, there has been a significant reduction in poverty rates in the six countries involved, namely: Cambodia, the People's Republic of China, the Laos People's Democratic Republic, Myanmar, Thailand and Vietnam. The GMS program has also contributed to infrastructure development in the sub-region, thereby enhancing the prospects for regional trade (ADB 2011). As African countries grapple with the challenge of integrating their economies, there are useful lessons they can learn from the experiences of regional integration groups in other developing regions, which will enhance the effectiveness of regional integration in Africa. First, regional integration must be seen as a process or instrument to promote development rather than as an end in and of itself. It is only useful to the extent that it enables countries and regions to address their development challenges. Second, regional integration is likely to be effective in promoting development when members set realistic goals and targets and also have a flexible approach to integration. Third, there is the need to establish a rules-based mechanism in the process of integration to enhance implementation of regional agreements. African countries are well-known for signing and not implementing regional agreements. Admittedly, in recent years, some efforts have been made to address this issue. For example, in 2014 the EAC adopted a scorecard to track member states' compliance with protocols on the movement of capital, services and goods. Other RECs are also strengthening efforts to enhance monitoring of regional agreements. Fourth, a fair distribution of the gains of integration is crucial for the stability, longevity and sustainability of regional integration groups. Integration tends to have an asymmetric impact on members due to differences in country size, endowments and productive capacity. It is therefore necessary to put in place a mechanism to ensure that the benefits of integration are fairly distributed across members. Finally, there is the need for a credible domestic financing mechanism to effectively support implementation of regional agreements. Overdependence on external support for financing of integration programmes, as has been the case in Africa, reduces domestic ownership of the integration process and also affects the ability of countries to effectively implement regional programmes. In this context, strengthening domestic resource mobilization is important for fostering regional integration in Africa.

2 The Contributions

In the chapter “*Transformative Regionalism, Trade and the Challenge of Poverty Reduction in Africa*” the author *Patrick N. Osakwe* lays the foundation for a new direction of Africa's regional integration agenda. Providing a new direction to Africa's regional integration agenda is overdue

as all the performance indicators show how weak the regional economic communities (RECs) are in terms of intra-regional trade, intra-regional investment, common competition policies, intra-regional migration, technological cooperation and skills development, infrastructure development, policy coordination, and long-term oriented development cooperation. It is not the purpose of the chapter to lament on all these failures, but to present a constructive response to these unfavourable trends and to show how a new integration mechanism based on a new agenda may work towards a more transformative regionalism.

Regional integration has played a vital role in fostering peace and security in Africa over the past few decades. At least in some regional economic communities (like ECOWAS, EAC, and SADC) regional integration has played a role in preventing conflicts and in managing conflicts between and within countries. This is not a small achievement in the African context as political stability is of fundamental importance for economic cooperation. However, the task of fully exploiting the regional economic communities' potential for economic development remains a challenge. All this is evidenced, for example, by the prevalence of weak production and export structures in African countries, the increase in the number of poor people on the continent, and the low shares of regional trade in Africa's total trade. Weak production and export structures indicate that structural transformation is not progressing fast enough, that driving forces of structural change are not strong enough, and that African RECs on the whole compare unfavourably with Asian and also with Latin American integration schemes. The increase in the number of poor people in Africa has also to do with the weak performances of regional integration schemes. More intra-regional exchange of goods and services definitely can contribute to poverty reduction and to economic growth with positive effects on employment growth and improvements of living standards. The low exchange of goods and services within the RECs is also a sign of so many unsolved "behind the border" issues. Regional integration agreements are not in conformity with national policies "behind the border" of the member countries. Regional integration agreements are not really enforced by the policy-makers because of conflicting policy objectives. There are so many examples for such conflicts. National food security policies and regional trade policies may conflict, especially in times of sharp global price increases, but also national industrial policies and regional trade policies may reveal conflicting issues as specialization decisions are often not credible. Also national infrastructure development plans may be in conflict with regional integration agreements, as re-election interests of the policy-makers may lead to quite different expenditure decisions than anticipated.

This chapter argues that regional integration can be made to work in Africa, but only if there is a shift in emphasis from the current trade reform-centred integration approach to an approach based on “Transformative Regionalism”. The paper provides a framework for “Transformative Regionalism”, and it is shown that this concept differs fundamentally from the current integration frameworks and the so far practised strategies of African regional economic communities. It is discussed how to foster it in Africa, and what the objectives and instruments are. The concept of “Transformative Regionalism” starts with designs of an industrial policy to impact on the speed of structural transformation. Appropriate trade and integration reforms are then derived from the new industrial and integration policies as well as policies impacting more directly on growth, poverty and inequality in Africa. Pragmatic (non-ideological) policies are key ingredients of new industrial and trade policies as too often dichotomies play a role in African countries’ policy choices, like state versus market, export-oriented versus import substituting industrialization, resource-based versus technology-based industrial development, etc.

Industrial policy is understood in a new form being near to the market and to the private sector, and it is the key for reaching a “transformative regionalism”. By such a bottom-up and top-down balanced type of industrial policy lasting effects can be generated; private sector development (PSD) can be better directed towards structural transformation. Obviously consumers also have to play a role in “transformative regionalism” so as to overcome the deindustrialization trend in Africa, as partly caused by the preference for imported goods (and global brands) rather than for local consumer goods (and local brands). Local beer and some local food industries are examples that local products (and local brands) are accepted by local consumers under specific conditions. However, too many other local industry products are not accepted by the consumers from the African middle and upper classes. In times of anticipated large increases of consumption spending all over Africa, the importance of local brands and of making them to become regional brands is increasing and this will help in the reindustrialization drive (Wohlmuth 2014). Also the large African economies, such as South Africa and Nigeria, have an important role in a “Transformative Regionalism”. Reforms in these countries can have a strong leverage effect and can bring forward structural transformation in RECs like SACU, SADC and ECOWAS. But also in North Africa, countries like Egypt and Algeria could start with undertaking first steps towards a “Transformative Regionalism”.

In the second contribution to this Unit 1 with the title “*Assessing the Success of SADC Regional Trade Integration: a Comparative Analysis with ASEAN and MERCOSUR Trade Blocs*” the authors *Ebaidalla Mahjoub Ebaidalla* and *Abdelrahim Ahmed Yahia* give an account of the major

differences between African RECs and RECs in Asia and in Latin America in terms of intra-regional trade performance. Although confined to trade integration performance analysis, the study gives hints for understanding the state of affairs in Africa's RECs and on how to overcome the unfavourable situation with regard to the expansion of intra-regional trade. The African RECs are contrasted with somewhat better performing RECs of developing countries, although also in Asia and in Latin America the RECs face huge implementation problems (and beside also various conceptual problems). The authors first give an overview of regional integration in SADC, ASEAN and MERCOSUR. The case of the Southern African Development Community (SADC) reveals not only huge discrepancies in per capita income of the member countries but also quite different shares of intra-SADC trade. South Africa with a high intra-trade share has a particular role in SADC stemming from its ability to supply high value added goods on the basis of a rather good cross-border and behind the border transport and trade logistics system. Angola's share in intra-trade is relatively, high obviously because of oil supplies and an increasing demand for consumer goods. The Association of Southeast Asian Nations (ASEAN) similarly also reveals quite different per capita incomes and shares of intra-regional trade among its members, but the overall intra-trade performance is much higher than in SADC. For MERCOSUR (Mercado Común del Sur) also large differences in per capita incomes and in intra-regional trade shares are ascertained, but again the overall intra-trade performance is much higher than in SADC. Somewhat similar to the role of South Africa for SADC is the role of Brazil and Argentina for MERCOSUR in terms of a relatively high share of intra-trade. These three countries have a broad basket of goods to offer, and the large markets and the high population numbers outweigh factors such as language differences (as between Argentina and Brazil).

In a literature review the authors present various case studies and methodologies to analyse trade flows of regional trade agreements. It is interesting to see how actual trade is related to potential trade when applying gravity models to regional trade agreements. These models predict bilateral trade flows on the basis of variables like the economic size of trade partners (measured by GDP and population) and the distance between the two trade partners (measured by geographical, language and cultural distance factors). The effectiveness of trade agreements can be measured by using such models, and so various factors impeding the integration performance can be identified. Good news for Africa is the fact that some of these gravity models for African regional trade agreements reveal a declining gap between potential and actual trade, such as seen in the studies for COMESA. The methodology used in such models and also used by the authors of this chapter is rather simple: in a first step the coefficients of the gravity model for intra-

ASEAN and intra-MERCOSUR trade are identified, and in a second step these coefficients are applied to the intra-SADC trade. Trade between two countries in the model is related to GDP, population, and to various variables of distance. The results for SADC show that the gap between actual and potential trade is huge, except for South Africa. For some country pairs such as DR of Congo-Madagascar, DR of Congo-Mauritius, Malawi-Madagascar and Zambia-Madagascar the huge differences between potential and actual trade have obviously to do with (geographical) distance. Important is the result that countries of SADC with common border, language and ex-colony links have more successful intra-trade links like Zambia and Zimbabwe. Distance and cultural as well as historical links are important. For South Africa, the results reveal that actual trade is higher than potential trade, meaning that South Africa is overexploiting its opportunities in SADC, while the many other countries in SADC are rather underexploiting their potential. Obviously, also a result of the investigation, intra-trade in SADC is more close to intra-trade in ASEAN than to intra-trade of MERCOSUR.

This paper - by the two Sudanese authors - assesses the performance of intra-SADC trade integration in comparison to the success of two non-African trade blocs, namely ASEAN and MERCOSUR. The analysis has employed a gravity approach to estimate the coefficients of ASEAN and MERCOSUR trade models, and the coefficients were used as a benchmark to project the potential trade for SADC members. The results reveal that the actual intra-trade of all selected SADC members, except South Africa, is quite far from its potential trade level. This implies an unfavourable performance of SADC relative to ASEAN and MERCOSUR. The results also indicate that South Africa is the most successful member in SADC integration, playing a role as an engine of trade. The paper ends with important policy recommendations regarding promoting regional cooperation in SADC integration. The study reveals that all actions to promote export diversification, foreign investment, and private investment will support and enhance intra-regional trade. This has implications for all policy areas, not only for macroeconomic policies but also for competition policies and policies related to doing business. Regrettably, these are the policy areas which show weaknesses in most of the SADC countries up to now, and also in the SADC integration agenda. There may also be room for improving transport infrastructure and trade logistics, but also important are the many hidden barriers to trade in SADC (“behind the border” barriers). All these are issues of a “transformative regional integration” agenda, and not issues of a simple “liberalization regional integration” agenda. But also a more realistic and pragmatic integration approach may be helpful (as the SADC integration agenda was over-ambitious and under-performing for decades). Obviously

the ASEAN and MERCOSUR integration agendas are more realistic and pragmatic (despite of many weaknesses left).

In two further papers the issues of a Tripartite Free Trade Area (TFTA) and of a Continental Free Trade Area (CFTA) are analyzed. The chapter with the title “*Patterns of African Regional Integration: The Tripartite and Continental Free Trade Areas*” was written by *Gerhard Erasmus, Trudi Hartzenberg and Paul Kalenga* and discusses the rationale of such an approach based on the obvious handicaps of the existing regional trade agreements in Africa which are based on vague definitions and concepts in treaties and which are overlapping in their membership. The other chapter “*Namibia and the Tripartite Free Trade Agreement*” by *Mareike Meyn* is presenting a case study to show what such an ambitious regional integration programme may bring for a particular country when participating in such a new and enlarged trade agreement. Both papers are complementary as the first paper is discussing the logic behind the new move, while the second paper looks from the perspective of a single country on the move to such a new and ambitious trade agreement.

The chapter with the title “*Patterns of African Regional Integration: The Tripartite and Continental Free Trade Areas*” by *Gerhard Erasmus, Trudi Hartzenberg and Paul Kalenga* is on the perspective roles of the Tripartite and the Continental Free Trade Areas. It starts from acknowledging the known facts that regional integration makes a lot of sense for Africa as the continent is characterised by small markets, small economies, and small countries, and because Africa has a large number of countries which are landlocked and need access to harbours for export and import. There has been over time a proliferation of regional integration arrangements over Africa, with multiple memberships being a key feature of the African integration landscape (as not less than 14 regional integration agreements are recorded by *Osakwe* in his contribution for this Unit 1, Table 6). The issue of multiple memberships is crucial as it signals that the key provisions of the regional trade treaties are not really considered as important in its legal and economic sense (they are simply not taken serious enough). All these regional integration agreements have their own agenda for trade, industry and development, and to a considerable extent these agendas are contradictory among each other. Belonging to various regional trade agreements means that the regional identity is not taken as a yardstick for action in this particular country. All these schemes suffer from obstacles related to the definition, use and application of rules of origin, non-tariff-barriers, customs administration and border control procedures, regulation of minimum quality and technical standards, and high transportation costs and “behind the border” barriers. Although the regional integration schemes were not successful in removing these obstacles internally, the idea was that the larger project of a Tripartite

Free Trade Area (TFTA) or even of a Continental Free Trade Area (CFTA) can help in moving towards a more harmonized system showing less differences in this regard. All this may be a great illusion, as recent developments in these regions show. The other possibility would have been to improve the functioning of the existing RECs first and then to move in a second step towards a harmonization.

The authors criticise this approach of harmonizing RECs on the basis of their actual weaknesses in functioning, and it is no surprise that the reality of the current TFTA/CFTA negotiations shows that the original plan was overoptimistic. The TFTA project – according to its original plan - should enable the existing and the new regional integration agreements in Africa to support the competitiveness of the national economies and of the regional enterprises so as to become ready for capitalising on the benefits of the regional and global value chains. This could only be achieved if the obstacles to intra-regional trade - as mentioned above – are removed³. The chapter convincingly shows that the TFTA negotiations have lost this perspective; the major tasks ahead – global integration and creating competitive advantages - are not anymore seen. Also, the agenda of the current TFTA negotiations is still on goods, not on services, intellectual property, trade facilitation, and other issues being of relevance for integrating Africa into global and regional value chains.

Many examples show that even in the limited field of the goods trade agenda the African REC agreements are still loose, so that the TFTA negotiations have to look at these issues first. It may be difficult to go ahead in negotiations between SADC, COMESA and EAC countries if not these basic issues are solved (rules of origin, non-tariff barriers, health and safety standards and technical regulations, transaction and transit costs, etc.). Implementation of provisions is another major issue, for the transactions in the individual REC and also for the transactions between the RECs, in order to make a TFTA a useful tool for development and growth. Transport is an important issue as too often only physical (hard) infrastructure deficits are considered, but not the many other (soft) infrastructure issues in terms of policies and regulations.

TFTA negotiations – as it looks now- will not create a unified FTA with unified rules and commitments, but may even lead to more FTAs because the established ones will stay in place (according to the *acquis* principle), and

³ This huge task was recently brought out in a new simulation study (by Jensen/Sandrey 2015, p. 94), showing how important such a move would be. A modest 20% reduction in the costs associated with transit time delays at customs, terminals and internal land transportation would be more relevant in terms of gains than removing all intra-African tariffs and the more traditional non-tariff barriers.

tariff concessions will only be exchanged between those members which are not yet part of an established FTA. If the internal problems of the FTAs prevail, then the TFTA cannot bring much relief (in terms of welfare benefits from a real opening of markets). The coexistence of TFTA and of the three RECs (COMESA, SADC and EAC) means also that the original plan of a single TFTA was too early abandoned. The negotiations are also still stuck in Phase I (mainly goods). Phase II of the negotiations will cover trade in services, intellectual property rights, competition policy and customer protection, and cross-border investment. Even Phase I negotiations are not yet ready (in terms of rules of origin and many other trade-related issues), and so the Phase II negotiations will have no real perspective (although a start of the negotiations is already envisaged).

On the basis of the TFTA model the CFTA model is discussed and negotiations are scheduled to begin in 2015. The authors of this chapter are sceptical on the grounds that the basic issues of the TFTA are not yet solved. A new plan will be launched, but this plan follows the same liberalization logic as in the past, but is not facilitating trade between member states on the basis of a “transformative regionalism” concept. More than this, it will on such a basis not support structural transformation in Africa. Related to the demands by *Osakwe* for a more Transformative Regional Integration (TRI) in Africa the TFTA approach was inappropriate from the outset, and the CFTA project shares the same characteristics. The TFTA model is based on a narrow liberalization agenda, and the same is projected for the CFTA model. The negotiations narrowed down the frame to a tariff liberalization agenda, and all attempts were downplayed to bring in an agenda to support policy coordination for structural transformation in the three RECs and all over the continent when discussing now the CFTA.

The Tripartite Free Trade Area (TFTA) aims to integrate the economies of 26 member states in Eastern and Southern Africa, but according to the authors design problems and deviations from the original plan have led to a deadlock of the negotiations (with agreements on the principles, but not on important details). More serious is however the lack of a “transformative regional integration” agenda. The predominant focus is still on a trade in goods agenda, but there is only muted enthusiasm for an effective liberalisation in terms of tariff reductions and less restrictive rules of origin and other trade impediments. This chapter considers not only the TFTA but also the prospects for Africa’s most ambitious integration project, the Continental Free Trade Area (CFTA) as a project of the African Economic Community (AEC) plan. While negotiations to conclude a continent-wide free trade area are to be launched in June 2015, the chapter argues that a new approach to these negotiations is needed, focusing on a practical, realistic and transformative integration agenda. It may offer better prospects than the

traditional approach that was adopted for the Tripartite Free Trade Area (TFTA) negotiations.

The other chapter on the TFTA is arguing directly on these lines, but is looking from the situation of a particular country about the potential achievements and benefits. The title of the paper is “*Namibia and the Tripartite Free Trade Agreement*”, and the author of the chapter is *Mareike Meyn*. A country case study is presented. Namibia is in the process of negotiating the Tripartite Free Trade Agreement (TFTA) aside with its neighbours. A country like Namibia could indeed benefit from the TFTA if the original plan agenda is realized. According to the original plan intentions the TFTA is an ambitious undertaking, targeting the liberalization of goods and services in compliance with WTO provisions, and aiming to establish joint rules and regulations for trade-related areas, such as customs cooperation, trade facilitation, competition policy, foreign investment, and also intellectual property rights. A country like Namibia could benefit if the TFTA (and later the CFTA) negotiations move in the direction of an agenda which is really supporting Namibia’s enterprises on the way to become part of regional and global value chains. Also, Namibia could benefit if a more “transformative regional integration” agenda would be followed.

As it looks now, neither the first agenda (TFTA) nor the second agenda (CFTA) are part of the negotiations. Evaluated against the Transformative Regional Integration (TRI) agenda the TFTA and the CFTA, as they are negotiated now, will however not be able to benefit a country like Namibia that much. As the TFTA process looks now, the outcomes of the negotiations will not support Namibia’s structural transformation process towards deeper export diversification, growth of innovative, high tech and export-oriented enterprises, more effective integration of enterprises into regional and global value chains, and broadening the range of trade and investment partners.

This chapter draws from a comprehensive study that applied a methodological approach combining literature review, trade data and tariff analyses, and also personal interviews with public and private sector representatives. The background study for this chapter has assessed carefully Namibia’s offensive and defensive trade interests in the TFTA with respect to export potential, import competition, revenue implications, trade policy implications, and new institutional settings. In the study the author uses the terminology “offensive trade interests” and “defensive trade interests” so as to assess the intensity of interest on the side of the key policymakers and the managers of enterprises in participating actively in the TFTA negotiations. The term “offensive interest” is understood to mean the interest which a country may have in gaining access to another market. “Defensive interest” is understood to mean a country’s interest to minimize competition on its domestic market as a result of trade liberalization. The outcome of the study

is that, when the TFTA negotiations remain based on a very narrow agenda, neither the offensive nor the defensive trade interests of Namibia are served and so do not justify an active participation in the TFTA negotiations.

The author argues that, in the light of the limited institutional, human and financial resources in Namibia, it is recommendable to concentrate on the full implementation of the 2002 SACU Agreement and the SADC FTA, as these partners include Namibia's major regional trading partners South Africa, Angola and the DRC. It is important to understand that Namibia is hardly trading with non-SADC Tripartite region countries and has very limited production capacities to do so in the medium-term. And, the private sector of Namibia is so far less concerned about 'accessing new markets' than about having a predictable trade regime with countries which are major export markets. Namibia is therefore interested in enforcing the rules and regulations of the SACU and SADC Agreements as this would best serve Namibia's development objectives towards its Vision 2030. The author summarises the insights based on a SWOT (Strength/Weakness/Opportunity/Threat) analysis. The SWOT analysis summarizes Namibia's challenges and opportunities in the TFTA and provides according policy recommendations.

In the very long term the situation may change for Namibia if Africa's TFTA and CFTA projects develop in the direction of a Transformative Regional Integration (TRI). Consolidating the trade infrastructure and trade institutions towards SACU and SADC has top priority for Namibia relative to new institutions which are foreseen in the context of the TFTA/CFTA negotiations. Spreading the already very limited technical, institutional and human resources base further at the level of the Tripartite FTA region might, according to the author, bear the risk that regional integration efforts are diluted and that no feasible progress will be reached at all. In the long run the situation may look more favourably for the TFTA and CFTA projects, and the benefits a country like Namibia can realise.

Both papers come to the conclusion that the ongoing and starting TFTA/CFTA negotiations are far away from the much needed Transformative Regional Integration (TRI) approach. This implies that short-term and medium-term strategic moves matter for making Africa's regional integration a success.

3 The Strategy

Six strategic imperatives matter for improving the regional integration agenda towards becoming a more transformative regional integration agenda:

a) Identifying the Opportunities and Constraints of Regional Economic Communities (RECs) in Africa and Streamlining the Working Modalities

Regional integration is believed to enhance the economic and social opportunities in the member countries, by creating trade and employment possibilities, by providing cross-border business opportunities also for informal manufacturing and services enterprises, by contributing to food security and poverty reduction, etc. However, these advantages can only be realised if the many constraints are removed which impede the realisation of all these opportunities. The lack of implementing fully the REC agenda in terms of rules, standards and regulations is a great problem. The greatest problem is the lack of awareness in this regard. Neither the rules of origin, nor the regulations on technical standards and non-tariff barriers are taken serious enough within the REC. There is a fundamental lack of information about the weaknesses of the real operational functioning of the REC. An inventory is needed what means that the REC secretariat has to check on all these issues so as to be able to propose to the member governments innovative ways to enforce the regulations. It is a great problem for the further development of the African RECs that such inventories are not available so that the base for implementing the REC agenda more effectively is weak.

b) Designing Realistic and Pragmatic Policies and Initiating more Inclusive Agendas for the RECs

All over Africa the RECs have agendas which are very ambitious and so are not always realistic in terms of objectives, targets, time tables, and working schedules. There is also a lack of pragmatic policies and action plans, meaning that ambitious objectives and targets are upheld while even modest advances in implementing agreed upon points on the agenda are not reached. Moving to more realistic and pragmatic agendas, timetables and working schedules will allow it to enhance step by step the degree of implementation. All this can be supported by an inventory showing the real situation in terms of trade integration and other integration areas. Such an inventory will also show which member country fails in which area. It is also a problem that the RECs are not inclusive enough in terms of participating actors and observers.

Regional integration will provide additional business possibilities for enterprises in formal and informal sectors, but these actors should be involved in any discussion about further steps in trade integration. Also other actors (NGOs, trade unions, professional organisations, donor organisations, etc.) can play a role in deepening the integration process; but they have to be informed and should be involved in decision-making. The integration process is not inclusive enough in terms of important “behind the border” measures. Regional integration requires that “behind the border” the infrastructures, the laws, standards and regulations, the judiciary systems, the payment systems, the communication systems, etc. are better coordinated so as to support the cross-border exchange. Certain bottlenecks (congested roads, road taxes and fees, delays at borders, customs or harbours) can create more harm than the remaining tariff and non-tariff barriers.

c) Moving towards a more Transformative Regional Integration Agenda in the established RECs

A move towards a more transformative regional integration agenda is needed. This means that the conventional integration model, starting with a free trade zone and then moving to a customs union, a monetary and economic union, and later a political union, may not be the sequence which is relevant for Africa as most RECs have a very heterogeneous membership in terms of income level, political regime, resource endowment, etc. Designing and implementing regional infrastructure plans, regional industrial policies, regional competition laws and authorities, regional steps towards IT connectivity, regional cooperation between associations of entrepreneurs and professional associations may help very much in accelerating the regional integration process. As the performance of African RECs is rather weak, in terms of intra-trade, the working modalities for cross-border transactions, also in terms of intra-REC foreign investment, and in policy coordination at all levels of policy-making, this is evidence enough that a new approach is needed to make the REC an actor in structural transformation. A good example of what can be achieved is food security. If the members agree on integrated and coordinated food security, trade and agriculture/agroindustry development strategies and policies, the most important sector for employment and poverty reduction in Africa, namely agriculture, will benefit as well as so many rural producers and agro-industrial processors. Such a transformative regional integration agenda will reduce food insecurity and poverty and will lead to more employment and exchange.

d) Learning the Lessons from Asian and Latin American Regional Integration schemes for more dynamic African RECs

African RECs can learn a lot from the working of the ASEAN and MERCOSUR regional integration projects. This is possible in terms of a more realistic and pragmatic approach, in terms of a more transformative and open integration process, and in terms of a more visionary and future-oriented integration process. Despite of many shortcomings also in ASEAN and MERCOSUR integration projects the decision-making processes and the implementation records reveal a more realistic and pragmatic integration approach. A step by step implementation process is dominating, while over-ambitious objectives and targets as well as timetables for implementation are avoided. The regional integration processes in Asia and Latin America are more transformative and more open. This is the case in infrastructure build-ups and as well in infrastructure regulations, but also in terms of an industrial policy which is deep enough to change the structures of the member countries. The transformative integration context is becoming visible. Foreign direct investment and cross-border technology cooperation are becoming stronger elements of regional integration and enhance the intra-trade flows. Technical cooperation is becoming part of the daily life of the enterprises in the member countries. The ASEAN and MERCOSUR integration projects are visionary and future-oriented in a particular sense. There are offensive and defensive elements, and protective and promoting elements in the development vision of member countries and regional integration projects, and political as well as economic aims play a balanced role in the agendas and negotiations. Future-oriented development plans and enterprise expansion plans in the member countries add to this dynamic model of regional integration and make it more transformative. Regrettably, so far the African RECs have neither looked at learning lessons from their African counterparts nor from the RECs in other developing regions. This has to be changed.

e) Assessing country by country the potential benefits and costs of pushing for a TFTA and a CFTA

The TFTA and CFTA agendas are of importance for Africa. The intention is to overcome a landscape of overlapping RECs with quite different rules and regulations being applicable for the various RECs in Africa. But there are also great differences in implementing the rules and regulations within the REC and towards other regions. The plans for negotiations about TFTA and CFTA have shown that the ambitions were very great from the outset, but the reality of negotiations reveals the same weaknesses as the individual RECs

have shown over the years in their implementation. So the view of so many observers is now that TFTA and CFTA cannot solve problems which are not solved first at the level of the individual REC. A first step should be to promote a regional integration process based on the objectives and targets for an individual REC; the idea is to make the REC working as projected. In a second step the TFTA and CFTA projects could be implemented. Country cases show that each country has to consider the benefits and the costs of pushing for a deeper integration into REC, TFTA and CFTA projects. There is enough evidence that a country can benefit a lot from using its scarce political, managerial and administrative resources to deepen integration with those countries with which it has already the strongest economic interdependencies. These countries (mostly neighbouring countries) should have priority in all decision-making on a deeper regional integration process. A benefit/cost analysis of regional integration must start at the REC the country belongs to, and can then be extended to the TFTA and CFTA projects. Main criteria for such an analysis are the chances to move to a more transformative regional integration process, what implies that the selection of partner countries is most important. It is necessary to look first of all to those partner countries with which infrastructure development, enterprise cooperation and industrial policy frameworks can be most effectively coordinated so that a more transformative regional integration agenda can be implemented. The enterprise-to-enterprise cooperation matters a lot so that those partner countries should have priority in a transformative regional integration process where enterprise-to-enterprise cooperation is already practised and has potential for further expansion. In the current TFTA and CFTA euphoria such basic elements of cooperation are too often overlooked.

f) Consolidating the agendas and going ahead with the implementation of the RECs, TFTA and CFTA agendas

Despite of the many problems with consolidating the RECs in Africa and in negotiating towards meaningful TFTA and CFTA projects, it is necessary to look at ways to harmonize the agendas and the implementation schedules. There is room to discuss the reform of agendas of African RECs under the umbrella of the African Union (AU) and in parallel with the TFTA and CFTA negotiations. It is necessary for a more transformative regional integration process in Africa to consolidate the agendas of the many RECs in Africa in parallel to the negotiations on TFTA and CFTA so as to come to a meaningful interaction at all levels of integration. The TFTA and CFTA negotiations give an excellent opportunity to rationalize the system of the African RECs by consolidation and harmonisation of rules and regulations and by reviewing and improving implementation schedules and mechanism

all over Africa; peer reviews with the aim of identifying deficits in organizing a REC and in implementing the policies of a REC may be helpful. Although a great number of studies has shown serious weaknesses of individual RECs in Africa, there is a need of a more comprehensive analysis of the system of African RECs and how it actually works; this should be part of the analyses undertaken as a base for TFTA and CFTA projects.

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Transformative Regionalism, Trade and the Challenge of Poverty Reduction in Africa

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1 Introduction

Fostering development through regional integration has been a major objective of African governments since most countries on the continent became independent in the 1960s. Regional integration can promote peace and security, contribute to infrastructure development, foster trade and investment, reduce vulnerability to global shocks, and enhance the quality of economic policy-making through serving as an external agent of restraint on domestic policies. In the first two decades of the post-independence era, the focus of regional integration in Africa was, understandably, more on political cooperation rather than economic integration, as African leaders strived to rid the continent of the vestiges of colonialism. Since the 1980s efforts have been made to shift the focus of regional integration from political cooperation to economic integration as evidenced by the emphasis on economic issues in the 1980 Lagos Plan of Action and the Abuja Treaty signed in 1991.

African governments have made significant progress in using regional integration to promote peace and security. Military intervention and mediation by the Economic Community of West African States (ECOWAS) played a pivotal role in ending the civil wars in Liberia, Sierra Leone and Cote d'Ivoire. ECOWAS diplomacy also played an important role in de-escalating conflicts in Togo, Guinea and Guinea-Bissau (Omeje, 2013: 8). Despite the progress that has been made on peace and security issues, there is the recognition that not much has been achieved in terms of diversifying the structure of African economies, boosting intra-African trade and investment, building supply capacities, and achieving sustained poverty reduction. African leaders are aware of this reality and are increasingly taking bold actions to promote economic integration. For example, in January 2012, they renewed their po-

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litical commitment to boosting intra-African trade and also decided to fast-track the establishment of a continental free trade area as envisaged in the Abuja Treaty. In addition, at the 21st Ordinary Session of the Assembly of Heads of State and Government of the African Union held in Addis Ababa, Ethiopia, from 19-27 May 2013, African leaders rededicated themselves to the integration agenda and to achieve the African Union's vision of an integrated, prosperous and peaceful Africa. But this is not the first time that they have renewed efforts to promote regionalism. A crucial question therefore is what should they do differently to ensure that they use regional integration effectively in support of economic development?

This paper argues that making regional integration work for Africa requires that African governments change their approach to economic integration and in particular shift emphasis from the current model of integration, which focuses mostly on trade reforms and processes and institutions of integration, to an alternative approach—Transformative Regionalism—in which regional integration promotes and also ensures progress in building productive capacities and achieving structural transformation for sustained development. The paper identifies the key elements of Transformative Regionalism, examines the extent to which the current approach to integration adopted by African regional economic communities (RECs) is consistent with transformative regionalism, and also highlights other critical elements of a credible policy package to promote regional integration in Africa. These include enhancing implementation of existing programmes and action plans, refocusing the role of the RECs on the goal of economic integration, doing away with false dichotomies that often cloud the debate on development in Africa, and recognising as well as exploiting the vital role of industrial policy and consumer behaviour in promoting regional integration.

The paper is structured as follows: After the Introduction in Section 1, Section 2 is on Trade and Transformation in Africa, presenting the Record, Section 3 is on Rethinking Regionalism in Africa, Section 4 is on African Regional Trade Blocs and Transformative Regionalism, Section 5 is on the issue how African Countries can Promote Transformative Regionalism, while Section 6 gives Conclusions.

2 Trade and Transformation in Africa, presenting the Record

The main focus of regional integration in Africa so far has been on promoting regional trade and investments through liberalisation. It derives from the idea that trade has great potential for poverty reduction and so should be facilitated and promoted. In this section, some facts on the importance of trade in African economies and the contribution of intra-regional trade to Africa's total

trade are presented. Also included are some facts on the structure of production in Africa with a view to highlighting one of the key challenges as well as opportunities facing Africa in the integration process, which is how to diversify the structure of production to promote regional trade.

Trade has and will continue to play a crucial role in African economies. It provides access to new technology and also foreign exchange needed for the import of goods not produced domestically. It also allows a country to be more efficient in production through specializing in goods in which it has comparative advantages. Over the period 1995-1999, the share of trade in Africa's gross domestic product (GDP) was 43 percent, which is comparable to the average for developing countries over the same period, although the ratio for Africa is a bit lower (table 1). More recently, there has been a significant increase in the role of trade in African economies and in other developing countries as evidenced by the fact that the trade-GDP ratio in Africa and in other developing countries was 60.3 percent and 60.9 percent respectively over the period 2008-2012 (table 1). Rapid improvements in information and communication technology, which reduced transactions cost significantly, coupled with trade reforms in Africa and other developing countries are some factors that contributed to the big increase in trade ratios observed over the past two decades. In other developing countries, the increase in trade ratios went hand in hand with an increase in the growth rate of real output while in Africa, there was no significant change in the growth rate of real output due largely to the negative impact of the recent political crisis in North Africa and the fact that the financial crisis had a more significant negative impact on Africa compared to other developing country groups.

Although the role of trade in African economies has increased significantly in recent years, the share of intra-regional trade in Africa's total trade has been flat over the past few decades. Table 2 shows that the share of intra-regional exports in Africa's total exports fell marginally from 12.2 percent in the period 1995-1999 to 11.4 percent in the period 2008-2012. Regarding imports, the share of intra-regional imports in Africa's total imports rose marginally from 12.2 percent to 14 percent over the same period. These numbers are quite low compared to what is observed in other regions of the world. In Europe, Asia and Latin America, for example, the average share of intra-regional exports in total exports was 68.9, 51.3 and 20.5 percent respectively in the period 2008-2012 (UNCTAD database).

Table 1: Trade and growth across regional groups (1995-2012)

	Merchandise trade (% of GDP)		Real GDP growth rate (%)	
	1995- 1999	2008- 2012	1995- 1999	2008- 2012
Africa	43.4	60.3	3.5	3.3
Other developing economies	49.1	60.9	4.3	5.8
Central African Economic and Monetary Community (CEMAC)	53.0	74.7	4.1	4.5
Common Market for Eastern and Southern Africa (COME- SA)	32.9	49.2	3.6	1.3
East African Community (EAC)	30.7	49.0	4.0	5.7
Economic Community of Cen- tral African States (ECCAS)	57.8	78.2	3.8	4.5
Economic Community of West African States (ECOWAS)	54.4	62.5	3.7	6.3
Southern African Development Community (SADC)	46.7	65.0	2.8	3.1
Arab Maghreb Union (AMU)	47.6	69.1	3.3	0.5

Source: computed by the author based on data from UNCTAD database

Table 2: Intra-regional trade shares

	Intra-Regional exports (% of total exports)		Intra-Regional imports (% of total imports)	
	1995-1999	2008-2012	1995-1999	2008-2012
Developing economies	41.3	54.7	39.5	57.5
Africa	12.2	11.4	12.2	14.0
Other develop- ing economies	40.6	52.7	38.5	54.9
CEMAC	2.0	2.1	4.2	4.4
COMESA	6.1	7.4	4.4	6.3
EAC	17.0	19.4	11.5	8.5
ECCAS	1.3	1.2	2.6	2.8
ECOWAS	10.2	8.0	10.2	10.1
SADC	14.9	11.9	17.2	17.7
AMU	3.0	2.8	3.1	3.2

Source: computed by author based on data from UNCTAD database

Lack of diversification, particularly the limited role of manufacturing in output, coupled with weak infrastructure and tariff and non-tariff barriers are some of the factors that have contributed to the weak intra-regional trade performance of Africa. Table 3 presents information on the structure of production in Africa and developing countries for the period 2005-2012. It shows that manufacturing plays a significant role in developing countries but not in Africa. The average share of manufacturing in total value added in Africa is 10 percent compared to about 21 percent for developing countries. Furthermore, the growth rate of manufacturing value-added was 2.9 percent in Africa compared to 7.3 percent for developing economies. Agriculture plays a more important role in output in Africa compared to developing countries. Its share of output was 16 percent in Africa and 9 percent in developing countries. In the period 2005-2012, the share of mining and utilities in total value added was 23.7 percent in Africa compared to the developing economies' average of 12.1 percent. In both groups, the service sector is the most dominant sector accounting for 45 percent of output in Africa and 52 percent of output in developing countries.

Table 3: Structure of production in Africa and developing economies (2005-12)

	Africa		Developing economies	
	Share of sector in total value added (%)	Growth of value added by sector (%)	Share of sector in total value added (%)	Growth of value added by sector (%)
Agriculture, hunting, forestry, fishing	16.1	4.8	9.3	3.5
Industry	38.7	1.8	39.2	5.9
Manufacturing	10.1	2.9	20.9	7.3
Mining and Utilities	23.7	-0.1	12.1	2.6
Construction	4.9	8.1	6.1	7.2
Services	45.2	5.5	51.5	6.2
Wholesale, retail trade, restaurants and hotels	13.6	6.3	14.3	6.5
Transport, storage and communications	7.5	6.9	7.3	6.7
Other activities	24.1	4.7	29.9	5.9

Source: computed by author based on data from UNCTAD database

Among the RECs, the importance of manufacturing in output is also very low but varies across sub-regions (table 4). For example, in the period 2005-2012, ECOWAS had the lowest share of manufacturing in output (5 percent) while SADC had the highest (13 percent). However, in terms of the growth of manufacturing value added, ECCAS had the highest growth rate (6.6 percent) followed by EAC (5.8 percent). The lowest growth rate was observed in AMU (1.7 percent). A key message from the facts presented in this section is that the structure of production in Africa is a major factor inhibiting progress in promoting regional trade in Africa, and that addressing the deficit in Africa's production structure requires fostering manufacturing development. De-industrialization in Africa is therefore referred to as a main development handicap, impeding stable growth, employment generation, poverty reduction, and as well regional integration.

Table 4: The importance of manufacturing in African regional groups

	Share of manufacturing in total value added (%)		Growth of manufacturing value added (%)	
	1990-1995	2005-2012	1990-1995	2005-2012
CEMAC	13.3	7.6	-2.0	3.3
COMESA	12.6	11.4	1.6	3.8
EAC	11.1	9.6	1.8	5.8
ECCAS	10.0	6.5	-6.8	6.6
ECOWAS	9.6	5.0	-2.2	2.9
SADC	19.2	13.2	-0.3	2.4
AMU	12.1	8.4	1.3	1.7
Africa	14.5	10.1	0.3	2.9
Developing economies	17.4	20.9	4.3	7.3

Source: computed by author based on data from UNCTAD database

3 Rethinking Regionalism in Africa

Regional integration is not an end in and of itself. It is only useful to the extent that it enables African countries to address the development challenges they face, the most serious of which is how to achieve sustained growth and poverty reduction. Recent research indicates that a necessary condition for sustained poverty reduction in Africa is the successful transformation of the structure of African economies. It is argued (UNCTAD and UNIDO 2011) that no country has achieved significant and sustained poverty reduction without going through a process of structural change involving a shift from

low to high productivity activities both within and across the three main sectors of an economy, namely agriculture, industry and services. Such a transformation will have a significant positive impact on growth as well as on income distribution, which are the two main sources of changes in poverty. In this regard, fostering structural transformation is a major development challenge facing African policymakers that have to be addressed as a matter of necessity for the continent to achieve sustained growth, reduce poverty, and be a pole of global growth in the 21st century.

The necessity for structural transformation in Africa is evident when one considers the fact that African countries have grown at a relatively rapid rate over the past decade and yet this growth has not created enough jobs to absorb the rapidly growing number of new entrants into the labour force. Recent growth has also been associated with an increase in the absolute number of poor people, even though the poverty rate has declined significantly in the last decade relative to the 1990s. As shown in table 5, Africa is the only group of countries where there was an increase in the number of poor people between 1999 and 2010, and it is not surprising that it is also the region with very low levels of manufacturing development.

Table 5: Poverty incidence across regions

	Poverty rate (%)		Number of poor (millions)	
	1999	2010	1999	2010
Sub-Saharan Africa	58	48.5	376.8	413.8
East Asia and the Pacific	35.6	12.5	655.6	250.9
Europe and Central Asia	3.8	0.07	17.8	3.1
Latin America and Caribbean	11.9	5.5	60.1	32.3
Middle East and North Africa	5.0	2.4	13.6	8.0
South Asia	45.1	31.0	619.5	506.8
Total	34.1	20.6	1743.4	1214.9

Source: UNECA, AfDB and UNDP (2013)

One of the reasons why recent growth in Africa has not had the expected impact on employment creation and poverty is that it has been driven by low productivity activities and also by sectors (such as informal services) that have very limited potential for employment creation. Inducing structural transformation from low to high productivity activities is therefore necessary

to create employment and reduce poverty in Africa. Against this background, one of the main goals of development policy and of regional integration in Africa should be to transform the structure of African economies to lay the foundations for sustained growth, job creation and poverty reduction. Therefore, if regional integration is to work for Africa it must be geared directly towards inducing structural transformation in the continent, and this requires the adoption of a more pragmatic and strategic approach to integration.

Trade reform-centered regionalism

The framework guiding regionalism in Africa has been the linear model of integration found in international trade textbooks, which involves a progressive move from a free trade area to a customs union, common market, monetary union, and then a political union. It is based on the premise that trade reforms will have a positive impact on trade and growth and that the benefits will eventually "trickle down" to poor segments of the society, thereby reducing poverty. The formation of trade blocs and the elimination of trade barriers have been the principal mechanism or instrument through which regional economic integration has been promoted in Africa over the past decades. The Abuja Treaty envisaged the division of the continent into five regional trade blocs (East, West, Central, South and North Africa) to serve as pillars of the proposed African Economic Community (AEC). Since then there has been a mushrooming of regional trade groups within the continent and, as shown in table 6, Africa currently has 14 regional trade blocs which cannot be easily mapped into the five trade blocs proposed in the Abuja Treaty. The African Union recognises only eight out of the fourteen regional groups. These are AMU, COMESA, CEN-SAD, EAC, ECCAS, ECOWAS, IGAD, and SADC.

Table 6: Regional economic groups in Africa

		Members	Year est.	Status of integration
1	Arab Maghreb Union (AMU)	Algeria, Libya, Mauritania, Morocco and Tunisia	1989	Draft agreement on establishing a free trade area signed in 2010
2	Central African Economic and Monetary Community (CEMAC)	Cameroon, Central African Rep, Chad, Equatorial Guinea, Gabon, and Republic of Congo	1994	Customs and monetary union
3	Common Market for Eastern and Southern Africa (COMESA)	Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.	1994	Launched customs union in 2009

To be continued

Continued				
4	Community of Sahel-Saharan States (CEN-SAD)	Benin, Burkina Faso, Central African Republic, Chad, Côte d'Ivoire, Djibouti, Egypt, Eritrea, The Gambia, Ghana, Guinea Bissau, Liberia, Libya, Mali, Morocco, Niger, Nigeria, Senegal, Sierra Leone, Somalia, Sudan, Togo, and Tunisia.	1998	No clear timeframe or plan to move towards a free trade area
5	East African Community (EAC)	Burundi, Kenya, Rwanda, Tanzania, and Uganda	2000	Launched common market in 2010
6	Economic Community of Central African States (ECCAS)	Angola, Burundi, Cameroon, Congo, Democratic Republic of Congo, Gabon, Equatorial Guinea, Chad, and Sao Tome and Principe.	1983	Launched Free trade area in 2004
7	Economic Community of Great Lakes Countries (CEPGL)	Burundi, Congo and Rwanda	1976	No clear timeframe or plan to move towards a free trade area
8	Economic Community of West African States (ECOWAS)	Benin, Burkina Faso, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo and Cape Verde	1975	Achieved free trade area status in 2000
9	Indian Ocean Commission (IOC)	Comoros, Madagascar, Mauritius, Réunion, and Seychelles	1984	No clear timeframe or plan to move towards a free trade area
10	Inter-Governmental Authority on Development (IGAD)	Djibouti, Ethiopia, Eritrea, Kenya, Somalia, South Sudan, Sudan, and Uganda	1996	No clear timeframe or plan to move towards a free trade area
11	Mano River Union (MRU)	Cote d'Ivoire, Guinea, Liberia, Sierra Leone	1973	No clear timeframe or plan to move towards a free trade area
12	Southern African Customs Union (SACU)	Botswana, Lesotho, Namibia, South Africa and Swaziland	1910	Customs union and common monetary area
13	Southern African Development Community (SADC)	Angola, Botswana, Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe	1992	Free trade area achieved in 2008
14	West African Economic and Monetary Union (WAEMU)	Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo	1994	Monetary union

Source: computed by author based on information from the websites of African regional organisations.

There are several limitations of the linear model of integration (or trade reform-centered regionalism) that has been pursued in Africa so far. First, it has not worked for the continent as evidenced by Africa's weak regional trade performance and poverty statistics compared to those of other developing country groups. Second, it associates trade mostly with trade liberalisation as if it is the most important aspect of trade and development policy. Third, it assumes that trade barriers represent the main obstacle to the inability of African countries to foster regional trade and effectively exploit the potential of trade for poverty reduction. UNCTAD (2013) suggests that infrastructure bottlenecks, particularly those related to energy and transport, are more binding constraints to boosting regional trade in Africa than tariff and non-tariff barriers. The experience of the Southern African Customs Union (SACU) is a very good illustration of the fact that the elimination of trade barriers is not the most binding constraint to boosting regional trade in Africa. SACU is the oldest customs union in Africa. Yet, the share of intra-SACU exports in SACU's total exports was only 7.5 percent in 1995-1999 and 5.8 percent in 2008-2012.

Another limitation of the trade reform-centered regionalism is that it assumes the relationship between trade and poverty is one-directional. In particular, there is the presumption that causality runs from trade to poverty reduction. This ignores the equally important fact that poverty limits the ability of poor countries to produce and trade. In other words, being poor affects a country's ability to produce and to trade and so structural issues have to be addressed. A more realistic approach is to recognise the effects of poverty on Africa's ability to trade by making the development of productive capacities a key issue in the trade-poverty discussion. Such a holistic approach recognises the fact that the relationship is bi-directional and so the focus of policy should be on how to exploit linkages between both variables rather than focusing on one aspect of the trade-poverty nexus. Admittedly, over the past decade African governments have acknowledged the need to pay more attention to the development of productive capacities in promoting regional integration. For example, the Agenda 2063 of the African Union underscores the important roles of building supply capacities and of a transformation for inclusive growth and sustainable development in Africa (AUC/African Union Commission, 2014: pp. 1-100). Nevertheless, it is still the case that productive capacity development issues have not received as much attention as trade and factor market liberalization in the discourse on regional integration on the continent.¹

¹ The United Nations Economic Commission for Africa (UNECA), the African Union (AU) and the African Development Bank (AfDB) produce an annual report on regional integration subtitled "Assessing Regional Integration in Africa" (see, for exam-

Understandably, the form of economic integration that has been promoted in Africa follows closely the European model of integration which places emphasis on trade reforms. While this approach made sense in Europe given the high productive capacities and the level of infrastructure development of the continent, it is not the appropriate approach to integration in Africa given the weak productive capacities and the infrastructure deficits of African economies. Furthermore, as indicated earlier, infrastructural bottlenecks, particularly those related to energy and transport, represent more important obstacles to intra-African trade than trade barriers, indicating that more attention should be paid by African governments to lifting these infrastructure constraints to trade. Another reason why the European model of integration may not be appropriate for Africa is that the institutions and structural foundations of the European Union (EU) make it possible to align its strategies with the national strategies of its member states (Patterson, 2012: p. 15). For example, the EU has well-developed institutions, has the capacity to enforce its decisions, and does not have sub-regional groupings (or RECs). By contrast, the African Union (AU) lacks the capacity to enforce decisions, relies on the RECs as pillars of integration, and there are often very weak links between these regional organisations and the national governments. In summary, the EU experience provides useful lessons for Africa, for example it underscores the importance of a fair sharing of the benefits of integration and of having quality infrastructure and the capacity to respond to trade opportunities. Nevertheless, it is not the appropriate model of integration for the continent given its structure and its stage of development.

Transformative regionalism

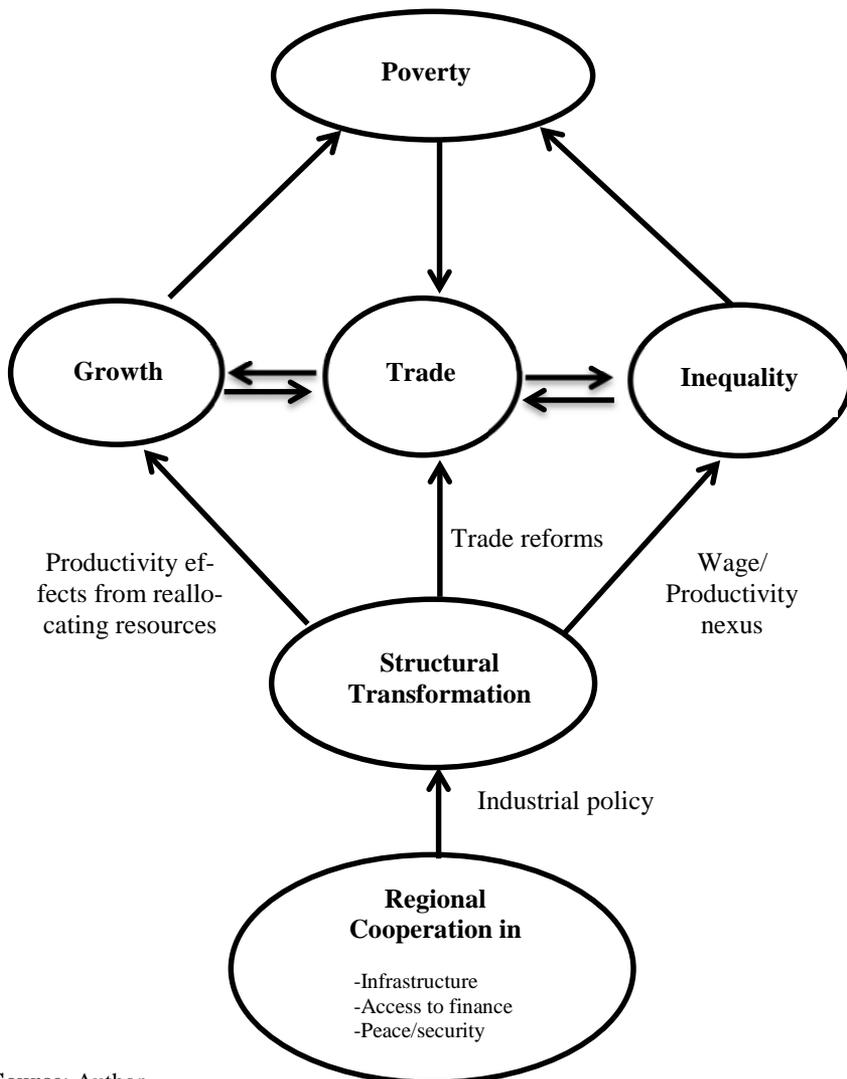
As indicated in the previous section, a key development challenge facing Africa today is how to develop productive capacity and how to induce structural transformation to create employment and reduce poverty. Therefore regional

ple, UNECA, AU and AfDB, 2013 and UNECA, AU and AfDB, 2012). These reports provide very useful information on the status of integration in Africa. They also monitor progress by African RECs in achieving targets on trade and factor market liberalization and the achievement of economic and monetary union as proposed in the Abuja treaty. While these reports highlight the importance of diversification and building supply capacities, the analysis is conducted within the framework of the linear model of integration in which countries move from a free trade area to a common market, and eventually to economic and monetary union. In this context, the approach adopted in these reports differs fundamentally from the framework of Transformative Regionalism as discussed in this paper.

integration should be specifically geared towards overcoming this development challenge and not to promote trade reform per se. To the extent that trade reform contributes to confronting the challenge it should be promoted but it should not be the exclusive focus of integration. In this context, what Africa needs is Transformative Regionalism rather than the Trade reform-centered Regionalism that has been adopted on the continent. Transformative Regionalism refers to an integration approach that promotes and also ensures progress in building productive capacities and in achieving structural transformation for sustained development. It differs from the trade reform-centered approach to integration in the sense that it begins with an identification of the most binding constraints to development in Africa and asks how integration can contribute to lifting or relaxing these constraints. In contrast, the trade reform-centered approach to integration assumes that trade barriers represent the main obstacle to promoting regional trade in Africa and that trade is the key to poverty reduction. Furthermore, in this framework the emphasis is on boosting the volume of trade and the implicit assumption is that the structure of production and of exports does not matter as countries produce goods in which they have currently a comparative advantage. This contrasts with Transformative Regionalism which takes the lack of development of productive capacities and of structural transformation as the key obstacle to promoting regional trade.

Figure 1 provides a framework to illustrate how Transformative Regionalism can contribute to achieving the ultimate development objective of African countries, which is to reduce poverty. Regional cooperation, for example in infrastructure, finance, and peace and security, can foster the development of supply capacities in an economy. When this is complemented with industrial policy it can induce structural transformation. Structural transformation coupled with trade reforms enhances trade, and this has an impact on growth and inequality which are two important sources of changes in poverty. Through promoting structural transformation, integration can also affect growth and inequality directly, thereby contributing to poverty reduction. In particular, when regional integration induces structural transformation, resources move from low to high productivity activities thereby stimulating growth. If the increase in productivity is reflected in higher real wages it also contributes to a reduction in inequality and hence poverty. It should be noted that in this framework, poverty also has a direct impact on trade through reducing the capacity to produce and hence reducing trade. On the other hand, structural transformation via regional integration reduces poverty, increases the capacity to produce and increases trade. Furthermore, in this framework trade reforms complement policies to build supply capacities and to transform economies and are not the main focus of integration.

Figure 1: Framework for Transformative Regionalism



Source: Author

For Transformative Regionalism to work in Africa it has to be strategic, coherent and pragmatic. It has to be strategic in the sense that it begins with an informed vision, specifies how to get to the vision, and provides clear indicators on how to monitor progress in achieving the vision. It has to be pragmatic in the sense that it focuses on what works and sets realistic targets and deadlines. It also has to be coherent in the sense that national and regional policies are consistent with the overall objective of integration. Another essential ingredient for success of Transformative Regionalism in Africa is that Governments have to lead the integration process but they have to ensure that other stakeholders are active in the process. The active participation of other stakeholders will ensure that integration is not simply an intergovernmental affair. A recent study on private sector involvement in African regional economic integration indicates that, although there is some evidence of participation, the RECs need to strengthen the role of the private sector in the integration process (Palm, 2011: p. 1). The RECs have established Business Councils but most of them do not have a private sector strategy and clear procedures for private sector participation. While getting the private sector more active in the regional integration process is desirable, it is important that Governments lead the process because most of the areas where there are challenges in integration (cross-border infrastructure, peace and security, access to long-term finance, and elimination of trade barriers) are areas where the private sector cannot provide effective leadership and direction in the integration process. In infrastructure, for example, it has been very difficult to get private sector investments in energy and transport which are key obstacles to regional trade and investment. Available data suggest that about 80 percent of private sector commitments to infrastructure in sub-Saharan Africa go to telecommunications while energy and transport sectors account for 13 and 7 percent respectively (ICA, 2012). Without government leadership and intervention, these neglected infrastructure areas will not get the required investments.

4 African Regional Trade Blocs and Transformative Regionalism

This section examines the extent to which existing frameworks and programmes on economic integration in African regional trade organisations are consistent with transformative regionalism. It focuses on three Regional Economic Communities (RECs), namely ECOWAS, EAC and SADC (see table 7). The three country groups are among the eight RECs which are recognised by the AU, and their experiences and challenges in the regional integration process are similar to those of other regional groups on the continent.

ECOWAS has 15 members and was established in 1975 to promote economic integration in the West African region. Over the past two decades, the region has experienced a significant increase in economic performance with the real GDP growth rate increasing from 3.7 percent in 1995-1999 to 6.3 percent in 2008-2012. In addition, ECOWAS has made some progress in facilitating the free movement of people in West Africa (UNECA, 2012: p. 22). It has also made progress in the area of political governance as evidenced by the fact that, unlike in the 1970s, all member states today have democratically elected governments. Furthermore, it has a good track-record in promoting peace and security as alluded to in the previous sections of the paper. Despite these advances on political governance and security issues, performance in the area of economic integration has been weak at best as evidenced, for example, by the declining share of regional trade in the global trade of ECOWAS over the past two decades (see table 2 above).

In recent years, ECOWAS has increasingly adopted measures that are consistent with some aspects of Transformative Regionalism. First, promoting economic transformation is now a priority issue for ECOWAS and several actions have been taken by the sub-region recently to promote transformation. For example, ECOWAS published the West African Common Industrial Policy programme in 2010 with a view to diversifying the production structure of the economies in the region (ECOWAS, 2010a: pp. 1-68). In particular, the sub-region expects to: (a) increase the local raw material processing rate which is currently at an average of 15-20 percent to reach an average of 30 percent by 2030; (b) raise the share of manufacturing in GDP from 6-7 percent to 20 percent by 2030; (c) increase intra-ECOWAS trade from 12 percent to 40 percent by 2030; and (d) increase the sub-region's share of global exports from 0.1 percent to 1 percent by 2030. Second, relative to the 1970s/1980s, ECOWAS now has a more strategic approach to promoting regional integration - with a vision, an action plan to achieve the vision, and a mechanism for monitoring and evaluation. The broad vision as expressed in the ECOWAS Vision 2020, adopted in June 2007, is "to create a borderless, peaceful, prosperous and cohesive region, built on good governance and where people have the capacity to access and harness its enormous resources through the creation of opportunities for sustainable development and environmental preservation" (ECOWAS, 2010b: p. 2). Third, ECOWAS is strengthening efforts to develop infrastructure and human resources with a view to enhancing supply capacities for trade and development. The ECOWAS Strategic Plan for 2011-2015 (ECOWAS/CEDEAO, 2010) accords priority to the development of energy, transport, and information and communications technology infrastructure. Furthermore, the Programme for Infrastructure Development in Africa (PIDA), developed by African regional organisations in 2010, has been adopted by African Heads of State and Gov-

ernment in 2012 as the framework for the development of infrastructure on the continent, signalling a renewed commitment by the continent to improve infrastructure for the development of productive capacities².

These measures indicate that ECOWAS is, in principle, promoting the development of productive capacities and structural transformation. But they do not mean that its regional integration approach has been transformative because Transformative Regionalism is not simply about establishing initiatives to promote productive capacity development and economic transformation. It also requires implementation of action plans associated with these initiatives, and this is one of the areas where ECOWAS is facing challenges in the integration process. Transformative Regionalism also requires progress in achieving established goals on structural transformation and as it was shown in table 4, ECOWAS has not had much success in transforming its production structure from dependence on traditional agriculture to dependence on manufacturing and/or modern services. While the growth of manufacturing value added in the sub-region rose from -2.2 in the period 1990-1995 to 2.9 in the period 2005-2012, the share of manufacturing in GDP fell from 9.6 percent to 5 percent over the same period. Another reason why the current integration approach in ECOWAS is not transformative is that it relies heavily on the linear model of integration which involves a progressive move from a free trade area status to a custom union, a common market, and then a monetary and an economic union. Consequently, the current approach has been geared more towards the removal of trade barriers than to the development of production capacities and structural transformation.

The EAC is a relatively small regional economic group with five members (Kenya, Tanzania, Uganda, Burundi, and Rwanda). It was first established in 1967 by Kenya, Tanzania and Uganda, and dissolved in 1977 due largely to ideological differences between its members and concerns about the unequal sharing of the benefits of integration. It was re-established in 2000 with the goal of widening and deepening economic, political and social cooperation among its members for mutual benefits. Its vision is to "attain a prosperous, competitive, secure and politically united East Africa" (EAC, 2011: p. 12). The EAC experienced an increase in growth from 4 percent in 1995-1999 to 5.7 percent in 2008-2012. Intra-EAC exports as a percentage of total exports also increased from 17 percent to 19 percent over the same period. It is one of the few RECs that have made significant progress in achiev-

² The African Development Bank (AfDB) is the Executing Agency for this Programme; see on the progress of PIDA: <http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/programme-for-infrastructure-development-in-africa-pida/>

ing targets in the integration process, particularly those on liberalization of trade and factor markets. For example, it established a customs union in 2005, a common market in 2010, and in November 2013 the leaders signed a protocol for the establishment of a monetary union. It is also one of the few RECs with a well-defined and comprehensive strategic framework for deepening and accelerating integration. Since its inception, it has had four development strategies outlining its goals, targets as well as how to achieve them, and indicators for monitoring performance. To support the integration process, the EAC's fourth development strategy, covering the period 2011-2016, stresses the need to expand productive capacities to facilitate diversification and to develop infrastructure networks (EAC, 2011).

The EAC has also developed a long-term industrialisation strategy for the period 2012-2032 (EAC, 2012). It identifies six strategic sectors that have to be supported to promote industrialisation, namely: iron-ore and other mineral processing; fertilisers and agrochemicals; pharmaceuticals; petrochemicals and gas processing; agro-processing; and energy and biofuels. With regard to the building of productive capacities, the EAC has also elaborated plans for infrastructure development and financing. These facts suggest that the EAC seeks to promote the development of productive capacities and structural transformation. The challenge as with ECOWAS is that these initiatives are poorly funded and for the most part rarely fully implemented. It is therefore not surprising that regional integration initiatives have not had so far a transformative effect in the region. Although there was an increase in the growth of manufacturing value-added from 1.8 percent in 1990-1995 to 5.8 percent in 2005-2012, the share of manufacturing in output actually fell from 11 percent to 10 percent over the same period. If the EAC intends to achieve better results on economic transformation through regional integration, it has to strengthen efforts and has to devote more resources to the implementation of the industrialisation agenda. So far, the focus as stressed in the EAC fourth development strategy has been on consolidating the customs union, implementation of the common market, and establishing a monetary and political union (EAC, 2011: p. 55).

Table 7: Regionalism in EAC, ECOWAS, and SADC

	EAC	ECOWAS	SADC
Vision	To attain a prosperous, competitive, secure and politically united East Africa.	To create a borderless, peaceful, prosperous and cohesive region, build on good governance and where people have the capacity to access and harness its enormous resources through the creation of opportunities for sustainable development and environmental preservation.	To build a region in which there will be a high degree of harmonization and rationalization, to enable the pooling of resources to achieve collective self-reliance in order to improve the living standards of the people of the region.
Framework of integration	Linear model of integration	Linear model of integration	Linear model of integration
Is the integration approach coherent?	No, largely due to overlapping memberships of RECs. But the ongoing process of establishing the Tripartite FTA with COMESA and SADC is setting the stage for a more coherent integration agenda.	No. Overlapping memberships of RECs has made it difficult to have a coherent approach to integration	No, but the ongoing process of establishing the Tripartite FTA with COMESA and EAC is setting the stage for a more coherent integration agenda.
Is the industrial policy used as an instrument?	The EAC has an industrialisation policy for the period 2012-2032	ECOWAS has the West African Common Industrial Policy	SADC has an industrial development policy framework
Is productive capacity development on the agenda?	Yes	Yes	Yes
Is there a strategy for private sector involvement in integration?	Yes	No	No
Progress in implementation of action plans on integration	Slow	Very slow	Very slow
Is regionalism transformative?	No, as evidenced for example by the fact that the share of manufacturing in GDP actually declined from 11 percent in 1990-1995 to 10 percent in 2005-2012.	No. For example, the share of manufacturing in GDP declined from about 10 percent in 1990-1995 to 5 percent in 2005-2012.	No. For example, the share of manufacturing in GDP declined from 19 percent in 1990-1995 to 13 percent in 2005-2012.

Source: Author

SADC is an offshoot of the Southern African Development Coordination Conference (SADCC) which was launched in 1980 by nine independent states in Southern Africa, primarily to reduce economic dependence on South Africa. In 1992, SADCC was transformed into SADC with a view to promoting deeper economic cooperation and integration in the sub-region. It currently has 15 members (Angola, Botswana, DRC, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe). Unlike ECOWAS, its economic growth performance over the past two decades has been weak. It had an average growth rate of 2.8 percent in the period 1995-1999 and of 3.1 percent in the period 2008-2012. It experienced a decline in the share of intra-regional exports in total exports from 15 percent in 1995-1999 to 12 percent in 2008-2012. As is the case with ECOWAS, promoting peace and security seems to have been a more dominant activity in SADC over the past decade than promoting economic integration in the sub-region.

In 2003 SADC adopted the Regional Indicative Strategic Development Plan (RISDP) as the blueprint for regional integration in the sub-region. It spells out the vision of SADC, its plans on how to get to the vision, and how to assess performance. The key priority areas of SADC in the RISDP for 2005-2010 were: trade, industry, finance and investment; infrastructure and services; food, agriculture and natural resources; social and human development and special programmes; and cross-cutting issues. SADC has also unveiled an Industrial Development Policy Framework (SADC, 2013) to guide and facilitate industrial development in the sub-region. Clearly, these initiatives indicate that SADC has made efforts to promote productive capacity development and structural transformation. It is also evident that it has not been successful in inducing structural transformation in the sub-region. For example, the share of manufacturing value added in output fell from 19.2 percent in 1990-1995 to 13.2 percent in 2005-2012. As with ECOWAS and EAC, implementation remains a major challenge. A recent assessment of the RISDP for 2005-2010 concluded that its implementation is behind schedule because member states did not set aside resources for implementation at the national level (SADC, 2011).

In summary, over the past decade the RECs have all strengthened efforts to promote the development of supply capacities and structural transformation. But poor and often lack of implementation of action plans have made it difficult to achieve economic transformation in these RECs. Furthermore, the RECs tend to "put the cart before the horse" in the sense that trade and factor market liberalization have been the primary focus of integration efforts in these organisations, and this diverts attention and resources away from much deeper issues such as the development of productive capacities and structural transformation. In addition, the setting of unrealistic targets cou-

pled with overlapping membership of RECs with different ambitions on integration creates an incoherent integration agenda and makes it even more challenging to achieve Transformative Regionalism.

5 How can African Countries Promote Transformative Regionalism?

African countries have to adopt a more balanced approach to integration that prioritizes the need for economic transformation and pays as much attention to productive capacity building as to the elimination of trade barriers. The continent has several initiatives to build productive capacities and to transform economies. These include the First Industrial Development Decade for Africa (IDDA I) covering the period 1982-1992, the Second Industrial Development Decade for Africa (IDDA II) covering the period 1993-2002, the Alliance for Africa's Industrialisation launched in 1996, the African Productive Capacities Initiative/APCI (2003/2004), and the Accelerated Industrial Development of Africa (AIDA) initiative adopted in 2008. There are also industrial development initiatives by RECs such as SADC, ECOWAS, EAC, and COMESA. A common feature of these initiatives is that they have so far not been successful in achieving the stated objective of economic transformation due in part to the lack of implementation of the action plans. In this context, there is the need for African countries to move away from the establishment of initiatives and norm-setting to actual implementation. The design and use of a credible mechanism to monitor implementation of these initiatives will go a long way towards ensuring that African governments achieve their transformation objectives. The EAC has developed a useful scorecard to monitor implementation of its Common Market Protocol that could be adapted by the African Union to monitor implementation of existing regional initiatives on productive capacities and industrial development (EAC, 2014: pp. 1-36).

There is a need for African countries to re-examine the role of the RECs in the integration process. Although most of them were set up primarily to promote economic integration, they are increasingly playing a more active role on peace and security issues. For example, over the past two decades conflict prevention, conflict management and conflict resolution have featured prominently in the activities of ECOWAS and SADC. Admittedly, peace and security is a necessary condition for economic integration, but it can be dealt with by other regional bodies (such as the African Union) to give the RECs sufficient space to focus on their main goal of economic integration. The AU developed the African Peace and Security Architecture in 2001 to deal with peace and security issues. It consists of a Peace and Security

Council, a Panel of the Wise, an African Standby Force, a Continental Early Warning System, and a Peace Fund. It also established a framework for post-conflict reconstruction and development in 2006. However, the effective implementation of the framework has been mired by resource constraints and the lack of a clear division of responsibilities between the AU and the various RECs in Africa.

Promoting Transformative Regionalism also calls for a rationalization of the RECs in order to have a more coherent integration agenda in Africa. It would also allow the continent to make more effective use of scarce financial and human resources in promoting programmes on integration and to make dialogue between the AU and African governments much easier. Furthermore, it would facilitate alignment of the strategies of the African Union with those of national governments. In this regard, the recent effort at rationalization by COMESA, EAC and SADC is welcome and should provide impetus for other RECs to do the same with the ultimate objective of having only one continental organisation.

African countries also have to adopt a more pragmatic approach to regionalism and industrial development than in the past. More specifically, they should set realistic targets and deadlines and also should avoid of being caught-up in false dichotomies that often cloud the debate on industrial development. For example, the tendency has been for economists to couch the debate on industrial development in terms of a choice between the role of the state versus markets, export-oriented versus import substitution industrialization, agriculture versus industrial development, and resource-based versus technology-based development strategies. Experience has shown that these choices are not mutually exclusive and have to be part of a coherent package to foster industrialisation. In addition, what works in one country at a given epoch may not necessarily work in another, and so there is the need for each country to be pragmatic and to use the policy combinations which are appropriate to its circumstances and realities.

Industrial policy plays a key role in achieving Transformative Regionalism. At the national level, it is necessary to ensure that investment goes to strategic sectors deemed crucial for structural transformation. It is also useful in unlocking the private sector potential in an economy. At the regional level, industrial policy can also promote coherence across industrial strategies and policies of member states. But for industrial policy to work in Africa, governments must not only provide support to entrepreneurs but also have to challenge them to perform through the establishment and the enforcement of well-defined performance benchmarks. There is also the need for industrial policy to be consistent with other economic policies. For example, the stance of monetary policy must not be such that interest rates are so high that they deter productive investment. For this to happen, however, central banks have

to balance the goal of maintaining price stability with the need to foster structural transformation for sustained growth and employment creation. In this regard, it is interesting to note that at a meeting of the African Central Bank Governors (ACBGs) held in Abuja in March 2014, they called for a review and an expansion of their mandate to include support of industrialisation and of other development programmes of governments (ACBGs 2014) .

Consumers can also play a crucial role in fostering regional trade and industrialisation in Africa. In the discourse on regional trade and industrialisation in Africa, the tendency has been to focus on government policies and on the activities of the private sector. But consumer behaviour is also crucial in achieving goals on regional trade and industrialisation. In particular, the consumption patterns and tastes of African consumers affect the kinds of goods that can be produced and traded profitably by domestic entrepreneurs. Most countries in Africa have a vibrant beer industry because people tend to buy beer produced by local breweries. Similarly, the food (particularly restaurant) industry in Africa thrives in part because there is local demand for the services they provide. It is therefore not surprising that the beer and food industries are the few industries on the continent that have not been severely affected by the deindustrialisation that has taken place in Africa over the past two decades. In this context, if African countries want to develop competitive industries and to boost regional trade, consumers have to learn to appreciate and to buy goods produced on the continent so as to create demand for such goods.

Success in promoting Transformative Regionalism also depends on the extent to which African countries are able to harness existing opportunities for industrial development that are currently not being exploited, particularly in agribusiness. For example, Nigeria produces 1.5 million tons of tomatoes each year and 60 percent of it rots due to the lack of storage facilities as well as the lack of processing tomatoes into tomato paste. Yet, it imports \$360 million worth of tomato paste per year. Nigeria also imports \$200 million worth of juice each year despite the fact that globally it is the second largest grower of citrus fruit (African Business, 2013: p.14). Similar examples can be found in other African countries and they do underscore the need to strengthen efforts to exploit these opportunities. Clearly, this will require boosting investment, particularly in energy infrastructure, and also promoting technological innovation, both of which are important drivers of structural transformation.

History suggests that large economies have been drivers of successful regional integration efforts in other parts of the world (UNECA 2002: p. 4). In this context, the relatively large economies on the continent (Algeria, Egypt, Nigeria, and South Africa) have an important role to play in making Transformative Regionalism work for Africa. They are already active in promoting

peace and security. Nigeria was the driving force behind ECOWAS successful interventions in Liberia and Sierra Leone. Similarly, South Africa has been the driving force behind peace and mediation efforts by SADC in Madagascar and Zimbabwe. There is the need for the four large economies to also play a more active role in the provision of finance and cross-border infrastructure on the continent. They should also position their economies as growth poles in the continent and should promote the development of regional production networks to catalyse trade and investment for sustained development in Africa.

6 Conclusions

African governments have a unique opportunity to make the 21st century an African century. The continent has had a relatively good economic growth performance over the past decade and there has been a significant decline in the poverty rate. Nevertheless, there has also been an increase in the absolute number of poor people on the continent, and employment creation remains a major challenge. Against this background, two issues will play a vital role in determining whether or not the 21st century will be an African century. The first is the extent to which African governments can maintain peace and security, and the second is the extent to which they can transform the production structure of their economies. Regional integration can contribute to addressing each of these challenges. It can foster peace and security and also catalyse investment in cross-border infrastructure which is crucial to enhance firm competitiveness and to stimulate manufacturing development. So far, African countries have made significant progress in promoting peace and security through regional integration. But they have not effectively exploited its potential for economic development as evidenced, for example, by the existence of weak production and export structures in African countries and the low shares of regional trade in Africa's total trade.

This chapter argues that regionalism can be made to work for Africa but that it would require a shift in emphasis from the current trade reform-centered integration approach to an approach based on Transformative Regionalism, in which regional integration promotes and also ensures progress in building productive capacities and in achieving structural transformation for sustained development. In this context, the chapter identified the key elements of Transformative Regionalism, examined the extent to which the current approach to integration adopted by African regional economic communities (RECs) is consistent with Transformative Regionalism, and also highlighted other critical elements of a credible policy package to promote regional integration in Africa. These include enhancing implementation of pro-

grammes and action plans, refocusing the role of the RECs on the goal of economic integration, doing away with false dichotomies that often cloud the debate on development in Africa, and recognising as well as exploiting the vital role of industrial policy and of consumer behaviour in promoting regional integration.

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Assessing the Success of SADC Regional Trade Integration: a Comparative Analysis with ASEAN and MERCOSUR Trade Blocs

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1 Introduction

Regional integration has been considered as a crucial ingredient for economic growth and development among countries and regions. In Africa, the initiatives for regional integration have started in early years of the last century. Particularly, after independence, African countries witnessed the establishment of a number of Regional Trade Agreements (RTAs). Despite of the diligent efforts to stimulate the economic cooperation in the African continent, yet the outcome of these efforts is still far from the expectations. According to the Economic Commission for Africa (ECA) (2010), the situation of intra-African trade is disappointing, since it remains consistently low compared with the continent's external trade. The recent statistics show that more than 80% of Africa' exports go to external markets, while African countries import more than 90% of their imports from outside of the continent (WTO, 2011).

The Southern African Development Community (SADC) is one of the prominent regional trade blocs in Africa. In the last ten years the average of intra-SADC trade is estimated at 10%, which is relatively high compared with other RTAs in Africa, such as COMESA and ECOWAS (SADC Trade Database, 2013). In 2008, the members of SADC have launched a Free Trade Area (FTA), removing tariffs on 85% of their products. Furthermore, the aspiration of the members is to push the cooperation process toward the Common Market, the Monetary Union and a Currency Union in the coming decade. Having these ambitious plans for further trade and development cooperation, it is important to assess the success of the SADC regional trade agreement (RTA) in comparison with other successful trade agreements in developing regions like Asia and Latin America. Indeed, there are many

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successful RTAs in the developing world like the Association of South East Asian Nations (ASEAN) in Asia and the Southern Cone Common Market (MERCOSUR) in Latin America; these two RTAs can be used as a benchmark to evaluate the success of SADC. Therefore, this paper aims at assessing the performance of SADC on the basis of the successes of ASEAN and MERCOSUR. This would be useful to gauge the prospects of African countries' trade integration for further regional trade arrangements and to uncover some policies that can help SADC policy makers to develop the process of integration so as to achieve more cooperation. The ASEAN and MERCOSUR RTAs are selected because they are most successful RTAs in developing regions (i.e. in Asia and in Latin America).

Unlike the previous studies on measuring the trade potential, this study uses an "out-of-sample" approach, which has not been used before to analyze the success of the intra-trade of SADC. In the case of Africa, to our knowledge this method of projecting the potential trade is only used by Ebaidalla and Yahia (2014) to assess the COMESA regional integration as based on the ASEAN trade integration. The analysis employs a gravity model for a sample of ASEAN and MERCOSUR countries over the period 1995-2012. The estimated coefficients of the gravity equation will be applied for a SADC trade model to calculate the potential trade. Then, the performance of such RTAs will be measured by the ratio of potential to actual trade.

This paper is organized as follows. Section two discusses some stylized facts about SADC and about the two regional trade blocs under consideration (i.e. ASEAN and MERCOSUR). Section three reviews the empirical literature on regional integration. While section four outlines the research methodology, section five presents the empirical results. Finally, section six ends with conclusions and policy implications.

2 SADC and non-African trade integration: An Overview

2.1 Overview of SADC Regional Integration

The Southern African Development Community (SADC) is made up of fifteen members, including Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. Prior to the formation of SADC in 1992, the Southern African Development Coordination Conference (SADCC) was established in 1980; aims are to strengthen socio-economic cooperation and integration as well as political and security cooperation of southern African states. The main objectives of SADC comprise achieving development and economic growth, peace and security, alle-

viate poverty, enhance the standard and quality of life of the people of Southern Africa, and support the socially disadvantaged through regional integration, democratic principles and equitable and sustainable development (SADC 2014). The SADC regional integration program included the establishment of a Free Trade Area by 2008, which involves the elimination of tariffs and non-tariff barriers, a Customs Union by 2010, a Common Market by 2015, and later the establishment of a Monetary Union and a single currency. The free trade area in SADC was launched on time in 2008, with all member states (except Seychelles, Angola and Democratic Republic of Congo) removing their tariffs on 85% of their products.

It is shown in table 1 that SADC is considered as the third populous region in our study, after ASEAN and COMESA, with a total population of over 272 million in 2010. The highest GDP per capita for SADC member was Seychelles (USD 10,842.77), followed by Mauritius (USD 7,586.97) and South Africa (USD 7,175.62). On the other hand, some countries like Congo, Malawi, and Mozambique display low levels of GDP per capita.

The table 1 also shows that intra-regional exports and imports of South Africa have the highest share of trade to SADC, with a contribution to total trade in 2000 and 2010 accounting for 54.45% and 47.81% respectively. On the other hand, the contribution to intra-SADC trade of the other countries is very low, except Angola, which takes up the second highest share of trade in SADC after South Africa with a contribution of 23.64% in 2010. Indeed, the importance of South Africa in intra-SADC trade results from its comparative advantage in the production of high value-added goods as well as its geographical location in the SADC region.

2.2 Overview of ASEAN Regional Integration

The Association of Southeast Asian Nations (ASEAN) was established in 1967, to accelerate economic growth, social progress and cultural development in the region. The Association also pays attention to peace and stability through justice amongst its member nations, and promotes active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific, and administrative fields. The founding countries of ASEAN are Indonesia, Malaysia, Philippines, Singapore and Thailand. Brunei Darussalam joined in 1984, Vietnam in 1995, Laos PDR and Myanmar in 1997, and Cambodia in 1999, making up what is today the association of ten member states of ASEAN (ASEAN Secretariat, 2013).

Table 1: SADC Regional Integration, Selected Indicators (2000 – 2010)

Member State	Population (million)	GDP per capita (USD)		Intra-SADC Exports- in USD million		Intra-SADC Imports- in USD million		Share in Total SADC trade (%)	
		2000	2010	2000	2010	2000	2010	2000	2010
Angola	19.55	655.63	4218.65	10.64	2331.38	330.79	1245.37	13.49	23.64
Botswana	1.97	3297.48	6980.36	320.41	897.55	1615.96	4262.20	5.51	3.28
Congo, Dem	62.19	406.57	330.00	12.45	1180.09	197.30	1596.65	3.26	3.53
Lesotho	2.01	415.47	1083.01	1.07	11.25	1.24	12.05	0.32	0.31
Madagascar	21.08	246.28	412.96	26.10	61.65	96.60	297.86	2.13	1.17
Malawi	15.01	154.00	359.58	58.41	203.86	231.90	907.07	0.87	1.00
Mauritius	1.28	3861.04	7586.97	102.78	283.53	363.96	456.49	4.12	2.12
Mozambique	23.97	235.84	386.96	54.71	614.90	329.20	2200.63	1.34	1.93
Namibia	2.18	2059.40	5113.16	436.29	1759.28	1244.86	3490.46	3.15	3.15
Seychelles	0.09	7578.83	10842.77	6.03	1.55	45.94	109.02	0.53	0.30
South Africa	50.90	3019.95	7175.62	2967.44	8391.86	335.96	3693.06	54.45	47.81
Swaziland	1.19	1433.18	3261.59	612.18	1163.58	1000.55	1541.21	2.05	1.08
Tanzania	44.97	308.14	524.69	52.56	780.57	197.30	945.00	2.51	3.78
Zambia	13.22	322.10	1224.95	264.85	1315.51	650.15	3296.75	2.09	3.95
Zimbabwe	13.08	535.04	723.16	1317.11	2283.80	1283.22	3446.17	4.18	2.94
SADC	272.68	972.11	2151.1	6243.04	21280.38	7924.94	27499.9	100.0	100.0

Source: Authors' calculations based on data from World Bank Indicators and websites of SADC (<http://www.sadc.int/about-sadc>).

ASEAN has adopted many trade arrangements which resulted in remarkable progress in intra-trade performance over the last decades (see Table 2). For example, the ASEAN Free Trade Area (AFTA) was signed in January 1992 with the aim of creating a free trade area by 2008. AFTA original signatories

were Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. Vietnam joined in 1995, Laos and Myanmar in 1997, and Cambodia in 1999. This free trade area means that all ASEAN goods can be traded to member states markets with a low tariff or without any tariff (ASEAN Secretariat, 2013).

Table 2 shows that the ten members of ASEAN have growing economies with a population of together about 593 million. We notice that the levels of development in the two years considered are very different across these countries. The table shows that the last four countries joining ASEAN (Cambodia, Laos, Myanmar and Vietnam) have a lower stage in economic development than the other six members. It is interesting to note that there is a large disparity in the share of ASEAN's members in total regional exports and imports. For example, Singapore has the largest share in intra-ASEAN trade with 34 per cent, followed by Malaysia and Thailand. For some countries, like Lao PDR and Cambodia, the intra-regional trade is very low.

2.3 Overview of MERCOSUR Regional Integration

In March 1991, Argentina, Brazil, Paraguay, and Uruguay agreed to form a customs union called the Mercado Común del Sur, or Southern Common Market. The union commonly known as MERCOSUR intended to create an integrated regional market whose members committed to liberalize trade with one another while imposing a common tariff on goods imported from non-members. The main objective of MERCOSUR is to facilitate the free movement of goods, capital, services, and people among its member states. MERCOSUR has further extended its scope by entering free trade agreements with Chile and Bolivia. The union's sheer size gives it considerable market power and influence over trade developments worldwide (Connolly and Gunther, 1999). Bolivia joined as associate in 1997, while Chile has signed a free trade agreement with MERCOSUR. Chile has joined in some of its working groups and joint initiatives, but it is not formally a member because it did not want to raise its tariffs to the planned Common External Tariff (CET) of MERCOSUR. Bolivia's motives were based on economic ones while Chile's declared interests were entirely in continuing its market opening.

Table 2: ASEAN Regional Integration, Selected Indicators (2000–2010)

Member State	Population (million)	GDP per capita (USD)		Intra-ASEAN Exports- in USD million		Intra-ASEAN Imports- in USD million		Share in Total ASEAN trade (%)
		2010	2000	2010	2010	2010	2010	
Brunei	0.40	18086.60	29915.3	8615.4	2383.8	0.54		
Cambodia	14.36	298.95	785.1	5583.6	4896.8	0.51		
Indonesia	240.68	789.81	3027.2	157779.1	135663.3	14.34		
Lao PDR	6.40	321.29	1099.9	2432.8	2076.4	0.22		
Malaysia	28.28	4004.56	8555.5	198800.8	164733.5	17.77		
Myanmar	51.93	268.432	706.4	7599.5	4198.7	0.58		
Philippines	93.44	1043.46	2129.4	51431.7	58228.6	5.36		
Singapore	5.08	23814.56	44862.8	371194.3	328078.9	34.18		
Thailand	66.40	1968.54	4743.3	195312.3	189728.4	18.82		
Viet Nam	86.93	401.55	1225.5	72191.9	84801.2	7.67		
ASEAN	593.90	1159.52	3129.09	1,070,941.4	974789.6	100.00		

Source: ASEAN secretariat (2013), Finance and Macro-economic Surveillance Unit Database, websites of ASEAN Member States' national statistics offices and World Bank Indicators.

Intra-regional trade has gradually been liberalized since the early 1990s. A Customs Union was established on January 1, 1995, with free trade in (most) goods among the four member countries and a Common External Tariff (CET) for trade with third countries (Laird, 1995). The CET has 11

tariff levels varying from 0 to 20 percent, but some important product groups, like automobiles, telecommunications, and computer equipment, are excluded from the agreement. However, it should be noted that the integration process has not led to an across-the-board reduction of external tariffs for all countries. On the contrary, in several product groups, the CET is a compromise between countries with domestic import-substituting producers (who start out with high tariffs that are reduced as a result of integration) and countries without domestic production (where low initial trade barriers have been raised) (Blomstrom and Kokko, 1997).

Table 3: MERCOSUR Regional Integration, Selected Indicators (2000–2010)

Member	State	Population (million)	GDP per capita (USD)		Intra- MERC		Intra- MERC		Share in	
			2000	2010	Exports- in USD million	Imports- in USD million	2000	2010	2000	2010
Argentina		40.37	9329.11	11460.38	8410.55	16977.30	6735.34	19653.49	42.48	40.98
Brazil		195.21	3694.46	10978.26	7843.87	22601.50	7857.39	18092.18	44.03	45.53
Paraguay		6.46	1531.89	3100.84	551.54	2818.17	1509.38	3826.96	5.78	7.44
Uruguay		3.37	6872.73	11530.64	1022.69	2291.09	1726.55	3115.45	7.71	6.05
MERCOSUR		245.42	4634.65	10857.64	17828.65	44688.06	17828.67	44688.08	100.0	100.0

Source: Authors' calculations based on data from World Bank Indicators.

Table 3 reveals that the population of MERCOSUR is estimated at 245 million, Brazil is one of the 10 largest countries in the world so that it is a dominant country within MERCOSUR in terms of population. However, the table 3 clearly shows that Brazil has a lower GDP per capita than Argentina and Uruguay. In 2010 the intra-exports of Brazil and Argentina are very high, while the intra-exports of the rest of countries are far lower. The table 3 also indicates that Argentina's and Brazil's share of total imports originating in MERCOSUR countries has increased, as their contribution to total trade in 2010 accounted for 40.89% and 45.53% respectively, and so these two countries are much more dependent on MERCOSUR for their imports than Uruguay and Paraguay.

3 Literature Review

Concerning the importance of regional arrangements in trade performance and economic prosperity, a huge body of literature on examining the performance of intra-trade of regional trade arrangements has grown in the last decades. However, there is a dearth of studies on the performance of African trade blocs, and most of the empirical literature is focused on advanced and transitional regions. In the last decade, few empirical studies on African trade integration have emerged (e.g. Chauvin and Gaulier (2002); Khandelwal (2004) and Ebaidalla and Yahia (2014).

For instance, Pastore et al. (2009) have studied the trade performance of EU members with the Mediterranean (MED) countries and the new EU members by using a gravity model of intra-EU trade including thirteen members over the period 1995-2002. Employing an “out-of-sample” methodology, they report that there is a substantial unexploited trade potential with both groups of partners, but the ratio of potential to actual trade with the MED countries is much larger and more dispersed and stable compared to that with the new EU members. The authors also found that the potential trade tends to converge to actual trade in a much longer time in the case of MED countries.

Stack and Pentecost (2011) employed a gravity model of new trade theory for a sample of twenty OECD trading partners with EU countries during the period 1992-2003. Based on an “out-of-sample” approach they project the potential trade for ten new member states and ten associated countries. They revealed that the projected trade ratios for the ten new member states are multiples of actual 2003 levels, indicating that trade expansion between these countries will tend to expand in the future. On the other hand, for the Mediterranean countries the ratio of potential to actual trade is found to be near unity value, implying fewer opportunities for further trade integration with the EU.

Hamanaka (2013) examined the level of services trade integration in Asia in comparison with Europe and North America. He found that the intra-regional services trade in Asia is higher than in Europe and North America. He also found that in Asia the intra-regional services trade is higher than that of goods trade, which is in sharp contrast to Europe and North America, where the intra-regional goods trade is higher than that of services trade. Moreover, the author indicated that while Asia's intra-regional trade of goods shows a declining trend, that of services trade remains high, although in the future its decline is expected.

Al-Atrash and Yousef (2000) investigated the trade performance of 18 Arab countries with 43 trading partners that represent over 90 percent of the exports and imports of the Arab world. Using a gravity model, they found that the intra-trade within the Arab sub-groups is higher than the overall intra-Arab trade. The authors also found that cultural attributes - measured by language - have a mixed effect: while English-speaking countries tend to trade more with each other, the French-speaking countries are in this regard not statistically significant.

For the case of Africa, Chauvin and Gaulier (2002) measured the potential of intra-SADC trade, using three complementary approaches: export diversification index (EDI), revealed comparative advantage (RCA) and trade complementarity indices (TCIs), as well as the gravity model approach. They found that there is some complementarity between SADC countries, but their evidence does not confirm the existence of potential trade among the bloc members. Moreover, South Africa is found to be the most significant member in terms of exports and can play an important role in fostering the intra-trade in the SADC region.

In the same vein, Khandelwal (2004) studied the prospects and challenges for trade expansion in the Common Market of Eastern and Southern Africa COMESA and in the South African Development Community (SADC). He argued that the COMESA FTA has taken a market-liberalization approach to regional integration, but has been hampered by country-level implementation issues. On the other hand, SADC has taken the approach of addressing infrastructure and supply constraints, but also suffered from implementation problems. Khandelwal also found that possibilities of growth in intra-regional trade may be limited, but that the two arrangements provide opportunities for their member states to adopt policy credibility for trade reforms and trade liberalization and to address structural problems.

Simwaka (2011) assessed the success of the SADC FTA over the period 1998-2007. He separated the data sample into two periods; pre-integration (before the adoption of FTA 1998-2000) and post-integration (after the SADC FTA came into operation 2003-2007). Using a gravity model, he found that the predicted trade is higher than the observed intra-regional trade,

suggesting an existence of a trade potential among SADC members. Simwaka concluded that the SADC FTA leads to trade creation and that it enhances the trade capabilities of member countries. His results, however, contradict the findings of Chauvin and Gaulier (2002), who found that SADC trade potentials are rather small or negative, especially for South African exports. Finally, comparing SADC with other regional integration arrangements, the author argued that ASEAN and the North American Free Trade Area (NAFTA) perform better than SADC.

Recently, Ebaidalla and Yahia (2014) assessed the performance of intra-COMESA trade integration on the basis of the success of ASEAN integration, using an “out-of-sample” model and employing a gravity approach. They pointed out that all countries of the selected sample are far from their potential trade level, implying an unfavorable performance of the regional trade integration process among the COMESA members. Their results also indicate that the gap between potential and actual trade has decreased in last decade, suggesting a convergence of the actual to the potential trade level over time.

4 Methodology and Data

To gauge the performance of intra-SADC trade on the basis of success of ASEAN and MERCOSUR integration, the analysis follows two steps: first, we estimate the coefficients of the gravity model of both intra-ASEAN and intra-MERCOSUR trade, and then we apply them into equations of intra-trade between the selected members of SADC to calculate the potential trade relative to non-African blocs. The calculated potential trade volume for SADC will be compared with the actual volume of intra-trade.

4.1 Model Specification

The gravity models are widely used in the literature as an analytical framework to identify the determinants of bilateral trade flows. The gravity model was firstly used by Tinbergen (1962) and Linneman (1966), and was later developed by Anderson (1979). Latterly, this model has been developed further and used extensively in the trade literature. Therefore, this paper employs the gravity model as a benchmark model to compare intra-region trade flows between SADC regional integration and non-African regional trade blocs under investigation.

The gravity model is based on Newton’s gravity law in Physics, which assumes that there is a gravitational pull between two physical bodies as proportional to their mass and inversely proportional to their distance. This

theory is analogous to the international trade as follows: the trade flow between two countries (exporter and importer) is proportional to the national income of each country's (economic mass), commonly measured by GDP or population, divided by the distance between the country's respective centers of gravity. Thus, trade between two countries depends on their Gross Domestic Product (GDP), population size, and the distance between them. Hence, the estimable gravity model that is used in our analysis could be specified as follows:

$$\begin{aligned} \ln T_{ijt} = & \alpha_{ij} + \beta_1 \ln GDP_{it} + \beta_2 \ln POP_{it} + \beta_3 \ln GDP_{jt} + \beta_4 \ln POP_{jt} \\ & + \beta_5 \ln DIST_{ij} + \beta_6 BOR_{ij} + \beta_7 LANG_{ij} + \mu_{ijt} \quad (1) \end{aligned}$$

Where i indicates the exporter countries, j are the trading partners, and t is the period under consideration, while T_{ij} is the volume of trade (exports + imports) variable between country i and country j ; POP_i and POP_j are the population at time t of country i and j , respectively; GDP_i and GDP_j are the gross domestic product of country i and j at time t ; $DIST_{ij}$ is the geographical distance in kilometers between the capital city of country i and of country j ; $LANG_{ij}$ is a dummy variable to capture common language and colonial history, taking value of 1 if the two countries speak the same language or have ex-colony links, and zero otherwise. BOR_{ij} is a dummy taking a value of one if the trade partners share common land borders or sea borders, and zero otherwise; finally, μ_{ijt} is the error term. All the variables are expressed in natural logarithms except the dummy variables.

According to the theory, the coefficient of GDP is expected to be positive, as an increase in GDP indicates more imports demand and exports supply. The impact of population size (POP) is mixed as suggested by most of the previous empirical studies. Markheim (1994) argues that a country with a large population size entails a large domestic market and a high degree of self-sufficiency and less need to trade (absorption effect). Other arguments show that a large population means more progress in specialization and the division of labour and this also means an increase of the production, all being factors which are generally associated with a larger need for trading (scale effect). The coefficient of distance is expected to be negative, as the larger physical distance between two countries' economic centers means that the cost of transporting goods between them is higher. Finally, the dummy variables LANG and BOR are expected to be positive, as sharing borders, ex-colony links, and using the same language indicate geographical closeness, better information, same culture and institutions as well as comparable legal systems (Ebaidalla, and Yahia 2014).

4.2 Data Sources

The data used in the gravity model concern two non-African blocs: ASEAN and MERCOSUR. The data about ASEAN cover eight members over the period 1998-2010³. On the other hand, the data for MERCOSUR members cover four countries during the period 1995-2011⁴. The data concerning the selected members of SADC span for the period 2004-2010⁵. The trade data for ASEAN and MERCOSUR members were extracted from IMF's Direction of International Trade statistics (IMF, 2014)⁶, while the trade data for SADC is collected from its web site⁷. The data about current GDP and population size were obtained from World Bank's World Development Indicators (World Bank 2014). Data on distance in kilometers between countries was sourced from the Distance From To website⁸. Finally, Information about common language, ex-colony history and common border were sourced from the CIA's World Factbook.⁹

4.3 Estimation Methodology

The gravity model in equation (1) for both ASEAN and MERCOSUR is estimated by using the three panel data methods, namely pooled (P), fixed effects (FE), and random effects (RE) models. As our regression models involve individual effects, it is important to decide whether they are fixed or random; thus we focus on the fixed and random effects models. When estimating the trade flows between a randomly selected sample of trading partners from a large population a random effects (RE) model is more appropriate, while the fixed effects model (FE) model is better when estimating the flows of trade between an *ex ante* predetermined selection of countries (Egger, 2006). However, the Hausman test statistic is applied to check further

³ The analysis of intra-ASEAN trade flows includes: Brunei, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand and Vietnam. The remaining countries were excluded, because they joined ASEAN integration after 1998.

⁴ The MERCOSUR sample includes the four founders of the treaty: Brazil, Argentina, Paraguay and Uruguay.

⁵ Due to the lack of data on some members of SADC, we select nine countries from SADC. See the list of countries used in the analysis in Annex I.

⁶ IMF (2014), Direction of International Trade Statistics (DOTS), Web Access: <http://elibrary-data.imf.org/finddataareports.aspx?d=33061&e=170921>

⁷ SADC Trade database (2013). <http://www.sadc.int/about-sadc>.

⁸ Distance From To website: <http://www.distancefromto.net/countries.php>.

⁹ CIA, World Factbook, Web Access: <https://www.cia.gov/library/publications/the-world-factbook/>

whether the fixed effects (FE) model is more appropriate than the random effects (RE) model. If the null hypothesis of no correlation between the individual effects and regressors is rejected, then the fixed effects (FE) model is better than the random effects (RE) one.

Following Simwaka (2011) and Pastore *et al.* (2009), the gravity model estimators are used as a benchmark to assess the potential trade of SADC regional integration. That is, to assess the performance of the SADC, the estimated coefficients of the gravity model relative to the intra-ASEAN and MERCOSUR trade model will be applied to a similar specification of the intra- SADC trade model. The success of intra-trade integration for SADC is measured by the ratio of potential to actual trade. The projected potential trade is the amount of trade that would be achieved if SADC could achieve intra-regional trade integration similar to that of ASEAN and MERCOSUR. The ratio of potential to actual trade measures the success of intra-trade integration of the SADC bloc relative to the ASEAN and MERCOSUR blocs. A ratio of one indicates that the potential trade equals actual trade, implying that the intra-trade of SADC is at a successful level compared to a specific non-African bloc. The higher is the ratio, the higher is the gap that needs to be filled by creation of more trade. A ratio below one indicates that actual trade is close to its potential level.

5 Empirical Results

5.1 Estimation of the Gravity Model

Since we use the ASEAN and MERCOSUR trade arrangements as benchmark to assess the trade integration of the African trade blocs, the gravity model of equation (1) will be estimated for both ASEAN and MERCOSUR trade integration, using pooled, fixed and random effects models. First, the results of the gravity model for selected ASEAN members are presented in Table 4 below. The results in the second column are those of the pooled panel data model. The shortcoming of this model is that it does not consider for heterogeneity of countries, and no country-specific effects are estimated, hence assuming that all countries are homogenous in terms of cross-section and time. Columns three and five present the results of the fixed effects (FE) models which take into account the heterogeneity by estimating country-specific effects. To support the efficiency of fixed effects, the F-test was performed to check the poolability of the data. The result of the F-test shows that the null hypothesis of equality of the individual effects is rejected, suggesting that a model with individual effects must be selected (i.e. fixed effects or random effects).

Finally, the results in columns 4 and 6 are those of the random effects (RE) model. The main advantage of a random effects (RE) model is that it allows - like a fixed effects (FE) model - for heterogeneity in the cross section, but it avoids the loss of degrees of freedom which occurs in the fixed effects (FE) model. To choose between the FE and the RE models, the Hausman test rejects the hypothesis that the coefficients of the FE models and of the RE models are equal, suggesting that FE estimates are more consistent. However, one problem with a fixed effects (FE) model is that variables that do not change over time (e.g. distance, common border, or common language) cannot be estimated directly because they are fixed effects (FE) and are therefore removed in estimates at the difference. Since both time varying effects and time invariant effects must be taken into account in gravity models, the analysis follows Pastore et al. (2009) in relying on the RE model instead of the FE model. Precisely, we rely on a RE model (see column 6 in table 4) which takes into account all variables which are specified in the gravity model. The table 4 shows that all the estimated coefficients of the preferred model in column 6 carry their expected signs, and in line with the theory, except the dummy variable of common language and ex-colony links. The coefficient of GDP of the exporter country is positive and significant as expected, implying that an increase in national income of the exporting country encourages trade flows to the trading partner. The impact of the exporter's population is also positive and significant, confirming most of the previous empirical studies (e.g. Simwaka 2011 and Pastore et al. 2009).

The GDP and population size of the trading partner have a positive impact on trade flows from the source countries. This finding indicates that a trading partner with a large economy and market size measured by its GDP and population size encourage the volume of trade with the exporter country. In addition, the coefficient of geographical distance is negative as expected, implying that high transportation costs between member countries negatively affect trade flows.

Table 4: Results of Gravity Model Estimation for intra-ASEAN trade (1998-2010)

The dependent Variable is the total trade (exports +imports, in US\$)					
Variable	2	3	4	5	6
	Pooled	FEM	REM	FEM	REM
Constant	-50.26*** (-12.36)	2.20 (0.06)	-32.67*** (-3.63)	-80.64 (-0.58)	-18.12*** (-4.07)
LOG(GDPI)	1.32*** (10.16)	-2.72*** (-3.03)	0.94*** (4.29)	-2.65** (-2.94)	0.09* (1.76)
LOG(POPI)	0.36*** (3.34)			3.96 (0.75)	0.08*** (2.88)
LOG(GDPJ)	1.49*** (11.76)	3.40*** (3.88)	1.46*** (6.77)	3.42*** (3.87)	0.17*** (5.73)
LOG(POPJ)	0.14 (1.32)			0.86 (0.16)	0.03 (0.48)
LOG(DIST)	-1.29*** (-3.92)		-1.12 (-1.19)		-1.41 (-1.47)
LANG	-0.21 (-0.42)		-0.23 (-0.16)		-0.38 (-0.27)
BOR	2.51** (5.36)		2.12 (1.61)		2.59* (1.93)
R2	0.64	0.78	0.58	0.78	0.61
F	94.14	34.74		33.70	
Hausman Test		31.95 (0.0000)		25.42 (0.0000)	
No. of Observations	728	728	728	728	728
No. of Groups	56	56	56	56	56
Obs. per group	7	7	7	7	7

Note: *, **, *** indicate significance at 10, 5 and 1 per cent respectively
-t-statistics in parentheses

Finally, the results in columns 4 and 6 are those of the random effects (RE) model. The main advantage of a random effects (RE) model is that it allows - like a fixed effects (FE) model - for heterogeneity in the cross section, but it avoids the loss of degrees of freedom which occurs in the fixed effects (FE) model. To choose between the FE and the RE models, the Hausman test rejects the hypothesis that the coefficients of the FE models and of the RE models are equal, suggesting that FE estimates are more consistent. However, one problem with a fixed effects (FE) model is that variables that do not change over time (e.g. distance, common border, or common language) cannot be estimated directly because they are fixed effects (FE) and are therefore

removed in estimates at the difference. Since both time varying effects and time invariant effects must be taken into account in gravity models, the analysis follows Pastore et al. (2009) in relying on the RE model instead of the FE model. Precisely, we rely on a RE model (see column 6 in table 4) which takes into account all variables which are specified in the gravity model. The table 4 shows that all the estimated coefficients of the preferred model in column 6 carry their expected signs, and in line with the theory, except the dummy variable of common language and ex-colony links. The coefficient of GDP of the exporter country is positive and significant as expected, implying that an increase in national income of the exporting country encourages trade flows to the trading partner. The impact of the exporter's population is also positive and significant, confirming most of the previous empirical studies (e.g. Simwaka 2011 and Pastore et al. 2009).

The GDP and population size of the trading partner have a positive impact on trade flows from the source countries. This finding indicates that a trading partner with a large economy and market size measured by its GDP and population size encourage the volume of trade with the exporter country. In addition, the coefficient of geographical distance is negative as expected, implying that high transportation costs between member countries negatively affect trade flows.

Unexpected, the coefficient of the dummy variable of common language is negative, but it is not statistically different from zero. This result suggests that in case members speak the same language or have ex-colony links this tends to reduce the size of trade between them. This finding could be explained by the fact that there are few countries of ASEAN which speak the same language and most of them were occupied by different colonizers. Finally, the impact of a common border is found to be positive, suggesting that members sharing a common land or sea borders enjoy more trade activities between them.

Second, the results of the gravity model of selected MERCOSUR members are presented in Table 5 below.

Table 5: Results of Gravity Model Estimation for intra-MERCOSUR trade (1995-2010)

The dependent Variable is the total trade (exports +imports, in US\$)					
Variable	2 Pooled	3 FEM	4 REM	5 FEM	6 REM
Constant	-4.017 (0.008)	-1.607 (-0.72)	-3.667 (-1.51)	-58.40*** (-5.77)	-4.977 (-1.40)
LOG(GDPI)	0.461*** (7.57)	0.785*** (5.13)	0.510*** (9.73)	0.511*** (3.30)	0.397*** (3.43)
LOG(POPI)	0.151 (1.42)			3.86*** (5.94)	0.595** (2.40)
LOG(GDPJ)	0.386*** (7.88)	0.087 (0.57)	0.367*** (7.01)	0.027 (0.18)	0.367*** (3.54)
LOG(POPJ)	0.004** (2.10)			0.007 (1.08)	0.001*** (3.17)
LOG(DIS)	-0.068 (0.39)		0.284 (0.95)		-0.600 (-1.26)
LANG	-0.476*** (-3.09)		-0.712*** (-3.10)		0.246 (0.59)
BOR	0.200 (1.20)		0.361 (1.17)		-0.292 (-0.64)
R2	0.87	0.58	0.56	0.50	0.93
F	202.62 (0.000)	50 (0.000)		47 (0.000)	
Hausman Test		3.82 (0.1484)		39.54(0.000)	
No. of Ob- servations	204	204	204	204	204
No. of Groups	12	12	12	12	12
Obs. per group	17	17	17	17	17

Note: *, **, *** indicate significance at 10, 5 and 1 per cent respectively, t-statistics in parentheses

We estimated the model using pooled, fixed and random effects methods. Here, we applied the same criteria that were used in the case of ASEAN to select the best model. The Hausman test rejects the hypothesis that the coefficients of the FE models and the RE models are equal, suggesting that FE estimates are more consistent. However, to consider the time varying effects and the time invariant effects we selected the random effects (RE) model as suggested by Pastore et al. (2009). Therefore, the preferred model is that of

RE presented in column 6 which takes into account all variables specified in our gravity model. The results of the random effects (RE) model in column 6 have high explanatory power as indicated by R squared. All variables also bear the expected signs and fit well with theory, except the dummy variable of common borders. The results show that the coefficients of exporter' income, importer' income, home population and importer' population are positive and statistically significant. This implies that GDP and population size of trade partners exert positive impact on trade flows between the members of the MERCOSUR integration agreement.

Expectedly, the effect of geographical distance is found to be negative, but it is not statistically significant. In addition, the results revealed that the coefficient of the dummy variable of common language is positive, indicating that MERCOSUR members that speak the same language or have ex-colony links tend to trade more among each other. Finally, the impact of the common border is found to be negative, but it is not statistically different from zero.

5.2 Estimating the Potential Trade of SADC Integration

Having estimated the gravity models of ASEAN and MERCOSUR trade blocs, the next step is to project the potential trade by applying the coefficients of the estimated gravity models to SADC members. Due to availability of data we measured the potential trade for nine SADC members over the period 2004-2011. The potential trade is compared with the actual trade in order to assess the success of intra-trade of SADC. The average of the potential to actual trade ratios between each member of SADC and their partner during the period 2004-2011 are presented in Annex II and III.

Annex II presents the average ratios of potential to actual trade of intra-SADC compared to intra-ASEAN trade performance. The results pointed out that for all selected SADC countries, except South Africa, the potential trade is far distance from the actual trade. Despite the huge gap between potential and actual trade, the differences vary from country pair to another. For country pairs like Congo-Madagascar, Congo-Mauritius, Malawi-Madagascar and Zambia-Madagascar, the ratios of potential to actual trade are high; this may be due to far distance between these countries and the absence of cultural linkages like language and history. The results also show that South Africa is the most successful country among the selected SADC members, as the ratio of its potential to actual trade is less than 1 with all trading partners of SADC. This implies that the actual trade of South Africa with other SADC member is greater than its potential trade. The success of South Africa can be explained by its geographical location in the SADC region as well as its comparative advantages in the high value added commodities. In addition, South

Africa is considered as the most developed country in the SADC treaty, as it has the highest GDP per capita (see Table 1). This finding also confirms the trade statistics presented in Table 1 which show that the contribution of South African trade to intra-exports and intra-imports is the largest one among the SADC members.

Regarding the trade performance of SADC relative to intra-MERCOSUR trade performance, the average ratios of potential to actual trade are presented in Annex III. Like the results of the SADC-ASEAN model, the analysis reveals that most of the selected SADC members exhibit high ratios of potential to actual trade. Countries like Congo, Madagascar and Mauritius are reported as having far distance between actual and potential trade with other SADC members. In the model of SADC-MERCOSUR, again South Africa is found to be the most successful SADC member, confirming the results of the SADC-ASEAN model.

Interestingly, the results show that the average ratios of actual to potential trade for the SADC-ASEAN model (Annex II) are less than for the SADC-MERCOSUR model (Annex III), indicating that the trade performance of intra-SADC relative to intra-ASEAN trade is better than the trade performance of intra-SADC relative to intra-MERCOSUR trade. This implies that the performance of SADC is more close to ASEAN than to MERCOSUR. This result also indicates that intra-MERCOSUR trade performance is more successful than intra-ASEAN trade. This finding could be explained by the fact that MERCOSUR is confined to a few members undertaking a sizable intra-trade between them.

Overall, the empirical results indicate that SADC exhibits an unfavorable intra-trade performance compared to the ASEAN and MERCOSUR trade arrangements. This result supports the claim that intra-African trade is very low and disappointing compared to that of major other regions in the world (UNECA, 2013). This finding also confirms the results of previous studies on assessing the performance of African trade arrangement (e.g. Chauvin, and Gaulier 2002; and and Yahia, 2014).

6 Conclusion and Policy Implications

This paper assessed the performance of intra-SADC trade integration on the basis of the success of two non-African trade arrangements, namely ASEAN and MERCOSUR. The study used an “out-of-sample” approach and employed the gravity model for a sample of countries from the SADC trade bloc. The estimated coefficients of the gravity equations have been applied to the intra-SADC trade model to calculate the potential trade. Then, the intra-

trade performance of the two trade blocs is measured by the ratio of potential to actual trade.

The empirical analysis shows that the actual intra-trade for most of SADC members is less than the estimated potential trade. Some SADC members like Congo, Madagascar and Mauritius exhibit low intra-SADC performance compared to ASEAN and MERCOSUR. The results also indicated that among SADC members, South Africa is the most successful country with potential to actual trade ratios less than unity. Moreover, the performance of bilateral trade between Zambia and Zimbabwe is successful; this being due to the common border and the fact that there is less geographical distance. This result is implying that the actual bilateral trade between countries with common language, border or ex-colony links is quite close to its potential level. This finding also confirms the significant impact of distance and cultural aspects on intra-trade of African trade blocs.

Based on the successful experiences of ASEAN and MERCOSUR, many policy implications can be drawn to enhance the intra-SADC trade integration. First and foremost, as the intra-SADC trade is far from its potential level, SADC needs to promote and to deepen the bilateral and multilateral forms of integration among its members. Therefore, members of SADC should pay considerable attention to the factors that are enhancing intra-trade, such as exports diversification, private investment, and foreign direct investment. All these measures are the most important reasons behind the industrialization success in ASEAN and MERCOSUR blocs. In addition, reaching the successful level of other regional trade integration arrangements needs promoting transport and communication infrastructure networks between the members; trade logistics is especially important. Finally, policy makers of the SADC bloc should adopt various policies to facilitate the flow of trade between the members. These policies include, for example, flexible tax regimes, reducing transactions costs, building social peace, and developing the human capital.

So, three core areas for action are of importance: a) developing further on the SADC integration arrangements, b) developing trade logistics, and c) harmonizing policies related to political and economic stability and to trade and investment in SADC countries.

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Annexes**Annex I: List of Countries used in the Analysis**

SADC Members	ASEAN Members	MERCOSUR
Congo	Brunei Darussalam	Brazil
Madagascar	Indonesia	Argentina
Malawi	Laos	Paraguay
Mauritius	Malaysia	Uruguay
Mozambique	Philippines	
South Africa	Singapore	
Tanzania	Thailand	
Zambia	Vietnam	
Zimbabwe		

Annex II: Intra-SADC Relative to ASEAN: Average Rate of Potential to Actual Trade (2004-2011)

	Congo	Madagascar	Mali	Mauritius	Mozambique	South Africa	Tanzania	Zambia	Zimbabwe
Congo	0.00	318.10	287.07	316.40	156.00	75.60	49.11	0.53	0.96
Madagascar	830.47	0.00	683.68	1.25	116.22	47.41	394.82	728.48	173.84
Mali	10.83	335.99	0.00	75.78	2.00	6.62	9.47	1.97	0.95
Mauritius	402.38	0.17	134.91	0.00	17.20	8.54	23.94	29.98	11.59
Mozambique	58.10	52.41	0.48	43.23	0.00	1.36	43.25	11.28	0.31
South Africa	0.59	2.24	0.78	0.89	0.22	0.00	0.65	0.21	0.19
Tanzania	1.01	12.90	0.47	17.26	3.51	12.04	0.00	1.02	10.75
Zambia	0.18	705.52	0.28	90.88	17.08	0.96	0.88	0.00	0.25
Zimbabwe	0.81	421.59	0.65	8.19	3.26	1.43	18.24	0.40	0.00

Annex III: Intra-SADC Relative to MERCOSUR: Average Rate of Potential to Actual Trade (2004-2011)

	Congo	Madagascar	Mali	Mauritius	Mozambique	South				Zimbabwe
						Africa	Tanzania	Zambia	Zimbabwe	
Congo	0.00	1086.50	66.47	1398.10	515.84	168.26	142.07	1.68	3.25	
Madagascar	492.42	0.00	403.30	3.59	331.83	103.64	1007.14	671.77	519.53	
Mali	26.14	96.11	0.00	197.49	5.24	14.39	22.67	4.93	2.49	
Mauritius	1544.75	0.51	449.82	0.00	50.21	18.72	62.06	82.85	35.85	
Mozambique	152.93	158.35	1.62	127.47	0.00	2.99	112.59	31.55	0.94	
South Africa	2.49	9.68	3.41	3.82	0.96	0.00	2.70	0.90	0.81	
Tanzania	3.03	44.31	1.77	58.39	11.79	26.87	0.00	3.22	37.18	
Zambia	0.51	294.49	0.99	22.85	53.04	2.12	2.43	0.00	0.82	

Patterns of African Regional Integration: The Tripartite and Continental Free Trade Areas

Gerhard Erasmus, Trudi Hartzenberg, Paul Kalenga¹

1 Introduction

Regional integration makes sense for Africa. The removal of intra-regional trade restrictions (such as tariffs, quotas, and non-tariff barriers) is necessary to address the challenges posed by small domestic markets, limited economies of scale, and the marginal position of Africa in global trade. African governments are in agreement on the importance of regional integration for development; most of their development strategies include a strong focus on regional integration.

However, the practicalities around Africa's regional integration and the implementation of legal instruments provide a mixed picture. African Regional Economic Communities (RECs) are, as a rule, top-down constructs which promise deeper integration results along a linear path and at pre-determined dates; moving from free trade areas to customs unions and common markets. Although progress has been made with regard to traditional methodologies, such as tariff liberalization, these arrangements still lack comprehensive rules-based designs, coverage and implementation. Rules about trade-related disciplines (services in particular) which have become the hallmark of successes in regional integration elsewhere are not included or are not sufficiently prioritized.

The African paradigm of regional integration has focused mainly on a trade in goods agenda, with little attention being paid to services and other behind-the-border issues such as investment, competition policy, standards harmonization, and government procurement. The result is that regional integration agendas are limited in scope (even with regard of the trade agenda, there are severe limits; see on the basic trade data for the TFTA area and for the African RECs in contrast to comparator regions Annex Box 2 and Annex tables 1 and 2).

¹ Affiliation and Function: tralac Associate, tralac Executive Director, and tralac Associate, respectively.

The rules-based foundation of regional integration is vital for ensuring effective implementation, predictability and certainty. This aspect is important for enhancing the involvement of the private sector, which is a key agent of regional integration. On this score the African record falls short of expectations. The legal instruments allow Member states wide margins in respect of how and when they comply with their obligations.² Many of these states also lack the technical means, national institutions, and domestic regulatory capacity to implement legal obligations, to develop appropriate policies, and to harmonize their content and execution across borders. Dispute settlement and trade remedies are largely absent; and private parties do not have access to national or regional fora with powers to protect their rights.³ African states do not litigate against each other over trade issues and they treasure their 'sovereign policy space.' This means regional secretariats and other regional institutions lack the powers to act on behalf of the collective.

The African pursuit of regional integration is ambitious in terms of negotiating and joining new agreements. This has led to the problem of overlapping membership, with multiple and often conflicting trade commitments. Overlapping memberships cause confusion and duplication, which undermine the effective implementation of legal obligations. It becomes costly for traders to comply with the different sets of rules and to reap the benefits of trade liberalization and regional integration.

It is for this reason that the proposed Tripartite Free Trade Agreement (TFTA), encompassing 26 countries belonging to the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC), was hailed as a more promising strategy. The idea of wider market integration on the basis of a larger and inclusive Free Trade Area (FTA) regime could be more realistic than the rush to establish several customs unions. One of the initially emphasised aims of the TFTA was to address the problem of overlapping membership.

In October 2008 the Heads of State and Government of the 26 member states of the EAC, COMESA and SADC agreed to establish the TFTA and to integrate the member states of these three regional economic communities (RECs) into a single arrangement. The proposed TFTA was to be a compre-

² Article 3 of the SADC Trade Protocol, which provides for derogations from tariff and non-tariff obligations, is a case in point.

³ In August 2014 the SADC Summit announced the adoption of a new Protocol for the SADC Tribunal. It removes the locus standi of private parties which existed under the previous Protocol. This was done in response to a ruling against Zimbabwe after it had expropriated, without compensation, private land.

hensive FTA covering trade in goods and trade-related matters such as services, investment, and competition policy. The negotiation process is still underway but the original deadlines have not been met. It has also become clear that the TFTA will not be the comprehensive and inclusive FTA mooted in 2008.

Some are still enthusiastic about grand integration schemes, at least as a political ideal. The African Union (AU) has announced plans to take the process further and to establish a Continental FTA (CFTA). The negotiations will be launched in June 2015 and the aim is to start implementation by 2017.

This chapter discusses the background to these initiatives, notes the conceptual challenges, reports on the progress that has been made (and the promises which failed to materialize), and refers to some of the more salient technical challenges. Suggestions about different priorities and alternative approaches to content and sequencing are included. The discussion starts with the latter. Section 2 is on problems of design, while section 3 is on the Tripartite FTA by contrasting the original plan and the outcome. In section 4 the plan for a Continental FTA is presented and commented, while in section 5 conclusions and policy recommendations are given.

2 Problems of Design

One of the first challenges facing policymakers and negotiators embarking on new initiatives, such as the TFTA and CFTA, concerns the clarity of design and specifically how to ensure effective outcomes. Modern FTAs are comprehensive, covering much more than the traditional trade in goods agenda that still forms the primary focus of most African Regional Economic Communities (RECs). It is acknowledged that 21st century investment, production and trade arrangements require a much more comprehensive approach with emphasis on new generation trade issues, such as services, investment, competition, regulatory, and intellectual property issues (Baldwin 2011). African trade negotiators should therefore identify the pitfalls in existing regimes and seek to address them, if these regimes are to address fundamental competitiveness and development challenges. This requires *inter alia* that they adopt appropriate approaches to tariff liberalisation and rules of origin which go beyond a conventional ‘mercantilist’ paradigm. But they should also expand the disciplines covered in these agreements. Successful FTAs have moved beyond tariffs to include trade in services and other trade-related disciplines, such as investment, competition, product standards, and intellectual property rights.

African regional trade regimes have not succeeded in making intra-African trade a powerful driver of economic growth and development. Alt-

though the levels of intra-regional trade and investment have in recent years increased, the potential has not yet been fully realized.⁴ To promote intra-regional trade, and to support the expeditious establishment of the CFTA, member states of the African Union (AU) adopted an action plan, “Boosting Intra-African Trade” (BIAT) in January 2012⁵.

Realising the potential for increasing intra-regional trade flows would require that key trade impediments are addressed. These obstacles include, amongst others:

- (i) The persistence of trade barriers, particularly non-tariff barriers.
- (ii) Restrictive rules of origin. They are often designed to achieve protectionist objectives, rather than preventing trade deflection or transshipment.
- (iii) Lack of consistent regulatory reform and of adequate regulatory implementation progress to reduce high transaction costs of doing business and to install transparent conditions with regard of harmonization and standardization.
- (iv) High transport and “behind-the-border” costs, with inefficiencies at border crossings.

The growing importance of production networks in global industrial organisation explains why market governance issues and new approaches to industrial policy merit more emphasis.⁶

Trade agreements are not an end in themselves. They have to serve particular policy objectives and should implement those reforms which are urgent and necessary. And they should do so in a manner which will stand a realistic chance of achieving effective outcomes while ensuring that obliga-

⁴ Member States of the African Union (AU) have adopted a strategy specifically to boost intra-African trade; for further details, see African Union Commission (AUC) and Economic Commission for Africa (ECA), 2012, ‘Boosting Intra-African Trade: Issues affecting Intra-African trade, Proposed Action Plan for boosting Intra-African Trade and Frameworks for the fast tracking of a Continental Free Trade Area’, January 23 – 30 2012, Addis Ababa.

⁵ See the full text at: http://www.uneca.org/sites/default/files/page_attachments/issues_affecting_intraafrican_trade_proposed_action_plan_for_biat_and_framework_for_the_fast_tracking_of_a_cfta_-ts6622_en_original.doc.pdf

⁶ Value chains and their implications for industrial policy are now enjoying much analytical focus. See for example: Low, Patrick and Julia Tijaja, *Global Value Chains and Industrial Policies*, E15Initiative, Geneva: International Centre for Trade and Sustainable Development (ICTSD) and World Economic Forum (WEF), 2013, Web Access: www.e15initiative.org/

tions will be honoured. Measured against this benchmark specific particular problem areas in the RECs become self-evident.

2.1 Overlapping trade regimes

Overlapping membership poses a major obstacle to regional economic integration in Africa. The objectives of COMESA, EAC and SADC (the focus of this chapter) are, for example, quite similar. But they pursue their integration efforts under different rules of origin and separate trade instruments. The complexity of choice of optimal configuration has resulted in member states belonging to different arrangements with different obligations and, in some respects, different pathways to integration.

Four COMESA members also belong to the EAC, while eight are simultaneously members of SADC. The same applies to SADC: in addition to overlaps with COMESA, Tanzania is a founding member of the EAC, which is formally a customs union. The Southern African Customs Union (SACU) exists since 1910 and consists of South Africa, Botswana, Lesotho, Namibia and Swaziland, all SADC members. Swaziland enjoys a special preferential arrangement with COMESA too. This state of affairs undermines implementation efforts, results in duplication, and causes unnecessary costs.

The consolidation of the COMESA, EAC and SADC into a single trade regime (under the TFTA) could make a major contribution in overcoming the problem of overlapping membership. This also offered an opportunity to go beyond a traditional trade in goods regime; targeting new disciplines such as services; and properly tackling trade facilitation issues.⁷ It could have addressed impediments such as diverging rules of origin, harmonization of technical regulations, and NTBs. Agreements could have been placed on firmer legal foundations. The discussion below will show how this opportunity has failed to materialize.

2.2 Reforming rules of origin

Substantial progress has been made within SADC, COMESA and the EAC towards the reduction and elimination of tariffs. However, rules of origin remain problematic. They will be critical in determining whether the Tripartite FTA will promote intra-tripartite trade and investment in a major way.

⁷ The recently concluded Trade Facilitation Agreement (TFA) of the WTO (http://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm#how) provides a suitable anchor for coordinating trade facilitation obligations and implementation in the RECs and the TFTA.

These rules are important to avoid transshipment and trade deflection; only goods entitled for preferential treatment should qualify. Rules of origin can be used to protect domestic producers of 'sensitive products' from competition. At the core of this problem lies a belief that protective rules of origin can promote industrialisation, particularly the development of upstream-downstream production linkages⁸.

The 'wholly produced' criterion for goods not manufactured but extracted (such as minerals) or grown from the soil (such as livestock, maize, wheat) applies to all the three trade regimes. It is also generally agreed that basic operations, such as labelling or repackaging, does not add sufficient value to confer origin.

A major problem arises if a good is manufactured using imported components: then traded goods will only originate from a country where 'substantial transformation' takes place. However, 'substantial transformation' is a rather complex process, especially in today's world of globally integrated value chains and production networks.

As an example, SADC rules of origin, for garments, are significantly different from those applied in COMESA and the EAC. Initially the SADC rules provided for relatively simple rules modelled on those of COMESA. After an agreement on tariff liberalisation schedules in the late 1990s, the SADC rules of origin regime were changed to cushion the potential impact of regional tariff reductions. The SADC Regional Indicative Development Plan (RISDP) states that implementation of the Trade Protocol should be 'accompanied by appropriate rules of origin, which will encourage the optimum utilisation of regional resources and allow forward and backward linkages in the various production chains'.⁹ The outcome was the emergence of product-specific rules of origin that use different methods to determine national origin. Value addition thresholds were raised considerably and permissible levels of import content were decreased.

A mid-term review of the SADC Trade Protocol conducted in 2004 called for the reform of the rules of origin. The review concluded that rules of origin were complex and not supportive to enhancing intra-regional trade and competitiveness (Brenton et al, 2004). A subsequent review resulted in the relaxation of some product-specific rules. However, rules for most textile and

⁸ This line of argument is, for example, supported by South Africa.

⁹ See Section 3.2.2.2 of the Regional Indicative Strategic Development Plan (RISDP); available at:

http://www.sadc.int/files/5713/5292/8372/Regional_Indicative_Strategic_Development_Plan.pdf

clothing items are still based on double-stage transformation; i.e. fabric and the garment have to be produced in the region. There is considerable pressure from some member states to move towards the single transformation rule (i.e. importing fabrics from anywhere in the world), emanating from the expiry of the MMTZ (Malawi, Mozambique, Tanzania and Zambia) arrangement.¹⁰ Wheat flour is still excluded from preferential trade; no agreement on its rules of origin has been reached.

The TFTA negotiations offered an opportunity to take a fresh look at the role of rules of origin in African regional integration. Value addition thresholds must recognise global production realities, specifically the fragmentation of production stages across geographic locations to decrease costs and take advantage of comparative advantages. The majority of the TFTA countries have small and less diversified economies which require imported inputs. The higher the amount of domestic value added required, the more difficult it is to comply, thereby constraining specialisation. Contrary to popular view, there is no evidence that restrictive rules have stimulated the development of integrated production structures (Erasmus et al., 2006).

Up to December 2014 the TFTA still lacked a final agreement on rules of origin. The negotiators seem incapable of marrying the SADC and COMESA/EAC rules of origin philosophies. This matter will stand over for the 2015 round of negotiations.

2.3 Streamlining product standards and technical regulations

International rules require that traded goods conform to certain minimum standards and technical regulations. This can affect trade costs, especially if markets contain different standards. These costs can be reduced through harmonization. COMESA, the EAC and SADC have developed certain initiatives to deal with technical barriers to trade (TBTs) and sanitary and phytosanitary (SPS) measures.¹¹ This happens largely via the development of legal frameworks which the member states must then implement domestically.

There have been attempts to harmonise standards in these RECs. COMESA has been working on a regional certification plan aimed at recognising national standards. The EAC enacted a Standards, Quality, Metrology

¹⁰ This arrangement was a compromise that led to the adoption of the restrictive yarn-forward as a standard rule in the textile and garments sector and allowed poorer SADC members (Malawi, Mozambique, Tanzania and Zambia – the MMTZ) to access the SACU market through a time- and quantity-bound single transformation rule. This arrangement expired in December 2009.

¹¹ The obligations of member states are modelled on WTO disciplines.

and Testing (SQMT) Act in 2006 and is developing a regulatory and institutional framework to implement the Act. SADC has added TBT and SPS annexes to its Protocol on Trade. They establish modalities for cooperation in the implementation of a regional (technical barriers to trade) regulatory framework and SPS measures respectively. SADC also established a regional accreditation body, the SADC Accreditation Service (SADCAS), which offers accreditation services in the areas of testing, calibration, certification and inspection. Since its establishment, SADCAS has accredited testing laboratories in Botswana, Seychelles and Tanzania.

Important lessons are to be learned with regard to the difficulties in implementing these instruments. The process of harmonising standards has proved, in most instances, to be tedious. And there are no effective regional remedies in place to deal with private sector complaints regarding standards. The associated compliance costs remain high. The state parties are not actively encouraged to accept as equivalent other members' standards or technical regulations. It is claimed that domestic Standardisation Quality Assurance, Accreditation and Metrology (SQAM) infrastructures are too weak and hence equivalence (which has to be based on conformity assessments) remains a challenge. If this is true it serves as another demonstration of the importance of governance in the pursuit of regional and global economic integration. Member states should prioritise domestic reforms, institution building, and the adoption of appropriate legislation. National development plans should be dovetailed with regional and global integration efforts; these are complementary problems. They require governmental strategies which will ensure balanced and harmonized outcomes.

Tripartite cooperation on Technical Barriers to Trade (TBT) and sanitary and phytosanitary (SPS) issues should target the upgrading of the SQAM infrastructure. Other benefits will then follow, such as the capacity to deal with the undesirable effects of the unregulated importation of sub-standard products of which frequent complaints are heard. Binding mutual recognition arrangements should be explored. This requires appropriate regional arrangements for accreditation, certification and testing, as well as domestic structures endowed with the necessary technical capacity. Such reforms are not cheap but they should be prioritized and should figure prominently on the assistance lists of international donors. There are examples where this has happened.¹²

¹² Namibia has 3 abattoirs which comply with EU standards for imported beef. Tanzania has acquired laboratory testing facilities for exported fish to meet SPS requirements. Donor funding played a major role in establishing these facilities.

2.4 Eliminating non-tariff barriers

There is ample evidence that the prevalence of non-tariff barriers (NTBs) presents a significant challenge to Africa's integration initiatives. NTBs are manifest in myriad contexts. They are related to border management issues, to standards, rules of origin, import bans, and to other restrictions. The World Bank points out that the African countries also use them to keep out exports of other African countries, hampering intra-regional trade.¹³

COMESA, EAC and SADC have established an online reporting mechanism, which may be accessed by any stakeholder to report an NTB. Numerous cases have been reported in COMESA through the NTB reporting system. They include technical regulations on sugar imports by Kenya, as well as Zambian permits regulating and restricting dairy imports.¹⁴

This reporting mechanism might be a promising start but still lacks teeth and cannot provide remedies to affected private parties. Remedial action should focus on matters such as a proper rules-based framework and increased transparency.

2.5 Embracing a trade in services agenda

SADC, COMESA and the EAC have not made substantial progress towards the liberalization of trade in services. Their integration efforts still predominantly emphasise trade in goods. A declaration signed at the Second Tripartite Summit in 2011 has promised to deal with services during the second phase of the negotiations, which would only commence once trade in goods negotiations have been completed, what is now scheduled for 2015.

Services agreements can follow one of two approaches. One is based on GATS with its positive list approach. This requires the parties to list sectors, sub-sectors and modes of supply in which governments will make binding liberalisation commitments. The negative list approach lists exceptions to liberalisation. All sectors and nonconforming measures are to be liberalised unless otherwise specified in a transparent manner in reservation lists. These

¹³ See: World Bank, *De-fragmenting Africa: Deepening Regional Integration in Goods and Services* (in this context see for example chapter 8); available at: http://siteresources.worldbank.org/INTAFRICA/Resources/Defrag_Afr_English_web_version-Part_2.pdf

¹⁴ See the online NTB reporting system www.tradebarriers.org where non-tariff barriers in COMESA, EAC and SADC countries can be notified. This mechanism does however not provide for judicial remedies.

listed reservations can still be liberalised through consultations or in periodic negotiations.

It is not yet clear which approach will be adopted as part of the TFTA negotiations. The trade in services negotiations will start in 2015 and is still uncharted waters, despite the fact that the benefits are obvious. The liberalization of trade in goods depends directly on related services such as transport, finances and communication.

The participating governments claim to lack domestic policies and regulatory frameworks necessary for liberalizing services sectors. And they have backtracked in one important area already; the original plan was to include the movement of business persons as part of the first phase of negotiations. This proved to be impossible. This matter has now been relegated to the next phase of the negotiations, which will hopefully be launched in 2015.

2.6 Advancing a trade and transport facilitation agenda

Non-tariff barriers such as inefficient administrative procedures at border crossings, and other costs incurred within domestic regulatory environments, are major impediments to intra-African trade. Transportation has been identified as a prominent example.¹⁵ This is due to deficiencies in both physical (hard) and policy and regulatory (soft) infrastructure.

There is a tendency which attributes these higher trading costs largely to infrastructural factors such as inadequate roads, railways and port facilities. This fails to recognise the relevance of much needed regulatory and policy reforms. Improvements in soft infrastructure will maximise the gains to be derived from hard infrastructure. A comprehensive approach for tackling high trading costs in the region is therefore required.

The tripartite initiative aims to get goods to market faster and at reduced cost, through improved infrastructure and more efficient border crossings.¹⁶ If these aims are successfully implemented, the gains will be substantial. This should encompass policy and regulatory reform towards more competitive domestic environments; harmonisation of customs documentation, procedures and legislation; expanding one-stop border posts; streamlining border management procedures; harmonising road safety measures (such as axle

¹⁵ See footnote 16.

¹⁶ For further detail on progress on to the North-South Corridor (NSC) see: <http://www.trademarksa.org>

load and vehicle dimension limits); harmonising road transit charges and carrier licensing; as well as third party insurance schemes.

Trade without transport is impossible. Tripartite member states may need to consider a comprehensive regional transport agreement in order to enhance competition. The expansion of the third-country rule and cabotage can go a long way in addressing the scale-related and cost problems in the transport sector.

3 The Tripartite FTA: The original Plan and the subsequent Outcome

The launch of the TFTA negotiations looked promising. This was an opportunity to tackle long-standing challenges pertaining to regional integration in Southern and Eastern Africa, as discussed above. These include, in particular, overlapping membership issues and the scope of the mutual trade obligations. The TFTA negotiations have, however, not yet delivered. Whether it will eventually do so remains to be seen. Present indications are not promising.

Familiar complications have surfaced and it is now clear that there will not be one single FTA from these negotiations. Only those members who do not already have FTAs in place between them will exchange tariff concessions.¹⁷ This will result in more, not less, FTAs; although there have been promises to strive for future consolidation.¹⁸ The problem with additional undertakings, which do not form part of the actual agreement, is that they are difficult to turn into new obligations. Concluded agreements will start to live a life of their own. The review of such agreements is seldom a realistic option. If the parties find it impossible to agree, it will require major political shifts to re-open the same debates at a later stage.

The original objective behind the launch of the TFTA was to establish an inclusive FTA, with the legal and institutional features typical of such an arrangement.¹⁹ One of the Kampala Summit decisions of 2008 stated: In the

¹⁷ This is the specific objective behind the *acquis* principle, which has to be read together with other principles on variable geometry and reciprocity.

¹⁸ The Declaration on Phase One of the Negotiations, adopted towards the end of 2014, reiterates the “*solemn resolve ... to expeditiously establish a Tripartite Free Trade Area covering our three regional economic communities in order to ensure integration of the three regional economic communities into a larger integrated market*”...

¹⁹ See e.g. the Terms of Reference for the “Study on the Establishment of the COMESA-EAC-SADC Free Trade Area (FTA)”; web access of the document: <https://www.google.de/search?q=Study+on+the+Establishment+of+the+COMESA->

area of trade, customs and economic integration, the Tripartite Summit approved the expeditious establishment of a Free Trade Area (FTA) encompassing the Member/Partner States of the 3 RECs with the ultimate goal of establishing a single Customs Union.

The Second Tripartite Summit of Heads of States and Governments held in June, 2011 in Johannesburg, launched the process by agreeing on three pillars for Phase I of the negotiations: (i) Market Integration (ii) Infrastructure Development, and (iii) Industrial Development. Negotiations on the Movement of Business Persons were to be addressed under a parallel but separate track.

This second Tripartite Summit also adopted a Declaration and a set of Negotiating Principles. These Principles became the pacesetters. They underwent further elaboration and directed the negotiations towards tariff agreements between only those member states which do not at present have FTAs between them. The principle of the *acquis* (which has to be read together with the principles of variable geometry and reciprocity) is the main element in this evolution.

The ‘clarifications’ of these Principles were adopted at the end of 2012 and provided as follows:

The negotiations shall be REC-driven and/or Member/Partner State driven

This is taken to mean that Member/Partner States can either negotiate as blocks or as individual countries.

Variable geometry

Variable geometry means the principle of flexibility which allows progression in cooperation among Member/Partner States in a variety of areas at different speeds. The Tripartite Free Trade Agreement (TFTA) will allow the co-existence of different trading arrangements which have been applied within COMESA, EAC and SADC Member States and any trading arrangements that may be reached during the negotiations. The principles of variable geometry, reciprocity, and *Acquis* are complementary.

Flexibility and Special and Differential Treatment (SDT)

Flexibility and “special and differential treatment” (SDT) should apply, among others, to transitional periods for implementation of agreements under the TFTA by countries who are at different levels of economic development and who have individual specificities as recognized by other Member States. The application of SDT would be considered during the negotiations. Tripar-

tite FTA countries should allow flexibility and recognize the “special challenges facing different economies”.

Transparency including the disclosure of information with respect to the application of the tariff arrangements in each REC

This is a standard requirement in all trade negotiations and refers to the need to share information on tariffs, trade statistics, trade policy instruments, and other trade-related measures as agreed by the first Tripartite Trade Negotiating Forum held in December 2011 with all parties in the negotiations. In this case, the TFTA principles ensure that all Member/Partner States and RECs share information in all areas. In the TFTA situation, the agreement is to share information on trade taxes and related taxes at the 8-digit HS level as well as information on trade values, also on the 8-digit HS level for both extra-regional and intra-regional trade. This will also entail an open and predictable negotiating process in which all interested parties are free to participate in an inclusive manner.

Building on the acquis of the existing REC FTAs in terms of consolidating tariff liberalisation in each REC FTA

Acquis is a French term meaning “that which has been agreed”. In the context of the Tripartite Free Trade Agreement (TFTA) it means that the negotiations should start from the point at which of the COMESA, EAC and SADC trade negotiations have reached. Tariff negotiations and the exchange of tariff concessions would be among Member/Partner States of the Tripartite FTA that have no preferential arrangements in place between them. This will both preserve the acquis and build on it.

A Single Undertaking covering Phase I on trade in goods

The Single Undertaking means that all components of the negotiations are parts of the whole and indivisible package and cannot be agreed separately. The Single Undertaking is usually described as meaning “nothing is agreed until everything is agreed”. The Single Undertaking as it refers to the Tripartite Free Trade areas could be interpreted as that all tripartite countries negotiating the TFTA should agree on components covering phase 1 on trade in goods.

Substantial liberalisation

Substantial liberalization means that the TFTA should cover “substantially all trade” among the Tripartite FTA in line with WTO provisions on regional trade agreements.

MFN Treatment

Most Favoured Nation (MFN) Treatment would mean that advantages that any tripartite country offers to third parties outside the tripartite FTA would be offered to other tripartite agreement countries. The purpose is to ensure that TFTA partners trade amongst each other on terms as good as or better

than that offered to non-FTA partners. These advantages would be extended on reciprocity.

National Treatment

National Treatment means that the products of the territory of any tripartite agreement member state imported into the territory of any other tripartite member state shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their sale, offering for sale, purchase, transportation, distribution or use.

Reciprocity

Reciprocity means that the Member/Partner States or RECs in the TFTA will grant to each other mutually agreed trade concessions.

Decisions shall be taken by consensus

This means that all decisions will be taken on the basis of consensus as defined in the Tripartite Trade Negotiation Forum (TTNF) Rules of Procedure. These Principles deal with the critical choices which will be prompted by negotiations of this kind. They reveal very important realities, which will surface in the TFTA debate too: Governments pursue national interests and hegemony are more successful in directing trade negotiations towards securing their own interests. It is difficult to overcome the traditional approach to regional integration of African governments. Committing to enlightened agendas and 21st century realities is easier said than done.

Phase I of the TFTA negotiations was scheduled to be completed by the end of 2014. A typical FTA for goods would have been in place by then. It did not happen. The inability to deal with the implications of the decisions taken as part of the Kampala Summit and of completing the negotiations in time resulted in a new game plan for the TFTA. Towards the end of 2014 a Declaration on Conclusion of Phase I of the Negotiations for the Tripartite Free Trade Area (TFTA) Agreement as well as a Declaration Launching Phase II Negotiations for the Tripartite Free Trade Area (TFTA) were adopted. The latter is accompanied by two Annexes, a Roadmap for the Phase II Negotiations (Annex 1) and the Principles, Processes and Institutional Framework (Annex 2).

Up to December 2014 the negotiations for Phase I have not yet been concluded. Important matters are still to be wrapped up. They include rules of origin, trade remedies, and the exchange of tariff offers. Vital points are therefore still undecided; the liberalization of trade in goods under an FTA

remains impossible as long as tariff schedules and rules of origin are absent. These are also critical elements to be notified to the WTO.²⁰

A rather peculiar procedure is now unfolding: an international trade agreement will be signed (or launched, whatever that means) before negotiations have been finalized. Article 44 states that “Tripartite Member/Partner States undertake to conclude negotiations on outstanding issues under Phase I set out in Annex [] (Annex to list all outstanding issues) after the launch of this Agreement”. From a technical point of view it is clear that there can be no ratification of a legal instrument which is still being negotiated. The official ‘launch’ of the TFTA will apparently take place in February 2015. This occasion might consist of not more than a *sui generis* diplomatic event.

The movement of business persons turned out to be another difficult hurdle during Phase I. A separate agreement has now been drafted. It contains its own provisions on entry into force and withdrawal.

Phase II of the negotiations will cover trade in services, intellectual property rights, competition policy and customer protection, and cross-border investment. It should be noted, however, that the present texts refer to outcomes with regard to these areas as “a credible level and amount of services liberalisation” and as “major areas of cooperation”.²¹ This causes uncertainty about final outcomes; ‘cooperation’ is an inexact term when it comes to legal obligations.

It remains to be seen what the second Phase will generate in terms of firm obligations on services, competition and investment. The present level of commitment is vague. Article 45 of the latest version of the TFTA Agreement mentions that the Parties recognize “the need to conclude Phase II Negotiations, and to provide flexibility in the implementation of the Agreement”. They “agree to negotiate and endeavour to conclude protocols on services and trade related matters²² within 24 months upon entry into force of this Agreement”. This is not a high level of commitment. And it may take a long time before results may materialize, despite the promise to start services negotiations in 2015. The Phase I Agreement will only enter into force “after the deposit of the instrument of ratification by a simple majority of the Tri-

²⁰ WTO notification will presumably happen under the Enabling Clause but substantially all trade has to be liberalized. Given the effect of the *acquis* principle there will be several FTAs to be notified.

²¹ See the Preambles to the TFTA Agreement (text of 19 November 2014) and the Agreement on the Movement of Business Persons.

²² The mentioned trade-related matters cover competition, investment, trade and development, and intellectual property rights.

partite Member/Partner States that are party to this Agreement".²³ It may take a while before those 14 ratifications (which will have to comply with national constitutional requirements, including parliamentary approval in some cases) have been deposited.

So where do these developments leave the TFTA endeavour? The draft TFTA is a compromise document which will be difficult to become implemented. Much more has to be done before even Phase I will be finalized. The practicalities of the negotiating process and the pressure to meet deadlines set at the beginning have turned out to be particularly troublesome (see Box 1 on the TFTA issues and negotiations).

One of the explanations for the meagre outcome to date has to do with the observed fact that regional integration endeavours, involving a large number of states and economies at very different levels of development, constitute a formidable challenge. More successful economies develop vested interests which they will defend and advance. Another lesson to be learned is that those prior decisions on how to structure regional trade negotiations are of vital importance. They will determine who owns and steers the process. However, the fundamental challenges on how to utilize trade and integration as engines of growth and poverty alleviation remain urgent. They should stay on Africa's negotiating agenda and on the list of tasks identified as part of the TFTA follow-up agenda.²⁴ They should also inspire the CFTA talks which will start in 2015.

²³ Article 39(3), TFTA Agreement.

²⁴ A 'built-in agenda' has been approved towards the end of 2014.

Box 1: The TFTA Issues and Negotiations

The TFTA was signed at the third Tripartite Summit on 10 June 2015 in Egypt. Sixteen of the 26 member states that have been participating in the negotiations have signed the Agreement. More countries may sign the Agreement before the required 14 ratifications that will see the Agreement enter into force. At this stage, South Africa has not signed, while some of the other members of the Southern African Customs Union (SACU), including Namibia, have signed. There are important areas of the TFTA agenda where negotiations are not complete. These include tariff liberalisation, rules of origin, and trade remedies. Even modest ambition, as regards tariff liberalisation by those countries that are negotiating bilateral tariff concessions, seems difficult to achieve. Member states had agreed to achieve at least 60% liberalisation on launch of the TFTA, with further liberalisation to be negotiated after that. This is still not realised. Rules of origin have proven to be very contentious, highlighting the differences in fundamental approach between SADC on the one hand and EAC and COMESA on the other. The challenges associated with the negotiations on trade remedies reflect the fact that some countries, such as South Africa and Egypt, have in place domestic policy, laws and institutions to manage the applicable disciplines of the World Trade Organisation (WTO), while many others do not, and these countries would like a more flexible regime.

It is fair to say that at this stage the TFTA is still very much in progress. The fact that the agreement has been signed by some member states, and that all member states have agreed to continue negotiations on the outstanding issues from phase 1, as well as to embark on the phase 2 of the negotiations, does signal some commitment to continue the TFTA process.

Source: Authors

Very strong political leadership and a strong dose of realism will be required to redirect the African integration process along the original TFTA route. One of the anomalies of African concerns about national sovereignty is that governments cannot have it both ways; they cannot demand sacrifices with regard to the sovereign policy space of stronger parties while being unprepared to fully comply with binding rules and decisions of judicial organs. Individual states cannot invoke their national sovereignty (including their

own constitutions) when subsequently confronted with the implications of having ratified trade agreements. If that were possible international law becomes dysfunctional and ineffective. It would also mean that regional integration endeavours in Africa will remain anaemic. Trade agreements require realistic compromises.

4 The Continental Free Trade Area

The year 2015 will see the launch of another ambitious African integration initiative, the start of negotiations to conclude the Continental FTA (CFTA). It is too early to report on the technical details since these negotiations have not yet begun. The African Union (AU) has decided to model the proposed arrangement on the TFTA and to use the RECs as building blocks. What this will mean (given the TFTA difficulties discussed above) remains to be seen. The aim is to bring all African RECs and all African governments to the negotiating table. That in itself will require careful preparation and will pose huge logistical challenges.²⁵

The idea of a single pan-African arrangement for trade and (even political integration) is an old one. It goes back to the 1960's and to the debate of those times on how to protect newly gained African nationhood against neo-colonial and Cold War dangers. The Abuja Treaty of 1991 for establishing the African Economic Community (AEC) became the manifestation of these ideals but has not been translated into reality. It is not difficult to understand why: the technical difficulties which a single trade regime between 53 independent nations will face, the extent to which African governments treasure their sovereignty, and the limited gains made with regard to the implementation of many of the technical rules in existing RECs, provide the explanation. The Abuja agenda is extremely ambitious and even foresees the establishment of a monetary union. In other words, it goes way beyond an FTA for goods.

African integration under the Abuja Treaty encompasses bold ideas, which are to be implemented in six stages and over several years.²⁶ The CFTA agenda seems to be essentially about a WTO-compatible FTA. The 21st century multilateral trade system differs fundamentally from earlier times

²⁵ The TFTA process ran into major difficulties during 2014 when the most important donor discontinued its financial support after complaints about spending and financial controls.

²⁶ Article 6, Abuja Treaty.

and conditions. Since the adoption of the Abuja Treaty the WTO has been formed and new rules have been adopted.²⁷ African FTAs now have to comply with the applicable GATT rules. Another challenge is to find practical solutions for the integration of African economies into the trade system of the 21st century. However, there is also a strong belief in the “Africa rising” story, which offers an opportune moment to re-launch continental integration initiatives.²⁸

The CFTA negotiations will be launched in June 2015 and will be conducted under the auspices of the AU. Before this can happen many technical preparations will be necessary. And political buy-in will have to be ensured. It may turn out that many of the challenges faced by the TFTA process will resurface in the CFTA context.

5 Conclusions and Policy Recommendations

Where do the developments described in this chapter leave the African integration process? Properly designed regional trade arrangements remain an appropriate route for Africa. FTAs are globally recognised as major vehicles for promoting competitiveness, industrialization, and economic growth. An important feature of contemporary industrial organisation is the increasing preponderance, complexity and sophistication of global value chains.²⁹ This has prompted the development of modern FTAs, which focus on services, regulation, standards, recognition of qualifications, competition, intellectual property, movement of people and capital, in addition to the traditional import tariff agenda. Customs Unions have become rare; the predominant form of regional integration is now the comprehensive FTA.³⁰

The TFTA could support African integration by building on the progress already achieved by the RECs and by actively pursuing a broader agenda. The Tripartite FTA must go beyond the abolition of tariff barriers and ad-

²⁷ The WTO came into existence on 1 January 1995.

²⁸ This phrase was coined by *The Economist* in its leader report in the December 3, 2011 edition. It was written at a time when 6 out of 10 of the world’s fastest growing economies were African, mainly as a result of the commodities boom. These optimistic views were accompanied by a caveat that “Africa still needs deep reform.”

²⁹ Chapter 7 of the 2011 WTO World Trade Report: *The WTO and Preferential Trade Agreements: From co-existence to coherence* elaborates on global value chains; full web access: www.wto.org

³⁰ Only 10% of all WTO RTA notifications are about customs unions; the rest are FTAs; customs unions only account for 10% of regional trade agreements as at 31st July 2013; see for web access: www.wto.org/english/tratop_e/region_e.htm

dress the high costs of trading and doing business in the region. Non-tariff barriers must be tackled within a rules-based context. Trade facilitation is critical, and measures to reduce the costs of complying with customs requirements should be prioritized. Services account for the fastest growing segment of intra-regional trade. As such, they can no longer be relegated to an 'emerging issue' for future cooperation endeavours.

These insights and their implications for inclusive development strategies may not yet be part and parcel of the African discourse on regional integration, which officially still reflects a linear agenda, a goods agenda, and a preference for grand designs. That path is fraught with political and governance challenges, as well as concerns about loss of sovereign policy space.

Recent developments around the TFTA process might be an indication that important players have lost their appetite for the traditional ball game. The very ambitious integration schemes of yesteryear are now scrutinized in a more sober spirit. It does appear, for example, that the effective shelving of the SADC customs union does reflect a more realistic perspective on this REC's integration ambitions.³¹

The failure to monitor the implementation of obligations and to enforce the applicable rules is one of the disappointments about existing regional trade arrangements in Africa. The protection of the rights of private sector players and the availability of remedies in the case of violations of their rights may turn out to be critical challenges for the TFTA and the CFTA.

Effective regional integration requires new approaches to legal and institutional arrangements (including secretariats and regional courts), as well as national designs for domesticating and implementing legal instruments on trade. Sound legal and institutional arrangements must be in place in order to achieve the outcomes associated with good governance for trade. This process needs time but should start with the right design, while supported by high level political leaders. The CFTA provides an opportunity to shape a new and practical integration agenda. Novel approaches to sequencing could be adopted, with trade in goods and trade in services negotiations starting simultaneously. On the trade in goods agenda, prioritizing matters, where early successes could be achieved, would make sense. Trade facilitation is a good example, providing an opportunity to link the integration agenda to the

³¹ Heads of State agreed at the 2010 Summit to focus on the consolidation of the FTA and to defer the establishment of the customs union, appointing a high level task team to consider this integration goal; see the web access for the Communique from the 2010 SADC Summit at:
http://www.sadc.int/files/3613/5341/5517/SADC_Jubilee_Summit_Communique.pdf
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implementation of the multilateral agreement on trade facilitation that African countries will be implementing too.

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Annexes

Annex Box 2: Trade between the three TFTA blocs (SADC, EAC and COMESA)

EAC-COMESA trade in the year 2013, by exports and imports:

EAC exported in 2013 to COMESA for US\$ 4.023 billion (out of its total world exports of US\$ 13.183 billion); this is a share of 31%. EAC imported in 2013 from COMESA for US\$ 2.409 billion out of US\$ 37.160 billion, what is a share of 6%.

Major export products of EAC to COMESA were vegetable products (US\$ 862.10 million), what is a share of 20%; food, beverages & tobacco (US\$ 588.62 m), what is a share of 45%; base metals (US\$ 409.90 m), what is a share of 67%; and chemical products (US\$ 344.76 m), what is a share of 58%. High shares have also animal or vegetable fats & oils (60%), plastic products (66%), wood products (55%), paper products (79%), footwear (76%), and non-metallic materials (88%).

Major EAC import products from COMESA were chemical products (US\$ 421.35 m), with a share of 11%; food, beverages & tobacco (US\$ 383.65 m), with a share of 31%; mineral products (US\$ 293.99 m), with a share of 3%; and base metals (US\$ 260.6 m), with a share of 8%. High shares have also live animals, animal products (49%), raw hides (29%), and wood products (24%).

SADC-EAC trade in the year 2013, by exports and imports:

SADC exported to EAC in 2013 for US\$ 2.482 billion, and this was 1.1% of the world total of SADC exports (of US\$ 220.201 billion). SADC imported from EAC in 2013 for US\$ 2.527 billion, what is a share of 1.2% (of the total SADC world imports of US\$ 203.773 billion).

Major SADC exports to EAC were base metals (US\$ 483.77 million), what is a share of 1.9%; machinery (US\$ 421.67 m), with a share of 4.0%; chemical products (US\$ 321.99 m), a share of 4.1%; transport equipment (US\$ 215.95 m), a share of 1.7%; food, beverages & tobacco (US\$ 186.45 m), a share of 2.0%; vegetable products (US\$ 178.58 m), a share of 2.8%, and mineral products (US\$ 176.33 m), a share of 0.2%. Higher intra-shares are in specialized equipment (10.3%), in paper products (5.6%), and in wood products (3.3%).

Major SADC imports from EAC were mineral products (US\$ 982.88 m), what is a share of 2.3%; food, beverages & tobacco (US\$ 265.41 m), with a share of 3.1%; chemical products (US\$ 212.97 m), a share of 1.1%; vegetable products (US\$ 193.06 m), a share of 3.3%, and base metals (US\$ 187.04 m), a share of 1.4%. A higher share is also in animal or vegetable fats & oils (3.5%).

SADC-COMESA trade in the year 2013, by exports and imports:

SADC exports to COMESA reached in the year 2013 the value of US\$ 16.354 billion, what is a share of the world total of 7.4% (out of US\$ 220.201 billion). SADC imports from COMESA reached US\$ 9.135 billion, out of a world total of US\$ 203.773 billion (what is a share of 4.5 %).

SADC exports to COMESA are high in mineral products (US\$ 3.324 billion, a share of 3.3%), machinery (US\$ 2.626 billion, a share of 25.2%), chemical products (US\$ 2.287 billion, a share of 28.8%), base metals (US\$ 1.787 billion, a share of 6.9%), food, beverages & tobacco (US\$ 1.316 billion, a share of 13.9%), and transport equipment (US\$ 1.181 billion, a share of 9.0%). High shares have animal or vegetable fats & oils (54.6%), plastic products (34.2%), and non-metallic minerals (28.9%).

SADC imports from COMESA reached in 2013 US\$ 9.135 billion, what is a share of 4.5% (out of the world total of US\$ 203.773 billion). Major imports of SADC from COMESA are mineral products (US\$ 3.010 billion, a share of 6.9%), chemical products (US\$ 1.614 billion, a share of 8.5%), food, beverages & tobacco (US\$ 1.056 billion, a share of 12.2%), base metals (US\$ 0.807 billion, a share of 5.9%), vegetable products (US\$ 0.515 billion, a share of 8.7%), and machinery (US\$ 0.440 billion, a share of 1.0%). Other high share items are wood products (12.7%) and textiles & clothing (9.2%).

Source: ITC Trade Map (basic tables were collected by the authors, and data were summarized by the chief editor of the Yearbook Volume)

Annex Table 1: Intra-REC trade (US\$ Millions)

Intra-REC trade (US\$ Millions)			
	2010	2013	CAGR (2010-2013)
AFRICA RECs			
SADC	30 997.35	41 736.51	10.40%
CEN-SAD	12 353.28	18 043.03	13.50%
COMESA	7 708.41	11 208.56	13.30%
ECOWAS	6 479.16	10 620.33	17.90%
AMU	3 179.29	5 336.61	18.80%
ECCAS	2 473.78	3 808.05	15.50%
WAEMU	2 746.24	2 952.82	2.40%
IGAD	1 449.91	2 450.34	19.10%
EAC	2 075.29	2 409.26	5.10%
OTHER RECs			
ASEAN	231 203.73	282 881.34	7.00%
MERCOSUR	49 890.03	56 996.07	4.50%
CARICOM	2 493.43	2 609.75	1.50%

Source: ITC TradeMap Database; Intra-trade data is the trade between member countries of the particular REC; import data were used mainly because customs officials monitor this for revenue purposes; 2014 latest data was not available for all countries in a REC and therefore 2013 data were used. Important to note is that data are never complete and therefore the figures presented above are at best indicative of the broader picture. CAGR – Compound annual growth rate (2010 – 2013).

Annex Table 2a: Tripartite FTA Region: Intra-REC imports, US \$ millions & % Shares

Year	2010	2011	2012	2013	2014
COMESA					
Total COMESA US\$	139,618	148,245	156,758	181,367	174,758
Intra-COMESA US\$	7,708	8,400	10,143	11,209	7,859
Intra-COMESA %	5.50%	5.70%	6.50%	6.20%	4.50%
EAC					
Total EAC US\$	26,430	34,327	20,387	37,160	39,073
Intra-EAC US\$	1,633	2,031	2,652	1,916	1,327
Intra-EAC %	6.20%	5.90%	13.00%	5.20%	3.40%
SADC					
Total SADC US\$	150,687	187,515	195,063	203,773	198,669
Intra-SADC US\$	30,997	38,233	39,719	41,737	36,474
Intra-SADC %	20.6%	20.4%	20.4%	20.5%	18.4%

Source: ITC Trade Database

Annex Table 2b: Top 10 Intra-COMESA Exports, US\$ Millions by HS 2

	COMESA to COMESA			COMESA from World		COMESA to World	
	2012	2013	2014	2013	2014	2013	2014
All products	9,752	10,780	7,717	5.9%	4.4%	8.9%	8.2%
Ores	1,038	1,585	534	62.1%	24.4%	50.8%	20.2%
Coffee, tea	634	593	535	69.8%	59.1%	17.9%	17.4%
Cement etc.	488	580	326	30.6%	19.4%	43.6%	38.2%
Inorganic chemical	291	572	153	33.0%	15.0%	39.9%	16.0%
Sugars	422	456	299	19.1%	15.5%	25.3%	18.0%
Plastics	356	413	295	5.5%	4.4%	22.6%	16.0%
Fuels	666	386	961	1.5%	3.7%	0.7%	2.8%
Iron and steel	328	367	264	4.9%	3.5%	22.7%	20.0%
Cereals	442	323	174	3.4%	1.9%	61.8%	71.0%
Machinery	214	297	192	1.5%	1.1%	38.2%	24.5%

Source: ITC Trade Database

Annex Table 2c: Top 10 Intra-EAC Exports, US\$ Millions & % Shares

	Exports to EAC		Exports to World			
	\$ millions		\$ millions		% Intra-EAC	
	2013	2014	2013	2014	2013	2014
Products	2013	2014	2013	2014	2013	2014
All products	2,810	1,327	13,183	11,262	21.3%	11.8%
Coffee, tea	229	105	2,356	2,040	9.7%	5.2%
Ores	207	1	635	731	32.6%	0.1%
Cement etc.	203	149	332	221	61.1%	67.1%
Fuels	177	87	522	970	34.0%	9.0%
Iron/steel	151	107	287	187	52.5%	57.1%
Edible fats	146	81	265	161	55.0%	50.4%
Plastics	127	72	262	131	48.6%	54.9%
Tobacco	95	63	415	578	22.8%	10.9%
Wood products	95	37	138	51	68.5%	72.7%
Machinery	91	39	244	145	37.3%	26.8%
top 10 %	54%	56%	41%	46%		

Source: ITC Trade Database

Annex Table 2d: Top 10 Intra-SADC Exports by HS Chapters, US \$ Millions & % Shares

Product	Intra-SADC Exports		SADC Exports to World			
	\$ millions		\$ millions		% of HS line	
	2013	2014	2013	2014	2013	2014
All products	43,163	37,965	220,201	203,477	19.6%	18.7%
Fuels	6,354	6,041	82,184	75,746	7.7%	8.0%
Machinery	3,459	3,189	7,682	7,221	45.0%	44.2%
Precious stones, metal	3,412	3,279	29,536	25,638	11.6%	12.8%
Vehicles	2,771	2,566	8,856	9,019	31.3%	28.5%
Ores	2,171	1,076	18,128	14,466	12.0%	7.4%
Electrical equipment	1,689	1,740	2,739	3,142	61.7%	55.4%
Tobacco	1,261	1,087	2,384	2,572	52.9%	42.2%
Iron/steel	1,240	1,196	1,737	1,665	71.4%	71.8%
Iron/steel	1,031	1,217	6,868	7,467	15.0%	16.3%
Plastics	1,002	977	1,689	1,733	59.3%	56.4%

Source: ITC Trade Database

Namibia and the Tripartite Free Trade Agreement

Mareike Meyn¹

1 Introduction

In October 2008, the first Tripartite Summit was held by the Governments of the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC). It was agreed to enhance regional economic cooperation and harmonisation in line with the African Union (AU) objective to accelerate the continent's economic integration. A Memorandum of Understanding (MoU) on regional cooperation and integration was signed by the Chairpersons of the three regional bodies in January 2010.

The areas of cooperation are anchored on three major pillars: market integration, infrastructure development, and industrial development. The centrepiece of the Tripartite Agreement is the market integration pillar, in particular the planned Tripartite Free Trade Agreement (TFTA). The TFTA foresees to harmonise trade arrangements among COMESA, EAC and SADC, aiming to overcome problems of existing (and contradictory) regional memberships. It further aims to enable economic actors to benefit from a larger market and to reach enhanced social and economic performance in the region covering 26 countries.

The TFTA is an ambitious undertaking, targeting the liberalisation of goods and services in compliance with WTO provisions and aiming to establish joint rules and regulations for trade-related areas, such as customs cooperation, trade facilitation, competition policy, and intellectual property rights. Moreover, it foresees to create a comprehensive cooperation framework, including industrial cooperation, R&D and infrastructure development.

Namibia negotiates the TFTA in the framework of the Southern African Customs Union (SACU), whose five members are also members of the SADC. This article elaborates on what Namibia is likely to gain when joining the TFTA in the SACU/SADC framework and what would be potential costs and areas for compromise. The following questions guide this assessment:

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- ✓ ***Export potential***
 - What does Namibia currently export to TFTA countries in terms of value and products?
 - Which tariff barriers do Namibian exporters face for their major exports to the TFTA region?
 - What are the main non-tariff barriers Namibia faces in main TFTA markets?
 - How do Namibian exporters judge the opportunities of expanding their exports to the region and what are the limiting factors?

- ✓ ***Import competition***
 - What does Namibia currently import from TFTA countries in terms of value and products?
 - Which tariffs apply for Namibia's major imports from TFTA countries?
 - Which non-tariff barriers apply for Namibia's major imports from TFTA countries?

- ✓ ***Revenue implication***
 - What would be Namibia's "hypothetical revenue loss"² when extending the SADC Trade Protocol to all TFTA countries?
 - What would be the implications for the SACU Common Revenue Pool (CRP) and for Namibia's revenue share?

- ✓ ***Trade policy implications***
 - What are Namibia's current trade policies and to what extent are they fully compliant with the provisions of the SACU Agreement and the SADC Trade Protocol?
 - What would be the implications for Namibia's trade policy framework if the provisions of the Draft TFTA are applicable?³

- ✓ ***Trade infrastructure and institutional setting***
 - Which institutions are foreseen by the Draft TFTA, to what extent do they exist in Namibia, in SACU and/or in the SADC region, and what are the challenges of implementing the provisions?

² The concept of the "hypothetical revenue loss" and its limitations are explained in section 5.3.

³ The 2010 draft legal texts of the FTA are taken as benchmark for the analysis as explained in section 4.3.4.

- What is the status of Namibia's trade infrastructure, and would any upgrading be required to implement the Draft TFTA?

The methodological approach to address these questions is a combination of literature review (including internal Protocols and Reports of the Tripartite Integration institutions), data analysis⁴, and stakeholder interviews, in particular with Namibian exporters to the Tripartite Integration region.

The article is structured as follows: after this introduction, the objectives of the TFTA and the challenges of negotiations are outlined in section 2. Thereafter, the regional integration process and intra-regional trade in the three regional blocks, which make-up the Tripartite Integration region, are discussed in section 3 before assessing in detail the Namibian perspective in section 4. Section 5 summarises Namibia's offensive and defensive interests⁵ in the TFTA negotiations and outlines the necessary trade policy reforms which Namibia would have to undertake and the institutions that would have to be set-up in Namibia in order to comply with the provisions of the Draft TFTA. Section 6 highlights the development perspectives of the TFTA for Namibia, and the final section 7 concludes and draws policy recommendations.

2 Objectives of the TFTA and challenges for negotiations

The 2010 *Draft Agreement Establishing the COMESA, EAC and SADC Tripartite Free Trade Area* (in the following called 'Draft TFTA') aims "to create a large single market with free movement of goods and services and business persons, and eventually to establish a customs union." For this purpose, the Draft TFTA foresees among others to (a) eliminate all tariff and non-tariff barriers to trade in goods; (b) liberalise trade in services and facilitate cross-border investment and movement of business persons; (c) harmonise customs procedures and apply trade facilitation measures; (d) establish and maintain a TFTA institutional framework; and (e) adopt and implement joint policies

⁴ For Namibian trade data, the United Nations (UN) Commodity Trade Statistics (Comtrade) database was used. For the tariff analysis and potential revenue implications of the TFTA, SACU's applied MFN and SADC tariffs were taken from the UNCTAD TRAINS database.

⁵ In the trade terminology 'offensive interest' is understood to mean the interest a country may have in gaining access to another market. 'Defensive interest' is understood to mean a country's interest to minimize competition in its domestic market as a result of trade liberalisation.

(Art. 4, Draft TFTA). It was agreed that the Draft TFTA shall serve as “starting point” for negotiations and will be adapted as the negotiations continue.

Negotiations of the TFTA are foreseen in two phases:

Phase 1: Negotiations on Trade in Goods

- Covers Tariff liberalisation, Rules of Origin (RoO), Customs Cooperation, Non-tariff Barriers (NTBs), Trade Remedies, Sanitary and Phytosanitary (SPS) Measures, Technical Barriers to Trade (TBT) and the Dispute Settlement Mechanism (DSM).
- Covers negotiations of the movement of business persons (are negotiated separately by the Tripartite Sectoral Ministerial Committee on Trade).

Phase 2: Trade-related aspects

- Covers Trade in Services, Intellectual Property Rights (IPR), Competition Policy, Trade promotion, and Competitiveness.

The first phase of the TFTA negotiations started in June 2011 and was scheduled to be completed within 36 months, by May 2014. However, in early 2014 the start of the TFTA was postponed to 2015. At the time of writing (September 2013) the countries had not even agreed on the modalities for trade liberalization. The Tripartite Task Force (TTF) of the three regional Secretariats proposes to differentiate between three different country types in the TFTA liberalisation offer:

- (1) Countries which cooperate already in regional FTAs with each other (as Namibia with the other 11 signatories of the SADC Trade Protocol);
- (2) Countries that will have to negotiate tariff liberalization offers with other RECs (as Namibia with non-SADC EAC and COMESA countries). Here the TTF proposal foresees that member states extend their “highest level of tariff liberalization achieved to all TFTA members”. In case of SADC, this would imply extending SACU’s offer currently applied to the seven signatories of the SADC Trade Protocol to the members of EAC and COMESA;⁶

⁶ This refers to EAC members (Burundi, Kenya, Rwanda, and Uganda) and to COMESA members (Comoros, Djibouti, Egypt, Libya, Madagascar, Seychelles, and Sudan). The other EAC/COMESA countries participating in the FTA are also signatories of the SADC Trade Protocol.

- (3) Countries that do not yet participate in regional FTAs and will have to submit tariff offers to all TFTA states (like Angola, DR of Congo, Ethiopia, and Eritrea).

Contention exists, however, with respect to the extension of the “highest level of tariff liberalization achieved to all TFTA members”. Thus, it is reported that South Africa is not ready to extend SACU’s offer under the SADC Trade Protocol, which covers 99.2% of all tariff lines, to all TFTA countries, but seeks a lower liberalization level vis-à-vis Egypt and EAC (Kenya). Moreover, countries could not agree yet on the threshold of liberalization (90%, 95%, 100% of tariff lines) and on the time frame of liberalization (3, 5, 8 years). Another area of dispute is the region’s rules of origin (RoO) regime, where South Africa argues for a higher domestic added value for products to be considered ‘Tripartite originated’ than what is acceptable to most countries.⁷

The limited progress of negotiations reflects the lack of capacities but also shows the gap between political rhetoric and divergent economic interests. Though all countries agreed to establish the TFTA, following the agenda of the AU’s integration plan, many countries appear to have difficulties in defining their offensive and defensive interests in the negotiation process. To date no regional leader has emerged who would push for the TFTA to become an effective tool for regional trade liberalization and none of the ‘economic giants’ of the TFTA region (South Africa, Egypt, Kenya) has shown interest in leading the process.

South Africa, by far the strongest economy in the TFTA and the one that would gain most in terms of expanded exports (given its significant trade surplus with the TFTA region), has acted rather in a defensive manner. This in turn makes it difficult for small economies that have only little to gain (because of both a limited production capacity and a lack of regional competitiveness) to compromise with respect to their defensive interests.

3 Regional integration progress and intra-regional trade in COMESA, EAC and SADC

The Tripartite FTA shall build on the tariff offers of the existing RECs and is expected to expand these to the other TFTA states.⁸ It is proposed that mem-

⁷ These protectionist tendencies of South Africa might be explained by its high level of unemployment and by the great influence of organised labour in policy formulation.

⁸ For the countries with overlapping membership (namely Malawi, Mauritius, Zambia and Zimbabwe) it is foreseen building on both *acquis* so that they would only have to

ber states extend their “highest level of tariff liberalization achieved to all TFTA members”. However, what is the current state of trade liberalisation and intra-regional trade within the region?

3.1 The Common Market for Eastern and Southern Africa (COMESA)

COMESA is a Regional Integration Grouping of today 19 member states⁹ which have agreed to promote regional integration through trade development. COMESA officially launched its FTA in December 1994, replacing a PTA which had existed since 1981. The Member States committed themselves to achieve sequentially a Customs Union (CU) by 2009, a Common Market by 2015, and eventually an Economic Community (EC) by 2018. However, both the FTA and the CU have been delayed, with the FTA being established by 15 member states.¹⁰ Under the current status as a FTA, COMESA is applying a variable speed and geometry approach. It allows non-participants to join when they are ready to reciprocate the terms of the arrangement.

To realize its vision to become an economic community, COMESA launched the establishment of a Customs Union in 2009. The Common External Tariff (CET) was scheduled to be established within a 3-year transition period. It is foreseen to harmonize the COMESA CET with the CET of the East African Community (EAC) to work towards a Single Customs Union (COMESA, 2012). COMESA aims to establish a four-band CET, i.e. only four tariff categories will exist.¹¹ However, the definition of what products are considered to be raw materials, processed, finished, and capital goods are different in the countries’ Nomenclature. To date, the countries could not agree on a common definition of the categorisation of goods. The difficulty to agree on a CET is further complicated by the countries’ very different protectionist interests (ranging from free trade economies like Djibouti to comparably protected economies like Egypt or Zimbabwe) and by the (Interim)

negotiate with those four countries (Angola, DRC, Ethiopia, Eritrea) that have not yet acceded to either COMESA or SADC (Annex 5, 4th Meeting of TTNF/Tripartite Trade Negotiation Forum, 05.-07. 09.12). What is not clear is whether Malawi, Mauritius, Zambia and Zimbabwe will grant each other preferential treatment under the COMESA or the SADC FTA.

⁹ Burundi, Comoros, Democratic Republic of the Congo (DRC), Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

¹⁰ DRC, Eritrea, Ethiopia, Swaziland have not joined the COMESA FTA.

¹¹ Namely 0% duty for raw materials and capital goods, 10% for semi-processed goods, and 25% for finished goods.

EPAs. Six COMESA countries are part of the Eastern Southern Africa (ESA) EPA with the EU¹², having agreed on different liberalisation commitments and exclusion baskets with the EU. However, if state A has removed its tariff for a product, which is fully retained by its neighbour state B, the countries cannot have a CET since they have very different perceptions of the sensitivity of a product.¹³

In the period 2006-09, COMESA exported commodities worth US\$ 139,748 Mio and imported commodities worth US\$ 134,299 Mio. About 50% of COMESA's exports went to the EU, 33% to the rest of the world (RoW), and only 9% to Africa.¹⁴ Intra-COMESA trade accounted for about 6.4% of total trade in the period 2007-11 (UNCTAD, 2013:17).

Libya and Egypt are considered as 'economic giants' in COMESA, together accounting for 67% of total COMESA exports. However, Libya exports almost solely oil, petroleum products, and gas. Egypt as the second largest exporter has a more diversified economy, exporting next to oil and petroleum products also chemicals, wires, iron and steel products, fruits, and cheese; together accounting for about 50% of its total exports.¹⁵

Burundi, Comoros and Eritrea are not only the smallest exporters in COMESA, but also in the whole TFTA region. Together, they account for only 0.18% of total COMESA exports and 0.08% of total TFTA exports. Their export products are primarily agricultural products.

3.2 *The East African Community (EAC)*

EAC dates back to 1967 when Kenya, Tanzania and Uganda first formed a CU, which collapsed in 1977. The three countries revived the EAC in 1999

¹² Comoros, Madagascar, Mauritius, Seychelles, Zambia and Zimbabwe.

¹³ If for example country A applies a zero tariff on milk because the product is not commercially produced in country A but country B aims to protect its dairy industry and has a tariff of 50% on milk, it will be difficult for the two countries to agree on a CET for milk. This is further complicated by the fact that both countries have already fixed their different tariff for milk vis-à-vis an external trading partner (the EU). Considering now that a country has about 6,000 tariff lines, the whole complexity of the impact of the EPA on African regional integration becomes clear.

¹⁴ The analysis on the trade performance of the three RECs is based on World Bank data for the period from 2006 to 2009.

¹⁵ Egypt's top 10 exports in the period 2011-2013 were: (1) petroleum oils other than crude (11%), (2) petroleum oils (10%), (3) petroleum gases (6.4%), (4) gold (5%), (5) chemicals (4.3%), (6) insulated wires (3%), (7) citrus fruits (1.7%), (8) cheese and curd (1.5%), (9) copper plates (1.6%), (10) iron and steel products (1.6%) (from: UN Comtrade, 2014).

and launched their CU in 2005. In July 2007 Rwanda and Burundi acceded to the EAC. EAC's economic integration agenda has been ambitiously pursued by starting the integration process with a Customs Union (CU), which shall be followed by a Common Market (CM), a Monetary Union (MU) and, eventually, a Political Federation (PF).

The launch of the CU in 2005 took place without having implemented a FTA, which was scheduled to be implemented in 2010. Thus, different to economic integration theory, EAC implemented the CU prior to having a FTA for its members. The reason for this was that the LDCs Tanzania and Uganda asked for transition periods to minimize potential negative effects from free trade with the stronger economy of Kenya. Thus, the EAC's approach to establish a CET and to eliminate NTBs underlies the principle of asymmetry as follows:

- goods between Uganda and Tanzania are duty free;
- goods from Uganda and Tanzania to Kenya are duty-free;
- and for selected products from Kenya, Tanzania and Uganda can apply duties, which have been gradually phased out by 2010 (EACCU Protocol, Art. 2.4).

Member states have agreed on a CET of 0% for raw materials and capital goods, 10% for intermediate goods, and 25% for consumer goods. The list of sensitive products is limited to only 24 HS codes. However, until today the EAC CU has not been fully implemented. Though the countries agreed to adopt in principle a "destination model" of clearance of goods where assessment of goods and collection of revenues is made at the point of entry, the merger of customs territories has not yet been realized (Sunday Monitor, 23/04/13). NTBs remain a major barrier to trade, including administrative customs documentation, cumbersome inspection requirements, police road-blocks, varying transiting procedures, and varying trade regulations (TMEA, 2013).

Comparing the intra-regional exports of the three RECs, EAC trades the most with the TFTA region. EAC countries export mainly to Africa (34% of total exports), followed by exports to the EU (30%). Kenya is the largest exporter in EAC, accounting for about 50% of the region's total exports. Kenya, Tanzania and Uganda together account for 96% of total EAC exports. Rwanda and Burundi account for only 3.3% and 0.65% of total EAC exports respectively.¹⁶ Intra-EAC trade accounted for about 12% of total trade in the period 2007-11 (UNCTAD, 2013:17).

¹⁶ World Bank data (2006-09), Web Access: <http://datacatalog.worldbank.org/>

Kenya's major export products are tea, horticultural products, coffee, petroleum products, and fish. Tanzania exports gold, coffee, cashew nuts, manufactures and cotton, and Uganda exports mainly coffee, fish and fish products, tea, cotton and flowers.

3.3 The Southern African Development Community (SADC)

SADC was originally established as a development coordinating conference (SADCC) in 1980 and was transformed into a development community in 1992, following the end of Apartheid in South Africa and Namibia. The overarching goal of the 15 Member States¹⁷ is to promote sustainable and equitable economic growth and socio-economic development through efficient productive systems, deeper cooperation and integration, good governance, and durable peace and security (SADC, 2012). The Regional Indicative Strategic Development Plan (RISDP) outlines a comprehensive development and implementation framework guiding SADC's regional integration agenda from 2005 until 2020 – from a free trade agreement to an economic union (SADC, 2012).

The primary determinant of the SADC economic integration agenda is the SADC Trade Protocol (TP), which was signed in 1996 and entered into force in 2000. The TP established a FTA for 12 countries¹⁸, liberalizing 85% of intra-regional trade in 2008, and 99.5% by 2012. For the elimination of tariffs, SADC applied the principle of asymmetry to mitigate the impact of tariff reductions for lesser-developed Member States.¹⁹ However, though today goods should be traded freely within the SADC region (with exclusion baskets of 0-1.3% of trade volume per country), the latest Monitoring Report found that liberalization commitments have not yet been fully implemented (USAID, 2010a and 2011).

SADC's deeper economic integration towards a CU, originally scheduled for 2010, appears to be stalled. Following the very different economic structures and protectionist interests of member states countries could not yet agree on a CET. As a 2008 study by ODI & DNA (ODI & DNA 2008) outlines, each tariff model (uniform tariff, SACU CET, lowest MFN schedule,

¹⁷ Angola, Botswana, DRC, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe. Madagascar's membership was suspended in 2009 following a political coup.

¹⁸ Angola, DRC and Seychelles have not yet signed/acceded to the TP.

¹⁹ Thus, SACU frontloaded its liberalization, having already 94.2% of tariff lines liberalized in 2005, while the LDCs Malawi, Mozambique and Tanzania had only liberalized about 30% of tariff lines in 2005 (see USAID, 2011 for details).

and simplest MFN schedule) would produce winners and losers and does not appear to be acceptable to all countries. Moreover, the revenue collection mechanism and the implications for the Common Revenue Pool (CRP) are heavily disputed. Being the dominant player in SADC, South Africa's position would be crucial in agreeing on a SADC CET, which requires concessions with respect to the complex SACU CET and the revenue distribution. However, to date, it does not appear that South Africa is ready to make such concessions and focuses rather on trade facilitation and the full implementation of the SADC FTA.

In the period 2006-09, SADC exported commodities worth US\$ 170,111 Mio and imported commodities worth US\$ 170,823 Mio. SADC exported 41% to the RoW, 26% to the EU, and only 14% to Africa. Intra-SADC trade accounted for about 12.9% of total trade in the period 2007-11 (UNCTAD, 2013:17). South Africa is by far the largest and the most diversified exporter in the region, accounting for 50% of total SADC exports (which are 30% of total TFTA exports). Angola is the second largest exporter in SADC, with an export value worth half of South Africa's total exports, which is, however, almost exclusively crude oil, diamonds and petroleum products.²⁰

The third and fourth largest exporters in the region are Botswana and DRC, with exports accounting together for only 6.2% of total SADC exports and 3.7% of total TFTA exports. Namibia is the fifth largest exporter in the SADC region.

South Africa is also the largest importer in the region, accounting for 54% of total SADC imports (33% of total TFTA imports). SADC countries' imports are, like COMESA's and EAC's imports, mainly composed of capital goods, such as machinery and equipment, chemicals, electric equipment, medicine, and scientific instruments, but also petroleum products and food-stuffs.

3.4 Opportunities and Challenges of COMESA, EAC and SADC Integration

Both, the integration objectives and the integration experiences of COMESA, EAC and SADC are similar. All the three RECs aim for deep economic integration, following the classical steps of regional integration schemes (FTA, CU, CM, etc.).²¹ However, all the three RECs are still stuck in early stages of economic integration and are struggling to move towards deeper integration.

²⁰ World Bank data (2006-09), Web Access: <http://datacatalog.worldbank.org/>

²¹ Though the EAC established a customs union prior to a FTA it is no exception from the 'early stage of economic integration'. Full free movement of goods in the EAC

The potential for intra-regional trade in the TFTA region is limited. Except for South Africa (and to a lesser extent Egypt) the TFTA countries are heavily dependent on the export of few primary products (such as oil, diamonds, or agricultural commodities) and they import primarily capital goods (machinery, transport equipment) as well as manufactured and consumer goods. Both, their export products and markets are heavily concentrated. With the exception of EAC the level of intra-regional trade is low. NTBs, such as cumbersome customs procedures, quantitative restrictions, and discriminatory trade regimes towards imports, are a problem in all three RECs and have often replaced intra-regional tariffs. Moreover, all countries struggle with poor infrastructure, which makes intra-African trade (on roads and railways) more expensive than exports overseas (UNCTAD, 2013:51-53).

Economic theory predicts that countries are more successful in regional integration the closer they are in per capita income and the absolute income level. This is due to the dominance of intra-sectoral trade, i.e. the trade within one sector (or industry), which is much more valuable in development terms than inter-sectoral trade, i.e. the trade between different industries.

Intra-industrial trade is a feature of trade between countries with similar industrial development levels, similar per capita income levels, small differences in market structure, and similar factor endowment/supply. The more advanced a country is, the more intra-industrial trade will occur from both, the demand and the supply side. Thus, the more unequal trading countries are, the less intra-industrial trade will occur (Balassa and Bauwens 1988). Since the bulk of intra-African trade is inter-industrial, it correlates positively with differences in per capita income, which results in high adjustment costs for weaker member countries of a regional integration scheme (Foroutan 1993:258-9). Subsequently, trade liberalization among African countries has often resulted in protectionist policies among the “loser countries” which feared further industrial polarization. The problem is well known to political leaders in Africa and mirrored in the integration objectives of the various RECs, all of which aim to address supply-side constraints and to promote industrial development, including the TFTA. However, effectively addressing changes of economic structures is a long-term development objective that appears to be beyond of what can be achieved by a regional trade agreement. The international development community realised that poor infrastructure and the lack of industrial development are major barriers for regional and

has not yet been achieved and the collection and distribution of customs revenue remains an unresolved problem.

international trade and have addressed these shortcomings in an increasing number of Aid for Trade (AfT) projects.²²

4 Namibia's offensive and defensive interests in the Tripartite FTA

By assessing Namibia's offensive and defensive interests in a Tripartite FTA we address the following questions:

1. What is Namibia currently exporting to the Tripartite FTA region, and could these exports be expanded by liberalising trade as a result of the TFTA? (offensive interest);
2. What is Namibia currently importing from the Tripartite FTA region, do these products stand in direct competition with Namibian products, and can Namibia expect a surge in imports from the Tripartite FTA region as a result of liberalising trade under the TFTA? (defensive interest);
3. What would be the revenue losses for Namibia of liberalising towards Tripartite FTA countries? (defensive interest);
4. What are the implications for Namibia's current trade policies? Are the rules and regulations of the TFTA stricter than Namibia's commitments under current trade regimes? (defensive interest).

²² The countries in the Tripartite Agreement region are subject to multilateral, regional and bilateral AfT programmes from different donors (WTO, OECD, EU, AfDB, country donors, etc.). One example is the £16.16 million Comprehensive Tripartite Trade and Transport Facilitation Programme (CTTTFP) that addresses customs and transport reforms and is funded by DFID.

4.1 Namibia's trade profile and trade perspectives with the Tripartite FTA region

Namibia's economy is based on natural resources, namely diamonds, copper, uranium, lead and zinc. It has the sixth largest diamond industry in the world and is the fourth largest producer of uranium. Namibia has experienced high growth rates in recent years (on average 6% in the period 2003-08), which was largely led by mining. The country's main export earners are mining (35% of total export revenue in 2008), agriculture and food processing (24%), and manufacturing (39%) (WTO, 2009:2007-8). There is a close link between agriculture and manufacturing activities in Namibia. Thus, manufacturing is dominated by food products, beverages and fish processing (together accounting for about 50% of Namibia's total manufacturing activities).

Namibia is highly trade-dependent with an openness ratio to trade (exports plus imports to GDP) of over 88% in the period 2000-07 (WTO, 2009: p. 210). The country is therefore vulnerable to trade shocks, such as commodity price and currency fluctuations, as well as to changes to SACU's trade or tariff regime which all are negatively affecting the Common Revenue Pool (CRP). Namibia shows a chronic but moderate trade deficit, with exports having paid for 94% of imports in the period 2009-11.

Namibia enjoys duty and quota free access (DFQF) for the majority of its exports, most of which go to the EU (32%) and to South Africa (31%). Further relevant export markets are Angola (10%), USA (5.5%) and Canada (4.4%). Namibia's 10 major export products accounted for 65% of total export revenue in the period 2009-2011. Major export products include minerals (diamonds, uranium, zinc and copper), fish, beer, and meat.

While Namibia's exports to the EU are dominated by minerals, exports to the region are mainly agricultural and agro-processed products. South Africa is the major export destination for Namibian agricultural and agro-processed products, such as beer, live animals, fish, and frozen bovine meat. High value fish (hake and monk fish) and premium cut beef go primarily to the EU market, which pays the best price.

Exports to non-SACU TFTA countries accounted for 13.3% of Namibia's total exports in the period 2009-2011 and were heavily concentrated on Angola, which received more than 72% of Namibia's total exports to non-SACU TFTA countries. Namibia's second largest export market in the Tripartite FTA region is DRC, accounting for 1.3% of Namibia's total exports in the period 2009-2011. Interestingly, both countries have not yet

signed/acceded to the SADC Trade Protocol.²³ Thus, 87% of Namibia's non-SACU Tripartite FTA exports were within SADC, with two countries that have not yet implemented the SADC Trade Protocol.

Other exports to the SADC region (Zambia, Mozambique, Zimbabwe, and Malawi) accounted only for 1.5% of Namibia's total exports. Namibia's exports to the non-SADC TFTA region are tiny, accounting for only 0.06% of Namibia's total export.

By trend, Namibia's exports to the non-SACU TFTA region are rather low value products, which are often not demanded in other markets, such as horse mackerel, meat offal, or hides and skins.

South Africa is by far the largest import market for Namibia, accounting for 73% of Namibia's total imports. Namibia's second largest import market is the EU with 11% of total imports, followed by China, India, Zambia, and the USA. Major import products are minerals and capital goods, such as motor vehicles and machinery.

Imports from non-SACU SADC countries accounted only for 2.4% of Namibia's total imports in the period 2009-2011, with more than half of it coming from Zambia (copper).

Namibia's imports from non-SADC TFTA countries only accounted for 0.09% of total imports in the period 2009-2011. The few products imported include engines and motors from Egypt and carbonate from Kenya.

In summary, it can be stated that Namibia's exports with the Tripartite FTA region are highly dominated by trade with South Africa, followed by a much lower relevance of SADC (Angola and DRC) as an export market (13.2% of total exports). Exports to the non-SADC TFTA region are de facto non-existent (0.06% of total exports, 2009-11). With respect to imports, South Africa's dominance is even higher, being virtually the only source for Namibian imports from the region. Thus, Namibia's imports from non-SACU SADC countries accounted only for 2.4% of its total imports, with more than 80% being copper and uranium from Zambia.

The wider TFTA region, i.e. the region, with which Namibia is currently not engaged in a trade agreement (SACU, SADC), is therefore currently irrelevant for Namibia's economic development. Namibia's options to expand trade with the wider TFTA region are discussed in section 5, after having provided an overview of Namibia's trade policy regime.

4.2 Namibia's trade policy regime

²³ Angola is a founding member of SADC and a signatory of the SADC Trade Protocol but has yet to submit instruments of accession. DRC is a member of SADC but has yet to sign the SADC Trade Protocol.

Namibia is already an open economy. Being in a customs union with South Africa, and having de facto implemented the EU-South Africa FTA (TDCA) and the SADC Trade Protocol, Namibia has liberalised its import regime for about 87% of total imports. The only remaining “protectionist shields” are NTBs, such as quantitative restrictions and non-automatic licenses, that protect in particular Namibia’s agriculture and agro-processed industries. Namibia applies trade restrictions to a number of imports that stand in direct competition with its local production, such as maize, wheat and products thereof, horticulture products, meat products, flour and pasta. It is argued that Namibia, as a small developing country with a limited production base, which is in a custom union with the ‘economic giant’ of South Africa, needs such protection to develop a certain industrial base. While this might be correct, it still implies limiting the options for Namibia’s intra-regional trade. First, because Namibia’s trade restrictions apply to all imports (i.e. also to those of lesser developed SACU and SADC countries) and second, because Namibia’s major export markets in the region (Botswana, Lesotho, Swaziland/BLS, Angola, Zambia) have put forward similar arguments to restrict their markets for Namibian exports.

NTBs remain a problem in all Tripartite FTA countries and have, according to observations of the Namibian private sector, even increased in recent years. Since COMESA, EAC and SADC have no mechanism to compensate weaker member states from trade diversion and trade creation²⁴ (unlike SACU or the EU), their weaker members face a double dilemma: they lose revenue by tariff liberalization while at the same time facing increased competition in their markets, with their production being substituted by more competitive neighbouring countries. Subsequently, member states have – with decreasing tariff protection - started to erect NTBs to protect their domestic producers against regional competition.

²⁴ *Trade creation* occurs if domestic products are replaced by more competitive regional products. This results in the increased consumption of cheaper substitutes, at the expense of local production. Thus, trade creation has detrimental effects for non-competitive domestic producers that will be displaced by their regional competitors. *Trade diversion* means the directional change of trade: products which were formerly imported from the rest of the world are now imported from regional producers as their production costs are lower than those of the rest of the world plus customs duty. Thus, the producer surplus of the regional supplier increases.

5 The Tripartite FTA – What’s in it for Namibia?

As discussed in section 4.1, Namibia’s trade with non-SADC TFTA countries is extremely small, accounting for 0.06% of total exports and 0.09% of total imports in the period 2009-2011. This section looks at the reasons for this low trade with the wider region, such as tariffs, non-tariff barriers, transport costs, and the complementarity of products.

5.1 Export potential

The Table 1 below provides an overview of Namibia’s major export products and the tariffs they face in the Tripartite FTA countries that have not acceded to the SADC Trade Protocol. As can be seen from the Table 1, major export products include fish, beer, salts, light oils, and live animals, which face tariffs between zero and 25%. The only prohibitive tariff is applied by the Seychelles with 200% on frozen tuna imports.

Why does Namibia export so little to TFTA countries and how can the reasons become targeted by the TFTA? According to Namibian exporters, tariffs are not a prohibiting factor, though lower tariffs in non-SADC TP (Trade Protocol) countries would be desirable. They observed, however, the following constraining factors for regional exports:

- *Protectionist tendencies in form of manifold NTBs*, e.g. for beer, dairy and milling products, cement – all of which are products that are produced in most TFTA countries;
- *Cumbersome customs procedures*, including delays and in-transparent, unpredictable and changing processes (particularly a problem in Angola, Namibia’s major non-SACU export market);
- *High transport costs* due to poor road and infrastructure networks;
- *Namibia’s limited production capacities* and non-competitive products (particularly in relation to food products that the region imports from the Rest of the World).

Table 1: Namibia's exports to non-SADC TP Tripartite FTA countries²⁵

Market	Code	Description	Export value (\$000)			Tariff applied in destination market	Hypothetical duty payable (US\$ 000)
			Average 2009-11	Share of X to all Tripartite	Share of X to country		
Total							20.017
Eritrea	010690	live animals	309	0,0%	99,8%	2	6
Seychelles	030341	frozen tunas	264	0,0%	12,0%	200	528
DRC	030374	frozen mackerel	37.900	1,4%	50,1%	10	3.790
Libya	030378	frozen hake	152	0,0%	20,6%	0	-
DRC	030379	frozen freshwater and saltwater fish	11.708	0,4%	15,5%	10	1.171
Libya	030429	frozen fish fillets	541	0,0%	73,1%	0	-
DRC	030499	frozen fish meat	7.110	0,3%	9,4%	20	1.422
Tanzania	220300	beer made from malt	662	0,0%	41,7%	25	-
Uganda	220300	beer made from malt	69	0,0%	48,5%	25	17
DRC	250100	salts, incl. table salt	6.188	0,2%	8,2%	10 or 20	1.238
Ethiopia	250100	salts, incl. table salt	20	0,0%	75,4%	5 or 10	2
Uganda	250100	salts, incl. table salt	11	0,0%	8,0%	25	3
Comoros	271011	light oils and preparations	1	0,0%	100,0%	15	0
Seychelles	271011	light oils and preparations	149	0,0%	6,8%	0	-
Tanzania	271011	light oils and preparations	102	0,0%	6,4%	0	-
Kenya	820530	planes, chisels, gouges	40.492	1,5%	96,4%	10	4.049
Tanzania	842121	machinery for filtering water	88	0,0%	5,5%	0	-
Tanzania	843049	boring or sinking machinery	101	0,0%	6,4%	0	-
Tanzania	843141	buckets, shovels, grabs	230	0,0%	14,5%	10	-
Rwanda	847130	data-processing machines	0	0,0%	5,6%	0	-
Uganda	847330	parts of data-processing machines	8	0,0%	5,6%	0	-
Angola	870323	motor cars	32.830	1,2%	5,7%	2-20	6.566
Burundi	870323	motor cars	5	0,0%	62,4%	0 or 25	1
Uganda	870323	motor cars	19	0,0%	13,2%	0 or 25	5
Burundi	870324	motor cars	3	0,0%	37,6%	0 or 25	1
Uganda	870324	motor cars	11	0,0%	7,7%	0 or 25	3
Rwanda	870333	motor cars	2	0,0%	20,3%	0 or 25	0
Seychelles	890200	fishing vessels	1.775	0,1%	80,8%	0	-

Source: UN COMTRADE database; accessed: 01.11.12

The Box 1 below summarises the opportunities and limitations for Namibia's main regional export products.

²⁵ The products marked in italic are most likely transit products and are disregarded.

Box 1: Product-specific barriers for Namibian exporters to the Tripartite region

Fish

Namibia exports mainly horse mackerel to the TFTA region; more valuable fish species like hake or monk fish go largely to the EU and the South African market where exporters get the best price. Horse mackerel is a basic food product that competes with the price of chicken pieces, i.e. producers are very much restricted in their price policy. The Namibian horse mackerel is the smallest of all the horse mackerels fished around the globe and the lowest in fat content. Therefore the product has to be sold at a discount to be competitive with horse mackerel from other zones (e.g. West Sahara).

Export advantages:

Close to Angola, DRC and Mozambique, which are major horse mackerel markets where the Namibian product is well accepted.

Limits of expanding exports:

Fish exports are naturally limited and depend on fluctuating fish stocks. To avoid the overfishing of its waters, Namibia manages its resource by a strict quota system. For horse mackerel the options for value addition are limited since the fish is not demanded in canned or filleted form.

Tariff and non-tariff barriers faced:

Though horse mackerel is categorized as “foodstuff”, and thus is considered as duty free under the SADC Trade Protocol, Namibia still pays significant duties when exporting to DRC or Angola. This risks resulting in under-declaration and production of faked invoices in order to reduce the customs duties to be paid.

Beer

Namib Breweries exports around 60% of its total production: 85% goes to South Africa, 6% to Botswana, and the remaining 9% to Zambia, Cameroon, Tanzania, Zimbabwe, Swaziland, Mozambique, Kenya, and Uganda.

Export advantages: Quality of product that is appreciated in export markets.

Tariff and non-tariff barriers faced: Most SADC countries have a monopolistic beer sector, which makes exporting complicated. Despite the SADC Trade Protocol duties and taxes differ substantially from country to country: Angola applies a tariff of 50%, Zambia of 40%, Tanzania of 5%. NTBs include random border stops and discriminatory taxation (incl. within SACU).

Milling products

Namib Mills produces about 70,000-75,000 tons maize meal and 55,000 tons wheat flour. In 2008, the company was initially able to export. Exports go to South Africa, Botswana, Zambia and Angola. However, capacities are still limited and the primary focus is on serving the local market. Only 5-7% of total production is currently exported.

Limits of expanding exports: Low capacities and products not being internationally competitive. Angola for instance imports directly from Brazil and Argentina. Moreover, production is of low value and high volume, which implies high transport costs.

Tariff and non-tariff barriers faced: NamibMills exports currently only to Angola where its pasta faces a tariff of 25%. Moreover, exports face an increasing number of NTBs since the country aims to set-up its own milling industry. NTBs are also applied within SACU, with Botswana, Namibia and Swaziland restricting the import of flour and flour products.

Dairy products

Namibian Dairies is one of the few industries in Namibia that produces in an integrated value chain, ranging from milk farmers over production of dairy products to packaging. The industry sources exclusively from local milk farmers (instead of importing subsidised milk powder). Thus, its prices are not internationally competitive. Namibian Dairies exports around 2-3% of total production to Angola. Export products are exclusively value-added products such as yoghurt or milk drinks.

Limits of expanding exports: High tariffs and non-tariff barriers. Most SADC countries (incl. the SACU members Botswana and Swaziland) have a controlled market for dairy products and strictly control/limit dairy imports.

Tariff and non-tariff barriers faced: Dairy exports face high tariffs and difficult customs procedures in Angola. Moreover, the industry complains about lengthy payment processes since the Central Bank of Angola limits the export of foreign exchange.

Meat and meat products

Namibia is a small meat producer in international terms having about 2 million cattle. About 85% of production is exported, primarily to South Africa (live animals cuts and canned meat) and to the EU (“premium cut”).²⁶ Exports to other TFTA countries are very limited. Namibia sees a potential in increasing exports of on-hoof, canned beef and low-quality meat into Angola (depending on infrastructure development like tarred roads, a functioning cooling chain but also enhanced customs clearance).

Limits of expanding exports: Being an arid country, the options for Namibia of expanding production are limited. Abattoirs work below capacity, and taxation of live animal exports has not yet succeeded in fully exploiting capacity utilisation.²⁷

While the TFTA might be able to address some of the existing trade barriers, such as tariffs or cumbersome customs procedures, it cannot target Namibia’s supply-side constraints, namely the limited production capacities of single

²⁶ ODI and DNA (2008:32-33) have investigated the options for re-directing Namibia’s “EU premium cuts” to other markets. They found that only 8 of the 17 markets analysed would pay a similar price than Namibia receives in the EU. Moreover, these markets would only absorb about 1/4 of Namibia’s current EU exports so that losing the EU market would imply a significant loss of revenue.

²⁷ The export of live animals is restricted or levied by the Namibian Meat Board so as to ensure that the overhang capacity of local abattoirs is limited. The same applies for animal hides and skins.

industries. Another factor that cannot be addressed by a trade agreement is the region's general lack of industrial development resulting in missing trade complementarities. These are long-term development issues, which would need to be addressed in order to allow countries to take full advantage of regional FTAs. However, while the TFTA (like the SADC Trade Protocol) mentions the problem of poor infrastructure and lack of industrial development and aims to overcome them, it remains unclear of how this should be achieved.

5.2 Import competition in Namibia if implementing the TFTA

Namibia's direct imports from non-SADC TFTA countries accounted for only 0.09% of its total imports in the period 2009-11. High tariffs are, however, not the reason for Namibia's low level of imports from the Tripartite FTA region. There are very few products which Namibia sources from the Tripartite FTA region (i.e. incl. SADC) for which non-SADC Tripartite FTA countries still face a medium to high MFN tariff in the SACU market. Tripartite FTA region products imported by Namibia include light oils, tea, tobacco, cotton, textiles and clothing. Of these, textiles and clothing appear to be the only sensitive product groups within SACU, which are, however, only of minor relevance (accounting for 0.1-1.8% of total Tripartite Region Trade in 2009-11). In other words: the import competition in the Namibian market as a result of liberalising towards the TFTA countries is expected to be practically nil.

As reported from the private sector in Namibia, the reasons for limited sourcing from the region include poor quality of products,²⁸ a poor road network and high transport costs,²⁹ lack of trade finance,³⁰ low production capacities, and non-existing business relations. Further reasons are possibly non-tariff barriers, such as Namibia's import bans and import controls for maize, wheat, flour, and horticultural products. As discussed before, the monitoring of NTBs takes place but remains difficult due to the countries' similar production structures, which motivates for erecting non-tariff barriers. With

²⁸ Namibia used to import significant amounts of maize from Zambia and sugar from Zimbabwe. However, the quality of products was declining so that importers have chosen to select other sources.

²⁹ This is quoted as a major reason by Namibian exporters for exporting mainly to South Africa, and southern Angola and DRC.

³⁰ Political unrest and worsening socio-economic conditions in some SADC countries have negatively impacted on intra-regional trade. For example, Namibian-Zimbabwean trade relations have declined significantly since Zimbabwe has shown severe difficulties in financing its imports and as it has hardly any capacity to export.

respect to transport costs, it has been fully realised by Governments that these need to be reduced to facilitate intra-SADC trade. A number of transport corridors exist and link Namibia to the SADC region.³¹ The World Bank Group (2012) undertook a comprehensive analysis of Namibia's regional transport and trade logistics capacities, requested by the National Planning Commission. The study found that traffic along the routes of the WBC grew on average by 33% in the period 2005-11. Growing transit traffic offers a chance for Namibia to reduce trade costs and to benefit from economic spillovers, such as increased investment.

5.3 Revenue implications

Income from the SACU Common Revenue Pool (CRP) is extremely important for Namibia, accounting for about 40% of the country's total revenue. Namibia's dependency on income from the CRP has increased in recent years, following the 2002 reform of the revenue sharing mechanism. When analysing the revenue implications of the TFTA, we therefore have to look at it from two angles: first, the implications for Namibia's direct imports and second, the implications for the SACU revenue pool.³²

Namibia's hypothetical revenue loss³³ from TFTA imports was on average US\$ 1.12 Mio p.a. for the period 2009-11, what is less than 0.1% of Namibia's revenue from the CRP in 2011.³⁴ South Africa's hypothetical revenue loss from TFTA imports was on average US\$6.47 Mio p.a. for the period

³¹ The routes of the Walvis Bay Corridor (WBC) are the Trans-Kalahari Corridor (TKC) connecting Namibia and Botswana to South Africa's industrial heartland (Gauteng), the Trans-Capri Corridor (TCC) into Zambia and further on to the DRC, and the Trans-Cunene Corridor (TCuC) linking into Southern Angola. A further corridor is the traditional North-South route from Windhoek to South Africa (RTFP, 2007: Chapter 6).

³² The analysis assumes that SACU's tariff liberalisation offer under the SADC Trade Protocol is expanded to all TFTA countries, thus that 99.2% of tariff lines are going to be liberalised under the TFTA.

³³ The "hypothetical revenue loss" is obtained by applying the base applied tariff (where known) to the average value of imports in the past three years (2009-11). The concept of "hypothetical revenue" assumes 100% collection efficiency and no rebates – both assumptions are unrealistic. However, both "errors" work in opposite directions: while the 100% collection efficiency overstates the revenue loss, the fact that no rebates are taken into consideration understates the revenue collection loss.

³⁴ Namibia's revenue share was ZAR 9.567 billion (about US\$ 1.127 billion), which equals 17.3% of the total CRP, in 2011/12 (SACU Secretariat, 2012).

2009-11, which is less than 0.1% of the total value of the CRP. The revenue implications of the TFTA can thus be considered as insignificant for SACU.

5.4 Implications for trade policies and trade-related institutions

Namibia has entered into several international agreements that already constrain its freedom of manoeuvre for trade policy making. These include the 2002 SACU Agreement, the WTO Agreement, and the SADC Trade Protocol. Moreover, Namibia has de facto implemented the TDCA between South Africa and the EU, liberalising its market for the majority of its EU imports. The requirements of the abovementioned trade treaties differ considerably with respect to what Namibian trade policies are allowed to do. However, generally, Government's policy space on any trade policy issue is set by the terms of the most restrictive agreement that it has signed. In case of Namibia, this is the WTO Agreement as explained now.

The 2002 SACU Agreement provides several exemptions from its standard provisions of free movement of goods, and explicitly allows Namibia to apply import and export restrictions for external SACU trade; i.e. from trade with countries that are outside the customs union. Additionally, Namibia applies bans for certain intra-SACU imports, which may not be permitted by the SACU Agreement but have not yet been challenged by any SACU member.³⁵ Namibia claims that current trade restrictions for agriculture and agro-processed products are necessary for Namibia so as to being able to develop any meaningful industries in a customs union with South Africa. This has worked successfully in the past for Namibia's dairy and poultry industries.

When undertaking a comparative analysis of the envisaged regulatory and institutional framework of the Draft TFTA with the SACU and SADC Trade Agreements it was found that the Draft TFTA has stricter rules than the 2002 SACU Agreement, with many provisions being identical to the WTO ones, such as trade remedies, border charges or infant industry protection. Thus, Namibia has already committed itself to abolish extra duties and phase out quantitative restrictions for intra-regional trade under the WTO provisions (and also under the SADC Trade Protocol), but these obligations have not yet been enforced.³⁶ Thus, the major issue under the TFTA would not be

³⁵ A possible reason is that also other SACU countries (except for South Africa) apply quantitative restrictions, such as temporary import bans.

³⁶ To date no member of the WTO or the SADC has brought according claims up to the respective dispute settlement mechanism to enforce the trade rules for Namibia. In case of WTO the likely reason is that the distortive effect resulting from Namibia's

to create additional obligations and commitments but the question would be of whether existing rules and obligations are enforced by the TFTA framework.

The institutional set-up of the Draft TFTA follows largely the SADC Trade Protocol and its Annexes, foreseeing the creation of Tripartite region institutions in the fields of competition, standardization/metrology, SPS, R&D etc. However, the cooperation between the trade-related institutions in the three regions and their relation to the proposed TFTA are not yet clear. Significant coordination would be required to avoid a duplication of cooperation institutions, which risks of putting further constraints on the countries' already limited capacities.

Namibia's trade-related institutions are comparably new and still face some difficulties with respect to policy enforcement:

- *Customs*: A comprehensive assessment of the World Customs Organization (WCO) found that Namibia needs to strengthen its services in the fields of customs valuation, rules of origin and inspection of goods (USAID, 2010b).
- *Standards and SPS*: According to the latest WTO Trade Policy Review (TPR) of 2009 (WTO 2009) Namibia has difficulties to comply fully with the standards, technical regulations and SPS requirements of major export markets. Moreover, the newly established Namibian Standards Institution (NSI) does not have the capacity to ensure full inspection services for imports. In 2009 Namibia created the National SPS and Food Safety Committee hosted by the Ministry of Agriculture, Water and Forestry (MoAWF) to coordinate SPS activities in the SADC context, which is, however, still at an infant stage.
- *Intellectual Property Rights (IPR)*: The development of national IPR policies and the set-up of institutions as outlined in the Industrial Property Bill are delayed due to capacity constraints.
- *Competition policy*: The Namibia Competition Commission (NACC) was established in 2009 and aims to develop and implement a National Competition Policy (NCP). To date, it still lacks the wider scope of competition-related interventions; e.g. how industrial policy interventions or investments are designed and controlled.

Being in the process of strengthening its national trade-related institutions, it is challenging for Namibia to meet also institutional obligations on a regional

non-compliance are marginal in international terms. In case of SADC the reason might be that other countries also apply additional duties for intra-regional trade.

level. The Table 2 below provides a rough overview of the planned institutional set-up of the Draft TFTA, and shows as well to what extent institutional equivalents exist in Namibia and at SACU and SADC level.

In fact, the creation of TFTA institutions, many of which do not yet exist on a country or REC level, is likely to become a major challenge when implementing the Treaty. Clarifying roles and responsibilities as well as establishing an effective coordination mechanism between the trade-related institutions at the different levels will be imperative so as to avoid duplication of efforts, which would put further constraint on the countries' limited administrative and skills capacities.

6 The relevance of the TFTA for Namibia's development

As stipulated in the Vision 2030 Namibia aims to become a "Prosperous and industrialised (country), developed by her human resources, enjoying peace, harmony and political stability" (Government of Namibia, 2004). With respect to industrial development, Namibia aims that manufacturing activities and services account for 80% of the country's GDP, that processed products account for at least 70% of export revenue and that the country's infrastructure is modernized and it has a significant share of a knowledge-based workforce (Ibid, p. 39).

Table 2: Comparative overview of Namibia's trade-related institutional framework in regional integration schemes

Topic	Competent Authority				Status Quo
	Draft TFTA	SADC	SACU	Namibia	
Trade remedies	<i>Trade Remedies Sub-Committee</i>	-	<i>SACU Tariff Board</i>	<i>Namibia Board of Trade/NBoT</i>	No existing institution at national or regional level
Non-Tariff Barriers (NTBs)	<i>Tripartite NTB Monitoring Unit</i>	-	-	Technical Barriers to Trade/TBT Enquiry Point at MTI	Web-based NTB monitoring mechanism exists as well as national TBT point. Effectiveness in Namibia limited since private sector is not aware of existing institutions and services. ³⁷
Trade Facilitation	<i>Sub-Committee on Trade Facilitation</i>	Sub-Committee on Trade Facilitation	-	TBT Enquiry Point at Ministry of Trade and Industry/MTI	
Standards, Metrology, conformity assessment, accreditation – SMCA	<i>Sub-Committee on SMCA</i>	SADC SQAM Expert Group SADCAS	-	Namibia Standards Institution (NSI)	NSI participates in SADC institutions and activities
Sanitary and Phytosanitary Standards (SPS)	<i>SPS Sub-Committee</i>	National SPS Committees		MoAWF (lead)	National SPS and Food Safety Committee established.
Competition	<i>Competition Policy and Consumer Protection Forum</i>	-	-	Namibia Competition Commission (NACC)	NACC cooperates on SADC level to share information on non-competitive behaviour
Intellectual Property Rights (IPR)	-	-	-	<i>Industrial Property Office and Industrial Property Tribunal</i>	Industrial Property Office and Industrial Property Tribunal not yet operational. MTI, Ministry of ITC, and Ministry of Environment are in charge
Dispute Settlement Body	<i>Dispute Settlement Mechanism</i>	<i>Dispute Settlement Mechanism</i>	<i>Tribunal</i>	n/a	No existing institutions

Note: Institutions marked in italic do not yet exist. ITC = Information Technology and Communication, MTI = Ministry of Trade and Industry of Namibia, MoAWF = Ministry of Agriculture, Water and Forestry of Namibia, SQAM = Standardization, Quality Assurance, Accreditation and Metrology, TBT = Technical Barriers to Trade; SADCAS = SADC Accreditation Service; NACC = Namibia Competition Commission

Namibia's industrialisation plan (see Government of Namibia 2011), which implies a fundamental change to its current production and export structure,

³⁷ None of the private sector representatives interviewed knew about the web-based NTB Monitoring Mechanism (www.tradebarriers.org) or was aware that the TBT Enquiry Point at MTI is supposed to follow-up reported NTBs in intra-regional trade.

is very ambitious. Targeted investment incentives, SME promotion, infrastructure development, close cooperation with the private sector as well as government investments in skills, education and R&D shall help to materialise Namibia's industrialisation objectives. The policy addresses also the regional level and the need to develop cross-border industrial incentives at the SACU and SADC level. The Ministry of Trade and Industry (MTI) is assigned with the task to facilitate intra-regional trade and to support Namibian businesses to successfully enter regional markets at lower costs. For this purpose, FTAs and PTAs with selected economies shall be concluded and the removal of trade and investment barriers shall be closely monitored (Government of Namibia, 2011:14-16). The TFTA can be seen in the context of intra-regional industrial development cooperation: "To gear a common single market to serve our Vision 2030 goals requires markets that function well and are well-connected... Access for our SMEs to a single African market has to be improved." (Ibid, p.14).

However, in the light of the limited institutional, human and financial resources in Namibia, it is strongly recommended to concentrate on the full implementation of the 2002 SACU Agreement and the SADC FTA – which include Namibia's major regional trading partners South Africa, Angola and DRC. Namibia is hardly trading with non-SADC Tripartite region countries and has very limited production capacities to do so in the medium-term. Subsequently, the private sector is less concerned about 'accessing new markets' than about having a predictable trade regime with countries which are major export markets. In other words: enforcing the rules and regulations of the SACU and SADC Agreements would best serve Namibia's development objectives towards Vision 2030.

The **matrix** below with the **SWOT (Strength/Weakness/Opportunity/Threat) analysis** summarizes Namibia's challenges and opportunities in the TFTA and provides according policy recommendations:

	STRENGTH	WEAKNESS	OPPORTUNITY	THREAT	Policy Recommendation
Export Potential	Neighbouring SADC countries have become medium-relevance export markets for selected products (e.g. beer, horse mackerel, milling product). Long-standing relations and common history with a number of regional trading partners (e.g. Angola, Zimbabwe, SACU countries).	Limited export capacities; Range of export products that is also produced in many countries in the region; High transport costs for intra-regional trade; Language barriers to major regional export markets (Angola, DRC).	SADC/TFTA market offers chances to expand value added exports: Potential market niches for Namibian agro-processed and manufactured products.	Protectionist tendencies in SADC/TFTA; Changing rules and procedures (e.g. in Angola); Region sources subsidized agricultural products from Rest of the World/Row (e.g. dairy/milling products), which substitute Namibian export products.	Strengthen dialogue with private sector to assess what hampers exports to the region and to what extent Government can support export expansion (e.g. NTBs, custom facilitation...); Enter into dialogue with Governments of the main regional export markets (Angola, DRC) to negotiate how bilateral trade could be facilitated.
Imports / increased competition	Namibia is already an open economy, being in a customs union with SA and having de facto a FTA with the EU for 87% of its total imports which enter its territory duty free.	Namibia does hardly source from the region: only 2.4% of its total imports come from the non-SACU TFTA region (of which 75% were mineral products from two countries).	The region could <i>potentially</i> supply some of Namibia's agricultural imports, e.g. maize and wheat.	Namibia's subsidized imports from Rest of the World/Row (e.g. wheat from US and EU).	Assess options for increased sourcing from the region and address reasons for the low level of regional imports, e.g. product quality, quantity, reliable delivery, NTBs, etc.
Revenue	n/a	Namibia's high dependency on the CRP/trade duties as income source.	Namibia's and South Africa's extremely limited trade with the non-SADC TFTA region, low level of MFN tariffs for intra-regional trade; The "top 10 TFTA revenue earners" account for >82% of the total hypothetical revenue from TFTA.	n/a	Exclude some of the 'top 10 revenue earners' from liberalization, e.g. worn clothing, motor vehicles, sugar confectionary.
Trade Policies	Namibia's trade policies are transparent and predictable.	Namibia's trade policies are not fully compliant with its commitments in its trade agreements; No enforcement of trade policy provisions of SADC TP, it is doubtful that TFTA provisions can be enforced.	Namibia has already committed itself to abolish extra duties and to phase out quantitative restrictions under the SADC TP.	Namibia's applied 'protectionist shields' (quantitative restrictions, import bans, export duties) are not compliant with the provisions of the SADC TP and the Draft TFTA; Unpredictable ad hoc trade policies within SADC are widespread, which hampers intra-regional trade.	All SADC Governments need to enforce their trade policy commitments as stipulated in the SADC TP; Intra-regional dialogue on NTBs needs to be strengthened further, private sector needs to be aware and fully included.

	STRENGTH	WEAKNESS	OPPORTUNITY	THREAT	Policy Recommendation
Trade-Related Policies (competition policy, IPP, procurement rules, quality infrastructure, etc.)	Namibia has already developed and implemented most trade-related policies.	Joint SACU policies not yet developed. Lack of technical expertise at national and regional level (e.g. on standards, SPS). Policy coordination between different regional levels unclear.	Relevance of trade-related policies in international and regional trade agreements acknowledged.	Strengthening policies at a national level while at the same time developing them at different regional levels risks to overextend Namibia's capacities Comprehensive set of trade-related policies risks overextending the capacities of TFTA countries.	Work towards joint SACU policies; Clarify roles of SADC vs. TFTA trade-related policies; avoid duplication.
Trade Related Institutions	Namibia has functioning institutions in most trade-related policy fields.	A number of Namibia's trade and trade-related institutions are new and/or face capacity constraints; Joint SACU institutions yet to be established.	Need to strengthen trade-related institutions in order to implement regional and international trade commitments raised.	Strengthening institutions at a national level while at the same time developing them at a SACU, SADC and TFTA level risks overextending the capacities of Namibia TFTA countries have hardly the capacities to set-up/participate in the foreseen institutional framework.	Strengthen trade-related institutions at the national level; Work towards joint SACU institutions; Contribute to the SADC/TFTA regional institutions but only if the added value for Namibia is clear (e.g. in case of the SADC Accreditation Body – since Namibia does not have a national accreditation body); (Clarify the roles of SADC vs. TFTA institutional set-up, avoid duplication; Respect principle of subsidiarity, i.e. refer to the responsibility of the lower authority.

7 Conclusions and Policy Recommendations

Summarising the opportunities and challenges for Namibia in the TFTA, it appears that both are very limited due to Namibia's extremely small trade with the wider TFTA region. While non-SACU SADC countries are of some relevance as an export destination for Namibia, particularly for some agriculture, agro-processed and simple manufactured products, Namibia exports hardly to the non-SADC TFTA region. Limited production capacities and high transport costs make it currently unviable to export to the wider region. Reducing tariffs and NTBs would mainly benefit Namibian exports to neighbouring SADC markets, such as Angola, DRC, Zambia or Zimbabwe. The full implementation of the SADC TP is therefore regarded as a priority by the Namibian private sector.

There are, of course, a number of potential benefits for Namibia within the TFTA, such as access to a larger market for its goods and services or an enhanced functional cooperation in the wider region (e.g. in the fields of joint infrastructure projects or joint regional development policies). These potential benefits require, however, that certain preconditions are met. To benefit for instance from a large regional market Namibia would need to increase its production capacities and to improve the competitiveness of its products. The same applies for regional producers that aim to supply Namibia, e.g. with agricultural products such as maize or wheat. At the moment both, the SADC region and Namibia, source rather from the RoW than from neighbouring countries since the price-quality ratio is superior when sourcing from international markets.

The biggest challenges for Namibia in the TFTA will not be the increased competition or the revenue losses but the capacity to implement the rules and regulations of the TFTA, to contribute to the establishment of its comprehensive institutional framework, and to coordinate trade policy-making between the national and the different regional levels. A number of trade-related institutions which are foreseen in the Draft TFTA have only recently been established in Namibia or are not yet operational. Moreover, trade-related institutions at the SACU and/or SADC level are very weak or non-existent. Consolidating the operation of existing national and regional institutions so that they become effective in supervising the proper implementation of the already existing trade commitments appears to be a top priority for Namibia. Spreading already limited technical, institutional and human resources further at the Tripartite FTA region level might, however, bear the risk that regional integration efforts are diluted and that no feasible progress will be reached at all.

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Unit 2: Specific Policy Issues of Regional Integration in Africa

Specific Policy Issues of Regional Integration in Africa - An Introduction

Isabelle Ramdoo¹ and Karl Wohlmuth²

1 The Issues

Regional Integration in Africa in times of global Mega-trade Arrangements

The stalemate at the WTO negotiations over the last two decades and the rapidly shifting pattern of global trade from the West towards the East have been accompanied by a proliferation of bilateral trade arrangements (BTAs) and regional trade agreements (RTAs). Among those the Mega-RTAs stand out as being strategic trade deals that deliberately seek to deepen integration among countries with a large share of world trade and foreign direct investment and which are global drivers or hubs in global value chains (Melendez-Ortiz, 2014). Three of those Mega-regionals are the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP), and the Regional Comprehensive Economic Partnership (RCEP)³.

The key objectives of the Mega-RTAs are two-fold. First, it is a way to advance a more ambitious trade agenda that fits the nature of “21st Century trade” and they are therefore a way for large players to set the “rules of the game” to fit their interests and needs. Second, these are essentially geo-political tools, as a response to the rise of new global trading powers, such as China. This is particular clear in the case of the TPP, which deliberately excluded China so as to contain the latter’s rise in Asia and in the Pacific

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³ The TTIP is an FTA between the US and the EU; the TPP is being negotiated by the US and Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam; and RCEP is being negotiated between ASEAN and its regional partners – Australia, New Zealand, China, South Korea, Japan and India.

(Ramdoos, 2014b). Content-wise, Mega-RTAs have high ambitions and go beyond tariff liberalization, which are on average already quite low for many products. The main gains are expected to arise from achieving regulatory compatibility and convergence. It is estimated that ad valorem tariff equivalent protection from non-tariff measures range between 19% - 73% (Draper, Lacey and Ramkolwan: 2014), and that up to 50% of those barriers could potentially be eliminated through such deals (Ecorys, 2009).

If successfully concluded, Mega-RTAs will undoubtedly have significant impacts on third countries, and in particular on countries that already have a free or preferential trade arrangement with Mega-RTA partners or for those that are highly dependent on those large markets (Guimbard and Le Goff, 2014). These may erode further their margins of preference. It will also have an impact on regional integration dynamics for several reasons. First, regions will have to lift up their levels of ambitions to remain attractive as they create larger markets. It means devising a regional integration agenda that creates strong markets for goods and services, addresses non-tariff barriers, and provides a more conducive environment for businesses. It also implies putting in place strong and ambitious regional frameworks on services, investment, competition policy, and intellectual property rights, all of which is currently lagging behind. Although TFTA and CFTA in Africa have such wide-ranging ambitions, the reality of implementation is much poorer.

Second, Mega-RTAs will be ground-breaking in setting the benchmark on regulatory issues. Therefore, African regional integration agenda should also take a lead role in setting high standards, to avoid the risk for regions of being side-lined and hence becoming mere standard-takers. This can be an advantage if it reduces the costs of meeting standards, or a disadvantage if African economies have to bear higher compliance and trade costs in order to maintain access to these markets.

Finally, Mega-RTAs will impact on the outward strategies of the African RTAs in deepening their trade and investment partnerships with other key partners, including the emerging Southern partners, to avoid the risk of marginalization and to tighten closer strategic ties with other big markets.

Regional Integration in Africa and Impact of EPAs

Five Economic Partnership Agreements (EPAs)⁴ were concluded in the period 2007 to 2014 between European Union (EU) and African regions and

⁴ These are the Eastern and Southern African (ESA) – an EU Interim EPA was signed in 2009; the Cameroon-EU EPA, which was signed in 2009, is provisionally applied since May 2012 (pending the conclusion of a full EPA) and entered into force in 2014;

countries. These agreements, which replace the non-reciprocal trade regime of the EU, marked the end of more than twelve years of intense and difficult negotiations on trade in goods and development. Negotiations are expected to continue in the future to broaden the scope of the existing deals, notably to cover services, investment and other trade-related issues, and to include other African countries.

While the EPAs sealed the access of African products to the European markets, these agreements are likely to have some systemic impact on Africa's own regional economic integration dynamism.

First, EPAs have, to some degree, fast-tracked certain processes towards concluding the creation of common external tariffs, in particular in East Africa and in West Africa. Alongside their EPA negotiations, these two regional economic communities, namely the East African Community (EAC) and the Economic Commission of West African States (ECOWAS), were also in the process of deepening market integration through the creation of a customs union. However, in order to preserve their regional processes, the sequence of finalizing their own CET before concluding the EPAs was important. It ensured a single agreement, covering all members of their respective regional economic communities (RECs). This was however not the case in other regions, given a less advanced state of regional integration and overlapping memberships, what resulted in agreements at sub-regional level, as countries had to choose the configuration in which they wanted to sign the EPAs.

Second, it is often argued that EPAs might have a 'lock-in effect', that is, it will tie countries to the regional grouping with which they have concluded an EPA (Ramdoe, 2014a; McDonald et al., 2013). In the long run, due to such international commitments, countries that are member of several groupings may therefore have to opt out of other RECs in Africa. This will be a challenge for RECs that are likely see their memberships reshuffled, triggered by external factors rather than driven by regional policy and political choices.

Third, EPAs contain a Most Favoured Nations (MFN) clause, which means that in the future, should an EPA signatory negotiate a free trade agreement with another developed country or a large developing country or region, the EPA signatory will have to extend any more favourable treatment to the EU. This may have several implications. First, African countries or regions have very few, if any, trade agreements beyond their own regions. Their tariffs are on average still very high compared to the average applied tariffs in developed countries. This means that the margin of preference for

the West African ECOWAS regional EPA; the SADC-EU EPA which was initialed in July 2014; and the EAC-EU EPA which was initialed in November 2014.

an FTA partner with Africa is relatively high. This MFN clause may largely undermine the attractiveness of African markets to third parties and compromise their future negotiating weight.

Finally, the fact that the EPAs have been concluded before the completion of a regional and a continental trade agenda in Africa complicates the political relationship among countries. The situation today is that some African countries give more preferences to the EU, compared to what they give to their own regional neighbours. In this context, initiatives such as the Tripartite FTA - between COMESA, EAC and SADC - or the recently launched Continental FTA are welcomed attempts to further the African regional integration agenda and to improve its coherence and effective implementation (Dinka and Kennes, 2007; UNECA, 2006).

All these impacts have to be understood when evaluating the impact of the EPAs on Africa and its policy choices. It is not so obvious that the African negotiators have looked at all these factors when signing the EPAs. On the other hand, too many important issues in the EPAs are not yet finalized and wait for further negotiations.

Regional Integration in Africa and Development: Impacts on Industrial Development and on Technological Development

Over the last two decades, many African economies have grown at particularly high rates, placing a number of countries in the club of the top growing economies for many years in a row (see for e.g. World Bank, 2013; The Economist, 2013; IMF, 2015). While high growth rates have been heralded as finally being the tipping point towards better economic opportunities, it was soon acknowledged that growth alone has not been sufficient to transform Africa's economic landscape. The windfalls did not automatically trickle down in an equitable manner to create jobs. Economic structures remain largely undiversified and productivity increases did not materialize (see AfDB et. al., 2013; ACET, 2014; UNECA, 2013; UNIDO, 2012).

While the positive economic outlooks were largely driven by the combination of a commodity boom (due to high prices of commodities and demand from emerging economies) and an improved macroeconomic management in a number of countries, the use of regional integration as a driver of growth and the related opportunities that countries could derive from connected and enlarged markets remained largely untapped.

In particular, there exist significant prospects to boost industrial development in Africa, notably through the pushing for regional value chains. In effect, as they currently stand, African markets and economies are too small and fragmented to compete internationally in global value chains.

National policies alone are insufficient. It is therefore critical to develop strategic regional policies to overcome the challenges that have impacted negatively on the ability to reverse the declining path of the industrial sector, notably by enhancing regional production capacities and by addressing other supply side constraints such as behind and beyond the border measures and the high cost of services within and across different regions.

One of the key bottlenecks to efficient economic transformation in Africa is the poor state of infrastructure connections within and across countries. These include transport infrastructure but also importantly, energy and telecommunications infrastructure. Poor provisions have had major cost implications on the competitiveness of countries and the productivity of companies. Improved regional integration and proper cooperation and coordination are therefore critical inverting the challenge.

Effective regional integration is also important to help bridging the technological lag of African economies. Here again, in the absence of a strong capacity at the national level, regions can pool their resources together to support the establishment of regional technology incubation centers or centers of excellence, based on institutions that are already operational in some member states. These centers can in turn specialize on identified areas where opportunities exist to develop regional value chains or to put in place regional economic zones. An important area of action is the use of IT for technological development; regional cooperation can be useful in this direction (Wohlmuth, 2011; Wohlmuth, 2015).

Last but not least, financial integration is another important dimension where effective regional integration can play a major role. In effect, financial development and integration are necessary if Africa is to move to a higher level of development. Currently, African financial systems have less depth than in other regions in the world, and financial services reach fewer people than elsewhere (Christensen, 2014). Key issues include developing regional agreements to strengthen financial cooperation and to extend banking systems across the continent in order to secure financial stability in and across the African countries. This is a largely neglected issue in negotiations about regional integration and cooperation. However, the Global Economic Crisis of 2008 and the following years led in Africa to some changes in awareness about the role of financial development (Wohlmuth et al. 2011).

Regional Integration in Africa and Development: The impact of regional integration on food security and agriculture

Despite its vast agricultural potential, Africa is a net importer of agricultural products (FAO, 2011), and many African countries are reliant on imports from outside the continent to meet the local demand for food products. At the

same time, a small number of commodities dominate Africa's agricultural exports, with most of these being exported to partners outside the continent. The limited size of national markets, long distances to major global markets, poor physical and regulatory infrastructure, low levels of technology, various barriers to cross-border trade, and reliance on rain-fed agriculture for food production are just some of the many factors dampening the performance of Africa's agricultural sector and contributing to high levels of food insecurity across the continent. Many of these challenges cannot easily be solved at the national level, and regional integration is therefore seen as key factor for transforming agriculture in Africa and for promoting food security in African countries (Rampa, 2012).

To the extent that regional integration promotes increased intra-regional trade that fosters economic growth and increases employment prospects and the income-earning capacities of the poor, including the poor farmers, it will enhance food security. In addition, by facilitating intra-regional food trade flows from surplus areas to deficit areas, regional integration in Africa can promote increased food availability and reduce price volatility. Furthermore through offering the potential to exploit the economies of scale being present in larger integrated markets, and by providing for improved infrastructure and supportive regulatory frameworks, regional integration can attract investment in African agriculture from regional and global sources, facilitate technology transfer to African agricultural producers, and enhance the productivity and competitiveness of Africa's farmers, leading to increased output and increased incomes for Africa's many poor farmers, making them more resilient to external shocks.

Rapidly growing middle classes in many African countries offer important potential markets for African farmers and agricultural producers, but getting food from rural areas to consumers in growing urban centers is a significant challenge, especially as the nearest urban centers are often across a border. Africa's 'thick' borders and the high transaction costs, incurred by traders, result in higher prices for the consumers and in lower profits for the producers (World Bank, 2012). Also, to meet the demand of the growing urban middle classes the African agro-industry has to become more conscious of quality standards and regional brands. Regional integration can address these bottlenecks and can bring about lower transaction costs, benefitting producers and consumers alike, contributing positively to both agricultural production and food security.

Nevertheless, efforts to leverage regional integration to promote agricultural transformation and greater food security in Africa face many challenges. These include: i) building sufficient capacity in regional institutions to facilitate agriculture-enhancing regional integration; ii) ensuring that the proposed beneficiaries of regional integration, including

low-income farming households, are able to benefit from increased market access opportunities so that regional integration processes are not captured by narrow commercial or national interests; iii) addressing the lack of coherence that exists between some regional and national initiatives; iv) ensuring greater prioritization of regional processes by national policymakers; and v) addressing the tensions that often arise between individual states when particular national interests are at stake, such as differences over the level of the common external tariff for particular product lines (Woolfrey, 2015). Furthermore, regional integration processes need to navigate the political economy dynamics inherent in agriculture trade, a dynamics that may involve certain groups of producers, traders, retailers or officials having a vested interest in the status quo. Regional integration may offer good prospects for overcoming the status quo situation in this important productive sector.

Regional Integration in Africa and South-South Cooperation

South-South Cooperation (SSC), the exchange of goods, resources, technology and knowledge between developing countries (i.e. countries of the global 'South'), has its roots in the early post-colonial era, when the newly independent countries of Africa and Asia sought to reduce their political and economic dependence on the former colonial powers of the global 'North' (Morais de Sá e Silva, 2008). There has been a resurgence of SSC over the past decade, driven largely by the fact that growth in the developing world has outstripped that in the developed world in recent years. In addition, the emergence of new growth poles in the South has not only led to a reorientation of global trade and investment flows and to a greater interest in economic cooperation and integration among developing countries, but it has also facilitated an increased assertiveness by many developing countries on the world stage.

The recent resurgence in SSC has manifested itself in many ways, including in the emergence of formal and not-so-formal alliances, such as the Brazil-Russia-India-China-South Africa (BRICS) alliance. Regional integration in Africa (and beyond) represents another very visible manifestation of SSC. Indeed, regional integration in Africa, and in particular the establishment of an African Economic Community (AEC), was one of the core aims of early African proponents of SSC in Africa. While regional integration in Africa is itself a form of SSC, regional integration processes on the continent are also likely to be strongly impacted by SSC between African and non-African developing countries, and especially that involving the emerging powers of the South, such as Brazil, China and India.

Traditionally, support for regional integration in Africa has come from the developed world. The European Union (EU) and its member states have

traditionally been the most significant financial backers of the regional institutions on the continent, including Africa's various regional economic communities (RECs). In addition, the model of regional integration being followed by most of Africa's sub-regions draws heavily on the experience of European integration. There is, however, dissatisfaction in many quarters as to the suitability and effectiveness of formal, 'top-down' integration processes in Africa. While Africa's various regions display many of the formal trappings of integrated blocs (free trade agreements, regional bodies, etc.), the level of economic interdependence and regionalization within these blocs remains relatively low, due, among other things, to inadequate infrastructure and weak productive capacity. This is where SSC can have a positive impact. An alternative concept of promoting regional integration Africa is presented in Unit 1 to this volume of the African Development Perspectives Yearbook. This concept is directly related to speeding up structural transformation and building productive capacities.

Emerging powers from the South, such as Brazil, India and China, tend not to get directly involved in regional integration processes in Africa, and prefer to engage bilaterally with African countries (Dube, 2013). This engagement - including through trade and significant investment in infrastructure - is nevertheless helping to improve the productive capacities of Africa's industries, which in turn provides these industries with a reason to seek out new markets, including in Africa itself. In this way SSC can provide the momentum for a more African-owned and African-driven regional integration agenda.

While the emergence of new partners from the South is undoubtedly beneficial for African development, it should be noted that the impact of these partners on Africa's regional integration depends on the African countries' ability to manage the partnerships and to take advantage from the SSC. These emerging partners have no strong ideological interest in African integration per se, and are simply pursuing their own economic and political needs. There is definitely an opportunity for African integration processes to benefit from SSC, for example from development financing provided by institutions such as the BRICS Development Bank, but this opportunity will have to be seized by African countries themselves.

Regional Integration in Africa and Development: The impact of regional integration on national trade and investment policies

Increased trade and investment flows are two of the channels through which regional integration is meant to facilitate economic and social development in Africa. By integrating their national markets and addressing shortcomings in regional infrastructure, African countries can create larger regional markets

that are more attractive to foreign investors and which offer domestic producers economies of scale. In addition, regional integration can generate trade-related gains through trade creation (although some trade diversion is also a possible outcome). African producers then are able to expand their markets without having to compete with the most-efficient global producers. Regional integration can also serve to provide an additional justification for reform-minded governments to undertake steps towards trade and investment liberalization that might otherwise lack sufficient political backing.

Nevertheless, in integrating their national markets through formal rules-based arrangements such as free trade agreements (FTAs), customs unions (CUs) and common investment areas (CIAs), countries also tie their own hands to some degree with respect to domestic trade and investment policy. For example, a member of a customs union cannot unilaterally adjust the tariffs it charges on imported goods as such tariffs would have to reflect the customs union's common external tariff (CET). While in theory customs unions should make provision for collective decisions on such matters as the structure of the CET, in the case of certain African customs unions, the most powerful member of the union has effectively been able to dictate tariff policy to other members. This has certainly been the case for instance with the Southern African Customs Union (SACU), where the CET has historically reflected the industrial policy interests of South Africa, the largest and most powerful SACU member (McCarthy, 2013). But the roles of Nigeria in ECOWAS and of Kenya in EAC are obviously not so different.

Regional trade and investment agreements have impacted national trade and investment policy in African countries by shaping the formal policy space in which these countries can create domestic policy, and by providing frameworks and examples for policy reform at the national level. For certain countries in Africa, however, regional integration arrangements have had less of a direct impact on domestic trade and investment policy than would be expected. While regional trade agreements have brought down tariffs between African countries, in some cases tariffs have been replaced by less-transparent non-tariff barriers (NTBs) so as to protect domestic industries and/or local vested interests. In other cases African countries have simply flouted obligations contained in their trade agreements by imposing taxes and restrictions on goods coming from neighboring countries. Behind the border measures and impediments effectively constrain the imports and also the exports; in crisis periods with events like large food price increases national governments may even impose unconstitutional export bans with regard of food items in a regional economic community, thereby aggravating the food insecurity by further price increases and increasing price volatilities.

Obligations contained in African regional investment agreements (RIAs), meanwhile, are often inconsistent with existing or planned national

legislation. South Africa, for example, is introducing new legislation on investment protection that differs in quite significant respects from the principles contained in the SADC Protocol on Finance and Investment (Woolfrey, 2013). Given South Africa's influence in SADC this is likely to lead to a review of the SADC Protocol. In such cases it appears that the impact of domestic policy on regional integration is far greater than the impact of regional integration on domestic policy. This, however, is possibly not the case for smaller, less influential African countries. But the major regional economic communities, such as SACU/SADC, ECOWAS and EAC, show the dominance of economically influential countries.

2 The Contributions

In this Unit 2 of Volume 18 three themes of great policy relevance are considered. First, the issues of food security and agricultural development as affected by regional integration decisions are discussed. Weaknesses and opportunities due to regional integration are considered with regard of these very important topics of productive capacity building. Second, industrial and technology policy issues matter in this Unit as regional integration may give the chance for the development of national corporate champions to become regional corporate champions. Regional integration can support the processes of entrepreneurial development by giving opportunities for the growth of firms. Third, the regional economic communities can become drivers in global trade and investment negotiations to create new global alliances and partnerships with the aim of diversifying the trade and investment patterns. Food security policy and agriculture policy, industry and technology policy, and new global trade and investment policies are the three interrelated themes of this Unit 2 of Volume 18 of the African Development Perspectives Yearbook.

In the first contribution with the title "*Food Staple Market Volatility and Food Security in Eastern and Southern Africa: what role for intra-regional trade and market policy?*" the two authors *Jamie Morrison and Alexandros Sarris* present evidence on the role of intra-regional trade flows for food security and poverty reduction. Uninterrupted trade flows of food products are important not only for food security, but also for market development and agricultural development. Their analysis argues convincingly that increased intra-regional trade in food staples within Eastern and Southern Africa can play a significant role in reducing levels of domestic food price volatility (effect of food price volatility reduction), in providing improved incentives for market development (effect of agricultural market development) and in

enhancing productivity growth (efficiency and allocation effects). The study recognizes also that the current levels of intra-regional trade are quite limited, what seems to be contradictory to the basic objectives of regional integration and intra-regional trade expansion and uneconomically as food surplus and food deficit regions could profitably exchange food across the borders in the regional economic communities (RECs).

Many observers of this low level of food trade in the RECs across national borders argue that a key reason for this lies in the contemporary systems of ad hoc trade instead of systematically exploiting market opportunities at both sides of the border and market-related policy decision making of many national governments, generally acting to ensure that legitimate short term food security objectives are met. Weak trading infrastructures and prevalence of behind the border barriers are one group of factors being responsible for the low volume of trade. Policy choices also play a role as governments tend to control trade flows for the reason of food security, especially so in times of price increases. The implementation of these policy measures can undermine private sector investments in market and value chain developments which are required to facilitate the levels of cross border trade that are needed to reduce food insecurity on a sustained basis.

Despite of RECs being in existence for a long time the levels of trade of food and of many other products remain low what means that incentives for private investors in agriculture and agro-industry are weak. The main role of regional integration would be enhancing market development, but in effect this role is not taken up. The consequences for agriculture development and agro-industry expansion may be serious. Any attempt to strengthen regional food and agriculture value chains is thereby impeded. The irony is that the formal regional integration framework is consolidated from the top, but in reality regional integration is not made to work in an economically meaningful way. While this case study refers to cross-border food staple trade, such conditions leading to low level trade prevail also in other product fields. Other policy trade-offs and specific marketing systems may be the reasons for the non-exploitation of market chances.

A major political economy problem remains. Balancing short term food security objectives with market development objectives remains a difficult task. The political pressure is strong in times of increasing food prices; this does not make it easy to pursue sustained long-term market development policies. There is an emerging consensus that governments have a role to play in managing staple food markets under a more predictable, rules-based regime, but the identification of those rules is highly problematic. Anyway, a reform of trade and market policies towards such a regime is needed almost all over Africa. To promote reform, efforts are needed to increase the

confidence of governments in Africa that they will be able to ensure food security-related objectives. International food market policies towards global trade and market regulation and investment promotion initiatives towards agriculture development are to become more coherent and effective. At the same time, the confidence of private sector stakeholders who are working in the food and agriculture supply chains has to be increased so that any change in policy is credible and will be sustained for a sufficient period for returns to investments to be realized. It is obvious that such considerations apply to all productive sectors in the regional integration process. Crises will occur again and again and should not destroy the base for credibility.

International and regional organizations have a key role to play in strengthening evidence on the merits of alternative approaches to facilitate an improved dialogue between the stakeholders in the transition process towards a more rules-based approach. This can best be done by a more transformative regional integration process in Africa; such an approach will allow it to strengthen the rules for trade and investment even in crisis periods.

In the second essay with the title *“Building Productive Capacities for Regional and Global Competitiveness: The Case of the East African Community”* the two authors *Andrew Mold and Rosemary Bagiza* go also along the concept of a more transformative regional integration process by focussing on the “productive capacities” as the base for an increasing competitiveness of firms, countries and regions. The concept of “productive capacities” was conceived for the transformation of “least developed countries” (LLDCs), but it is also relevant for low-income and lower middle-income countries in Africa. The basic idea is to develop in a determined way human capacities, technological capacities, financial sector capabilities, industrial capacities, infrastructural capacities, entrepreneurial capacities, policy development capacities, and public sector leadership capacities in context, by interlinking the actions towards these various segments. This concept is taken as the frame for analysing the regional integration process in the East African Community (EAC).

East Africa’s macroeconomic performance has improved dramatically in the 2000s. This is important, but this is not enough. Important is the capacity to transform the economic structures in the region. Shifting labour from low-productivity to high-productivity sectors is the vehicle to achieve development. This change can be facilitated by building productive capacities; in this context macroeconomic reforms are important. The chapter focusses on the development of firms on their way to become national and regional champions, by looking at the business climate and the related conditions for entrepreneurial development. Concerns exist about the ability of local firms to capitalise on the macroeconomic reforms and the business

climate-related reforms. The chapter emphasises in various stages the importance of enhancing ‘productive capacities’ if growth is to prove sustainable. The authors look at the major challenges in the business environment using a comparative analysis of data available through the World Bank Enterprise Surveys, among various other sources. The focus is on the five member states of the East African Community (EAC) - Burundi, Kenya, Rwanda, Tanzania, and Uganda. Economic size, economic policies, and economic strategies are quite different in these five countries, despite of some progress with formal regional integration processes. With regard of the state of “transformative regional integration”, similar weaknesses as with other regional economic communities (RECs) in Africa are observed. The low level of intra-regional trade, the low level of intra-regional investments, and the low level of policy coordination, especially so in crisis periods, have to be mentioned. The low level of business activity of national firms of a member country in other countries of the region is the main issue of the chapter. Weaknesses of the regional integration process, such as border and behind the border barriers, explain only partly this failure. The chapter comes out with additional factors which are to be changed so that progress becomes possible.

Although many factors impinge on competitiveness of firms in East Africa, one of the most persistently reported constraints on a better business performance is the difficulty in obtaining access to finance. The “access to finance” constraint has various facets – structure of the finance and banking sector, regulation, coordination of policies on banking and finance, use of IT for developing new finance instruments and products, development of sub-regional finance infrastructure, etc. The inadequacy of the national and regional finance and banking systems is a major factor which needs for overcoming the constraint sector-wide structural changes and comprehensive reforms. These are preconditions for speeding up regional integration and for making the concepts of Transformative Regional Integration (TRI) and Productive Capacity Building (PCB) relevant for East Africa.

The authors then derive three main policy recommendations to improve the competitiveness of EAC firms: a) governments have to tackle the serious problems associated with the banking sector’s failure to provide sufficient credit; b) public sector investments have to be stepped up so as to crowd-in more private investment; c) and specific measures should be introduced to facilitate the up-scaling of firms. These three areas (banking and finance; public investments and crowding-in private investments; and up-scaling of firms for capturing regional and global markets) are not simple cases for reforms, but for structural changes. And all this has to be done in all the member states more or less simultaneously. On this last point of firm size, there is compelling evidence that the firm size in the EAC region is

excessively small, so that it is difficult even for relatively large companies to compete effectively on both the domestic and the international markets. But this problem of growth and size of firms is not only related to relatively large companies; also smaller companies suffer from insufficient possibilities to grow (some firms even prefer to stay small so as to remain below the radar of unduly taxing government agencies). Given the small-scale of domestic markets, this means that regional integration is even more important for the EAC than for Africa as a whole. However, this regional integration process has to become more transformative and related to the building of productive capacities.

In a third chapter with the title ***“Regional Integration in Africa - The Impact of the Economic Partnership Agreements”*** the two authors ***Isabelle Ramdoo and Sanoussi Bilal*** look at the potential to use region-to-region partnership agreements in order to unlock development potentials in regional economic communities (RECs) of Africa. Economic Partnership Agreements (EPAs) between EU and African regions were negotiated for more than a decade, and some agreements were reached in recent years/months - for ECOWAS (all members included), EAC (all members included), but also for SADC (but covering mainly the SACU member countries, and separately included also Mozambique), Central Africa (only Cameroon with an EPA), and for the ESA (Eastern and Southern Africa) region (some few countries are included with individual EPAs: Mauritius, Madagascar, Seychelles and Zimbabwe). So the picture is quite heterogeneous. Only ECOWAS, EAC and SADC (SACU +) have all or most of their members on board, but even for these country groupings with EPAs the observable progress is limited (in terms of the formal ratification status and in terms of the depth/the finalized themes of agreements).

The negotiation process between African regions/countries and European Union (EU) was full of impediments, threats, last minute agreements, cancelling agreements and renegotiations, so that the negotiation strategies may explain a lot of the results. Even the public labelling of the agreements played a role in this process. From some observers the EPAs are called “free trade agreements” with the purpose to secure access of EU firms to the growing African markets, although the EPAs were from the beginning conceived as development cooperation agreements in the tradition of the Lome, Yaounde and Cotonou Conventions. Overlapping memberships of quite many African countries in various RECs have added to the negotiation problems, as it was not clear which EPA will be relevant for these countries. There was also the problem that countries in a particular RECs implemented quite differently the rules and regulations of the REC (such as with rules of origin and non-tariff barriers).

Different styles and modalities of implementation of rules and regulations with regard of the various African RECs have also added to the EPA negotiation problems. The same is true for different speeds and depths of regional integration processes. Also, the fact that African regional integration was conceived for long on the basis of the linear extension concept of the European regional integration model (free trade zone, customs union, common market, monetary integration and economic policy coordination, etc.) meant that an African approach was missing from the outset. New problems emerged when Africa began to negotiate a Tripartite Free Trade Agreement (TFTA) and a Continental Free Trade Agreement (CFTA). However, the fact that some EPAs are now ready for ratification and implementation lead to the question what the development potential of such region-to-region-partnerships will bring for African development, for a more transformative regional integration process in Africa and for the building of productive capacities in Africa. The chapter extends the analysis of Africa's competitiveness by looking at the role of new partnerships with innovative characteristics.

When the Cotonou Partnership Agreement was established in 2000, succeeding two Yaoundé Conventions and four Lomé Conventions, it called for fundamental changes in the longstanding non-reciprocal trade preferences that had governed the African, Caribbean and Pacific (ACP) and European Union (EU) economic and political relationship for almost forty years. The system of non-reciprocal trade did not deliver: the trade between African member countries and the EU could not keep pace with the trade dynamics of other developing regions, and the intra-REC trade in Africa more or less stagnated what makes a great difference to other developing regions. More importantly, the structure of trade has not changed: exports of raw materials and of unprocessed goods instead of more and more processed goods and sophisticated goods dominate the scene till now. The contribution to African development remained small, even negative in some respects. The authors give a balanced analysis of the relationship between ACP and EU, but also show that the different development levels within EPA groupings (including least developed countries, low income countries, middle income countries) made it so difficult to negotiate a new package. With the instruments of exclusion lists, escape clauses, safeguard clauses, and specific finance modalities it was tried to install a new system that is reciprocal, but based on asymmetrical trade liberalisation steps. It is a bureaucratic system with so many exceptions, but the main issues are still to be negotiated (rules of origin, non-tariff barriers, investment, services, competition, intellectual property rights, new modalities of development cooperation, promotion of private sector development, support for inclusive growth, etc.). The authors therefore give an outlook of potential developments up to 2020 (when the Cotonou

Agreement ends), and give an account of opportunities if constructive future negotiations take place and if the core of the agreements is really implemented. Risks for development remain, and these risks are systematically presented in the analysis. Only a more transformative regional integration process in Africa can also lead to an optimal use of the EPAs for development.

Too much time was lost since 2000 in conceptualising and developing a new trade system which is embedded into a development cooperation framework. Regrettably the new trade system is not really embedded into such a development cooperation framework. For the first time, ACP countries were required to negotiate reciprocal, though asymmetric trade agreements, leaving the era of trade preferences with so many actors beside of the EU (such as USA, Australia, China, and many others) and existing without any binding commitment for both sides. At the same time the Economic Partnership Agreements (EPAs) were negotiated with a major (developed) trading partner, the EU, despite the fact that the regional integration agenda in Africa was still in the making. EPA negotiations started in 2002 in regional configurations. In Africa, negotiations initially started with four regions and ultimately continued in five regions. In 2014, after twelve years of difficult negotiations, only three regions (ECOWAS, EAC, and SADC) had concluded a regional EPA. In one other region (ESA), only four countries ultimately signed individually an EPA. In the last region (Central Africa), only one country had concluded a bilateral EPA with the EU. The chapter therefore provides an analysis of the three recently concluded EPAs in Africa, although the third (for SADC) is just an extension of SACU (by adding Mozambique). The chapter explains the rationale behind and the process of EPA negotiations and provides a state of play of the trade regimes governing the relationship between the EU and African regions and countries. Finally, it highlights the key elements of the recently concluded EPAs and their likely implications for market development, trade expansion, development, and for regional integration.

3 The Strategy

The contributions to Unit 2 have generated a lot of ideas and recommendations which can be used to build up a new strategy for promoting a more transformative type of regional integration in Africa. The three strategy elements are reflected below with reference to some key points. Basic to these three strategy elements is the conviction that the regional integration process has to be strengthened so as to make the integration process more transformative and more effective with regard to

structural change in the economies in the region. First, more action is needed to coordinate food security, agriculture and agro-industrial policies in the regions. Second, more action is needed to coordinate industrial development, technological development, corporate growth, and business environment policies in the regions. And finally, more action is needed to improve the established and prospective economic cooperation agreements with other developing country regions (South-South Cooperation) and with developed country regions (EU, USA, China, India, ASEAN, BRICS, etc.) by strengthening the negotiation capacity of the African regions when building development cooperation partnerships and comprehensive trade and investment agreements with other regions.

Strengthening the Role of Regional Integration for Food Security, Agricultural Development and Agro-industrial Development

More regional coordination is needed in the areas of food security, agriculture development and agro-industrial development policies. In crisis periods (with escalating food prices) the policies in Africa are more focused on public short term measures at the national level to prevent further food price increases although more regional coordination among the countries of a regional economic community (REC) would rather prevent further price increases (as food surplus and food deficit regions can better exchange their produce). Export bans of countries within a region, and also other discriminatory policy measures (tax and duty measures, tariff and nontariff-barrier measures) may also add to the problem. A long-term oriented food security strategy for the region (for the REC and across the RECs) is therefore recommended. Such a new strategy has however preconditions. With regard of agriculture development policies and agro-industrial development policies much more coordination and cooperation are needed.

At the moment such policies are not really coordinated so that conflicts arise between trade and food security policies leading to tradeoffs at the expense of the agreed upon regional objectives. Such a strategy element can be started only with the support and at the level of public and private actors (the responsible ministries, public agencies, public corporations, private traders, private processors, and other private sector associations, but also civil society organizations) and executed in the form of regional dialogues. It is not enough to rely only on public agents and agencies as usual to communicate on regional cooperation. Private actors have to be involved because of their knowledge about markets and their ability to generate sustainable trade and investment flows across the border. In order to cooperate more effectively, regional standards (quality-, safety- and health-related ones) are important; so far the national standards were not

harmonized in the African RECs so far. Regional standardization agencies play a role. Such a regional coordination process will also help to increase the role of regional value chains for food and agricultural products (for unprocessed and processed ones) and to enlarge the opportunities of the African producers to become partners of global value chains.

Strengthening the Role of Regional Integration for Industrial Development, Technological Development and for Developing Industrial Champions

Much more coordination is needed at the regional level with regard of industrial development policies, technology development policies, towards the promotion of corporate growth, also by establishing “industrial champions”. Although industrial development is considered a s key aspect of all the African RECs, the words of the agreements are not translated into deeds. The provisions in the agreements have to be made relevant by action plans and operational targets for industry and trade policies, for hard (physical) and soft (regulatory) infrastructure policies, for standardization policies, for science, technology and innovation policies, for regional specialization policies, etc. All the RECs in Africa have the potential for establishing an integrated industrial development strategy as strengths and competences differ from country to country as well as the market size and the resource base, so that the countries in the region can aim for a regional diversification strategy. So far the actions were not successful as the low level of intra-regional trade and of cross-country investments show. But this may change with a new form of cooperation and coordination practiced which is based on a dialogue between public and private actors in the region. So far only public agents were active in the coordination process.

A major weakness is related to the size of the firms, and this weakness has to be overcome by facilitating strategies. At all levels the growth of firms in Africa is unsatisfactory and has to be promoted. While micro-, small- and medium-sized firms are handicapped by patronage, bureaucracy and corruption so that many of them prefer to stay informal and small, the (small number of) large companies in Africa is often part of narrow patronage networks excluding other firms. Only few large companies in Africa are internationally competitive because of political connections, corruption, narrow industrial networks, and the lack of competition (and competition policies). Building national and regional industrial champions out of the large public and private companies in the region may help to develop internationally competitive firms. A regionally coordinated Science, Technology and Innovation (STI) policy may be an instrument to support such a process of building industrial champions. Some examples show that

applied research institutes and centers of excellence in higher education can be related to dynamic economic sectors with products in international demand. Only few countries in Africa have a limited number of such industrial champions with above average productivity and returns. These “African Challengers” have the ability to restructure the markets in Africa; many of them are in South Africa, and some others are in Egypt, Morocco, and in Nigeria, but definitely also other large companies in the African RECs could grow to such a position. This is however possible only if policies are changed towards competition, openness in trade and foreign investment, and openness of public/private contracts and public procurement. Also, the anti-corruption strategies have to be strengthened and the narrow patronage-based industrial networks have to be restructured. It is obvious that all this can only take place on the basis of a vision which guides the strategies in the countries and in the region.

Strengthening the Role of Regional Integration for Global Competitiveness and New Development Cooperation Partnerships

Africa is in the process of building new development partnerships, with partners in the South, in the West and in the East. There are new partnerships in the making with the BRICS group of countries, with China, India, USA, EU, and other countries and regions. These new partnerships have a focus on trade, investment, and development cooperation. Also new forms of interaction with transnational corporations and lead firms of global value chains are emerging. The African RECs can play a role in streamlining such partnerships and forms of interaction towards regional development and more inclusive growth. The negotiations of Africa’s RECs with the European Union (EU) are presenting evidence that new modalities of cooperation are emerging and that there is considerable dynamics in the process. The negotiations between the ACP countries and the European Union (EU) towards EPAs (Economic Partnership Agreements) have already revealed that a dialogue may lead to some concrete results and to benefits for both sides (although the outcome of the negotiations is still on the paper and is not yet translated into reality).

The long process of negotiations about the EPAs from 2002 onwards to late 2014 has however informed the policymakers in both regions (African ACP countries and EU) that a new development cooperation framework has to be based not only on stricter rules and regulations for trade and investment, but also on a new development cooperation model which is based on identifying the prevailing economic, social and political structures in Africa and on assessing the needs to transform the structures in Africa in a longer-term process. The RECs in Africa had to consolidate their internal positions

in all these years when negotiating with the EU on trade liberalisation and a new development cooperation framework. Regional integration infrastructure in Africa was strengthened in order to be able to negotiate effectively with the EU. This process needs to be continued as so many points are still unresolved on the agenda. The way to a reciprocal trade agreement with an asymmetrical trade liberalisation timetable was complex and full of difficult compromises. In this process the negotiations about a new development cooperation framework were unduly delayed and overshadowed by mistrust and by unrealistic expectations.

Anyway, the EPA negotiations can also be a model for Africa's cooperation strategies with other world regions (developed and developing ones). It was an important step in the process of negotiations with the EU to analyse the internal weaknesses of the African RECs; this may be of value when starting negotiations with other partners, like BRICS, China, India, Russia, Brazil, Mexico, Turkey, Arab region, ASEAN, MERCOSUR, USA, Japan, Australia and New Zealand, etc. A consolidation of the institutional working modalities of the African RECs is needed so as to enable them to negotiate favourably with non-African partners. However, the limits became visible during the EPA negotiations as overlapping memberships in regional integration schemes, ignorance of agreed upon regulations on rules of origin and on non-tariff barriers, and non-harmonization of technical standards prevented a quicker consolidation of the integration process and impeded the negotiations with the EU. Also, the RECs did not have at hand a transformative integration agenda, which is needed to make the RECs attractive for non-African partners. As complex as the EPA negotiations have been and as preliminary the outcome so far is, the clear signal is that both sides have to change their regional integration agenda so as to benefit from a new partnership. The ECOWAS EPA and the EAC EPA brings out the responsibilities of the contracting parties at both ends. The EU Africa Strategy has to be redrafted as it only bundles various existing programmes but is not an integrated strategy yet. A more transformative regional integration strategy is needed for the African RECs in the years to come. Both, new strategic approaches in Africa and in the EU will be helpful for the dynamic development in both regions, and so the basis for a mutually beneficial cooperation will be enhanced.

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Food Staple Market Volatility and Food Security in Eastern and Southern Africa: what role for intra-regional trade and market policy?

Jamie Morrison and Alexandros Sarris*

1 Introduction

Food security is affected by food staple grains price volatility, and the latter has long been a recurrent issue in many African countries. Although it was the increase in levels and volatility of international prices that caught global attention in recent years, levels of volatility in international markets remain relatively low in comparison to those observed in domestic African markets. Minot (2013) demonstrates that, in a sample of Eastern and Southern African countries, food price volatility is high although it has not increased in recent years. He calculates that when measured on the basis of the standard deviation of the monthly proportional change in price, volatility in international prices is 0.06 to 0.08, contrasting to the higher level of 0.12 in African prices.

Although climatic events inevitably play a role in determining production levels and hence trade opportunities and food security, given the predominance of rain-fed agriculture in the region it has been argued that in large part price volatility has been the result of the widespread and ad hoc use of trade and market interventions. Substantive research by Jayne and co-authors over a prolonged period provides support to this contention (Chapoto and Jayne, 2009; Jayne et. al. 2010). The World Bank has also researched this issue extensively and estimates that Africa could feed itself if regional trade could be expanded (World Bank, 2012).

While a focus of many of these studies has been on the negative implications for poor households, attention is also turning to the significant uncertainty that ad hoc systems of intervention have caused for private sector actors, suppressing their investments in market development and

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reducing their engagement in formal cross border trade¹. This has contributed to limited growth in intra-regional trade² which could otherwise have potentially played a role in maintaining more stable prices in a region subject to frequent weather induced supply shocks.

Where it has occurred, cross-border trade has contributed positively to the region's food security situation, with neighbouring countries essentially pooling production through trade to help to stabilize local markets. Examples include Mozambique-Malawi, Malawi-Zambia, and Uganda-Kenya (Chapoto and Sitko, 2014). However, the fact that formal intra-regional trade still accounts for less than 10% of total trade in food staples suggests that this contribution could be far greater.

Many governments are well aware that their actions in pursuit of short term food security objectives can be detrimental to longer term goals of increased, market led productivity growth in food staples, but they often appear to lack the confidence to rely upon market and trade based approaches in ensuring that food security objectives are met (Chapoto and Sitko, 2014).

This is not to suggest that weaknesses in market and trade policy design and implementation are the sole, or even primary, cause of limited trade. Many other factors, including limited transportation infrastructure, informal charges on trade, and political borders have been identified as critical determinants of limited intra-regional trade (Haggblade, 2013). However, it has been argued that in many Eastern and Southern African countries, the unpredictability attributable to ad hoc interventions contributes significantly to a lack of investment in key market infrastructure (Sitko et al, 2014; Chapoto and Jayne, 2009; Booth et. al. 2007).

In building the confidence of governments to place greater reliance on market-based approaches and increased economic integration, enhanced dialogue, cooperation and coordination are essential, not only within different

¹ Acknowledging that informal cross border trade can be significant and to a large extent is a result of policies that restrict formal trade, this chapter focuses on the promotion of formal intra-regional trade because of the associated improvements to market infrastructure and institutions that it can generate and because of the contribution that this can have in increasing efficiency and reducing price-related risks along the value chain.

² This chapter restricts discussion to intra-regional trade as opposed to engagement in international trade more broadly defined. Whilst the latter can significantly impact price levels and volatility, it opens several broader debates that are beyond the scope of this paper (see for example Morrison and Sarris, 2007) and requires a different set of policy approaches.

government ministries but also with key stakeholders, including the private sector, civil society, regional organizations as well as other governments in the region.

In turn, this requires a better understanding of the relative merits of trade and market interventions vis à vis approaches based on an improved functioning of markets utilizing so-called market-based approaches. This includes, for example, greater reliance on strengthened market information systems, warehouse receipt systems, commodity exchanges, and other risk management institutions. A better understanding of the relative merits and an improved monitoring of the actual implementation of trade policy interventions are needed to strengthen an evidence-based dialogue on which instruments to avoid and which to promote and under which conditions.

Having set out the positive role that increased regional trade can play in Section 2, the paper then considers in Section 3 why intra-regional trade has been limited. Section 4 examines the scope for a greater use of market-based instruments as an alternative to trade policy interventions, and in Section 5 several aspects required to facilitate the transition to a greater reliance on regional trade are considered. Finally, Section 6 presents conclusions and policy recommendation and provides suggestions for follow-up research and action.

2 Potential role of increased regional trade in food staples

Increased cross border trade between African countries can: (i) reduce price volatility on “small” and weakly integrated domestic markets, (ii) reduce countries’ reliance on volatile global markets, in turn reducing food import bills where regional prices are more stable, and (iii) improve the availability and timeliness of supply. All of the above can lead to improved food security. Regional trade can help to reduce price volatility by shifting food from areas where local markets are unable to absorb surplus production to food deficit regions. For example, Minot (2013) calculates that there have been lower levels of volatility in cooking oil, bread, wheat and rice which are widely traded in the region than in commodities with more limited trade in the region such as maize. This is particularly important given the region’s reliance on rain-fed food staples which are susceptible to climate risk and associated production shortfalls and/or bumper harvests. Rainfall patterns differ within regions of the African continent and while some countries or areas within countries are suffering from inadequate rainfall, others will be benefitting from better than average conditions. Associated with the fact that harvests take place at different times in different countries, this implies that trade

between countries can adjust quantities available and thereby smooth prices through greater spatial market integration, reducing also the level of downside price risks faced by producers.

As Dorosh et al. (2010) explain, reducing barriers to regional trade offers an inexpensive means of reducing domestic price volatility. This is so because the import parity price sets an upper bound and the export parity price a floor below which domestic prices will not fall under the condition that traders are free to import and to export when market conditions permit. Sitko et al. (2014) provide examples from Zambia, Kenya and Malawi where interventions during periods of domestic shortage caused prices to increase significantly above import parity prices.

Regional trade effectively expands the size of the market, increasing the elasticity of demand facing farmers (Jayne et. al. 2010). This can help to sustain initiatives aimed at productivity increases by creating more stable producer incentives and by strengthening the level of market integration of smallholder producers, whether as buyers or sellers. This is critical in increasing smallholder participation in markets, a precondition for their adoption of productivity-enhancing technology and related investments (FAO, 2012; FAO, 2013).

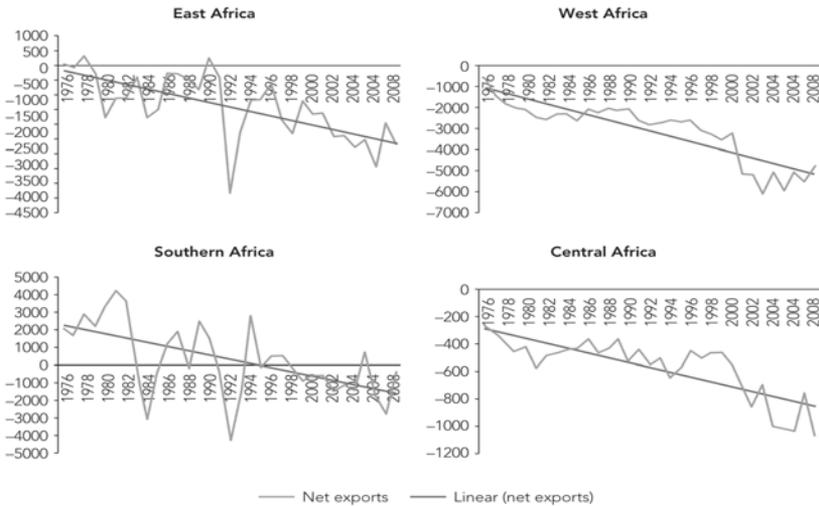
Increased local production, in association with increased regional trade, can also help to reduce food import bills. As Konandreas (2012) reports, Net Food Importing Developing Countries (NFIDCs) and Least Developed Countries (LDCs), as groups, have faced significant increases in their food import bills since 2007. Similarly the World Bank reports (World Bank, 2012) that the volume of net exports of food staples in all sub-regions of Sub-Saharan Africa has decreased between 1976 and 2008 and has become strongly negative.

Konandreas (2012) provides an interesting analysis of the drivers of the increases in food import bills across different countries by separating the effects of increases in unit import prices from increases in volumes of net imports. Whilst in some Eastern and Southern African countries the price effect dominates (Lesotho, Madagascar), in the majority of these countries increased volumes of imports have been as important, if not more important than price increases³.

³ An interesting case is provided by *Zambia*, where significant increases in maize production over recent years (in part resulting from government maize purchases from farmers at prices well above regional market prices) have resulted in Zambia becoming a net exporter of maize to the extent that any increases in prices have been more than offset by reduced volumes of net food imports.

Figure 1 indicates that most regions in Sub-Saharan Africa (SSA) have tended to become net importers of food staples over time. This trend is projected to continue (FAO, 2006), thus creating significant African country exposure to international price and external supply shocks. At the same time large tracts of land in Africa such as those in Guinea Savannah that amount to around 400 million hectares remain unutilized for agriculture (World Bank 2009a). Along with the proven potential for yield increases, as evidenced by the consistent divergence between actual yields and experimental yields as well as farmer yields under controlled environments, these unutilized tracts of land could provide Africa with the bulk of its staple food needs (World Bank, 2012). At the same time, the additional staple food production could help to satisfy a large part of the future food import needs of African countries, which has been estimated at 50 billion USD per year (Rakotoarisoa, et. al., 2011).

Figure 1: Volume of net exports of food staples by African sub regions 1976-2008 ('000 tons)



Source: World Bank (2012)

The rapid increase in staple food imports in Africa is caused by the rising demand of urban populations, which are growing at over 4 percent annually, compared with less than one percent per year for rural populations (World Bank, 2012). At the same time, the significant production potential for staple foods in Africa has not been realized, because of stagnating food productivi-

ty. This has been pointed out by several authors, e.g. World Bank (2009) and Kariuki (2011).

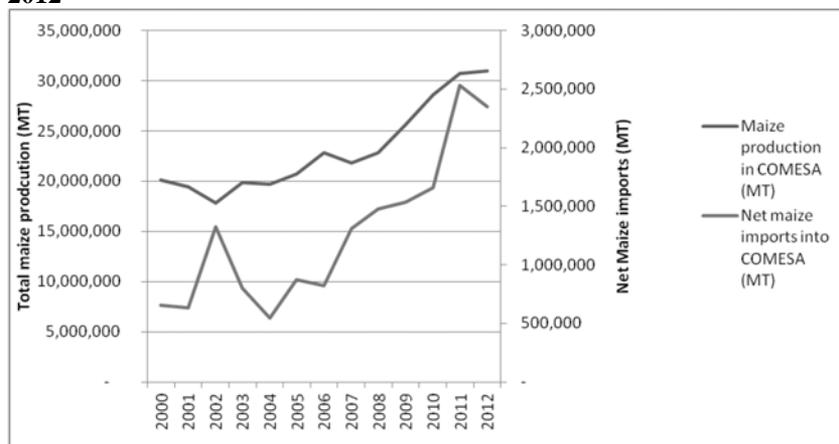
The fact that countries could potentially source staples regionally, rather than globally, if regional trade would become more significant, means that increased volumetric needs could be purchased at lower and potentially less volatile prices.

The chapter proceeds by examining why intra-regional trade in food staples is limited and by discussing the steps that could be taken to promote greater reliance on intra-regional trade by countries seeking to achieve often conflicting objectives related to national level food security on the one hand and to reducing levels of inefficiencies in food systems on the other.

3 Why is intra-regional trade in food staples limited?

Annex Table 1 shows the global pattern of trade in basic cereals (rice, wheat, maize, etc.) for 2011. In the table the regions shown are broken down between the ACP (the 79 African Caribbean and Pacific countries that enjoy preferential status with the EU), which in turn is divided between the seven regional ACP groups of which 5 are in Africa), the non-ACP developing countries split among LDCs and non-LDCs, the EU-27 countries, and the rest of the world, a group that includes all non-EU developed countries. It can be seen that trade within each regional group in Africa is quite small. For instance, cereal imports of the Eastern and Southern African ACP country group (ACP-ESA) from other ACP ESA countries in 2011 were only 5.6 percent of total imports into ACP-ESA. Imports from other African country groups constituted another 6.1 percent of ACP-ESA cereal imports. The same holds for all other African groups.

In COMESA, annual net maize imports averaged 1.5 million tonnes between 2005 and 2011 (see figure 2). During this period, only Uganda consistently maintained a net exporter status, with Zambia and Malawi being exporters in most years. However, the three countries export only a small proportion of the total demand recorded for COMESA maize imports, with over 90% coming from outside the region (Sitko et al. 2014).

Figure 2: Net maize imports and staple production in COMESA 2000-2012

Source: Sitko et al. (2014)

Another factor that explains the lack of regional integration is the proliferation of Non-Tariff Barriers (NTBs). For instance, consider the East African Community (EAC) which is supposed to become a customs union without tariffs among its 5 member countries (Kenya, Uganda, Rwanda, Burundi and Tanzania). While tariffs as such have been eliminated between EAC Member states, all Partner States except Rwanda have imposed measures with equivalent effect to tariffs which increase import costs or import unit values. These have been of different types, including additional taxes and charges (tariff-equivalent measures) and measures related to rules of origin. These measures affect most of the intra-regional trade, and especially dairy, agricultural, pharmaceutical, aluminium, and alcoholic products. In terms of the common external tariffs (CETs), most of the cereal imports into EAC face tariffs higher than 50% (Stahl, 2005).

On NTBs, the WB/IFC/EAC (2014) study on compliance with the obligation to eliminate NTBs (based on data from 2008 to 2013) found that:

- Of the 51 reported NTBs, Tanzania had 18 (35% of the total), Kenya 16 (31%), Uganda 9 (18%), Rwanda 5 (10%), and Burundi 3 (6%) NTBs.
- NTBs were most often linked to continued charges, rules of origin, sanitary and phyto-sanitary measures, and technical barriers to trade.
- Though all products traded within the EAC were affected by the reported NTBs, specific sectors or products tended to be particularly affected: manufactured foodstuffs, rice, tea, dairy products, and alcoholic beverages.

One of the few studies that had tried to quantify the effects of NTBs is that by Karugia et al. (2009). The study examined the trade of maize and beef between Kenya, Tanzania, and Uganda. Since maize prices are higher in Kenya than in Uganda and Tanzania, Kenya formally imports maize from both Uganda and Tanzania. As regards beef, Uganda exports to both Kenya and Tanzania since beef prices are lower in Uganda than in both of the other countries. A survey of traders and transporters of maize and beef cattle, carried out by the authors in East Africa, showed that the prevailing NTBs in these two important food sectors included: administrative requirements including licenses; municipal and council permits in all countries; taxes/duties, mainly excise duties and cess taxes; road blocks; customs barriers; weighbridges; licensing; corruption (e.g. bribes); and transiting costs. Licenses as NTBs included business license, road transport license, and a livestock clearance certificate.

The impacts of NTB's on cross border trade and welfare were computed using a static spatial equilibrium model where trade policies and transportation costs are treated as exogenous variables. The analysis looked at the impact of partial or total removal of NTBs on intra-regional trade and social welfare. It shows that Kenya would import more maize from both Uganda and Tanzania, and Uganda would export more beef to Kenya and Tanzania. Positive net welfare gains are attained for the entire EAC maize and beef sub-sectors from the removal of the NTBs.

A major factor in limiting intra-regional trade in food staples is marketing costs. An assessment report by the World Bank, of maize marketing in East Africa (World Bank, 2009b), revealed that: (i) protectionist measures through export bans lead to lost opportunities for farmers and traders, who then reduce their investment in production in subsequent seasons leading to overall reduction in food production; (ii) apart from reducing potential outputs, arbitrary bans on selling of cereals lead to reduction in quality, quantity and value, causing losses to the economy as a whole; and (iii) the export bans and other trade restrictions scare away private sector development and investments in the food sub-sector, leading to sluggish growth in the sub-sector, and lost opportunities for farmers and consumers.

The above quoted World Bank study (World Bank, 2009b) is very revealing concerning the marketing margins, and the possibilities to increase regional trade. First, the authors of the study cite evidence indicating that distance of a production centre from the main market is negatively correlated with the volume of production (Dorosh, et. al. 2009, Diao et. al., 2008). Then they indicate the size of marketing costs between farm gate and urban wholesale markets in three main EAC countries (Kenya, Tanzania, and Uganda). They find that these are uniformly large and between USD 50 and 70 per

tonne. It is clear that these marketing costs are very large, and mainly due to transport charges, which account for more than 70 percent of the marketing margins in all three countries studied.

Another major obstacle to smooth inter and intra regional trade is road blocks. A World Bank (2012) study reports that even legal trucks equipped with all the required documentation end up paying substantial amounts of road block bribes and other charges. In Cameroon one can find 47 roadblocks between Douala and Bertoua, a distance of 500 km. In Kenya the private sector reports 19 road blocks along a 90 km segment of road leading to Nairobi. At an average bribe or charge paid at each roadblock of USD 2.40 to USD16.80, it is clear that these roadblocks amount to a significant surcharge to staples which impacts negatively on local consumers. Such charges and the large transport costs make import parity prices lower than local prices and help shift consumers toward imported staples.

The study by the World Bank (World Bank, 2012) also indicates that prices of key inputs, such as nitrogen fertilizer, are four to five times or more higher in African countries (eg Nigeria, Senegal) than in other developing countries with a similar port access (e.g. India, Turkey, Ukraine).

A key determinant of increased intra-regional trade is sustained private sector engagement and associated investments in market development. However, levels of engagement and investment have been discouraged and are small as a result of uncertain business environments. In many situations the uncertainty is suggested to be attributable to government concerns over the food security-related risks of increased openness to trade, and the knock on effects that policies implemented to mitigate these risks can have on private sector activity. For example, concerns about the food balance situation may result in a government restricting exports of a food staple at short notice. If private sector exporters have already entered into contracts to supply a commodity to buyers in an importing country, these restrictions can result in significant losses (both financial and reputational), and both types of losses reduce the willingness of the exporters to enter into such contracts in the future. The likelihood that they will invest in market-related infrastructure (including storage infrastructure) required to expand volumes of trade is also reduced.

The primacy of national food security objectives in determining trade and related market policy interventions has been longstanding in many African countries and pre-dates the current global context of increased food price volatility (see for example, Morrison and Sarris, 2010).

Many governments are concerned about their ability to source food staples regionally and the consequent domestic food price increases if they are unable to do so. The concern is often compounded by the limited information

on the physical availability of staples at any given point in time (both within countries and regionally), meaning that countries often do not know whether sufficient surpluses (or stocks) will be available when and where they are needed⁴.

Further compounding this issue is the fact that many neighbouring countries also intervene in staples markets, and that these actions can effectively negate the opportunity for potential trading partners to source staples from surplus areas or countries. For example, faced with concerns over domestic food availability, a country may implement an export ban, removing the ability of a neighbouring country to import from surplus areas within the implementing country. Similarly to their concerns about the ability to use regional trade to control upside price risk, which can be to the detriment of domestic consumers of food staples, governments may also be concerned about their inability to prevent “rapid” shifts of informally traded staples across borders; such shifts might result in local food deficits.

As a result of such concerns, governments have tended to intervene through national trade and market policy interventions that have increased price-related risks for producers and post-production value chain actors, consequently reducing private investments (both in on-farm production and in off-farm market infrastructure). In doing so they restricted the sustained growth in regional trade that would be required to allay precisely those concerns that they are seeking to address.

Private sector investments in market development are required to increase the level of formal cross-border trade. The margins available, and the fact that substantial trade already occurs on an informal basis (Little, 2010), mean that such investments could generate sufficient returns to private investors if they could be sure that their investments would not be undermined by ad hoc policy interventions that result in generally unpredictable restrictions to trade. These are generally observed in terms of unannounced export bans, import restrictions, variations in import tariffs, and stringent application of rules of origin. Although tariff barriers are relatively low (particularly within customs unions), the use of non-tariff barriers and customs procedures, in addition to the transaction costs associated with transportation, can be significant.

However, it is not just at the border that policy intervention can create uncertainty. Governments also intervene directly in domestic staples markets

⁴ Recently, significant efforts have been made by the *Eastern Africa Grains Council (EAGC)* to develop Regional Food Balance Sheets with a view to providing credible information on the availability of and requirements for food staples to policymakers.

with the twin objectives of ensuring price stabilization and maintaining strategic reserves (Konandreas and Mermingkas, 2014). Often, however, in Eastern and Southern Africa and in contrast to many Asian countries, the intervention buying and selling that is used as an instrument in achieving these objectives does not adhere to announced prices or to announced purchase and selling patterns, creating considerable uncertainty for private sector investors.

In some cases, governments have intervened heavily in staples markets, all but crowding out opportunities for private sector trade. For instance, over the past decade, the Food Reserve Agency (FRA) has been playing an increasingly active role in the Zambian maize market. Mandated to operate a strategic grain reserve, the FRA entered the market to purchase maize in support of producer prices following bumper harvests. Purchases increased from just under 200,000 mt in 2009/10 to 883,000 mt in 2010/11 and to 1,746,000 mt in 2011/12. Amounts of FRA-purchased grains have exceeded quality storage capacity resulting in significant losses and the need to export, where possible, at prices insufficient to cover the cost of purchase, transportation and storage activities. There are also difficulties in exporting significant quantities of maize given the limited transportation capacity, indicating that much of the surplus will need to be absorbed domestically. Sitko et al (2014) report that the Grain Traders Association (GTA) in Zambia has drawn up plans to expand storage capacity from 550,000 mt to 825,000 mt, with the investment to be made if the policy environment becomes more predictable.

Centralized intervention buying can also create difficulties in ensuring that stocks are held in the optimal location to allow redistribution to deficit areas in time of need. Given the increased attention that is being given to establishing national or regional food stocks, public sector intervention in domestic markets needs to be cognizant of these difficulties.

The unpredictable nature of policy implementation has been cited as preventing the private sector from taking forward positions, reducing private sector willingness to invest in and use market institutions/infrastructure, and suppressing incentives for storage (a precondition for price-smoothing). Limited investments in market institutions and for market infrastructure development are apparent in the fact that market-based mechanisms, such as Warehouse Receipt Systems (WRSs), Commodity Exchanges (CEs) and Market Information Systems (MISs) which could facilitate price discovery and thus reduce price volatility, have had limited success in the region. High costs of commerce, the difficulty in financing carryover of stocks, and a lack of confidence in contract enforcement and delivery have all been cited as contributing factors.

Warehouse Receipt Systems (WRSs) have several positive attributes: they can facilitate the link between storage and finance; stabilize intra-seasonal prices; increase producers' ability to decide when to sell; reduce the pressure on traders to rotate stocks; improve locational stock visibility; and increase the efficiency of food reserve management.

While successful examples of the WRSs exist for higher value export commodities, for example for coffee in Ethiopia, there has been limited take off where WRSs have targeted food staples such as maize (see e.g. Gross et al., 2011). In many African countries, the establishment of WRSs has encountered difficulties including deficiencies in storage infrastructure, weak regulatory frameworks, the limited capacity of producers to deliver quantity and quality on time, and limited involvement of financiers.

Given the limited investment in such institutions and infrastructure, there is a resultant dearth of available evidence on the effectiveness of different market-based instruments. This has often made it difficult to convince policymakers of their merits. Pilot projects across the region suggest that under certain conditions the benefits are real. For example, the nascent commodity exchanges such as the Agricultural Commodity Exchange for Africa (Malawi), Zamace (Zambia), and the Ethiopia Commodity Exchange have all demonstrated that, with the appropriate support and/or policy environment, such instruments can function. In some cases this has involved mandatory trading of export crops through the exchange to ensure adequate volumes of trade (for example in Ethiopia), suggesting that sustained activity may be difficult to attain, particularly during early stages of commodity exchange development, without public sector support. However, in the absence of such conditions their sustainability, particularly in the context of food staples, has been questioned.

Another source of evidence, albeit from a country at a more advanced stage of development, is South Africa where grain markets have effectively been liberalized and where there is a functioning commodity exchange, the South Africa Futures Exchange (SAFEX). Whilst lessons can be drawn from this example, one has to be cognizant of the fact that the level of institutional and infrastructural development at the time that government withdrew from intervention buying, and the political economy realities within which the reforms were undertaken, differ substantially in South Africa from the situation prevailing in the majority of the countries in the region. More information on the process of reform and on the functionality of the grains markets in South Africa can be found in Traub and Meyer (2010).

4 Policies and supportive actions for market based instruments

It is clear that public sector investment in market infrastructure, including storage and other logistical facilities, and market institutions, such as those required to ensure harmonisation of standards, alone will be insufficient. There is an urgent need to encourage private sector investment in aspects such as storage and associated seasonal financing, information systems, transport, and post-harvest handling. In order, however, for the private sector to invest in such trading capacity, there are two key requirements. The first is an adequate and relatively stable volume of trade and the second is a relatively stable policy environment. Both can be served well by unhindered trade across national boundaries.

Such free trade has enabled countries like Mozambique and Uganda to achieve more stable maize prices as well as better food security. The flows are largely from northern Mozambique or Uganda to Kenya and Zambia. The maize flow from Uganda to Kenya is consistently around 120,000 tonnes per year and this enables private investments in trade infrastructure, including trucks and storage facilities.

Another set of soft investments that could facilitate trade are market-based risk management instruments. These include commodity exchanges (CEs), warehouse receipt systems (WRSs), weather index insurance (WII), and others. A more recent study (by Gross et al. 2011) is concluding that the following actions are necessary before market-based instruments are likely to play an effective role in the management of food security-related risks of increased regional trade:

- implementation of effective systems of grades and standards;
- strengthened legal systems and improved integrity of contracts;
- strengthened market information systems (especially at the regional level);
- increased provision of finance, through, for example, the piloting of new approaches such as donor guarantees to support WRS finance;
- removal of legal and regulatory constraints; and
- commitment to rules-based intervention for accumulation and release of stocks and the implementation of trade policy, including assurances that announced policy will equate to actual policy implementation.

Some African countries, such as South Africa, have created such conditions and a flourishing South Africa Exchange (SAFEX) has been operating successfully for several years. A large regional market would create the volume necessary for supporting more of these institutions.

The last point in the list above does not mean that there is no role for trade policy intervention. Governments in many developing countries are

often constrained, both from a budgetary and an administrative capacity perspective, from designing and implementing effective and efficient consumer or producer safety nets or support packages that are adequately targeted to achieving their objectives.

Trade policy, although being a blunter instrument, will therefore continue to be an important instrument both in ensuring food security and in facilitating longer term market development. Trade policy has undoubtedly been overused and misused in many African countries. Policies have often been inappropriately used in attempting to achieve multiple objectives, often with significant conflicts between their use as short term responses to food shortages or high food prices, as opposed to their use in stimulating longer term development. Critical will be determining how trade policy can be better used in achieving the government's objectives without having detrimental effects on market development.

With increased pressure for greater regional integration, and the need for more consistent and harmonized trade policy required to achieve this, care will be needed to take account of the policy needs of countries at different levels of development, and to allow appropriate flexibility for trade policy to be used more effectively in achieving legitimate policy objectives. A case in point is the East African Community (EAC), where transition towards a harmonized tariff regime recognised the greater level of development and hence competitiveness of Kenyan agriculture vis à vis its trading partners (Vitale et al. 2013).

5 Transition to an improved environment for regional trade

Chapoto and Jayne (2009) suggest that three models characterise the different roles of the private and public sector in food markets. In model 1, the role of the state is limited to the provision of public good investments, the establishment of regulatory frameworks, and the strengthening of institutions. In model 2, the primary reliance is still on markets, but there is a role for operations of, for example, buffer stocks, marketing boards and state imports. Model 3, by contrast, is one of discretionary state intervention in markets based on the premise that the private sector cannot ensure adequate food supplies in response to production shortfalls. While arguing that model 3, whereby governments retain unconstrained authority to intervene when they deem it necessary, has become the dominant model, the authors recognise that the level of public sector commitment to model 1 is likely to be insufficient to allow sustained implementation of that model. Chapoto and Jayne (2009) therefore argue that a rules-based model (model 2) would provide an alterna-

tive whereby levels of uncertainty surrounding interventions are reduced, although the authors also question whether this model can become a credible longer term solution.

Similar conclusions could be drawn from, for example, Buffie (2010) and Morrison and Sarris (2010) who suggest that the optimum set of policy interventions will probably require some level of intervention and further, that a short sharp shock that seeks to radically change a country's trade policy set is likely to induce backsliding (see past experience with grain market policy reform in East and Southern Africa, discussed in Jayne et al. 2010). For viable and sustained reform it will be important that any change in approach to intervention is introduced during a transition period.

Two aspects require consideration: (i) determining what the "rules" should be during the transition path to greater reliance on market-based instruments in the context of a more stable trade policy, and (ii) building the confidence of public and private sector stakeholders to make the transition to a credible longer term policy environment working.

(i) Determining rules during the transition

A key difficulty in determining the appropriate set of rules for intervention is that the analysis of the impacts of different types of market interventions is problematic, due to: (i) weak data, particularly on the level of informal trade and on actual policy implementation, and (ii) the difficulty of defining causal relationships between policy interventions and indicators of interest, such as levels of food insecurity, particularly the differential impacts that are generally observed across heterogeneous groups of stakeholders and in the short as opposed to longer term (see for example, Thomas, 2007). As a result, demonstrating the benefits of a shift from reliance on trade and market interventions to a greater reliance on market-based instruments with limited state intervention is difficult. Weaknesses in the governance of markets not only relate to the unpredictable and ad hoc interventions of the public sector, but also to the setting of the rules under which interventions should be made. For example, intervention prices can be set too high or too low. Determining how these policies should be adjusted over time, while the transition to greater reliance on market-based approaches is made, further complicates the task facing policy analysts. The identification of a set of rules governing interventions in markets and the use of trade policy is therefore likely to contain an element of trial and error.

(ii) Developing the confidence of stakeholders to make the transition

The difficulty of demonstrating ex-ante the benefits of a transition to a new policy set means that an increased level of trust and confidence must be built between the involved stakeholders so that, when unexpected results occur, it is possible to make informed policy adjustments.

Recognizing that many actors have a stake in policy decisions and that many organizations are contributing to policy debates, but often with insufficiently coordinated dialogue required to increase the levels of confidence to move away from the status quo, improved dialogue between the involved stakeholders is critical. As an example, the Food and Agriculture Organization (FAO) has facilitated the establishment of a platform for dialogue, the Agricultural Trade Policy Advisory Forum for East and Southern Africa (ATPAF-ESA), coordinated by the Eastern Africa Grains Council (EAGC). Launched in 2012, the ATPAF-ESA is an informal network of research institutes, international and regional organisations, and private sector and government institutions. The Forum provides a platform⁵ that builds on and strengthens existing initiatives aimed at improving the policy environment consistent with enhanced intra-regional trade in food staples.

Although decisions are invariably made at the national level, regional and international level dialogue is also critical. National decisions on strengthening food security should thus take into account their implications for food security in other countries, and regional cooperation should play an important role in harmonizing policies and finding solutions to common issues faced by countries. Regional Economic Communities and Commissions, such as COMESA and its specialized agency, the Alliance for Commodity Trade in Eastern and Southern Africa (ACTESA), have a key role to play in coordination through sharing of notifications of, and justifications for, national level interventions that are inconsistent with existing agreements.

⁵ The platform is structured around four pillars: improved policy monitoring – expanding upon existing information systems such as the *Regional Agricultural Trade Information Network (RATIN)*; enhanced evidence on the implication of policy choice; improving the capacity of all stakeholders to contribute to dialogue; and enhanced dialogue aimed at improving evidence-based decisions on the design and implementation of trade and related policy.

6 Conclusions and Policy Recommendations

Increased intra-regional trade in food staples can play a significant role not just in reducing levels of food price volatility, but in providing the market opportunities required to allow sufficient returns to investment along food staples value chains, including in productivity enhancing technology.

However, official intra-regional trade in Africa remains limited. In large part, this is argued as being due to the uncertain business and trading environment created by ad hoc policy decisions of national governments acting to ensure that legitimate short term food security objectives are met. Such actions are undermining both necessary investments in market and value chain developments required to facilitate cross-border trade and adherence to regional level commitments aimed at promoting greater regional integration. All this is critical to the creation of an environment being conducive to enhanced intra-regional trade.

However, a change in the policy approach to ensuring food staples security, which will essentially constrain the policy options available to governments, requires that they have increased confidence that they will be able to ensure food security-related objectives through a more nuanced use of both public sector interventions and market-based approaches. Increasing confidence requires strengthened evidence on the merits of alternative market-based instruments in different contexts and at different stages of the transition path to a less discretionary policy environment, and on the merits of an appropriate blend of policy and market instruments during this transition, in addition to improved dialogue and capacity development to generate stakeholders' willingness to adopt these instruments. Such evidence, while emerging and conclusive for the cases it examines, is not as yet widely available.

This analysis raises a number of questions and identifies several areas for further research and dialogue. These include further evidence on the contribution of increased intra-regional trade to reducing domestic market price volatility; on the extent to which discretionary trade and market policy interventions undermine regional trade; on the relative merits of different types of market-based instruments in mitigating price volatility and in improving food staples availability, and on this basis, the generation of improved insights on appropriate rules and on how these could be introduced during a period of transition from the status quo.

In terms of an agenda for action, it seems that first priority should be given to building trust between governments and the private sector. Building trust is a long term process, and involves predictability and consistency of policies from the government side, as well as commitment to long term trade development from the private sector side. Another major priority is action

and investment to reduce the large costs of transport that make up the largest portion of trade margins. Priority should also be given to demonstrating in more contexts and cases that the private sector in Africa, when facing reasonable and stable policies, can deliver, in terms of supplying food staples where and when they are needed, and at reasonable prices, and when comparing this performance with the performance of public institutions. An examination of the various non-tariff barriers facing inter-regional as well as intra-regional trade, with a view to simplifying or eliminating them, is another priority area of work. Designing better public systems of market information and early warning would help both the public as well as the private sector to plan more effectively. Systems and institutions facilitating risk management should be piloted to examine their effectiveness.

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Annex Table 1. Global trade pattern in cereals in 2011

Trade flows in Cereals in 2011 (figures denote exports from region in row to region in column in million USD)

	DEV1	DEV2	ACP WAF	ACP SADC	ACP ESA	ACP EAC	ACP CEMAC	ACP PAC	ACP CARIB	ROW	EU27	Total
DEV1	39.5	176.4	110.4	0.4	16.2	0.1	0.1	0.0	0.5	37.9	133.1	504.7
DEV2	3672	27656	36663	1006.8	837.3	815.6	256.2	111.9	477.6	1683.7	3324.7	45709.0
ACP WAF	0.5	12.8	18.6	0.5	0.5	0.5	0.0	0.4	0.4	0.4	22.2	72.2
ACP SADC	0.1	40.2	8.6	59.6	105.7	6.5	2.8	0.0	4.1	223.0	70.1	882.8
ACP ESA	4.1	35.6	1.9	57.9	123.9	68.0	0.6	0.0	7.0	10.8	32.4	336.0
ACP EAC	0.0	22.7	0.8	0.5	27.7	32.6	12.1	0.1	27.7	3.9	39.9	165.5
ACP CEMAC	0.0	0.9	0.0	0.0	1.0	0.0	0.2	0.0	0.3	1.2	1.0	4.7
ACP PAC	0.4	4.5	1.0	0.1	0.1	0.0	0.0	1.7	0.3	4.2	0.6	13.0
ACP CARIB	147	104.1	144.0	0.2	7.8	0.1	0.6	0.0	89.9	34.7	80.0	608.7
ROW	2701	21763	3335.9	421.5	614.1	238.4	51.3	230.7	1160.3	16749.7	1981.0	49247.8
EU27	370	6411.1	566.5	117.3	464.2	16.7	221.3	0.8	222.8	891.0	16649.3	25931.7
Total	6937	56589	7854.0	1664.8	2198.3	1178.1	545.7	345.3	1957.3	21680.8	22524.4	123475.9

Export shares (Percent)	DEV1	DEV2	ACP WAF	ACP SADC	ACP ESA	ACP EAC	ACP CEMAC	ACP PAC	ACP CARIB	ROW	EU27	Total
DEV1	7.8	34.9	21.9	0.1	3.2	0.0	0.0	0.0	0.1	7.5	24.4	100.0
DEV2	8.0	60.5	8.0	2.2	1.8	0.6	0.6	0.2	1.0	8.1	7.7	100.0
ACP WAF	0.6	17.7	25.7	0.7	0.3	0.1	0.6	0.1	0.6	22.8	30.8	100.0
ACP SADC	0.0	45.6	1.0	6.7	12.0	0.7	0.3	0.0	0.5	25.3	7.9	100.0
ACP ESA	1.2	10.6	0.6	17.2	36.9	20.3	0.2	0.0	0.2	3.2	9.6	100.0
ACP EAC	0.4	13.7	0.5	0.3	16.7	19.7	7.3	0.0	0.2	17.0	24.1	100.0
ACP CEMAC	0.5	19.6	0.5	0.4	22.0	4.1	0.0	0.0	0.7	24.7	22.3	100.0
ACP PAC	3.3	34.5	7.3	0.6	1.0	0.4	0.1	12.9	2.4	32.6	4.9	100.0
ACP CARIB	24.2	17.1	23.7	0.0	1.5	0.0	0.1	0.0	14.8	5.7	13.2	100.0
ROW	5.5	44.2	6.8	0.9	1.2	0.5	0.1	0.5	2.4	34.0	4.0	100.0
EU27	1.4	24.7	2.2	0.5	1.8	0.1	0.9	0.0	0.9	3.4	64.2	100.0
Total	7.8	34.9	21.9	0.1	3.2	0.0	0.0	0.0	0.1	7.5	24.4	100.0

Import shares (percent)	DEV1	DEV2	ACP WAF	ACP SADC	ACP ESA	ACP EAC	ACP CEMAC	ACP PAC	ACP CARIB	ROW	EU27	Total
DEV1	0.6	0.3	1.4	0.0	0.7	0.0	0.0	0.0	0.0	0.2	0.5	0.4
DEV2	32.9	48.9	46.7	60.5	38.1	69.2	47.0	32.4	17.0	24.4	15.6	37.0
ACP WAF	0.0	0.0	0.2	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.1	0.1
ACP SADC	0.0	0.7	0.1	3.6	4.8	0.6	0.5	0.0	0.2	1.0	0.3	0.7
ACP ESA	0.1	0.1	0.0	3.5	5.6	5.8	0.1	0.0	0.0	0.0	0.1	0.3
ACP EAC	0.0	0.0	0.0	0.0	1.3	2.8	2.2	0.0	0.0	0.1	0.2	0.1
ACP CEMAC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ACP PAC	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.5	0.0	0.0	0.0	0.0
ACP CARIB	2.1	0.2	1.8	0.0	0.4	0.0	0.1	0.0	4.6	0.2	0.4	0.5
ROW	38.9	38.5	42.5	25.3	27.9	20.2	9.4	66.8	59.3	77.3	8.8	39.9
EU27	5.3	11.3	7.2	7.0	21.1	1.4	40.6	0.2	11.4	4.1	73.9	21.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Authors calculations from GTAP data

Note. Region definition

DEV1	Non ACP developing LDC
DEV2	Non ACP developing non LDC
ACP-WAF	ACP West Africa
ACP-SADC	ACP SADC
ACP-ESA	ACP Eastern Southern Africa
ACP-EAC	ACP East Africa Community
ACP-CEMAC	ACP CEMAC (Central Africa)
ACP-PAC	ACP Pacific
ACP-CAR	ACP Caribbean
ROW	Rest of World
EU27	EU-27

Building Productive Capacities for Regional and Global Competitiveness: The Case of the East African Community

Andrew Mold and Rosemary Bagiza*

1 Introduction

After two ‘lost decades’ when incomes per capita actually declined in many countries of the region, East Africa’s economic performance improved dramatically in the 2000s¹. However, concerns remain regarding the sustainability of the growth process. In particular, there is concern about the ability of local firms to capitalize on the much improved macroeconomic performance. The private sector is generally perceived to be quite weak, particularly in the industrial sectors. Given the renewed emphasis on the central role for industrialisation in attaining sustainable economic growth and development (e.g. UNECA, 2013 and 2014; EAC, 2012; Page, 2012; and Rodrik, 2014), this matters a lot.

The traditional consensus view - one that is still propagated widely across Africa, particularly by the International Financial Institutions (IFIs) - is that the policy measures to create a vibrant private sector are quite straightforward; namely, the putting in place of a good “investment climate” comprising of a stable social and political regime, a minimal level of government interventions (beyond the provision of essential public goods), a sound macro management and legal framework, low business costs, a reasonable skill base, and adequate infrastructure. There is an extent to which such views are tautological, in the sense that once all the constraints on the private sector are removed, then a country is in all probability no longer a developing one!

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¹ The wider Eastern Africa region here refers to the 14 countries of the region, as defined by the UN Economic Commission for Africa – namely, Burundi, Comoros, the Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Rwanda, Seychelles, South Sudan, Tanzania and Uganda.

Development is all about identifying the key bottlenecks to growth, in the midst of resource scarcity. The traditional view tends to simply assume these dilemmas away, and argues that, once pro-business policy measures have been put in place, the ‘market will take care of itself’, and competitive firms will come into existence and flourish. Proponents of this view are likely to be encouraged by the findings of a recent Gallup (2014) survey which revealed that the people of East Africa are among the most entrepreneurial in the world, with a majority of the respondents arguing that they entertain plans to start up their own business – a level of business acumen many times higher than in Western Europe or the United States.²

Increasingly, however, there is a realisation that a vibrant private sector requires much more than a good investment climate - it needs the ability to respond vigorously to markets in an increasingly competitive and technology-oriented environment (Lall, 2005; Kelsall, 2013). This ability does not arise automatically nor is it easy to attain in a setting of low per capita incomes. It is based on cumulative effort to build a range of technological, managerial and institutional capabilities: just opening up to global markets, technology and capital flows, without a base of capabilities, means that the economies cannot competitively handle new industrial technologies. The development of capabilities faces market and institutional failures, and needs focused strategies, to tap foreign sources of knowledge, technology and skill (Lall, 2005; 1). In short, it requires some form of industrial policy.

Against this backdrop, this chapter broadly endorses UNCTAD’s view, as articulated in its Least Developed Country Reports (UNCTAD 2006 and UNCTAD 2013), on the importance of enhancing ‘*productive capacities*’ if growth is to prove sustainable. What is meant by productive capacities? According to UNCTAD (2013:95), they are

² This interpretation needs to be tempered by the fact that this probably reflects ‘survivalist’ strategies by respondents, in the absence of formal sector employment opportunities. When Gallup (2014) asked people around the world whether they entertained plans to start up a new business in the coming 12 months, only 4 percent, 12 and 15% of residents in the EU, Asia, and the Americas respectively replied yes. In Africa, the corresponding percentage was 35%, and in Kenya and Uganda, it was 42 and 43%. Ultimately, as Gallup observed, entrepreneurial intentions tended to be highest in regions where many new businesses are born out of necessity rather than opportunity. Limited job opportunities in less developed countries tend to drive up intent to start a business and in the absence of well-paying jobs, residents turn toward self-employment.

"...the productive resources, entrepreneurial capabilities and production linkages which together determine a country's capacity to produce goods and services and enable it to grow and develop...At UNCTAD, the development of the concept...was linked to earlier efforts to understand how structurally weak and underdeveloped economies like LDCs should promote economic growth and how they should initiate and then accelerate the growth process. Such efforts also sought to understand what are the key factors or capabilities that enable such economies to produce goods they can consume or sell, and what kinds of productive activities create quality jobs that contribute to poverty reduction."

The relevance of such ideas is easily understood in the context of Eastern Africa. In the 1980s and 1990s, most countries in the region undertook comprehensive structural adjustment policies. A key component of these strategies was trade liberalisation. For a majority of countries, the result was (disappointingly for advocates of the reforms) a significant rise in trade deficits, as imports surged and exports failed to respond to the new liberalised environment. As a consequence, many countries in the region had to sustain higher trade and current account deficits. This was particularly worrying in the context of what Thirlwall (2011) described as 'balance of payments-constrained growth' - i.e. low income countries are sustaining large current account deficits because of an incapacity to pay for imports with sufficient exports - a situation which subsequently acts as a break on economic growth.³

Underlying these problems is the failure to address the broader challenges of competitiveness. For a time, growth can be based on factor accumulation and sectoral reallocation. Indeed, in recent years, a lot of academic attention (e.g. MacMillan and Rodrik, 2011 and 2014; Page 2012, UNCTAD, 2014) has been placed on the importance of achieving 'structural transformation', whereby economic activity and employment shifts towards high productivity sectors, and thereby produces an acceleration of output growth. But over the longer run, the failure to enhance competitiveness, particularly in the industrial sectors, can ultimately be responsible for growth slowdowns (UNIDO, 2013). Addressing this challenge will be particularly important for

³ *Balance of Payments Constrained Growth* is defined by Thirlwall (2011) thus: "no country can grow faster than that rate consistent with balance of payments equilibrium on current account, unless it can finance ever-growing deficits, which in general it cannot". This statement is of course particularly valid in the context of low-income countries in Eastern Africa, with both a structural trade deficit and a low capacity to attract foreign capital inflows (beyond ODA and some types of FDI).

countries in Eastern Africa as they strive to obtain their ambitious goals of reaching middle-income status.⁴

For the sake of focus, this chapter looks at the major challenges in the business and competitive environment in a sub-set of the Eastern Africa region – the 5 member states of the East African Community (EAC): Burundi, Kenya, Rwanda, Tanzania and Uganda are considered. We do this by a comparative analysis of data available through the World Economic Forum's Global Competitiveness Reports and World Bank's Enterprise Surveys, among other sources. In trying to pinpoint more precisely some of the strategic weaknesses in the private sector, we confirm commonplace observations that the major constraints on a better business performance are related to energy costs and access to finance, as well as high trading costs, corruption, inadequately trained staff, and infrastructure bottlenecks. More general problems also exist in some sectors, relating to the lack of a sufficiently competitive business environment and the shallowness of the consumer market (driven by what are still extremely low incomes for the majority of citizens).

However, the accumulated evidence on these points is huge, and it is fact that all this requires concerted and effective policy action. Repeating this message for policymakers is thus not particularly helpful. Indeed, as Rodrik (2007:88-9) has forcefully argued,

"...the fact that poor economies are poor indicates that they suffer from a variety of afflictions: they are poorly endowed with human capital, making ineffective use of capital and other resources, have poor institutions, have unstable fiscal and monetary policies, provide inadequate private incentives for investment and technology adoption, have poor access to credit, are cut off from world markets, and so on. To say that one has to overcome all these disadvantages in order to develop is at once tautological and quite unhelpful."

In such a context, rather than presenting a 'shopping list' of constraints, what the policymaker needs to know is what the most binding constraints to growth are - in other words, where policy action will provide the 'biggest bang for the buck'.

⁴ For example, Rwanda's Economic Development and Poverty Reduction Strategy (EDPRS) had targeted a per capita income of 1,240 USD and an average GDP growth of 11.5% by 2018. In September 2014, the Kenya National Bureau of Statistics (KNBS) rebased its National Accounts, resulting in a 25 percent revaluation of its GDP, raising its per capita income from USD 943 to USD 1,246. Kenya thereby achieved middle-income status 16 years ahead of the date stipulated in its Vision 2030.

As a consequence, in this chapter we do not go into the more ambitious agenda regarding what a fully-fledged set of policies to enhance 'productive capacities' would look like - that, we feel, is dealt with comprehensively elsewhere.⁵ Instead, the chapter pays special attention to a few key constraints on the private sector – in particular, the persistent difficulties in getting access to credit and the small scale of operations of national firms. On the former point, it is argued that more serious thought needs to be given to improving the banking performance. On the latter point, it is suggested that, if firms are to be more successful in competing domestic, regional and international markets, policies will be needed to facilitate the upscaling of their operations. Given the small-scale of the domestic markets, this means that regionalization for EAC member states is all the more imperative than for Africa as a whole.

In section 2 the competitive challenges within the EAC are discussed in the form of an overview. In section 3 the issues of structural transformation versus structural stagnation within the EAC are considered and evaluated. In section 4 the business environment in EAC is assessed by reviewing some survey evidence. In section 5 important reforms of the banking sector so as to support structural transformation in the EAC are presented. In section 6 policy measures to improve the business competitiveness are discussed. Section 7 gives the conclusions.

2 Competitive Challenges within the East African Community – An Overview

The EAC is possibly one of the most ambitious regional integration schemes in Africa. It is, in fact, a reincarnation of an earlier regional block that collapsed in 1977 amid political and ideological recriminations between the three original member states (Kenya, Tanzania and Uganda) and concerns that the benefits from regional integration were not being evenly shared (Adar and Ngunyi, 1992).

The EAC in its present form envisages integration among partner states progressing from a customs union to a common market, then to a monetary union, and ultimately to a political federation. The treaty establishing the EAC was initially signed by Kenya, Tanzania, and Uganda in November 1999, with Rwanda and Burundi acceding in July 2007. The next step in the integration process was the introduction of the Customs Union which com-

⁵ e.g. UNECA (2014 & 2013), UNCTAD (2013), AU (2012), EAC (2012), Morris, Kaplinsky and Kaplan (2012), Rodrik (2011), Wade (2009).

menced in 2005 (Rwanda joined in 2009). The implementation of the Common Market began in July 2010. A monetary union protocol was signed in November 2013 and has yet to be ratified by all the Partner States. Consultations on the establishment of a political federation are also ongoing.

Albeit starting from very low levels of per-capita income, the EAC has been among the fastest growing regions in sub-Saharan Africa over the past decade (McAuliffe et al., 2012). The EAC has managed to almost double its per-capita income since 2005 - despite a fast growing population - and economic performance has remained strong throughout the period of the global economic downturn since 2008. Three of the five EAC countries have recently revised their national accounts (Tanzania, Kenya, and Uganda)⁶, and the regional GDP now stands at an estimated USD 134 billion for 2013 (up from a previous USD110 billion).

On the global scale of things, this is still tiny (if the EAC was a country, it would still only rank 59th economy in the world). Often, however, from the perspective of investors, it is the rate of expansion of the market that counts, and, in those terms, collectively the EAC represents a market of some interest. The fact that FDI to the EAC has been increasing sharply (see Table 2 below) and that hard currency bond issues in 2014 by Rwanda and Kenya were successful⁷ suggests that international investors have a relatively upbeat interpretation of prospects for the region.

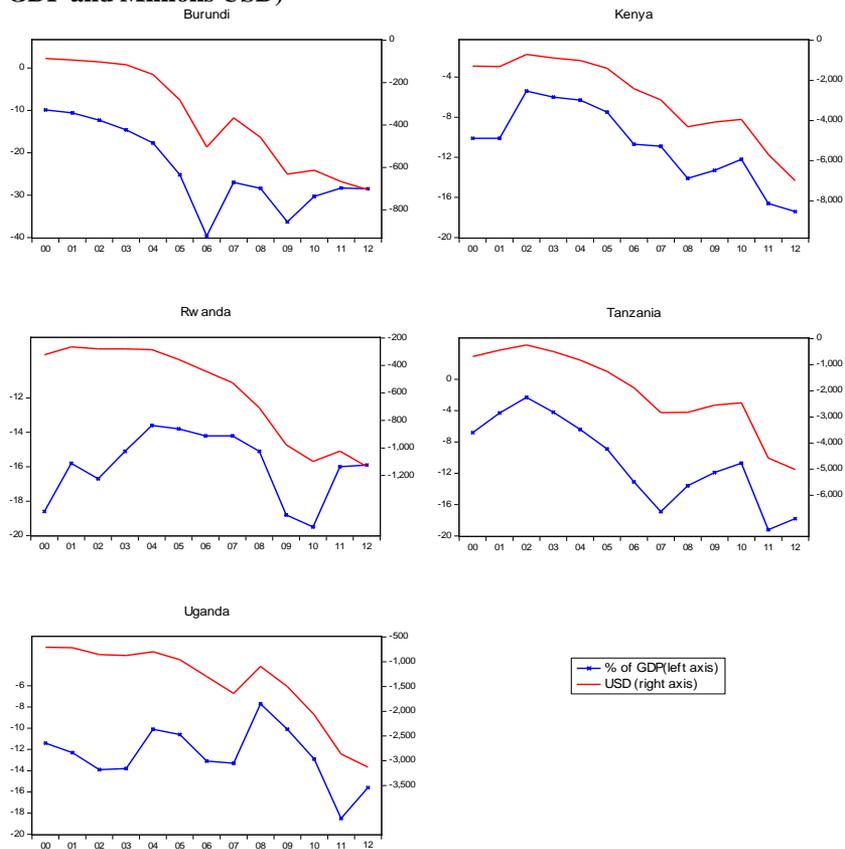
Regarding competitiveness, however, the story is rather different. With few exceptions, in recent years firms from the region have struggled to retain market shares even in their own domestic markets, let alone to make inroads into foreign markets. Despite the relatively strong macroeconomic performance, the competitive position of the EAC as a whole remains weak. Compared to other sub-Saharan economies, EAC countries have a smaller share of exports in GDP, lower levels of domestic savings, a higher reliance on donor aid, and a more limited physical infrastructure and human capital (McAuliffe et al., 2012). The EAC is a net importer of goods from the rest of the world, and the growing trade deficits over the last decade and a half of all partner

⁶ Tanzania, Kenya and Uganda 'rebased' their GDP figures, resulting in a 32, 25 and 13 percent rise in their respective GDPs. See Manson (2014).

⁷ Rwanda raised USD 400 million by issuing its debut Eurobond in April 2013, while Kenya subsequently raised USD 2 billion through its own Eurobond issue in June 2014. So far, Uganda is the only country in the region to have explicitly excluded itself from issuing hard-currency bonds in the near future; its Central Bank Governor Emmanuel Mutebile was arguing that the associated risks of issuing debt in hard-currency are too high in a context of countries vulnerable to sharp and unexpected currency depreciation (Blas, 2014).

states are a direct consequence of a lack of underlying competitiveness of its own productive sectors (Figure 1).³

Figure 1: EAC Trade Balances in Goods and Services, 2000-2012 (% of GDP and Millions USD)



Source: World Bank, WDI Indicators (2015)

Simply in terms of average productivity levels (reflected in GDP per capita figures), the most competitive economy in the region is – by quite a large magnitude – Kenya (Table 1). This partly reflects a model of development that has been more market-oriented than in neighbouring Tanzania and Uganda. It is also, by quite a margin, the largest market in the EAC, representing over 40 percent of the regional GDP. As a consequence, this gives Kenyan firms a distinct advantage in terms of scale economies and a larger

domestic market. Nonetheless, they are still vulnerable to imports from Asia and Europe - both regions with which Kenya sustains large trade deficits, particularly in manufactured goods. Concerns have also been raised regarding the extent to which Kenyan firms are put at a competitive disadvantage through imports of counterfeit goods⁸ and also through cheaper manufactured products coming from Egypt.⁹

Table 1 - Selected macroeconomic and social indicators for EAC Partner States in 2013

	Burundi	Kenya	Rwanda	Tanzania	Uganda
GDP per capita (USD)	294.2	1,055.2	709.4	742.6	611.4*
GDP (billion USD)	2.72	55.26	7.45	42.53	25.74
Average real GDP growth (2009–2013) (%)	4.4	4.4	6.8	6.7	4.8*
Inflation rate (%)	7.9	5.7	4.2	7.5	5.5
Population (Millions)	9.4	41.8	11.3	46.2	35.4
Life expectancy at birth (Years)	51	59	65	61	50
Literacy Rates	65	62	68	78	71

Source: EAC Facts and Figures 2014, and national sources

At the same time, the EAC market provides a number of opportunities with which to strengthen the competitiveness of national firms. Firstly, under Article 12 of the EAC Customs Union Protocol, partner states agreed to adopt a common external tariff (CET) with a three-band structure (0% for

⁸ According to one estimate, manufacturers in the EAC lose over \$330 million annually due to counterfeit products: Olingo (2014).

⁹ Manufactured goods from Egypt come zero-rated into the region under the Common Market of Eastern and Southern Africa (COMESA) agreement, illustrating one of the difficulties arising from overlapping membership of RECs (Regional Economic Communities). All EAC members except Tanzania are members of COMESA. Egypt also reportedly has a significant cost advantage in terms of much lower power costs, as on average Kenyan manufacturers pay US\$ 0.21 per kilowatt hour (KWh) of electricity, compared to just US\$0.03 in the case of Egyptian manufacturers (see: Olingo, 2014).

raw materials, 10% for intermediate goods, and 25% for finished goods).¹⁰ All partner states are in formal legal compliance with this obligation to adopt the CET. Not all economists would agree with the following statement¹¹, but in principle, the CET gives partner states potential scope for being able to ‘recapture the domestic market’ for a whole range of consumer goods which are currently being imported – a *de facto* policy of import substitution, albeit advisably of a more modest nature to the kind of policies implemented in the 1970s and 1980s.¹²

More strategically over the long term, regional markets provide a learning-by-doing platform for nascent and less competitive companies. At around 22 percent of total trade, intra-EAC trade is the highest of any regional block in Africa. Crucially, unlike EAC exports to outside the region (which are mainly commodities), the bulk of intraregional exports are manufactured goods (food products, beverages, tobacco, cement) and oil re-exports. In the period from 2007 to 2011, the share of manufacturing in trade within regional economic communities (RECs) was highest in the EAC (58.3%) (UNCTAD, 2013:37).

The regional market can thus act as a strategic springboard for manufacturing companies in the sense that market access barriers are expected to be much lower than in other global markets. Regional markets also open opportunities for companies to enhance economies of scale and thus increase their incentives for investment specialisation and competitiveness (Kiuluku and Chekwoti, 2013). As we will see in the following section, however, in terms of promoting more diversified exports, thus far it has principally been the two largest economies in the region which have benefited most – Kenya and Tanzania.

Beyond trade, intra-regional investment opportunities are possibly just as important as ways of enhancing the competitiveness of firms. Data is at best piecemeal on intra-regional FDI flows, but UNCTAD data does seem to suggest an upturn in intra-regional FDI within the EAC, where it now constitutes an estimated 14 percent of total inflows (Table 2). Kenyan firms, in particular, have been making major inroads within the EAC market in the

¹⁰ For Uganda, which had been an early starter in trade liberalisation with the process dating back to the late 1980s, the imposition of the CET actually implied a rise of some tariffs.

¹¹ Milner et. al. (1998) argues that any tariffs on imports undermine the capacity to source from the least cost supplier, and hence do handicap the competitiveness of firms.

¹² The Executive Secretary of UNECA, Carlos Lopes (2014), frequently refers to ‘smart protectionism’ to distinguish policies like these from the failed - and crude - import substitution policies that were often implemented in the 1980s. See Bruton (1998) for a discussion of why these policies often did not work effectively.

financial services (e.g. Equity Bank), hotels (e.g. Serena group), and trading sectors (e.g. Nakumatt supermarkets). There is however far less evidence of intra-regional investments in manufacturing - something that could truly incentivise the emergence of regional value-chains and the emergence of a more competitive productive sector.

Table 2: Intra-regional and extra-regional FDI projects in selected regional groups

Region	Period	Billions of dollars			% share in total	
		Total	Intra-regional	Extra-regional	Intra-regional	Extra-regional
COMESA	2003-2005	17.9	0.2	17.7	1	99
	2009-2011	34.0	2.6	31.4	8	92
EAC	2003-2005	2.3	0.0	2.3	2	98
	2009-2011	9.9	1.4	8.5	14	86
SADC	2003-2005	23.3	1.0	22.3	4	96
	2009-2011	32.0	3.2	28.8	10	90
ASEAN	2003-2005	58.2	6.3	52.0	11	89
	2009-2011	117.4	14.4	103.0	12	88
EU	2003-2005	325.7	161.2	164.5	50	50
	2009-2011	310.5	129.2	181.3	42	58

Source: UNCTAD (2012). Note - Data refer to the sum of the value of cross-border mergers and acquisitions and “greenfield” FDI projects. Data for the value of “greenfield” FDI projects refer to estimated amounts of capital investment.

3 Structural Transformation versus Structural Stagnation within the EAC

In recent years, economists and policymakers across Africa have begun to focus on issues associated with structural transformation. A number of

regional leaders have been at the forefront of these reflections (e.g. Zenawi, 2012).¹³ It is now increasingly recognized that, without structural change, the growth experienced in the region since the early 2000s is unlikely to be sustainable. McMillan and Rodrik (2011) highlight the fact that structural change in Africa over recent decades has not been of the type from low-productivity to high-productivity sectors, but rather from high-productivity sectors towards low-productivity ones, leading to a net reduction in growth. While the same authors (McMillan, Rodrik and Verduzco-Gallo, 2014) qualify this view in a later article, and concede that there is some evidence of structural transformation (and hence higher productivity growth) across Africa since the early 2000s, they note the pace of structural transformation has still not been sufficiently rapid to create the kind of competitive surge that the region needs.

In a new twist on some old economic theories,¹⁴ it has also recently become part of the mainstream wisdom that countries with more diversified production and export structures have higher incomes per capita (Imbs and Wacziarg, 2003, IMF, 2014), and that countries that produce and export more sophisticated products—those that are primarily manufactured by countries at higher income levels—tend to grow faster (Hausmann et al., 2007; Page, 2012).

What can we say about the extent of structural transformation within the EAC? Firstly, EAC exports are still heavily reliant on agriculture and natural resources (Table 3). The most marked case is Burundi, the least developed EAC member state, where traditional exports (coffee, tea) still account for nearly 80 percent of total exports. Even in other member states, the pace of diversification into more sophisticated export goods has been fairly slow. Non-traditional exports have risen across the region – particularly notable being Kenya’s horticultural exports. But, with a few exceptions, manufactures are not among the leading exports.

¹³ See, for instance, the views on states and markets by Zenawi (2012). The urgency of bringing about ‘structural change’ has also been a recurrent theme of Ugandan President Yoweri Museveni’s speeches.

¹⁴The acknowledgement of the importance of a more diverse economic structure was recognised long ago by economists of the ‘structuralist’ school, particularly those associated with UNECA’s sister organisation in Latin America, UN-ECLAC. Together with Hans Singer, Raul Prebisch, the first Executive Secretary of ECLAC, argued vigorously in favour of structural change and a greater diversification of the economy if developing countries were to have a chance of emulating high income countries in terms of achieving broad-based human development.

Table 3: Leading Exports (and percentage of total) for the EAC Countries, 2012

Country	Export	% of total exports	Top 3 as % of Total Exports	Value in US\$ million
Burundi	Coffee	60.9	85.7	82.0*
	Tea	17.2		23.2*
	Manufactures	7.6		10.2*
Kenya**	Tea	21.1	44.1	1179.2
	Horticulture	14.3		795.4
	Chemicals	9.7		543.7
Rwanda	Tea	11.1*	31.0	65.7
	Coffee	10.3*		61.1
	Coltan	9.6*		55.5
Tanzania	Traditional		13.8	
	Tobacco	6.2		157.6
	Cashew nuts	4.1		104.5
	Coffee	3.5		88.7
	Non-traditional		82.4	
	Minerals	44.0		1126.4
	Manufactured products	19.9		508.7
Other exports	18.5	472.7		
Uganda	Traditional		22.1	
	Coffee	15.8		372.2
	Cotton	3.2		74.9
	Tea	3.1		73.9
	Non-traditional		15.7	
	Fish and fish products	5.4		128.3
	Petroleum Products	5.8		136.7
Cement	4.5	106.9		

Source: National sources of EAC countries and EIU 2014

Secondly, the lack of depth to manufacturing in the region is revealed by an analysis of the structure of member states' economies. The IMF (2012) examines data at a national disaggregate level over the period 1995–2010. While a degree of structural transformation has been seen in some countries by developing the manufacturing sector (Tanzania) and the service sector (Kenya), the pace of transformation has been slow, and accompanied by only a weak growth in labour productivity. Of particular concern is the fact that since the mid-1990s the manufacturing sector has stagnated across the region – indeed, in 4 out of the 5 EAC partner countries, it has actually contracted (Table 4).

Table 4: The Pace of Structural Transformation in the EAC

Country	Agriculture		Annual percent change in agricultural GDP share	Mining		Manufacturing		Construction		Tertiary	
	Initial	Final		Initial	Final	Initial	Final	Initial	Final	Initial	Final
Burundi (1995-2010)	49.8	33.4	-2.2	0.8	0.4	10.6	10.0	3.0	5.9	34.3	48.8
Kenya (2000-2010)	29.4	24.4	-1.7	0.4	0.4	10.3	9.9	2.9	3.2	55.1	59.8
Rwanda (1995-2010)	45.9	39.4	-0.9	0.2	0.5	8.1	6.7	5.1	7.8	39.5	44.8
Tanzania (1998-2010)	31.8	23.9	-2.1	1.5	2.4	8.5	9.5	5.2	7.0	45.8	48.3
Uganda (2000-2010)	24.6	16.0	-3.5	0.3	0.4	7.9	7.5	11.8	16.2	51.0	56.7

Source: IMF (2012)

Thirdly, the sectoral spread of the manufacturing industry that does exist within the EAC tends to be thin. Manufacturing in the region is dominated by *food and beverages*, largely related to basic processing of agricultural output (AfDB, 2014) (Table 5).¹⁵ *Cotton-based textiles and clothing*, the production of *leather and wood-based products* (including furniture, paper and printing) also figure prominently in regional production patterns. Despite the thinness of the manufacturing sector, there is some evidence of nascent industrial development of more advanced products for local or regional consumption.

¹⁵ Indeed, this is a pattern which replicates itself across many countries in Africa, the reason probably being related to 'natural trade barriers' which exist in food and beverages (which are often perishable and expensive to transport over long distances). To some extent, this provides support to the view expressed in the previous section that a modest degree of protection to offset the disadvantages of distance and low levels of productivity may well be conducive to the emergence of activities in certain sectors.

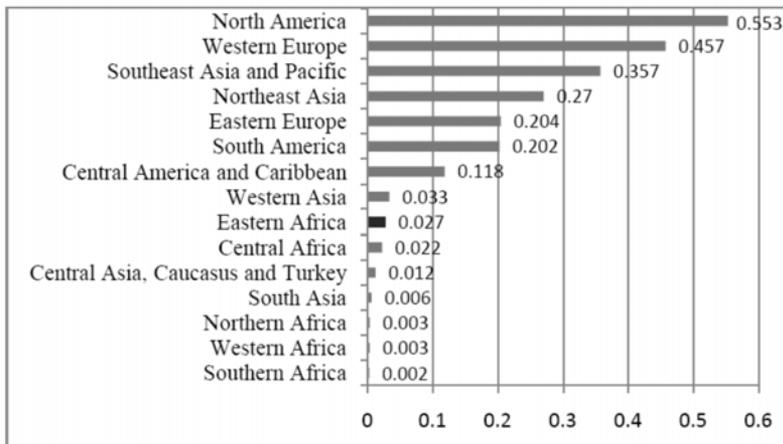
In Kenya, for instance, a pharmaceutical manufacturing industry has emerged to meet domestic medicine requirements and over 30 manufacturers are currently in operation (Oxford Analytica, 2014). Both Kenya and Tanzania also have small industries producing more advanced products like vehicles, electronic equipment (e.g. cell phone assembly), or machinery and equipment. The AfDB (2014:35) notes, however, that much of this production is still to a large extent dependent on imported components.

Table 5: Composition of Manufacturing Activity by main Sector and Employment Share

Industrial Group	Kenya (2011)	Rwanda (2012)	Tanzania (no date)	Uganda (2011)*
Food , Beverage & Tobacco	39.7	72.4	57.0	52.0
Textiles and Apparel	13.6	4.9	5.0	5.0
Tanning and Leather	1.6	na	na	na
Wood products, Furniture, Paper and Printing	5.7	8.3	na	8.0
Vehicles and M&E	3.5	na	na	na
Other	35.9	14.4	38.0	35.0

Source: AfDB (2014)

This brings us to a major limitation in the current patterns of intra-regional trade – the lack of truly regional value chains. One of the key mechanisms to improving competitiveness is scaling up regional production—that is, integrating firms into regional value chains to allow the firms to reap the advantages of greater specialization and scale (World Bank, 2012b). Such integration would not only facilitate exports to global markets but would also result in greater inter-regional trade through increased task-based or component-based trade. Yet the integration of production networks in the Eastern Africa region is at present very limited. Intra-industry trade—a proxy for integration in manufacturing networks—in the Eastern Africa region is much lower than in East Asia, Europe, or the Americas (Figure 2). Beyond the obvious answer of removing further the existing barriers to intra-regional trade, a key policy question is how such networks can be encouraged.

Figure 2: Intraregional intra-industry trade (Grubel-Lloyd Index, 2008)

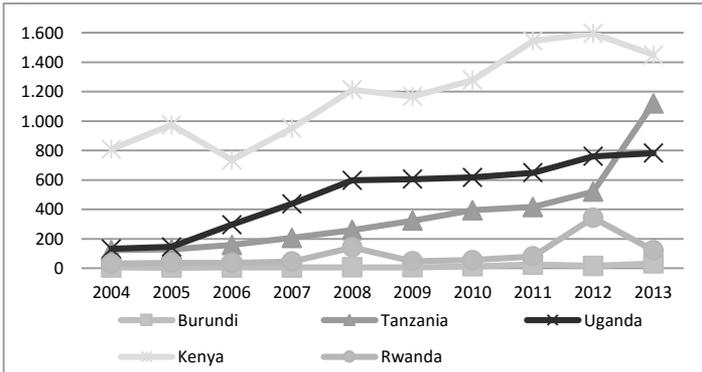
Source: Brulhart (2009)

Finally, the only country within the EAC to buck the aforementioned trend towards a declining share of manufacturing in value-added in GDP – rather surprisingly, perhaps, given its historic reputation as the least-market oriented country in the region¹⁶ – is Tanzania. Despite a disappointing performance in the agricultural sector (World Bank, 2012a), a combination of better macro-economic management, market-friendly reforms, higher investment, and general increases in productivity since the early 2000s have led to an acceleration in its growth performance (Robinson et. al., 2012, Edwards, 2014). Vindicating the arguments made in the previous section, Tanzania's manufacturing sector has recently developed quite strongly, driven primarily by demand from regional markets, supported by the strengthening of the Eastern African Community (EAC) common market. Manufacturing's share of Tanzania's exports grew from 3 percent in 2000 to 17 percent in 2010, with the key products being processed food, beverages, and tobacco products, followed by manufacturing of furniture and other wood products (IMF, 2012:68). Tanzania's total trade turnover (exports plus imports) with its EAC partners rose to just over USD 1.5bn in 2013 (Figure 3). Tanzanian intra-

¹⁶ Under the leadership of Julius Nyerere, Tanzania was seen by many in the North in the 1970s and 1980s as a pioneer socialist experiment, with attempts to introduce Maoist health care and a developmental model based on the principle of self-determination. See Coulson (2013).

EAC exports rose by an impressive 115% in 2013, with the Kenyan market being the most important trading partner.

Figure 3: Intra-Regional EAC Exports, by Country (2004-2013), millions USD



Source: EAC (2014)

It is important that other EAC members follow this course of developing the manufacturing sector. The lessons from the case of Tanzania should be learned by other EAC members.

4 A Challenging Business Environment? An Evaluation of Survey Evidence

Despite its popularity in economic literature and public policy, the concept of national economic competitiveness remains controversial. Even Michael Porter, whose name more than any other is associated with the concept of national competitiveness, conceded that “*we must abandon the whole notion of a ‘competitive nation’ as a term having much meaning for economic prosperity*” (Porter, 1990: 6) and elsewhere he noted that “*while the notion of a competitive company is clear, the notion of a competitive nation is not*” (Porter, 1998: 158). Critics such as Paul Krugman went further. For Krugman (1994), the concept of national competitiveness is not only based on wrong premises (i.e. the wealth of a country is based on its success in international markets, where nations compete with each other like companies), but it is also dangerous: it may lead to wrong allocation of resources and ‘even to protectionism’.

The rankings of the national business environment, like those carried out in the World Economic Forum's ‘*Global Competitiveness Index*’ or the World

Bank's 'Doing Business' survey are similarly controversial, in part because of the inevitably subjective nature of the evaluations, and also because of the methodological difficulties of combining different indicators into a single index of 'competitiveness' (Manuel et. al, 2013; Høyland et. al, 2012, Kahn, 2012). As Manuel et. al. (2013:20) argue, "*Aggregation relies on strong built-in assumptions, making it an inherently value-laden practice. The act of ranking countries may appear devoid of value judgement, but it is, in reality, an arbitrary method of summarising vast amounts of complex information as a single number.*" In addition, evaluations of country's performances vary quite sharply between the different indexes, again suggesting that they need to be treated with some circumspection. Nor has the fact gone unnoticed by critics that sometimes developing countries which were subsequently ranked as very 'successful', such as China or South Korea, have been poorly ranked by business rankings in the past. This has been ascribed to an 'Anglo-Saxon bias' in the evaluations of the business environment which does not correspond at all to realities or priorities for developing countries (e.g. Amsden et. al., 1996; Amsden 2001).

Needless to say, the general business environment in the EAC is very far from the free market ideal of Anglo-Saxon economic textbooks. Informality is rife¹⁷, markets are often fragmented and, because of the small size of national economies, firms tend towards oligopolistic and monopolistic structures. For most developmental economists, especially those that come from a structuralist perspective, such an observation is unsurprising - market failures are as plentiful as government failures in low-income settings. This has a number of important implications. As Kahn (2012:134) notes, in observations reminiscent of Rodrik's warnings cited earlier, "*there is no question that if electricity supply could be improved, if roads and ports appeared, and if the bureaucracy became more efficient, enterprise across the board would benefit. But these are precisely the big-ticket public goods that have taken a long time to develop and deliver. They should be developed, but in the meantime the trick is to identify areas where there are potentially big returns to relatively small investments but where these investments will not be made by private investors because market failures prevent them from being assured of private returns or the private risk is too high.*"

¹⁷ The EAC member states have some of the most pervasive informal sectors in the world. For instance, estimates from the AfDB (2012) (albeit on old data) suggest that Tanzania Uganda, and Kenya have 88, 76, and 63 percent of their workforces respectively working in the informal sector.

Taken together, these are not minor caveats and mean that the results from the different business surveys need to be taken with some circumspection. That said, in this chapter we argue that these surveys can at least provide a proximate idea of how the business environment is *perceived* relative to that of international competitors, and the disaggregated data included in the surveys may also reveal some policy issues which need prioritising. In this spirit, this section provides a brief overview of the conclusions of a number of recent surveys.¹⁸

i) The Global Competitiveness Index

The longest-standing and most comprehensive index of competitiveness is the World Economic Forum's *Global Competitiveness Index* (GCI), which has been published (albeit with a number of methodological changes) since 1979. The GCI is defined by the World Economic Forum as a set of institutions, policies, and factors that determine the level of productivity of a country, conditions of public institutions and technical conditions. The GCI consists of 12 pillars of competitiveness - comprising of a total of over 110 variables, of which two thirds come from an Executive Opinion Survey, and one third from publicly available sources such as the United Nations. The 12 pillars of competitiveness are grouped in three areas - '*Basic Areas*' (Institutions, infrastructure, macroeconomic environment, health and primary education), '*Efficiency enhancers*' (higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, market size), and '*Innovation and Sophistication Factors*' (business sophistication, and innovation). The GCI places countries in three stages of development: Factor-driven (stage 1), efficiency-driven (stage 2), and innovation-driven (stage 3), each implying a growing degree of complexity in the operation of the economy. Stage 1 consists of countries with a per capita GDP of less than USD 2,000, stage 2 countries range between USD 3,000 to 8,999, while stage 3 countries have more than USD 17,000 of GDP per capita. In the factor-driven stage, currently all the EAC members states, it is argued that countries compete primarily on the basis of unskilled labour and natural resources, or on natural endowments; and as such, the economies compete on the basis of selling basic products or commodities, with low productivity reflected in low wages.

¹⁸ Space constraints do not allow a more disaggregated overview of all the sub-components in the indexes, but the interested reader is encouraged to consult the respective reports.

According to the Global Competitiveness Report 2014-2015 (WEF 2014), Rwanda scores highest as the most competitive economy in the EAC, ranking 62nd out of the 144 countries surveyed worldwide (Table 6). This puts Rwanda in third place in Africa, after Mauritius and South Africa (39th and 56th respectively). Rwanda scored particularly well in terms of the 'basic requirements' for global competitiveness (institutions, macroeconomic environment, and health and primary education, though less well on infrastructure), but lagged in terms of business sophistication and efficiency enhancers (e.g. higher education and training, technological readiness and market size). Access to finance and the lack of an adequately educated workforce were identified as the leading constraints for doing business. Within the EAC, Kenya came second with an overall score of 3.93 and was ranked 90th worldwide, while Tanzania, Uganda and Burundi came in 121st, 122nd and 139th. However, outside of Rwanda, the pattern of the 'most problematic factors' for doing business was rather different in the other EAC member states - access to finance was the second most important constraint in all four countries, but corruption figured as the leading difficulty.

Table 6: The Global Competitiveness Index 2014-2015 and 2013-2014 rankings

Country	GCI 2014-2015		GCI 2013-2014	
	Rank	Score(1-7)	Rank	Change
Rwanda	62	4.27	66	4
Kenya	90	3.93	96	6
Tanzania	121	3.57	125	4
Uganda	122	3.56	129	7
Burundi	139	3.09	146	7

Source: WEF 2014

Comparing for two years (GCI 2014-2015 to GCI 2013-2014) the ranking of Rwanda is further improving, but also the rankings of Kenya and of the other EAC countries have improved.

ii) The 'Doing Business' Report

In contrast to the GCI, the World Bank's *Doing Business* report has a narrower remit, focusing only on the regulatory environment. "Doing business" surveys began in 2002 and have undergone a number of methodological revisions - particularly subsequent to the publication in 2013 of the "Independent Panel Review of the Doing Business" report, chaired by the former South African finance minister Trevor Manuel (Manuel et. al, 2013). The surveys purport to assess how easy it is to do business in the surveyed coun-

tries; the higher the rank, the more conducive the regulatory environment is considered for starting and operating a firm. The overall ranking is an aggregation of 10 component indicators: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency.

Data for the ranking is not based on firm or household surveys but rather on 'expert' assessments, justified¹⁹ on the grounds that some of the key bureaucratic or legal constraints are best assessed by professionals (e.g. lawyers) who deal with the same issues on a daily basis, rather than firms that may encounter, for instance, registration problems just once. Again, however, issues have been raised to the extent to which the perceptions of the 'experts' who are consulted can be considered reliable. The survey respondents from each country are sometimes as few as one, and usually come exclusively from the largest business city. Some critics have also raised concerns that the Doing Business indicators and surveys display a bias against civil law systems, favouring the Anglo-Saxon common law legal system (Snodgrass, 2008).

According to the Doing Business 2015 report (World Bank Group 2014b), despite a re-classification due to a change in methodology, Rwanda was still ranked the best performing country in the EAC, being placed in the 46th position globally (and the third easiest place to do business in Africa after Mauritius (28th globally) and South Africa (43rd globally) (Table 7). Rwanda has consistently implemented reforms to improve its ranking and this has resulted in a significant promotion from a 150th rank globally in 2008 to a 46th rank in 2015. In contrast, although there have been some noted improvements in some spheres²⁰, the rest of the EAC member states rank very low in terms of their general regulatory environments.

The business environment in the region is assessed as particularly weak in terms of trading across borders (ranked 157 out of 189) and getting electricity (ranked 133), but the region also scores quite badly on dealing with construction permits, protecting minority investors, resolving insolvency, and getting credit (see Figure 4).

¹⁹ See World Bank Group (2014a)

²⁰ Burundi has notably improved its ranking in terms of the ease of registering a business, thanks to the implementation of a one-stop shop at the Burundi Revenue Authority in 2012.

Table 7: Doing Business rankings 2015

Country	Doing Business 2015		Doing Business 2014	
	Rank	Overall DTF (Distance to frontier)	Rank	Change
Rwanda	46	70.47	48	2
Tanzania	131	56.38	130	-1
Kenya	136	54.98	137	1
Uganda	150	51.11	152	2
Burundi	152	51.07	150	-2

Source: World Bank Group, Doing Business 2015 (published 2014)

Figure 4 : The Business Environment 2015 - Regional Average Ranking

Source: World Bank Group, Doing Business 2015, Regional Profile (published 2014)

Rather satisfactory are the regional rankings for *registering property* and *enforcing contracts*.

iii) The World Bank's 'Enterprise Surveys'

A more disaggregated view of factors that impinge on competitiveness within the EAC can be obtained through the World Bank Enterprise Surveys, which have been undertaken in 135 countries since 2002. According to the World Bank (2014), "*an accommodating business environment is one that encourages firms to operate efficiently. Such conditions strengthen incentives for firms to innovate and to increase productivity—key factors for sustainable development.*" Their coverage includes small, medium, and large companies. Typically 1,200-1,800 interviews are conducted in larger economies, 360 interviews are conducted in medium-sized economies, and for smaller economies 150 interviews take place. The enterprise surveys are applied to a representative sample of firms in the non-agricultural economy. The sample is consistently defined in all countries and includes the entire manufacturing

sector, the services sector, transportation, and construction sectors (World Bank, 2014).²¹

The pattern that emerges for the EAC is fairly consistent in terms of the major obstacles to businesses - persistently *access to finance*²² and *electricity* are cited as the binding constraints - though there is some notable intra-regional variation, with tax rates, corruption, practices of the informal sector, and (in the case of Burundi) political instability all being frequently mentioned. Of the firms surveyed in Tanzania and Rwanda, 38.7% and 23% respectively cited access to finance as the major obstacle in the business environment. In Burundi and Uganda, 41.3% and 23.2% of firms respectively identified electricity as a major obstacle to business. The outlier among the EAC countries was Kenya, where 24.1% of firms surveyed in 2013 identified the practices of the informal sector as the major obstacle. Because of the way in which they avoid taxes and compliance with minimum labour, health, environmental and product quality standards, informal sector firms are seen as disloyal competition that undermines their own competitiveness.

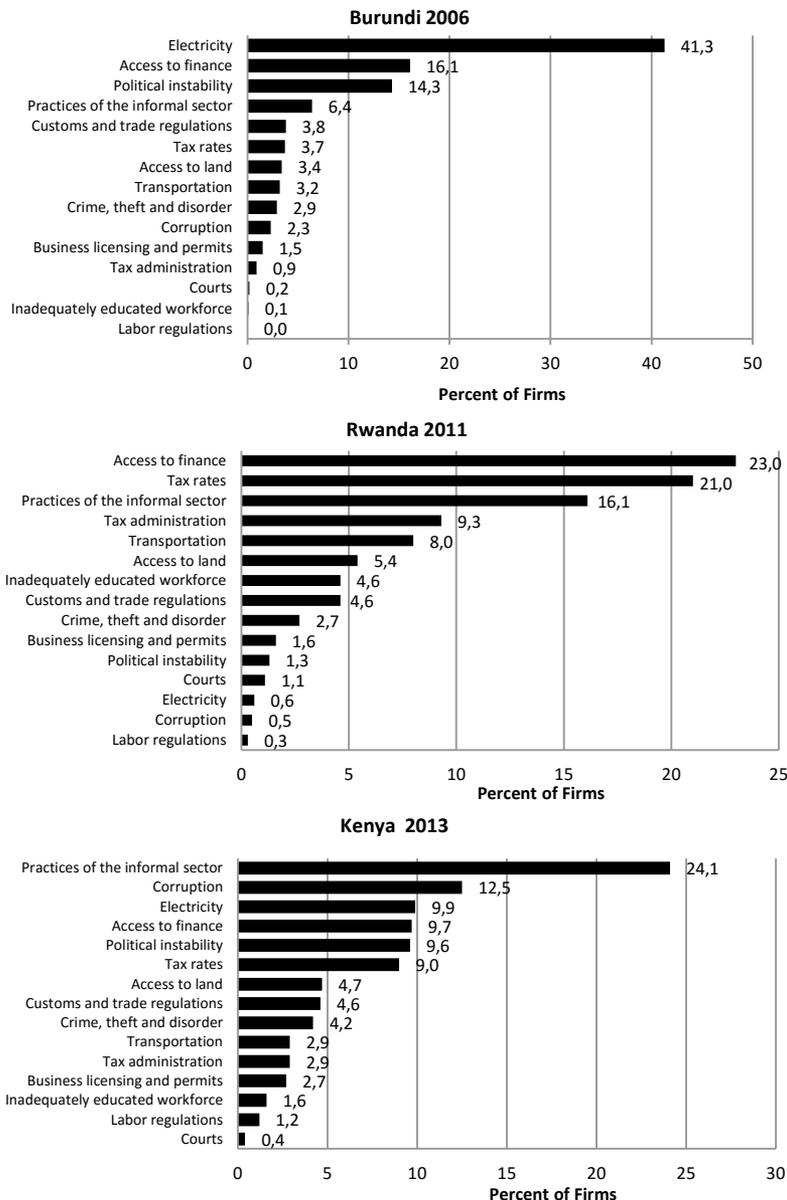
Other important obstacles to an effective business environment within the EAC include tax rates, electricity, corruption, access to land, and the practices of the informal sector. Customs/trade regulations and transportation - reflecting higher logistical costs - seem to figure more prominently in the cases of landlocked Burundi, Rwanda, and, to a lesser extent, Uganda rather than for Kenya and Tanzania - both of which have major ports (Mombasa and Dar es Salaam) (Figure 5).²³

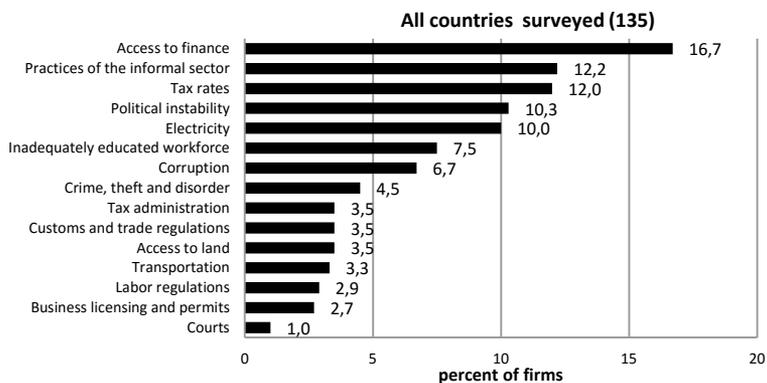
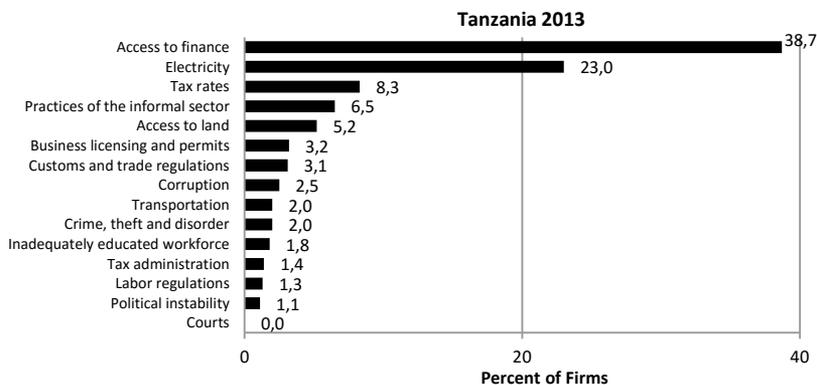
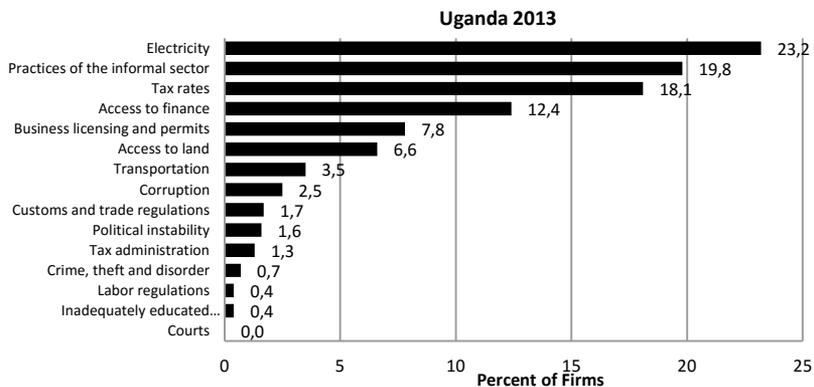
²¹ Public utilities, government services, health care, and financial services sectors are not included in the surveys.

²² Access to finance is in fact identified as the biggest obstacle in no less than 23 of the 135 countries covered by the enterprise surveys.

²³ In an African-wide survey by Ernst and Young (2013), the highest proportion (44%) of respondents already doing business on the continent listed "*improving transport and logistics infrastructure*" among their top two concerns. Pointedly, seven out of ten countries evaluated in the wider Eastern Africa region were classified in the bottom quintile ('logistics unfriendly'). Pretensions to integrate into regional and global value chains are likely to be frustrated as long as countries in the region rank so poorly in terms of logistics infrastructure.

Figure 5: Firms' biggest obstacles according to the Enterprise Surveys (latest available)





Source: World Bank Enterprise Surveys; data from World Bank 2014

On the other hand, the existence of major ports in the EAC gives a lot of chances to the other countries, especially if infrastructure development plans for the EAC are brought forward as planned.

iv) UNIDO's Competitive Industrial Performance Index

The distinctive feature of the UNIDO's *Competitive Industrial Performance* (CIP) composite index is its focus on industrial competitiveness and manufacturing development, as well as its exclusive use of quantitative data (rather than the more subjective evaluations of competitiveness in the former indexes). The CIP index's aim is to measure '*the ability of countries to produce and export manufactured goods competitively*'. Probably because of the slow-moving nature of changes to some of the component indicators used, it is also published less regularly than the 'Doing Business' or GCI indexes. The CIP Index was computed in 2010 for 135 countries; and is composed of eight main indicators: manufacturing value added per capita, manufactured exports per capita, medium and high-tech manufactured exports' share in total manufactured exports, manufactured exports' share in total exports, the impact of a country on world manufacturing value added, and the impact of a country on world manufactures trade (UNIDO, 2013).

The picture provided by this index is, perhaps unsurprisingly, quite different from the World Economic Forum (WEF) or World Bank business environment indexes (Table 8). Kenya ranks highest in the EAC in terms of industrial competitiveness, followed by Tanzania, while Burundi is considered as the least competitive. Kenya's economic dominance in terms of industrial competitiveness within the EAC region is explained by a stronger private sector, a more advanced human capital base, and better links with the global economy in terms of investment and trade flows. Notable, however, is that fact that all countries in the region - including Kenya - rank very low globally, again reflecting the relatively weak competitive base of the EAC as a collective.

Kenya and Tanzania are in a better position than the other three EAC countries, but all of them are far away from the relatively high rank of South Africa.

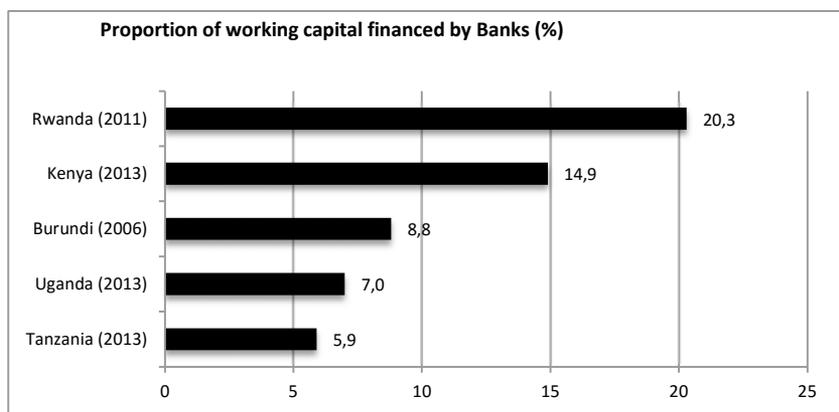
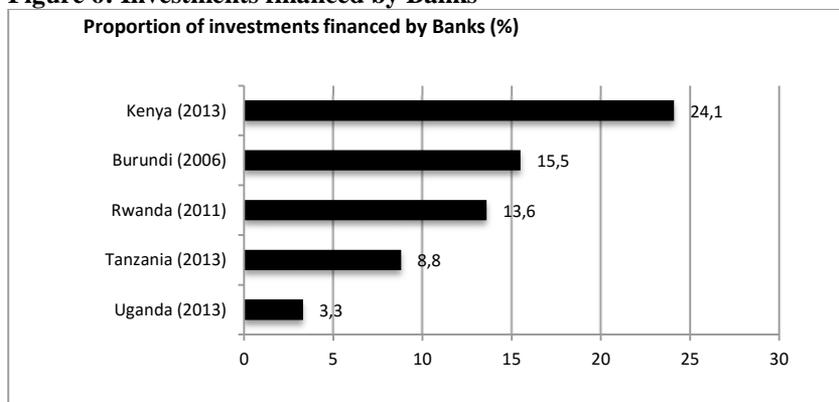
Table 8: UNIDO's Competitive Industrial Performance Index 2010 for EAC Countries

Country	Rank- ing	MVA pc	MX pc	MHVA sh	MVA sh	MHX sh	MX sh	Im- WMVA	Im- WMT
Burundi	132	7.4	2.0	1.5	7.4	24.0	15.7	0.001	0.000
Kenya	102	46.8	62.1	4.1	10.0	24.9	49.0	0.026	0.023
Rwanda	129	21.8	8.8	6.7	6.4	7.6	46.4	0.003	0.001
Tanzania	106	45.7	43.7	1.2	10.0	13.6	48.5	0.028	0.018
Uganda	120	25.3	11.8	11.1	6.8	15.2	34.8	0.012	0.004
Memo:									
Japan	1	7994.0	5521.0	53.7	20.4	79.8	91.6	14.1	6.5
South Africa	41	567.3	991.2	21.2	14.9	45.7	68.3	0.4	0.5

Source: UNIDO 2013, Competitive Industrial Performance Report 2012/2013, Notes: MVA pc = Manufacturing value added per capita, MX pc = Manufactured export per capita, MHVA sh = Medium and High-tech manufacturing value added share in total Manufacturing Value Added, MVA sh= Manufacturing value added share in total GDP, MHX sh = Medium and High-tech manufactured exports' share in total manufactured exports, MX sh= Manufactured exports' share in total exports, ImWMVA = Countries' value added share in World Manufacturing Value Added, ImWMT= Countries' value added share in World Manufactures Trade

5 A Failure of the Banking Sector to Underpin Structural Transformation?

In line with the number of firms citing “access to finance” as a major obstacle to firm growth, World Bank Enterprise Surveys (WBES) data reveal that the proportion of investments financed by banks in some EAC countries is very low, especially when compared with the experiences of some other late developers, such as South Korea, which used its banking sector aggressively to support industrial development. In 2013, less than 3 percent of investments by Ugandan firms were financed by banks. In Tanzania, the proportion of working capital financed by banks was below 6% (Figure 6). Despite extensive banking reforms in the region over the past decade, firms are not recurring sufficiently frequently to the banking sector for credit.

Figure 6: Investments financed by Banks

Source: WBES/World Bank Enterprise Surveys, World Bank 2014

One key explanatory factor is the high cost of capital in Eastern Africa, as revealed by the large average spreads in interest rates (i.e. the difference between lending and deposit rates). Kenya and Uganda seem to be particularly afflicted (Table 9). In Uganda, for instance, in 2012, the spreads were in excess of 12 percent. By way of comparison, the average spread in East Asia and the Pacific stands at around 5 percent (UNCTAD, 2014). Historically, in high income countries, it has tended to fluctuate between 3-5 percent. So credit is especially expensive and difficult to access in the region for the business sector (Table 9).

Table 9: Interest rate spreads in the EAC, 2000-2012

	2007	2008	2009	2010	2011	2012	2013
<u>Deposit Rates</u>							
Burundi	8.3	8.1	7.6	7.3	7.6	8.8	9.0
Tanzania	7.8	7.1	6.8	5.9	6.2	8.4	8.8
Uganda	10.1	11.6	9.2	9.8	23.9	12.7	12.2
Kenya	6.1	7.4	6.9	5.5	8.5	9.6	9.4
Rwanda	7.6	6.7	8.5	7.1	8.0	10.0	8.5
<u>Lending Rates (short term)</u>							
Burundi	17.6	16.7	16.7	16.2	15.5	15.7	16.7
Tanzania	41.6	13.7	13.8	14.2	14.5	14.2	13.8
Uganda	18.2	19.0	20.0	19.7	26.7	24.8	22.0
Kenya	13	14.4	14.1	13.7	20.2	17.8	16.5
Rwanda	16.4	16.5	16.5	16.9	16.9	16.8	17.1
<u>Interest Rate Spreads (Lending - Deposit Rates)</u>							
Burundi	9.3	8.6	9.1	8.9	7.9	6.9	7.7
Tanzania	33.8	6.6	7.0	8.3	8.3	5.8	5.0
Uganda	8.1	7.4	10.8	9.9	2.8	12.1	9.8
Kenya	6.9	7.0	7.2	8.2	11.7	8.2	7.1
Rwanda	8.8	9.8	8.0	9.8	8.9	6.8	8.6

Source: Own calculations, from EAC (2014)

Why is this so in the EAC region? There are at least five possible explanations at the sectoral level:

1. **Inefficiencies in the banking sector** - e.g. factors like excessively high salaries for senior staff, or poor managerial practices, are simply priced into the bank's interest rates. In a continental-wide study, Beck and Cull (2013) confirm that Africa's banks are, on average, less efficient, but more profitable and operate in less competitive environments. Cull and Trandafir (2010) show that for Uganda high operating costs are an important factor in explaining the interest rate spread. The largest explanatory component of interest rate spreads, however, is the high profit margin.

2. **Banks are making the bulk of their profits elsewhere** - Econometric analysis of African-wide determinants of high interest rate spreads by Beck and Cull (2013) reveals that the largest single explanatory factor is non-interest income. For instance, in Kenya two thirds of the profits in the banking sector are reportedly derived from trading in treasuries.²⁴ So competitive lending to business is not a priority.
3. **The lack of depth in financial markets** - while there have been notable improvements in recent years in access to finance across the EAC, the levels are still very low. As a consequence, the potential pool of depositors is small, and consequently banks have to resort to more expensive sources of capital. This is ultimately priced into the interest rates that they charge to clients.
4. **A lack of genuine competition** - A study by Ahokposi (2013) of 456 banks in sub-Saharan finds that interest margins are associated with market concentration. Sanya and Gaertner (2012) show that banks are more profitable in the EAC compared to those in South Africa, as evidenced by the higher spreads and the return on assets (ROA). Lending spreads, in particular, are about 6 to 8 percent higher in the EAC, while banks' return on assets is nearly three times as high, suggesting that the level of competition within the EAC is substantially less than in South Africa.²⁵
5. **Banks typically allege informational asymmetries** - Banks often claim they do not know enough about the applicants, or the applicants do not have sufficient collateral. This can be a particular problem in economies dominated by small and informal sector firms, as it is the case in the EAC. As a consequence, banks are often reluctant to lend to such firms.

All of these probably have some explanatory power, though the last point (explanation 5) is weakened when data on private credit in Kenya are analysed – credit seems to be going principally to household borrowers, the trading sector, and real estate, where non-performing loans are highest. In contrast, relatively little goes to the manufacturing sector, where paradoxically the risk of default is really quite low (Table 10).

It is at the macroeconomic level, however, where explanations for the scarcity and high cost of credit in the region are most compelling. The EAC's

²⁴ Based on a private communication with the Governor of the Central Bank of Kenya Professor Njuguna S. Ndung, Dakar, July 2014

²⁵ In theory, these attractive rates of return should attract new participants to compete for a market share and to push down lending spreads; however, in practice this does not appear to be happening. There is also some evidence (UNCTAD, 2013) of a negative association between foreign banking presence and private credit, so simply inviting foreign banks in order to make the market more competitive may not always work.

underdeveloped manufacturing base means that most goods still have to be imported, making the exchange rate arguably the most important determinant of inflation (other than the impact of climatic fluctuations on local food production). As a consequence, to maintain currency stability and to encourage capital inflows, central banks tend to keep real interest rates high (Nkontchou, 2014) - and this inevitably feeds through to high lending rates from commercial banks. Once again, then, without addressing the fundamental challenges regarding competitiveness of tradable goods, long-term rapid sustainable growth is likely to remain elusive.

Table 10: Distribution of Loans and Non-Performing Loans (NPLs): Kenya

Sector	% of Total Gross Loans	% of Gross Loans classified as Non-Performing Loans
Agriculture	4.9	7.2
Manufacturing	13.5	6.5
Building & Construction	5.2	4.1
Mining and Quarrying	1.1	0.5
Energy and Water	3.9	1.6
Trade	19.8	22.4
Tourism, Rest. & Hotels	2.4	3.0
Transport & Communication	7.4	7.7
Real Estate	13.3	11.6
Financial Services	3.9	2.3
Personal/Household	24.6	33.2

Source: CBK/Central Bank of Kenya 2012

6 Policy Measures to Improve Business Competiveness

Decisive policy measures are required if the private sector within the EAC is to prove more resilient and capable of capitalising on the renewed dynamism of the region's economies. Borrowing from the findings of our overview of the different business surveys/indexes, this penultimate section looks at three policy areas where the authors feel that more strategic and concerted efforts could be made. These deal with the lack of credit to the private sector, increasing overall levels of investment, and implementing policies to facilitate the upscaling of the size of firms in the region.

i. Addressing Problems Associated with Bank Lending

The lack of access to finance has repeatedly figured as one of the major complaints about the business environment in the region. Without some solution to the problem, the private sector will remain hobbled by low rates of investment and growth. In countries like Tanzania and Uganda, private sector credit is equivalent to just 18 percent of GDP, whereas the global average is around 130 percent of GDP (UNCTAD, 2014). Banks everywhere like to deflect criticism of their operational strategies, saying they need to adjust to market conditions and the like, but the accumulated evidence is fairly resounding - the banking sector is providing insufficient support to private sector development. Fixing deficiencies in the banking sector should thus be a priority.

Yet the debate on the banking sector in the EAC currently focuses almost exclusively on the issue of ‘financial inclusion’ (i.e. the lack of access to the formal banking sector on the part of potential depositors, particularly in rural areas). Undoubtedly, if the region is to mobilise domestic savings more efficiently, improving ‘financial inclusion’ is an important objective.²⁶ However, it does not address the fundamental question of how to improve lending policies towards the private sector.

One of the enduring lessons from many ‘late developers’ is the central role that bank financing has played in providing resources for the expansion of the industrial sector. Other options, such as stock market financing, may be quite inappropriate for most of the low income countries – it is volatile, unreliable, uses up scarce administrative resources and can be macro-economically destabilising (Singh, 1999). Certainly, within the EAC, beyond the still small (and often volatile) stock market of Nairobi, regional bourses have played only a minor role in financing productive investment.

Fixing the private banking sector, therefore, needs to be a priority if the business environment is to improve. Two reports published in 2014 (UNCTAD 2014: 44; AfDB, 2014) provide several suggestions on how to redress such problems:

- i. Obliging banks to lend more to the private sector by reducing excess reserves in the financial system through the imposition of

²⁶ Private sector banks, such as Kenya’s Equity Bank, have been making significant inroads into rural areas, by adopting a new business model that abandons the dependence on opening expensive and often inaccessible traditional bank branches in remote areas (Allen et. al., 2013). Similarly, the region has been at the forefront of new technologies like M-PESA which leverage mobile phone technologies to increase access to financial products.

- taxes on reserves;
- ii. Providing partial guarantees by the state to commercial banks to encourage them to lend to entrepreneurs for investment in strategic activities;
- iii. Introducing collateral registries for movable assets to increase firms' access to finance (this can particularly help smaller firms which are especially credit-constrained)²⁷; and
- iv. Increasing competition both *within* the banking sector and *between* banking and non-banking financial sectors (e.g. by allowing non-banking firms to offer some types of financial services) so as to facilitate the expansion of the range of alternative sources of credit.

More generally, however, in saving-constrained low-income economies, 'first best' policies (like enhancing the legal and supervisory apparatus governing financial markets or increasing competition) may often be impractical or take a long time to implement (Rodrik, 2007:92-93). In such circumstances, policy makers may need to consider 'second-best' solutions, such as a moderate amount of 'financial repression'.²⁸ This may entail controls on bank entry and ceilings on deposit rates, which generate rents for incumbent banks. Paradoxically, Rodrik argues, these rents may induce banks to expand efforts to mobilise deposits (since there are rents to be made on them). Both the quality and level of financial intermediation can thus end up being higher than under financial liberalisation.

In a similar vein, UNCTAD (2014) argues that central bank monetary policy should be designed to keep interest rates at levels that do not discourage investment. They also suggest linking changes in interest rates to real GDP growth or employment (rather than just focusing on inflation). The significant interest rate hikes in the EAC region witnessed in 2011, in response to the inflationary spike induced by the global increase in food prices,

²⁷ Kenya, Tanzania, and Rwanda have already instituted such registries, though whether they are working effectively to increase access to credit remains as yet unstudied.

²⁸ The 'Second Best theorem', as described initially by Lipsey and Lancaster (1956), argues that when economies are afflicted by many distortions, it is impossible to know whether the removal of one particular distortion will move the economy towards a Pareto efficient solution, or whether some distortions end up cancelling out others, and hence its removal can end up reducing aggregate welfare. In its simplest form, then, this theorem warns against simplistic assumptions that the 'first-best' policy option is always the best. Particularly in developing country settings, the theorem provides a timely warning about the need to explore all possible policy responses in contexts of widespread market failure and distortions.

is an example of perhaps ‘using a sledgehammer to crack a nut’ – interest rates across the region were raised in a bid to control price rises. Yet the phenomenon in this instance was principally due to ‘imported inflation’ – high international prices for food – and not because of excessively lax domestic monetary policy. The result in some countries was high interest rates (reaching nearly 30 percent in Uganda, for instance), leading to a choking off in lending to the private sector. Monetary policy used in this way is often a blunt instrument in the context of poor countries with relatively undeveloped financial markets.

ii. ***Raising Investment Rates***

Aggregate investment rates in the region are still arguably too low to sustain vigorous private sector development. In the cross-country study by the Growth Commission (Spence et. al, 2008), it was established that developing countries that had managed to sustain economic growth over the long-run had maintained investment rates of at least 25 percent of GDP. This empirical regularity in no way implies, of course, that reaching 25 percent guarantees attaining sustained growth (some natural resource-rich economies, for example, have attained high rates of investment, without this proving sustainable). However, high rates of investment would seem to be a necessary, rather than a sufficient, condition for long-term economic growth.

In the EAC, investment rates suffered sharp declines in the 1980s and 1990s. Those declines were partly due to civil unrest and conflict, but were also partly policy-induced – public sector investment rates were sharply curtailed under structural adjustment policies and, contrary to the convictions of the advocates of structural adjustment, the private sector either languished or failed to step into the gap left by declining public sector investment. The result was lower economic growth and lower overall investment rates. Over the period since 2000, investment rates have recovered, but, notably, public sector investment remains quite weak in three to four out of five countries in the region (see Table 11).

This matters because in the context of low-income countries, relatively high rates of public sector investment are required in order to ‘crowd in’ private sector investment. As argued long ago by Albert Hirschman (1958), one of the main challenges of economic development is precisely to bring into play hitherto un- and under- utilised resources. Public sector investment strategies can be one of the most effective ways to do so. In the context of a weak private sector, arguments in favour of the ‘crowding in’ effect of public sector investment – through lead infrastructure projects and public investment in other areas where the state can try to compensate for market failure – are all the more convincing (see Box 1). Put bluntly, particularly in the

poorest parts of the EAC, if it was not for the public sector investments, in many sectors there may be little in the way of private sector activity.

Table 11: Shares of private and public sectors in gross fixed capital formation (GFCF)

	GFCF as % of GDP (1990-1999)		GFCF as % of GDP (2000-2012)	
	<i>Private</i>	<i>Public</i>	<i>Private</i>	<i>Public</i>
Burundi	-	-	7.7	6.6
Kenya	9.8	7.8	12.0	6.1
Rwanda	6.8	7.3	8.6	9.0
Uganda	10.3	5.6	16.1	5.5
Tanzania	15.6	6	19.5	6.4
Africa Average	12.7	7.6	13.4	7.5

Source: UNCTAD (2014b); Note: GFCF - Gross Fixed Capital Formation

Box 1: Efforts in Rwanda to Catalyse Private Sector Development through Investments in the National Airline

For landlocked Rwanda, the combination of high transport costs and non-tariff barriers mitigate against the easy integration of the country's manufacturing firms into global or regional value-chains. Against this backdrop, wisely, the Rwandan government is not pinning all its hopes on an industrial transformation, but is also targeting service sub-sectors, including the ICT, tourism, and financial sectors. For such a service to be viable, Rwanda needs to be sufficiently well connected through air transport.

The development of a national airline could thus be considered of strategic importance, even if the air travel market in and out of Rwanda is not yet a profitable investment option for private investors. Inspired by similar ventures elsewhere (e.g. Singapore Airlines, Ethiopian Airlines), the Rwandan government has been investing substantially to support and develop its national carrier, RwandAir. As an example of the kind of financial support received, in April 2013 the government gave RwandAir USD \$80 million from the proceeds of its eurobond issue as a soft loan to repay more expensive debts taken out with private banks acquired for the purchase of new planes (MINECOFIN, 2014). This may not seem like a large injection of funding, but when it is considered that the whole of the government budget only reached around US\$2.4 billion in the fiscal year 2013/14, then such injections reflect a significant commitment on the part of the central government. The Government of Rwanda aims to make RwandAir a profit making company by 2018 and to expand its annual

turnover from the current USD 46m to more than USD 350m during the same period. Objectives include: (i) to expand its fleet from 7 to 12 aircraft including 3 wide-bodied aircraft; (ii) increase destinations from the current 13 to at least 25; (iii) achieve and maintain IOSA (IATA Operational Safety Audit) certification, thereby strengthening operational management and safety control standards; and (iv) significantly strengthen branding. Increased connectivity will support Rwanda's tourism sector and, crucially, help to improve the country's overall business environment (EDPRS, 2013: 24). In competitive markets like air travel, such a strategy is risky, but the potential payoffs are large.

Source: Authors

Over the last decade, Kenya, Uganda and Tanzania have sustained especially low shares of public investment in total gross fixed capital formation, barely reaching 6 percent of GDP, suggesting a need to explore ways of increasing public sector investment. Fosu et. al. (2011) calculates that the public investment to GDP share that maximizes consumption stands at between 8.4 percent and 11.0 percent. This implies that all EAC countries, except Rwanda²⁹, are currently investing too little. Low levels of public sector investment could condemn such economies to a low-level equilibrium of sluggish investment and growth. Sustainable financing of public sector investment is, of course, a key challenge. Governments of the region have recently been exploring forms of non-concessional financing, either through issuing hard-currency bonds and/or through the development of national bond markets.³⁰

They have also been increasingly turning to finance from emerging country partners - principally China.³¹ At the same time, all countries in the region have been making strenuous efforts to improve tax collection and collecting from other revenue sources. These challenges should not, however, obfuscate the need for attaining higher levels of public investment.

²⁹ In the Rwandan case, greater private sector investment would seem to be required. However, in a setting of a low income land-locked economy, the key question is whether private sector investment is going to be forthcoming in the magnitudes required. Pointedly, FDI to Rwanda has been relatively low, the domestic private sector is quite weak, and the banking system is risk-adverse without the degree of capitalisation to sustain high levels of investment.

³⁰ See footnote 7 for details.

³¹ For instance, China Exim Bank is providing 90 per cent of the financing for the new standard gauge railway from Mombasa to Nairobi. The project is currently being cost-estimated at USD 3.6 billion (Kalinaki, 2014). President Museveni of Uganda has explicitly said that Uganda will also in the future turn increasingly to China to finance major infrastructure projects (Kynge, 2014).

iii. *Scaling-Up the Size of National firms*

A final major challenge is what we might term **the** ‘*imperative of scaling up*’. At present, by international and even African standards, EAC companies stand out because of the small scale of their operations. According to the African Business Magazines annual rankings of the largest African companies, based on market capitalisation, the EAC region as a whole has just 19 firms ranked in Africa's top 250 companies. Out of these, the no.1 company from the region is *Safaricom*, ranking 19th in the whole of Africa, followed by *East African Breweries* on the 49th place. Notable also is the fact that there are 14 Kenyan companies out of the 19 largest companies from the EAC in the top 250 list; with only 6 EAC companies making it into the top 100 (Table 12). It is interesting, too, that, apart from Kenyan companies which are dominating the list, the only two other countries in the region represented on the list are Tanzania and Uganda. Also notable is the extent to which service sector firms seem to dominate the list, with *banks and financial services* being by far the most represented sector. Beyond tobacco and alcoholic beverages, agro-industries/manufacturing firms are conspicuous by their absence.

The high cost and scarcity of credit discussed earlier are clearly key constraints to firm growth and development, but if competitiveness on global and regional markets is to be attained, it seems clear that EAC businesses need to scale-up the size of their operations. Given the small size of domestic markets, this means that regionalization for EAC is all the more imperative than for Africa as a whole. At the moment, however, the only truly regionalised industry is finance - and this mostly concerns Kenyan banks (e.g. Equity Bank). That needs to change.

Thus the issue becomes less about promoting ‘national champions’ and more about promoting ‘regional champions’ within the industrial sectors. It implies pursuing a much more ambitious level of regional integration, which goes beyond facilitating intra-regional trade, and shifting towards policies designed to accelerate ‘deep integration’ through the free movement not just of goods, but also of the factors of production – labour and capital, knowledge and entrepreneurship. As noted in Section 2, this is happening to some extent already with the implementation of the EAC Common Market, and with phenomena like the growing cross-border FDI and the increasing number of firms cross-listed on regional stock markets. But it is a trend that needs accelerating.

Table 11: The EAC's largest firms, 2014

Re-gional Rank-ing	Afri-can Rank /250	Company name	Coun-try	Industry	Total Market capitalisa-tion (mio. \$)
1	26	Safaricom	Kenya	Telecom	5,724
2	49	East African Breweries	Kenya	Consumer Goods - Food and Beverages	2,465
3	72	Kenya Commercial Bank	Kenya	Banks and Financial services	1,573
4	87	Tanzania Breweries	Tanza-nia	Consumer Goods - Food and Beverages	1,154
5	99	Barclays Bank Kenya	Kenya	Banks and Financial services	1,013
6	100	Equity Bank Kenya	Kenya	Banks and Financial services	1,000
7	102	Standard Chartered Bank (Kenya)	Kenya	Banks and Financial services	983
8	104	Cooperative Bank of Kenya	Kenya	Banks and Financial services	973
9	106	British American Tobacco Kenya	Kenya	Consumer Goods - Food	954
10	121	Bamburi Cement	Kenya	Construction and Materials	845
11	125	National Microfinance Bank	Tanza-nia	Banks and Financial services	813
12	147	Nation Media Group	Kenya	Media	676
13	154	Tanzania Cigarette Company	Tanza-nia	Consumer Goods - Food and Beverages	611
14	156	Stanbic Bank Uganda	Uganda	Banks and Financial services	603
15	177	Athi River Mining	Kenya	Mining and Metals	485
16	192	CRDB Bank	Tanza-nia	Banks and Financial services	410
17	205	Diamond Trust Bank Kenya	Kenya	Banks and Financial services	364
18	237	Kenya Electricity Generating Co	Kenya	Utilities	306
19	250	Tanzania Portland Cement Company	Tanza-nia	Construction and Materials	273

Source: ABM/African Business Magazine, May 2014 Edition

In policy terms it also implies that there needs to be more targeted policy support for high-growth firms. As recently noted by Isenburg and Brown (2014), a tendency exists among many incentive programs to subsidize small and medium-sized enterprises (SMEs). It is part and parcel of a rhetoric that claims that 'small is beautiful' and that these firms are the seedbeds of employment and future private sector development. But SME support policies are based on the criterion of size, not on whether the activity in question has the potential to spawn new areas of specialisation. As Rodrik (2007) notes, it is the latter that produces economic growth. The contemporary emphasis by the donor community and policymakers on the importance of small firms as

creators of employment opportunities may thus be exaggerated (Rodrik, 2014, Page and Soderbom, 2012).³² Financial support should thus target the constraints on the growth of firms of all sizes and policymakers should not shy away from providing targeted support for 'national' or 'regional' champions.

Of course, these policies would need to be carried in a way that ensures sufficient competition at the sectoral level. One of the key lessons from late developers like South Korea in the 1960s and 1970s is the extent to which authorities promoted competition to discipline firms into greater efficiency. Industrial organisation in South Korea was based around four major 'Chaebol' – large conglomerates like Samsung and Hyundai. Each conglomerate was backed by a bank, and each conglomerate strived to have a presence in the same markets, whether it was manufacturing consumer durables, like televisions, fridges, automobiles, etc., or in capital goods. The result was that, despite the relatively small size of the Korean domestic market, competition in most markets was intense, and prices were kept down and efficiency was optimised (Wade, 2004; Amsden, 2001, Chang, 1994).

The experience of the EAC has been quite different, with clearly sub-optimal degrees of competition in a number of strategically important sectors. Precisely because of the weakness of the business environment, some private sector actors – often foreign-owned firms – can end up having large shares of the domestic market. Publicly available figures on market shares are difficult to come by, but to cite just two anecdotal sector examples, in the regional beverage market East African Breweries is clearly the major player, while Safaricom dominates the telecom market in Kenya MTM still has a powerful hold on telecoms in Rwanda. Clearly, such market conditions can lead to monopolistic or oligopolistic profits, to the detriment of national and/or regional consumers and pushing up the prices of goods and services that private firms use in their own production processes. In other words, all this is not conducive to building up productive capacities and competitiveness.

The balancing act is admittedly a difficult one for governments. They must balance the need to facilitate the emergence of regional 'champions', while avoiding excessive concentration of market power. Yet, with the small size of domestic markets in EAC member states, this is a hard balancing act to achieve. Subsequent to the adoption of a modern Competition Act in 2011,

³² While it is true that small firms create about half of the new jobs in Africa, they also have higher failure rates and ignoring this can exaggerate net employment growth.

Kenya is now the only other country in the region, along with Tanzania, to have established a competition authority.³³

As the process of regional integration deepens, a strong and effective regional competition authority is required. A step in the right direction is the imminent (as of January 2015) implementation of an East African Community (EAC) law on competition.³⁴ The acid test for such a body, however, is the extent to which the Competition Authority is given 'teeth' to act against monopolistic or oligopolistic positions in particular markets. Getting the trade-off right, between providing sufficient market competition on the one hand and allowing the evolution of firms with operations of a sufficiently large size (to have realistic prospects of competing regionally and internationally) on the other hand, is a difficult juggling act for government authorities. But it is central to improving the productive capacities of the region.

7 Conclusions

We started this discussion alluding to UNCTAD's concept of 'productive capacities'. Clearly, for countries to sustain economic growth and development there is a need for its firms to attain such capacities. But how does this happen? Are intrinsic weaknesses in the private sector in Africa to blame for the lack of such capacities? A recent paper, by Harrison et. al. (2013), is challenging the myth that African firms are inherently uncompetitive. The authors analyse firm-level competitiveness across the world by using World Bank Enterprise Surveys/WBES data and find that, once they control for geography, political competition, and the business environment, formal African firms actually demonstrate higher levels of productivity and growth than the non-African average, particularly in low-tech manufacturing.

It is likewise often insinuated that Africa lacks a sufficiently broad entrepreneurial class to make a vibrant capitalist development feasible. Contrary to this view, by Naudé et. al. (2011) it is claimed that poor countries may have as many citizens with the necessary personal traits for entrepreneurship as any other country. As noted in the introduction, for East Africa this argument

³³ Burundi has also reportedly enacted a competition law, but it would appear that the competition authority is not yet fully operational.

³⁴ The EAC Competition Act, which has as its objective the promotion of fair trade, the protection of consumer welfare, and the establishment of the EAC Competition Authority, was passed by legislators of the East African Assembly in 2006, but its implementation had been delayed for eight years by intermittent disagreements between member states.

is borne out by opinion polls.³⁵ Surveys such as these do show at least that the simple assumption that citizens of the region lack the necessary business acumen and drive are wrong. Lacking (and this is something that is reiterated in the GEM/Global Entrepreneurship Monitor 2013) are the necessary training and funding schemes, and the readiness to remove the kind of impediments in the business environment which were identified in this chapter.

The discussion in this chapter has, by necessity, been selective. There are a whole host of areas where governments need to catalyse the necessary changes to improve the business environment. Dealing with the structural weaknesses in the energy sector, and addressing problems related to the deficit of skilled workers, come to mind. However, beyond the usual platitudes about the need to undertake the necessary investments in infrastructure, or to provide a more facilitative regulatory environment, in this chapter we have focussed on certain key areas where progress would, we feel, make a marked difference to private sector development. It is notable that an EAC country like Rwanda, which has made considerable progress in improving its ranking in the World Bank's 'Doing Business' Study, has yet to benefit from large-scale volumes and influxes of domestic or foreign investment. Clearly, there is more to improving the prospects for productive capacities than simply providing the 'right' investment environment. This logically leads to discussions on the nature of industrial policy in the region – and the extent to which the state needs to take a pro-active role in capital formation, in identifying 'winners', and in supporting the emergence of a more dynamic private sector.³⁶

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³⁵ GEM/Global Entrepreneurship Monitor (2013) and Gallup (2014)

³⁶ UNECA (2013 and 2014) has explored these ideas extensively.

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Regional Integration in Africa - The Impact of the Economic Partnership Agreements

Isabelle Ramdoo and Sanoussi Bilal¹

1 Introduction

When the Cotonou Partnership Agreement was established in 2000, succeeding two Yaoundé Conventions² and four Lomé Conventions, it called for fundamental changes in the longstanding non-reciprocal trade preferences that had governed the African, Caribbean and Pacific (ACP) and European Union (EU) economic and political relationship for almost forty years³. Two main reasons motivated this change. First, the impact of these unilateral preferences was rather disappointing: the share of ACP trade in EU market was continuously falling, and most countries did not manage to use these preferences to diversify their economic structures. Secondly, the preferences were not compatible with the rules of the World Trade Organization (WTO)⁴, as they discriminated against non-ACP developing countries⁵. For the first time, ACP countries were required to negotiate reciprocal, though asymmetric trade agreements, i.e. the Economic Partnership Agreements (EPAs) with a major (developed) trading partner, the EU, despite the fact that their own regional integration agenda was still largely in the making.

This paper provides an analysis of three recently concluded European Partnership Agreements (EPAs) between Europe and African regional groupings and countries. Section 2 explains the rationale behind and the process of EPA negotiations. Section 3 provides a state of play of the trade regimes

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² The first Yaoundé Convention was signed in 1963, and the second Yaoundé Convention was signed in 1969. The Lomé Conventions (1975-2000) provided unilateral trade preferences for ACP imports into the EU market. Such preferences were temporarily extended under the Cotonou Agreement until the end of 2007.

³ See for instance European Parliament 2013; Keijzer et. al. 2013; Negre et. al. 2013; and Laporte, G. 2012

⁴ This is a breach of a fundamental principle of the Most Favoured Nation (MFN) treatment as set out in Article I of the General Agreement of Tariff and Trade (GATT) 1994 of the WTO, which states that a WTO member (the EU) cannot discriminate between members when granting preferences.

⁵ See for instance Buse, M. and H. Grossmann. 2004; Bormann, A. et. al. 2006

governing the relationship between the EU and African regions and countries. Sections 4, 5 and 6 highlight the key elements of the recently concluded EPAs and their likely implications for market integration and, more broadly, for regional integration. Section 4 highlights the recently concluded EPAs, and especially so the market access coverage and the product coverage. Section 5 considers the EPAs, the regional market integration and the national policies issues in context. Section 6 analyses the prospects and challenges with regard of the EPAs and regional integration. Concluding section 7 also presents the Way Forward after the EPA agreements.

2 The rationale behind Economic Partnership Agreements

EPA negotiations started in 2002 and were expected to be concluded by 31st December 2007, the date at which the waiver⁶ that had been granted by the WTO to EU and ACP was set to expire. Besides ensuring that ACP products would secure indefinite duty free quota free (DFQF) access to the EU market, EPAs were mainly meant to be development tools. The ambition was broad. In particular, they were expected to be mutually beneficial trade and development agreements that would fit the development needs of ACP economies and regions, while maintaining the economic interests of Europe. The agreements were expected to foster regional integration and inclusive growth by improving trade and investment flows, as well as the business environment, and by securing sustainable access into the EU market. In addition, EPAs would be a vehicle to facilitate the integration of ACP countries into the global economy, therefore contributing to the overall objective of poverty reduction. Finally, EPAs would help to mobilize focused financial development support to accompany reforms necessary to implement commitments taken by ACP signatories⁷.

However, negotiations proved to be more difficult than expected so that by the end of 2007, of the 77 ACP countries only 36 had concluded EPAs with the EU. With the exception of the Caribbean EPA, all other EPAs remained limited in scope, covering only trade in goods and some development

⁶ As a result of the incompatibility of the EPAs with WTO rules, a waiver is required for each trade preference provision that entails discrimination among WTO Members, so as to cover the non-discrimination principle imposed by the Article I of the General Agreement on Tariffs and Trade (GATT). The waiver to the preferences granted under the Lomé Convention expired in February 2000, and a request for the extension of the waiver under the Cotonou Agreement was requested in 2000. After much debate, the EU was granted a waiver until 31 December 2007.

⁷ See for instance Buse, M. and H. Grossmann, 2004; Curran L. et. al. 2007

cooperation provisions⁸. The interim EPAs were expected to be later replaced by full and comprehensive EPAs, once negotiations on trade in services and other trade-related issues would be completed. On those issues, there was no set deadline. The EPA process proved to be a very complex undertaking (see Box 1).

Box 1: EPA Process: A complex undertaking

Trade negotiations have generally a relatively straightforward process: usually, once negotiations are successfully completed on a full range of issues (and the text is legally polished), agreements are signed and ratified by contracting parties, and then following the Agreements they are becoming fully implemented. In the context of the EPAs, the lengthy negotiating process caused a highly complex situation, which led to ‘creative’ legal (temporary) solutions to address the risk of trade disruption, as the deadline to the expiry of the waiver was getting closer.

As the deadline for the waiver came close in 2007, African and Pacific EPA regions were not ready to sign and to ratify comprehensive trade agreements with the EU. Negotiations had remained essentially focused on trade in goods, which was meant to address the issue of compatibility with Article XXIV of the GATT, which require free trade agreements to cover “substantially all trade” and markets to be liberalised “within a reasonable timeframe”. Parties therefore agreed to conclude a deal on trade in goods only to prevent trade disruption, pending conclusion of a full agreement later on⁹.

Interim EPAs were initialled in 2007 by the EU with 15 Caribbean countries, 19 African countries¹⁰ and 2 Pacific countries¹¹. The process of “initialling” gave a political signal that negotiations were concluded in good faith among the Parties. However, to give legal effect, EPAs had to be formally signed and ratified by all parties. In the meantime, to prevent trade disruption pending the entry into force¹² of EPAs, on 20th December 2007 the EU adopted a

⁸ See ECDPM Frequently Asked Questions, October 2014

⁹ See Curran, L et. al. 2007; Bormann, A. et. al. 2006

¹⁰ These are Botswana, Lesotho, Namibia, Swaziland, and Mozambique in the SADC EPA configuration; Comoros, Mauritius, Madagascar, Seychelles, Zambia, and Zimbabwe in the ESA configuration (Comoros and Zambia finally pulled out of the Interim EPA by not signing the Agreement); Burundi, Kenya, Rwanda, Tanzania, and Uganda in the EAC region; Cameroon in the Central Africa region; and Cote D’Ivoire and Ghana in the ECOWAS region.

¹¹ Fiji and Papua New Guinea

¹² Entry into force of an agreement is a lengthy and tedious process; it requires signature, ratification and implementation; this may sometimes take years.

bridging temporary measure, the Market Access Regulation (MAR 1528/2007). The objective of the MAR was for the EU to provisionally apply EPA preferences as from 1st January 2008 for countries that have concluded such a deal, pending signature, ratification, and implementation of these agreements.

In 2008, the Caribbean countries signed their regional EPAs. In Africa, out of the 19 countries, only 6 countries of the ESA region (i.e. Comoros, Zambia, Madagascar, Mauritius, Seychelles, and Zimbabwe) concluded an interim agreement at the end of 2007 and 4 countries (i. e. Madagascar, Mauritius, Seychelles, and Zimbabwe) signed in August 2009 the agreement, which was being provisionally applied since 14th of May 2012 (and consented in January 2013 by the European Parliament). The remaining 15 countries decided not to sign their EPAs, despite the political commitment they had made by initialling their interim EPAs. The reason was that some issues contained in the Agreements were still deemed to be “contentious”¹³ and therefore would need to be resolved before signature. Despite this, the countries continued to benefit from DFQF access to the EU market as a result of the regulation MAR 1528/2007.

Negotiations took another seven years. In the meantime, given the temporary nature of the MAR, the EU decided¹⁴ to amend the MAR to remove, as from 1st October 2014, countries that had not, by that date, taken the necessary steps to ratify the EPA concluded in 2007. Thus, these countries had to do so or to conclude a new (regional) EPA to be reintegrated under the MAR 1528/2007.

Source: ECDPM Sources

With the approaching of the 1st of October 2014 deadline in 2014, three African regions, namely the Economic Commission for West African States (ECOWAS), the Southern African Development Community (SADC), and the East African Community (EAC) concluded regional EPAs. The ECOWAS and SADC EPAs were initialled in July 2014, before the deadline, whereas the EAC EPA was initialled two weeks after the deadline, resulting in countries falling back on the Generalized System of Preferences (GSP) regime. This meant that Kenya, the only non-least developed country (LDC) of the region, lost full duty free access to the EU market, impacting heavily in exports of its horticulture sector¹⁵. The EU later (i.e. in December 2014) reinserted EAC countries back on the MAR (Market Access Regulation of 2007) status.

¹³ See Bilal S./Ramdo I. (2010).

¹⁴ In May 2013, the decision was made with the EU Regulation 527/2013.

¹⁵ See Bilal, S. 2014

These three regions now have two years (until 1st January 2016) to sign and to ratify their EPAs, failing which they will permanently lose the preferences provided by EPAs and fall under the GSP Scheme or the Most Favoured Nations (MFN) regime.

The following sections provide a more detailed analysis of the context and the content of the recently concluded EPAs.

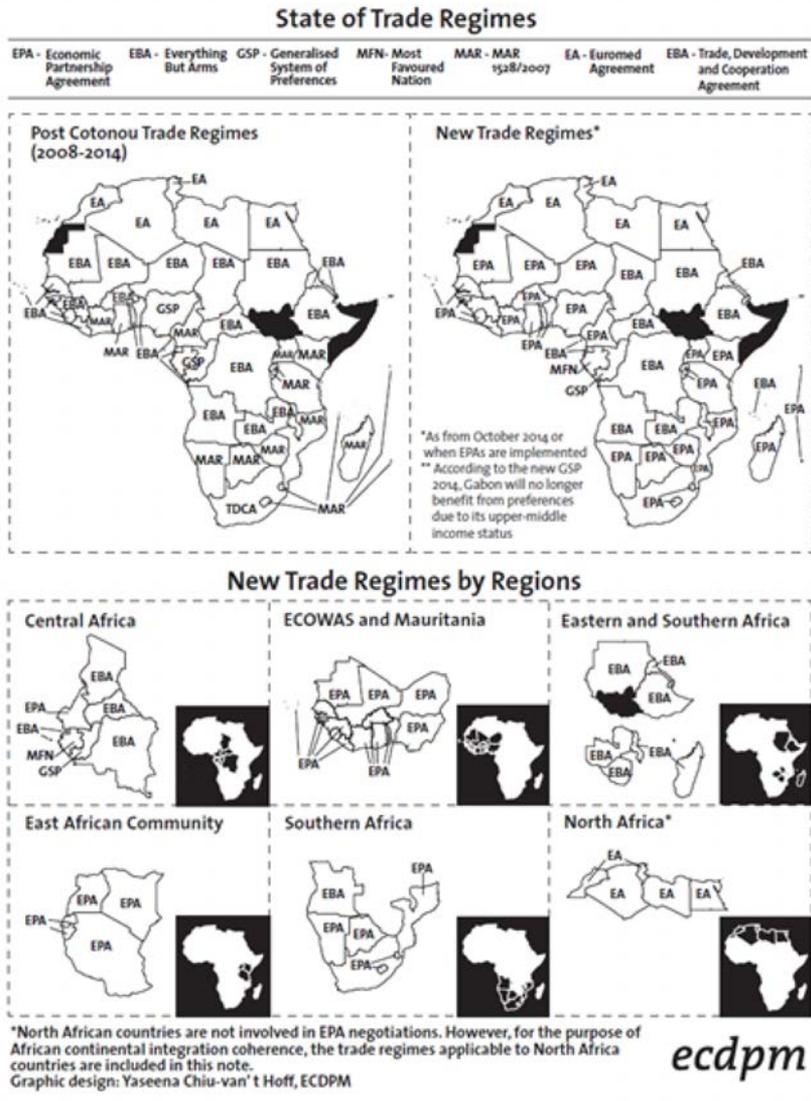
3 Trade regimes between the EU and Africa

Figure 1 below shows the state of play of the trade regimes which were applicable to African countries during the period covered by MAR/Market Access Regulation of 2007 (i.e. between 2008 and 2014) and following the recent conclusion of a number of EPAs in Africa in 2014.

Despite the EPAs, the trade regimes now governing the trade relationship between Europe and African countries/regions remain complex. There are today five different trade regimes, if North African countries, that were not part of the EPA negotiations, are counted. These are:

1. The Euro-Mediterranean Free Trade Area (EMFTA) that governs the trade relationship between Europe and North African countries.
2. Lower middle income countries and LDCs that have not initialled EPAs are governed by the GSP Scheme, accessible to all developing countries, irrespective of their geographical location. This implies that two different regimes apply to countries, depending on their income levels, that is:
 - a. LDCs have a particular regime, termed Everything But Arms (EBA), that confers duty free quota free market access on all products, except arms;
 - b. Lower-middle income countries (LMIC) have tariff preferences to a broad range of products. In Africa, Congo Republic is a LMIC and therefore trades under the GSP Scheme because it has not initialled an EPA. Nigeria is also such a case, despite the fact that it recently concluded an EPA with ECOWAS. It will move to the EPA regime once it has signed the EPA and two-thirds of the ECOWAS countries have started the process of ratification.
3. The countries not being eligible for GSP preferences, which are in the case of Africa the upper-middle income countries, trade under the normal non-preferential regime, i.e. on a “most favoured nation” (MFN) basis. Gabon is such a case.

Figure 1: Trade Regimes between the EU and Africa



4 Recently concluded EPAs: Market access and product coverage

ECOWAS was the first region in Africa to conclude and officially endorse a regional EPA on 10th July 2014¹⁶. They were followed by the SADC EPA group, when chief negotiators ‘initialled’ the EPA on 15th July 2014, and on 16th October 2014 by the EAC, marking the conclusion of 12 years of negotiations on trade in goods with the EU. While these agreements are sufficient to ensure access of key products to the EU market, negotiations are however expected to continue on services, investment and other trade related issues to ensure a comprehensive framework that is set to govern trade ties between African regions and Europe. There is however no specific timeframe to conclude the negotiations on these issues.

The timing of the conclusion of these EPAs needs to be underscored. The conclusion of the SADC and ECOWAS EPAs pre-empted the 1st October 2014 deadline, after which all non-LDCs in both groups (i.e. Ghana and Ivory Coast in the ECOWAS group and Botswana, Namibia and Swaziland in the SADC group) would have otherwise lost their duty-free quota-free preferences for their main exports to the EU market, and would have fallen back on the GSP regime or in the case of Botswana, would have lost all preferences after 2016 when the transitional period accorded to upper middle-income countries expires¹⁷.

The case of EAC is different. The region concluded its EPA on 16th October 2014, that is, two weeks after the 1st of October deadline. This resulted in Kenya effectively moving out of the MAR as from 1st of October, and therefore losing its free market access to the EU, to export under the GSP. Although a deal was initialled on 16th of October, two-thirds of Kenyan products¹⁸ continue to face increased duties on the EU market, resulting in significant revenue losses for cut flower, fish, processed fruits and vegetable exports¹⁹. On 14th November 2014, the EC, acting on the basis of delegated

¹⁶ See on the website of ECDPM: <http://ecdpm.org/great-insights/extractive-sector-african-perspectives/epa-update-july-august-2014/>

¹⁷ See Bilal, S. and I. Ramdoe, 2010; 2013

¹⁸ Over 20 percent of Kenya exports, worth some €1 billion in 2013, are exported to the EU, three quarters of which are vegetable products, and another 10 percent of which are foodstuffs, beverages and tobacco. As a result of the preferences loss, two-thirds of Kenyan's exports to the EU faced new duties under the EU GSP, ranging from four percent to 24 percent, amounting to about €5.7 million (Sh637 million) per month in customs duties. The most affected products were cut flowers (8.5% duties), processed vegetable and fruits (over 15 percent), fish (6 percent), and pineapple and other fruit juices (11.7 percent) (see Bilal 2014).

¹⁹ See Bilal, S. 2014

powers, initiated a process to reintroduce Kenya under the MAR 1528. Once the Regulation is published in the Official Journal, Kenya will be able to trade again on a duty free basis with the EU²⁰.

4.1 Market access coverage

The following section summarises some of the key provisions as contained in EPAs and provides some comparison in terms of coverage, policy space and development, and the likely impact that these agreements will have on the trade dynamics in the three regions.

It is important to highlight at the outset, that although EPAs were negotiated in regional configurations, only two regions, namely the East African Community (EAC) and Economic Community of West African States (ECOWAS) covered the full membership (in this latter case plus Mauritania, a non-ECOWAS member) of the regional economic communities (RECs) and therefore could negotiate as a block, on the basis of their on-going regional integration agenda. The rest, because of overlapping membership of countries in different RECs, or lack of interest of some of their members, at best, represents “sub-sets” of their respective configurations. This is a structural weakness that may have significant implications on the impact of EPAs on the REC’s agenda in the future.

In the case of ECOWAS and EAC, negotiations were based on the regions’ own integration process, using the Common External Tariff²¹ (CET) as a basis for the tariff phase down. This allowed for more coherent tariff schedules with the EU, ensuring that concerns of all countries could be duly considered during the negotiations. Regional unity and strong political leadership have proved very useful, in particular when some countries showed some strong reservations in the very last stages of negotiations on issues they deemed sensitive for their own national economic agenda.

On its side, the SADC EPA negotiating group comprises seven member states, out of a total of fifteen. These include the five Southern Africa Customs Union (SACU) member countries, namely Botswana, Lesotho, Namibia, Swaziland and South Africa, as well as Mozambique and Angola. While Angola was part of the negotiations, it did not conclude the EPA. Therefore, the current SADC EPA consists of only 6 countries. It must be recalled that South Africa’s trade was covered by a different regime, the Trade, Development and Cooperation Agreement, concluded in 1999²². South Africa joined

²⁰ See EC,2014, C(2014) 5210 Final

²¹ The ECOWAS CET was adopted in October 2013, to be effective on 1st January 2015.

²² See for instance Hoffmann, 2014

the EPA negotiations in 2006 to improve its market access to the EU and to ensure functional coherence of SACU, a customs union, of which it is the largest member. SADC is not yet a customs union, contrary to the SACU. Therefore the current market access offer of the SADC EPA group consists of a single offer for the 5 SACU countries, based on SACU's CET, and a separate offer for Mozambique, which is not part of the SACU.

4.2 Product coverage

ECOWAS, as a region, has committed to liberalise 75% of its tariff lines, based on its CET, over a period of 20 years. Products are classified in four categories and liberalisation will be gradual, as summarized in Table 1.

The list of exclusion covers a wide range of products ranging from agricultural goods to industrial goods currently being produced or expected to be produced as ECOWAS countries move up the industrial ladder. These include, inter alia, meat and meat products, fish and fish products, vegetable products; cereals; cocoa and cocoa preparations; pasta; cement, textiles and apparel; paint and varnish. The list of exclusion was subject to intense discussions among the ECOWAS countries themselves, in particular in the last phase of negotiations, as those exclusions were the main concern of Nigeria. In effect, in its process of industrialization, the Nigerian private sector is investing massively in agricultural and agro-processing in an effort to provide locally produced goods to its domestic market and to the region. Similar investments are being made in other industrial sectors such as light manufacturing, cement and the textile sector. The exclusion list therefore ensures that local industries will not be subject to competition from duty-free products from Europe.

The SADC EPA group is set to liberalise 80% of its trade with the EU. The market access schedule consists of two distinct lists:

1. The first one is covering the SACU region, namely Botswana, Lesotho, Namibia, Swaziland (BLNS) and South Africa, as summarised in Table 2; and
-

Table 1: ECOWAS Tariff phase down

	Applied CET Rate				
	0%	5%	10%	20%	35%
Category A: Basic commodities; capital goods; spe- cific inputs; essen- tial social goods	100% in Yr T	100% in Yr T+5	n/a	n/a	n/a
Category B: Inputs and inter- mediate products (Tariff phase down over 15 years)	5 year morato- rium, effective as from Yr T+5	100% in Yr T+10	50% in Yr T+10 100% in Yr T+15	n/a	n/a
Category C: Final products (Tariff phase down over 20 years)	n/a	100% in Yr T+10	50% in Yr T+10 100% in Yr T+15	50% in Yr T+10 75% in Yr T+15 100% in Yr T+20	n/a
Category D: Sensitive products	EXCLUDED				

Note: Year T is the year in which the Agreement enters into force. Tariff phase down will be effective at the end of each 5-year period. For example: If the Agreement enters into force on 1st January 2015, then Category A products will be fully liberalized on 1st January 2020 (i.e. T+5); Zero-rated Category B products will apply from 1st January 2020 and products subject to 5% tariff in this category will be fully liberalised on 1st January 2025 (i.e. T+10), and so on.

Source: European Commission Proposal for a COUNCIL DECISION on the conclusion of the Economic Partnership Agreement (EPA) between the West African States, ECOWAS and the UEMOA, of the one part, and the European Union and its Member States, of the other part, COM(214)578 Final

- Another one is covering Mozambique, whose market access schedule had been agreed already in 2007. The two market access schedules have yet not been merged and therefore still remain separated. There is however an Annex to the text for Mozambique to update its tariff nomenclature and to subsequently submit an updated tariff schedule, including the staging categories proposed by Mozambique during the negotiations.

Table 2: Overview of SACU Tariff Schedule (TS) and Tariff Rate Quotas (TRQ)

Category	Tariff Phase Down and Time frame
A	Tariffs to be eliminated on the date of entry into force of the Agreement
A* (mainly agriculture and fisheries products)	Tariffs to be eliminated, applicable when all SACU countries have ratified and provisionally applied the Agreement
B*	Tariff to be phased down over 6 years, in equal instalments, applicable when all SACU countries have ratified and provisionally applied the Agreement
C*	Tariff to be phased down over 10 years, in equal instalments, applicable when all SACU countries have ratified and provisionally applied the Agreement
AUTO18 (vehicles; parts & accessories)	Duty shall be 18% ad-valorem, effective on the date of entry into force of the Agreement
PM5 (machinery, electrical appliances; vehicle parts & accessories)	5% preference margin over MFN
PM40 (textiles: clothing, fabric, households, and yarns)	12-year tariff phase down, with a maximum margin of preference of 40% over the MFN applied rate at the end of the liberalization period.
X	Excluded
TRQs	
Wheat/ Meslin²³	300,000 Metric Tons (MT), duty free
Barley	10,000 MT, duty free
Cheese with some exception	7,100 + 250 MT per annum, duty free
Pig Fat	200 MT, duty free
Cereal based food preparation	2,300 MT, duty applied: 25% of MFN
Pork	1,500 MT, with a tariff phase down of 12.5% every year, over 6 years, with final duty: MFN minus 75%
Other dairy fats	500 MT, with a tariff phase down of 12.5% every year, over 6 years, with final duty: MFN minus 75%
Ice cream	150 MT, at MFN minus 50%
Mortadella Bologna	100 MT duty free

Source: Draft EU-SADC EPA text, as initialled on 15th July 2014

However, the text of the Agreement is applicable to the entire SADC EPA group.

²³ Meslin: mixture wheat/rye

Similarly, the market access schedule of the EU is different for South Africa than from the rest of the SADC EPA group. In fact, while the BLNS and Mozambique have full duty free quota free (DFQF) access to the EU for all products (with the exception of arms and munitions), South Africa has a more complex tariff schedule, comprising exclusions and tariff staging with liberalisation spanning over up to 11 years, as summarised in Table 3.

Table 3: Summary of EU Market Access Schedule to South Africa

Category	Tariff Phase Down and Time frame
A	Tariffs to be eliminated on the date of entry into force of the Agreement
A* (mainly agriculture and fisheries products)	Tariffs to be eliminated, applicable when all SACU countries have ratified and provisionally applied the Agreement
B* (mainly Fisheries)	Gradually eliminated, when all SACU countries have ratified and provisionally applied the Agreement, over six years, in equal phase down
C* (mainly fisheries)	Gradually eliminated, when all SACU countries have ratified and provisionally applied the Agreement, over ten years, in equal phase down
D* (oranges)	Specific dates when oranges are allowed. EU market is not open from 1 st June to 15 October; from 16 th October till 30 November, 11 year phase down, when all SACU countries have ratified and provisionally applied the Agreement
X	Excluded
<i>TRQs (see Annex 2) – includes inter alia, milk, butter, flowers, jams and jellies, sugar, wine, juices</i>	

Source: Draft EU-SADC EPA text, as initialled on 15th July 2014.

Despite the differences in their levels of development, by joining the EPA, South Africa's trade regime with the EU is better harmonised with other SACU countries, ensuring regional coherence and preserving the CET which binds SACU countries together²⁴. For South Africa, the EPA is more favourable than the previous TDCA with significantly improved access, in particular for a range of agricultural products (such as wine, sugar, fruits) and for industrial products (such as textiles and motor vehicles) that were previously not liberalised.

The EPA now includes 98% duty free coverage for industrial products and 60% for agricultural products²⁵ for South Africa. For BLNS, while they

²⁴ See for example Pant, M. 2010; Maré, J. 2013; and Davies, R. 2014

²⁵ Source: Business Day Live/Linda Ensor, 2 July 2014, Web Access: <http://www.bdlive.co.za/business/trade/2014/07/02/sa-benefits-from-sadc-deal-with-eu>

benefit from DFQF on the EU market, as a result of a common offer to the EU, they nevertheless had to make additional efforts to open their markets for some products that they considered sensitive because there were strong interests from the EU for such products in South Africa. To mitigate any potential negative impacts that imports from the EU might have for these products, they managed to secure a transitional safeguard²⁶ clause for a list of specific products, such as frozen chicken, milk, sweet corn, some vegetables and fruits, cocoa and chocolate, pasta, etc. This was a key political compromise in favour of BLNS countries, as they were asked to make significantly more efforts to open their markets, due to the common schedule with South Africa²⁷.

EAC committed to liberalize 82.6% of its trade over 25 years, based on its CET. The tariff phase down is summarized in Tables 4 – 6 (overall schedule, schedule for intermediate goods, and schedule for final products). This was agreed in 2007, when EAC initiated an interim EPA, but later on decided not to sign, until some critical issues, notably linked to the treatment of export taxes, policy space regarding industrialization and trade negotiations with third parties, and asymmetric rules of origin were resolved. This new regional EPA was finally initialled on 16th October 2014²⁸.

As in other regions, the EAC exclusion list reflects the sensitivity of products necessary for food security and industrial development and includes products such as agricultural products, wines and spirits, chemicals, plastics, wood-based paper, textiles and clothing, footwear, ceramic products, glassware, articles of base metal, and vehicles.

²⁶ The Transitional Safeguard Clause (TSC) was negotiated in the form of an import duty, for a period not exceeding 4 years, with the possibility of extension. The list of specific products under this clause is defined in Annex V of the Agreement.

²⁷ See Davies, R. 2014

²⁸ See Bridges Africa, 2014; and Omondi, G. 2014

Table 4: Overall EAC Tariff phase down

Year	MFN Rate (CET)	% of trade liberalised	Number of Tariff Lines
Products in annex II.a To be liberalized when Agreement enters into force (T0).	0%	65.4%	1,950
Products in Annex II.b To be liberalized within 15 years after T0	10%	14.6%	1,129
Products in Annex III.c To be liberalized within 25 years after T0	25%	2.6%	960
Total trade liberalized EAC		82.6%	
Exclusion	10% - 100%	17.4%	1,390
Total Tariff Lines			5,429

Source: Draft EAC-EU EPA, as initialled on 16 October 2014

Table 5: EAC tariff phase down for intermediary products

Tariff phase down	20%	30%	40%	50%	60%	70%	80%	90%	100%
No. of Tariff lines: 1,129	Current MFN Rate: 10%								
Timeframe	T0 + 7	T0 + 8	T0 + 9	T0 + 10	T0 + 11	T0 + 12	T0 + 13	T0 + 14	T0 + 15

Source: Draft EAC-EU EPA, as initialled on 16 October 2014, Annex II.b

Table 6: EAC tariff phase down for final products

Tariff phase down (%)	5	10	15	20	30	35	40	45	50	60	70	80	90
No. of Tariff lines: 960	Current MFN Rate: 25%												
Timeframe	T0 + 12	T0 + 13	T0 + 14	T0 + 15	T0 + 16	T0 + 17	T0 + 18	T0 + 19	T0 + 20	T0 + 21	T0 + 22	T0 + 23	T0 + 24

Source: Draft EAC-EU EPA, as initialled on 16 October 2014, Annex II.C

The rules of origin in the three EPAs are quite flexible. Cumulation provisions allow countries to source inputs regionally, from the EU, and from some categories of third countries. The EAC EPA even has asymmetric rules of origin compared to the EU. This means that for a number of products, when EAC countries export to European countries, they can add less value to non-originating materials compared to what the EU has to do, when the latter exports the same type of product to these countries. This is an additional

flexibility that is not found in other EPAs. While it allows EAC countries to export less transformed products to the EU, it however sounds a bit counter-intuitive, given the latter's insistence of having greater flexibility in the text to allow countries policy space for the purpose of industrialization and value addition. The incentive for local value addition may be weakened thereby.

5 EPAs, regional market integration and national policies

The asymmetric nature of the EAC, ECOWAS and SADC EPAs allows for a certain number of products to be excluded from liberalization. For ECOWAS countries, it represents products considered sensitive (subject to a CET of 35%²⁹), for a total of 25% of all tariff lines.³⁰ Members will continue to benefit from tariff protection to allow for local transformation and value addition. In the case of SADC, 20% of trade is excluded, also reflecting key sensitivities. In the case of EAC, exclusions represent 17.4% of trade.

The Agreement allows some policy space for countries to protect their domestic economies in case that imports from the EU threaten to cause injury to their domestic industries, disturbance to a sector, or to the market of agricultural products. This is possible through the use of trade defence instruments, in particular through the use of safeguard measures. Measures can take the form of:

1. A suspension of the tariff phase down;
2. An increase in the customs duty on the product concerned up to a level which does not exceed the MFN applied rate; or
3. The introduction of tariff quotas on the product concerned.

The ECOWAS EPA has a specific safeguard clause for nascent industries while the SADC EPA group has a specific agricultural safeguard clause, in addition to the BLNS transitional safeguard clause mentioned earlier³¹.

In addition, all the EPAs contain flexibility for countries to apply export taxes. First, countries are not expected to remove existing export taxes. In addition, in exceptional circumstances, export taxes can be introduced in case of specific revenue needs, to promote infant industries or for environmental

²⁹ See De Roquefeuil, 2014

³⁰ The EU had for years maintained that to comply with the GATT Article XXIV rule, which requires parties to a regional trade agreement to liberalize substantially all trade between them, ACP countries willing to conclude an EPA should liberalize at least 80% of their trade with the EU. ECOWAS countries' initial offer was to open up only 65% of their trade. An agreement at 75% of tariff lines thus resulted from significant concessions on both sides to reach such a compromise.

³¹ See Ramdo, I. 2014

protection. Duties on exports may be raised on a temporary basis, after consultation with the EU, on a limited number of products (for ECOWAS, number not specified) and for a limited period of time (for EAC, time period not specified). Interestingly, the EAC agreements provide for an MFN treatment for export taxes³². This means that EAC should not discriminate between the EU and major trading partners (see definition below) when applying export taxes.

The SADC EPA provision on export taxes allows BLNS countries and Mozambique to act for specific revenue needs, for the protection of infant industries or the environment, or where essential for the prevention or relief of critical general or local shortages of foodstuffs or other products being essential to ensure food security.

Moreover, any SADC EPA state (i.e. including South Africa) can potentially apply export taxes on a limited number of products, if it can justify industrial development needs. Temporary duties can only be applied to a total number of 8 products³³ per SADC EPA state at a given time and for a maximum period of 12 years in total (with possibility of extension or reinstatement). Two conditions however apply to the use of this measure³⁴:

1. In the first 6 years of the introduction of an export tax for industrial development purposes, the SADC EPA state will exempt from the application of the tax exports to the EU on an annual amount equal to the average volume of exports of the product to the EU over 3 years preceding the introduction of the tax. As from the 7th year following the introduction of the tax until its expiry, the SADC EPA State will exempt from the application of the tax exports to the EU on an annual amount equal to 50% of the average volume of exports of the products to the EU over the three years preceding the date of introduction of the tax. Products exempted from export duties are meant to be processed in the EU and shall not be re-exported to third countries. Export duties may be re-instated on any consignment circumventing the terms of the agreement.
2. Export duties or taxes shall not exceed 10% of the ad valorem export value of the product. This clause is particular to the SADC EPA and does not appear in the EAC or ECOWAS agreements. It is meant to preserve a certain amount of raw material production for beneficiation in the country of production, while securing supply, at least equivalent to the current level of export to the EU, in the first six years of the

³² See draft EAC-EU EPA text

³³ As defined at an HS6 tariff line level, or in case of 'ores and concentrates' at an HS4 tariff line level.

³⁴ See Draft SADC EPA Text, 2014

measure. This guarantee of supply quantity is then halved, potentially allowing time for the EU to diversify its sources of supply.

This provision is the outcome of the tense debate regarding the beneficiation strategies in SADC³⁵, in particular from strategic raw materials on the one hand, and the need to ensure security of supply of some of those raw materials for the EU on the other hand. However, it is not clear to what extent this measure will indeed allow beneficiation, given that it appears that in the short term (i.e. in the first 6 years of the introduction of the tax), the export tax may have only little effect to retain inputs for local production, given the guarantees given to the EU.

One of the major points of contention in the negotiations was the so-called most favoured nation (MFN) clause. The recent signals given by the US in the context of the extension of its Africa Growth and Opportunity Act (AGOA) that it would also seek reciprocity, in line with the EPAs, confirmed the concerns of African negotiators.

The reason to seek “automatic” extension of more preferences from the European side was justified on the basis of equity, given that the EU extended full duty free and quota free access to African regions in the EPAs. But from the perspective of African countries and regions, it was a major economic and political concern. By agreeing in advance to extend all the preferences they might negotiate in the future, they were severely putting at risk their policy space to negotiate meaningful future trade agreements, regardless of whether those trading partners would give them other non-tariff advantages, such as more flexible rules of origin or other forms of ease access through more flexible rules and regulations, than what is provided for by EPAs.

Despite strong reserves from EAC, ECOWAS and SADC EPA groups, the three agreements finally include an MFN clause. The clause is not automatic and any future preferences would have to be examined before becoming extended to the EU. In addition, it excludes agreements among African regions and countries, ACP countries and other developing countries and LDCs. “Major trading partners” in the texts are qualified to mean:

1. SADC EPA considers a “major trading country” as a developed country or any country whose world share of merchandise exports is higher than 1% (1.5% for a group of countries) before the entry into force of the EPA. Before any extension, the SADC group will have to demonstrate that it has given substantially more favourable treatment to the “major trading country”;
2. ECOWAS EPA considers a “major trading country” to be one whose share of world trade is higher than 1.5% (2% if negotiating with a

³⁵ See for instance Department of Mineral Resources, 2011

group of countries) *and* whose degree of industrialization, measured as the value in manufacturing activities in GDP, is higher than 10% before the entry into force of the EPA.

3. In the case of EAC, the EU has to demonstrate that it has been given less preferential access by the EAC region in case the latter signs an FTA with another large economy (defined in the same way as in the SADC EPA). MFN may then be extended, on a case-by-case basis, following consultations.

It is interesting to note that in the case of EAC, the MFN clause applies to the whole chapter on trade in goods (which includes rules of origin, rules, standards and regulations). This is not the case for ECOWAS and SADC, where the MFN clause is only applicable to customs duties, fees, and other charges. Issues such as rules of origin or regulatory measures are not included.

The use of agricultural export subsidies will no longer be permitted upon the entry into force of the EPA, a long-standing demand from ECOWAS and SADC regions. This may be viewed as an important concession to EPA signatories given the deadlock at the WTO regarding the removal of export subsidies.

All three EPAs do not contain an explicit non-execution clause. Instead, a reference is made to the Cotonou Agreement, where parties can adopt “appropriate measures” pursuant to the Cotonou Agreement but with no specific reference to human rights or the rule of law.

The SADC EPA contains an important Protocol on Geographical Indications where 105 South African products, namely 3 agricultural products and foodstuffs (rooibos, honeybush, and Karoo lamb) and 102 wines are now protected. On the EU side, 251 products are covered by the Protocol. These include 105 agricultural and foodstuffs, 5 beers, 120 wines and 21 spirits³⁶.

6 Prospects and challenges

6.1 EPAs and regional integration

It is important to emphasize not only the economic merits and challenges, but also the strategic and political significance of the regional dimension in the EPA process³⁷. In this respect, concluding EPAs at regional level has been a major achievement for some regions, in particular EAC, ECOWAS and SACU, as all three are customs unions. For these African policymakers, it

³⁶ See Davies, R. 2014

³⁷ See for instance Draper, 2007

ensures the coherence with their own regional integration process, and above all, it maintains unity of regional blocks, that could have otherwise been at risk, if some countries (i.e. Ghana and Ivory Coast in ECOWAS and Botswana, Lesotho, Namibia and Swaziland (BLNS) in SADC) had no choice but to implement individual EPAs, for the sake of maintaining trade preferences with the EU.

But some others have not been able to preserve their regional unity. This is the case of Central Africa (Economic Commission for Central African States - ECCAS and Communauté Economique et Monétaire de l'Afrique Centrale - CEMAC), where Cameroon alone signed an EPA, in contradiction with the principles of the CEMAC customs union, which should call for a common external tariff and trade policy. In COMESA (Common Market of Eastern and Southern Africa), only four countries of the ESA grouping signed and implemented an EPA (i.e. Madagascar, Mauritius, Seychelles and Zimbabwe) as well as four others as part of EAC (i.e. Burundi, Kenya, Rwanda and Uganda).³⁸ Similarly, only a sub-group of SADC countries have concluded an EPA so far. COMESA and SADC are only FTAs at present. So the conclusion of bilateral EPAs by some of their members does not challenge their regional integrity at the moment; it only means their members have to trade with the EU under different trade regimes.³⁹ But it may have some serious practical implications in the future, should COMESA and SADC turn their (so far mainly aspirational) objectives to become customs union into reality.

The case of ECOWAS is in this respect quite revealing. West African Monetary Union (WAEMU) has been a customs union since 2000. The conclusion of an interim EPA by Ivory Coast in 2007, in the absence of a regional one, was thus in direct conflict with the WAEMU Treaty. Not surprisingly, Ivory Coast never ratified and implemented its interim EPA. Regional EPA negotiations continued instead at the ECOWAS level until their successful conclusion in 2014. If Ivory Coast had to implement its interim EPA, this would have de facto meant the breakup of the WAEMU customs union, as EU imports would have avoided the WAEMU CET by entering the WAEMU market via Ivory Coast.⁴⁰ It is easy to understand the challenge (and tensions) that such a threat has caused in the region.

³⁸ Tanzania, the fifth member of EAC, is the only one not to be a member of COMESA as well.

³⁹ Note that this may have some (most likely marginal) incidence on their intra-regional trade, as they export to the EU under different rules of origin for instance.

⁴⁰ The same narrative holds true for SACU, as Botswana, Lesotho and Swaziland had signed an interim EPA, whereas Namibia and South Africa had not.

The case of ECOWAS is also illustrative of how the EPA negotiations have affected the dynamics of the regional integration process. Ghana, like Ivory Coast, had also concluded an interim EPA with the EU at the end of 2007. At first sight, this may have appeared as less problematic, since Ghana was not part of a customs union then (it is a member of ECOWAS but not of WAEMU). However, ECOWAS had the intention to form such a customs union, building on the WAEMU one. So, Ghana and Ivory Coast having each concluded an interim EPA, they would have derailed the formation of an ECOWAS customs union should they have gone ahead with implementing their interim EPAs. As it happens, the drive to preserve regional unity and to foster deeper ECOWAS integration has been a fundamental factor in the adoption of an ECOWAS CET in October 2013 soon after conclusion of an ECOWAS-EU EPA. The two processes have been conducted in parallel, by the same group of technical experts and policy makers, at national and regional levels, as the ECOWAS CET was the basis for the liberalisation schedule under the EPA (as previously discussed in Section 4.2). In this regard, the EPA process may have contributed to support, and perhaps even speeded up, the formation process of an ECOWAS customs union.

If the outcome is, so far, rather positive, at least for ECOWAS, EAC and SADC/SACU, the numerous hurdles and tensions that the EPA negotiations have created, including in the regional integration process and between regional members, should not be underestimated. It seems clear that countries like Nigeria or Tanzania have agreed to a regional EPA more for the sake of preserving regional unity and for the interests of their regional partners than for the intrinsic merits they perceive for themselves in such an agreement. Moreover, the “EPA history” has taught us to be careful about official endorsement of an agreement, unless it is formally signed, ratified and implemented, a process that may take years, or be interrupted, before all EPAs fully come to life.

For the EU, the conclusion of regional EPAs has also been a priority. It ensures policy coherence between EPAs and its overall support to building regional integration, notably through development cooperation with several regional economic communities (RECs). It would have been difficult to justify support to regional integration in a broader context if EPAs had contributed to break up regional blocks. It finally confirms the fact that in the end, strong political leadership was needed to solve the deadlock in the negotiations. This is a key factor for future trade relationship between Europe and Africa.

6.2 Building regional markets and supply chains

If used in an efficient manner, and provided that the business environment is conducive to do so, EPAs could be used as a leverage to build regional markets, through investment in and the development of value chains, both nationally and regionally. This is so because the rules of origin, in particular the cumulation provisions, are flexible and quite conducive for regional sourcing of inputs, for any further value addition in EPA countries being beneficiaries. Cumulation provisions allow EPA regions to be able to source inputs in order to add value to export goods for the EU market:

- a. To be able to cumulate among themselves (i.e. with the same EPA grouping);
- b. To cumulate bilaterally with the EU;
- c. To cumulate diagonally, with other EPA regions⁴¹, provided they sign a customs cooperation agreement;
- d. To cumulate with countries whose products enter at MFN zero duty on the EU market;
- e. To cumulate with any third country benefiting from “duty free quota free” market access in the EU. These include LDCs and GSP countries (provided the product enters duty free on EU market);
- f. To cumulate with countries that have a free trade agreement with the EU (with the exception of agricultural products); and
- g. The SADC EPA has a specific provision for cumulation with non-ACP African countries (i.e. North African countries), in support of Africa’s integration.

Some critics highlight the risk that EPAs might undermine or disrupt the already weak regional trade dynamics and industries, notably by putting local products in competition with European products⁴². Notwithstanding these challenges, EPAs can also potentially help to reinforce intra-regional trade links, not only across EPA regions, but also with other African LDCs that are not yet part of these EPAs. While this may open up trade and investment opportunities for EPA signatories, LDCs that are not part of EPAs but benefit from EBA preferences however cannot cumulate with EPA signatories, as such provisions do not exist in the GSP regulations. This gives substantial advantages to EPA signatories.

Beyond the scope for value addition, EPAs may offer opportunities to build and to strengthen the links between African suppliers and global supply

⁴¹ With the exception of fisheries products from Pacific EPA states (HS 1604 and 1605).

⁴² See for instance various South Centre publications (2007; 2012; 2012); UNECA, 2005; AUC, 2010

chains. As African economies develop their industrial capacities, predictable market access to the EU may provide attractive prospects to potential investors as businesses look to relocate activities to lower cost-production regions for manufacturing products. Strengthening the local private sector to avail of such opportunities may contribute to stimulate the economic transformation process and accelerate Africa's integration in the global economy, as set by the objective of EPAs. However, to do so, EPAs would have to be more ambitious than what they are today. They need to cover also trade and services and intermediaries. Development aspects of EPAs should be activated to assist countries in improving trade facilitation and addressing supply side constraints.

6.3 Addressing systemic challenges

Notwithstanding potentially positive trading prospects for African businessmen and businesswomen, EPAs nonetheless pose a number of systemic challenges that need to be addressed⁴³. While EAC, ECOWAS and to some extent SADC EPAs (in particular the SACU countries) managed to agree on regional frameworks that avoided regional fragmentation, it is however less clear to what extent these EPAs can support broader regional integration ambitions, in particular the continental integration agenda⁴⁴.

The regional integration process is still largely in the making in most of the 5 African EPA regions. Although most regions have free trade areas in place, not all countries are currently implementing their commitments. Deepening of trade integration within specific regions remains a challenge in many cases. ECOWAS and EAC have reached a more advanced stage in their internal market integration, since they already had a CET in place, which is to be implemented by all their member states. This was particularly useful to maintain regional coherence at the time the EPAs had to be concluded⁴⁵.

In other regions however, in particular in SADC and in Eastern and Southern Africa (ESA), the situation is more complex. FTAs are moving at variable geometry and sequencing, and so the conclusion of an FTA with a (large) third partner, prior to completing the regional market integration agenda, may result in the following situations:

1. Some countries have given more preferences to the EU than what they extend to their regional partners. Although current EPA texts make provisions for regional preferences, i.e. countries can extend any more

⁴³ See for instance South Centre, 2007; Szambelan, J. 2012; ACBF, 2014

⁴⁴ See ACBF, 2014

⁴⁵ See for instance De Roquefeuil, Q. 2014; Coste, A. and E. von Uexkull, 2015

- preferences given to the EU to their own regional partners, it is not clear to what extent countries/regions are willing to do so.
2. In the ESA region, the four EPA signatories (i.e. Mauritius, Madagascar, Seychelles, and Zimbabwe) have individual EPAs with very different market access schedules. Should they decide to deepen ties with their regional partners (notably by joining a customs union), it is unclear how they will address the alignment of their market access (the degree of openness varies from 80% for Zimbabwe to 98% for Seychelles)⁴⁶.
 3. In the case of the SADC EPA, there is an accession clause, which allows countries to join the EPA in the future, but based on the SACU's schedule. Again, to what extent non-SACU members will be willing to align themselves to commitments made by SADC is not known.
 4. The case of Cameroun, a member of a CEMAC, another customs union, a country which signed an individual EPA in 2009, and ratified it in July 2014, while the remaining countries of the customs union did not do so, is likely to put at risk the viability of the CEMAC in the future.

Additionally, the level of “formal” trade across regional economic communities (RECs) remains rather low, as illustrated in Figure 2, although the level of intra-regional trade, i.e. the trade within the same REC, varies substantially from one region to the other, as shown in Figure 3. In an effort to address this challenge at the continental level, efforts are being made to boost intra-African trade flows, notably with the launch of a Pan-African initiative, expected to lead to a continental free trade area, by 2017.

Some of the challenges at the African level are linked, amongst others, to overlapping memberships of countries in several regional economic communities, making functional market integration difficult. Overlapping memberships slowed down the negotiations process. The EAC region is an interesting case to highlight. Initially, four of the five members of EAC, namely Burundi, Kenya, Rwanda and Uganda, were negotiating with the ESA group while Tanzania (not a COMESA member but a SADC member), was part of the SADC EPA grouping. It is only in 2007 that they decided to form a coherent EPA group, reuniting all members of EAC under one roof. Not doing so would have undermined the advancement of the EAC customs union and future regional integration. But by doing so, it also weakened the ESA group that ended up with only four signatories.

This not only leads to a costly competition for resources, but also to potential conflict and to inconsistencies in policy formulation and implementation. It also causes unnecessary duplications of functions and efforts, frag-

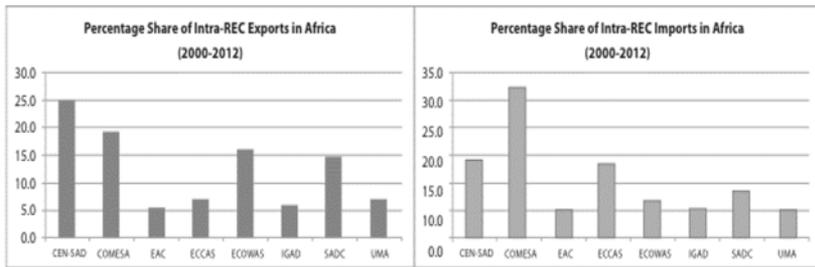
⁴⁶ See Bilal, S. and I. Ramdoe, 2010

mentation of markets, which consequently reduces the ability of RECs to pursue coherent and effective integration programmes. It further complicates the RECs' relationships with partners outside the continent. The EPAs are a case in point. With the exception of EAC and ECOWAS, it was difficult to negotiate EPAs with whole regions, given the overlapping memberships of some countries, sometimes being members in more than two organisations.

To address this, the tripartite free trade initiative among SADC-EAC-COMESA is an attempt to harmonise rules and trade regimes among the three RECs⁴⁷. This process has however been quite slow, given diverging interests among member states (and challenges to finance the initiative).

The networks of trade within and between regional economic communities (RECs) is quite complex and show the limited extent of trade interactions (see Mihalakas 2011). Figure 2 below gives the average percentage share of intra-REC trade, 2000–2012.

Figure 2: Average percentage share of intra-REC trade, 2000-2012



Source: ACBF 2014, Africa Capacity Report

Some observers have shared concerns that EPAs may hide an unintentional lock-in effect, that is, it contains countries within the region in which they have negotiated their EPAs. As regions are seeking ways to address overlapping memberships and to create larger economic entities, it is unclear how this issue will be addressed. The SADC EPA makes provisions for the accession of any country or organisation to the SADC EPA, but EPAs also contain a stand-still clause, where countries cannot increase their tariffs in the future, beyond what is provided for in the EPAs⁴⁸.

In the hypothetical case that in the future SADC and ECOWAS decide to harmonise their trade regimes to form a bigger customs union, the question

⁴⁷ For instance see UNECA, 2011; Shayanowako, P. 2011; Riedel, J. and A. Slany, 2014

⁴⁸ See for instance Mevel et. al. 2014; IF&ATPC/International Food and Agricultural Trade Policy Council, 2011; South Centre, 2007; and ACBF 2014

will be how to align market access schedules without terminating the EPAs in their current state.

It is too early to draw conclusions on whether or not EPAs would hinder or foster intra-regional trade or market integration. In theory, an enlarged FTA that would have addressed “behind the border measures” would unlock dynamism for enhanced intra-trade flows, notably by encouraging regional sourcing for more value addition to tap export markets. But some critics⁴⁹ have voiced concerns that EPAs would instead further discourage intra-African trade because producers would rather favour to supply the EU market as a result of the security given by the permanent duty free regime. It is often argued that one of the reasons that may explain the low level of intra-African trade is that African economies have maintained a trade structure that is excessively dependent on unprocessed commodities vis-à-vis European markets, to the extent that their production structures remained widely undiversified, so that they had little to trade with each other.

6.4 Financial Support and Development

The ECOWAS EPA has confirmed the West African EPA Development Programme (PAPED/Programme de l’APE pour le developpement), which is the comprehensive development framework that will accompany and address potential challenges linked to the implementation of EPAs. In terms of financial support the EU, together with its Member States and the European Investment Bank (EIB), is expected to provide support to the PAPED in the programming period 2015-2019 for at least €6.5 billion. Support will focus on trade, agriculture, infrastructure, energy, and capacity building for developing a civil society. The PAPED is supported by a well-developed development matrix that reflects the priorities of the region.

The PAPED will be implemented through two instruments, namely:

1. A Regional EPA Fund will be set up to channel the funds;
2. A Competitiveness Observatory (CO) will be set up using performance indicators so as to monitor and to evaluate the impact of the EPA.

While the EAC and SADC EPAs have a section on development cooperation, there is no equivalent to ECOWAS’ PAPED. Parties agree that a regional development financial mechanism, such as an EPA Fund, could be set up, but there are no commitments on the modalities or on potential additional sources of revenues (beyond existing sources, such as the European Development Fund (EDF) or Aid for Trade (Aft) commitments). There is some recogni-

⁴⁹ See Akamanzi, A. 2007; South Centre, 2007; AUC/African Union Commission, 2010; and UNECA 2005

tion of the potential fiscal impacts of the tariff phase down on SADC EPA countries, and in particular on LDCs such as Lesotho, but no commitment is made in terms of financial support.

EAC and SADC EPA countries will however be able to use regional funds provided under the 11th EDF⁵⁰ for 2014-2020 and funds under the financial commitments made to assist countries to implement the WTO provisions on Trade Facilitation. EU member states and financial institutions such as the European Investment Bank (EIB) could potentially also contribute to financing EPA-related projects (see below).

6.5 Broadening the scope: going beyond trade in goods

The current African EPAs cover only trade in goods, although all EPAs have a Rendez-Vous Clause for a more comprehensive agreement covering other issues such as trade in services, competition, investment, etc. This is an important issue to consider, in particular as global trade increasingly specialises in trade in tasks and intermediaries along global value chains. An ambitious trade agreement, that reflects the reality of the global economy, must therefore take due account of the changing nature of trade and the implications that global value chains have for African countries.

In Africa, RECs are now in the process of deepening their own regional integration agenda, notably to boost intra-REC trade but also to improve the trade relationship across regions, towards building a common continental agenda on trade. To achieve this, it is therefore essential to have coherent and comprehensive frameworks, based on agreed common denominators that reflect this ambition. These frameworks should be bold in coverage and in depth. But such frameworks should not be confined only to the African agenda, in particular as African countries and regions are increasingly expected to play a more important role on the global scene, as the sustainability of economic prospects is confirmed⁵¹.

The current African EPAs, in that sense, are quite traditional FTAs and do not sufficiently reflect the changing nature of international trade and the growing importance of Africa, although many African countries are yet to play a significant and influential role in global value chains. As it stands, it is understandable that the agreements had to be concluded within a particular deadline (i.e. 1st October 2014), first and foremost to prevent trade disruption

⁵⁰ See on the funding for 11th EDF for 2014-2020:
http://ec.europa.eu/europeaid/funding/about-funding/where-does-money-come/european-development-fund_en

⁵¹ See for instance UNECA, 2012

for some African countries and to ensure its WTO compatibility. But the current Agreements also reflect the level of (un-) readiness and (un-) willingness of African countries to negotiate more comprehensive agreements, in particular on issues where the regional agenda is not very advanced. While it is important to ensure proper sequencing in negotiations – i.e. allowing time for regional negotiations to be concluded first, before entering in agreements with third parties – it is unlikely that EPAs will deliver on significant results if they remain trapped in a shallow “trade in goods” agreement framework.

Given the slow pace of advancement of regional integration, notably on issues such as services, investment, competition, public procurement, or intellectual property rights to name a few, it may not be realistic to push for coverage of these issues in a comprehensive agreement. No agreement is better than a bad agreement, in this context. And lessons from the 12 years of difficult negotiations should be learnt, namely that unwillingness and lack of ownership of the process can only sour a relationship.

To assist countries and regions to finish their own regional agenda, which would then serve as the basis for a more comprehensive EPA, it would therefore be worth exploring development support to reforms in order to fast-track these issues, both by supporting national efforts to put in place the necessary rules and regulations and by supporting regional negotiation efforts to ensure coherent, coordinated and simultaneous advances towards a rapid conclusion of such regional agendas.

7 Conclusions and way forward

7.1 EU's Free Trade Agreements with its main trading partners: minimizing the risks for EPAs

As part of its broader trade diplomacy, the EU is deepening trade ties with its key trading partners, as can be observed by the number of comprehensive trade agreements recently concluded (including with South Korea, Singapore, and Canada). The current negotiations with the United States are likely to set different benchmarks for its future trade agenda, since the key stakes of the Trans-Atlantic Trade and Investment Partnership (TTIP) will not be so much around tariff negotiations, but rather around rules, standards, and regulations.

The first implication for EPAs is that it will gradually erode all margins of preferences: tariffs in the EU are in any case very low, and soon, EPA signatories, despite their duty free quota free (DFQF) access, will be faced with competition from other FTA partners of the EU. To many, this means that all the benefits of the EPAs will be completely eroded, especially if EPAs remain focused on trade in goods.

The second and most important implication of these new “mega” trade deals for EPAs is that the tariff liberalisation effects of these new trade deals might be relatively modest. However, non-parties to these agreements will be confronted with changes in the regulatory landscape and would therefore become rule-takers. In the context of EPAs, despite the agreements in place, it is therefore feared that regions as trading partners to the EU will constantly have to compete over higher standards and regulations to access the EU market, although market access per se is guaranteed⁵².

Finally, we are unlikely to see African regions enter in the race for “mega-trade deals” at least in the short term, even in the event that the US would seek to enter into FTAs to replace AGOA preferences. But it is not unlikely to see more traditional forms of trade agreements involving RECs ready to go to so, with some of their trading partners. Some EPA regions, such as ESA and EAC, may use the provisions of the MFN clause to seek the extension of any better rules that the EU would agree in the future with its main trading partners. For those EPAs, whose MFN clause excludes this possibility (i.e. SADC and ECOWAS), they may find themselves in the unfair situation where they would have to further open their markets (due to their high applied tariffs), while in return they will not benefit from any better frameworks that will come out of such new trade agreements. This issue should be addressed in Joint EPA committees.

7.2 EPAs, development and economic reforms

It is expected that EPAs would have positive spillover effects, notably on economic reforms and on the increasing interest of private operators to invest in the local economy to reap the benefits of the EU market. But while this is the well-intended effect, it will not happen automatically. It will be difficult to measure to what extent any potential reforms or investment decisions can be directly attributed to the EPAs. Development impacts will therefore only be measurable overall, if EPAs are used as a tool to kick-start certain reforms or to accompany others, and if they are linked to countries’ and regions’ own programmes and priorities.

One example is trade facilitation: EPAs could provide scope to build regional value chains, notably by making use of cumulation provisions in rules of origin to identify comparative and competitive advantages among producers along specific product value chains. But this requires effective cross-border customs procedures, addressing transport costs, and coordinated hard

⁵² See for instance Draper, P. et al. 2014; Draper, P. et al. 2014; Ramdoo, I. 2014; WEF/World Economic Forum, 2014

and soft infrastructure and logistics. Support to those linkages could be sought through the development cooperation provisions of EPAs, provided priorities are clearly identified and efforts are well coordinated.

The regional programming of the 11th European Development Fund (EDF) for 2015-2020 from 2014 provides an important opportunity to address some of the EPA-related financing issues, including in financing infrastructure.⁵³ In addition, given the current financial constraints and the difficulty for Europe to commit additional funding (beyond the EDF and existing Aid for Trade commitments and mechanisms, such as regional funds), a pragmatic approach would be necessary to further explore collectively innovative financing mechanisms (such as blending grants and loans⁵⁴, and various forms of public private partnerships and cooperation⁵⁵), in particular to finance large projects such as cross border infrastructure or energy projects, currently a major prerequisite to industrial development in many African countries and a key element of effective regional integration.

There is already an on-going debate in Africa, notably under the joint leadership of the African Development Bank (AfDB), the African Union Commission (AUC) and the UN Economic Commission for Africa (UNECA) to explore new ways of financing development, including by using Africa's own resources.⁵⁶ It would be appropriate to join this debate, and to make creative use of existing financial mechanisms as leverage for innovative financing, including from the European private sector, multilateral financial institutions, and African financial institutions.

7.3 Behind the border hurdles: Trade facilitation and the EPAs

Some of the key challenges on intra-African trade are the bottlenecks that exist both “behind the border” and “beyond the border”. While current SADC and ECOWAS EPA texts agree to cooperate on trade facilitation, there is little in the agreement to unlock and to address those challenges that are a major hurdle to the cost of doing business in these regions.

A major step was reached by the WTO in December 2013 in Bali, with the agreement by members to move ahead with the trade facilitation agenda, as an early harvest, to reduce red tapes and to streamline customs. However, with the recent difficulties to agree on the Protocol to amend the WTO Trade Facilitation Agreement, it seems that there will be delays in implementing

⁵³ See for instance Krätke F., 2014.

⁵⁴ See for instance Bilal, S. and F. Krätke, 2013.

⁵⁵ See for instance Bilal, S. et al. 2014.

⁵⁶ See for instance NEPAD and UNECA, 2014; and Aggad-Clerx, F. and El Fassi, S., 2014.

what was agreed in Bali, including on technical assistance for developing countries to remove the barriers to trade. While this is being dealt with at the multilateral level, trade facilitation is clearly a cross-cutting issue, which will have an impact on trade flows and the cost of doing business, including in the context of EPAs.

It may therefore be opportune to explore the possibility to implement the commitments of the Bali Agreement, within the regional context, given the importance and urgency of removing those barriers to boost trade in Africa, and in particular in EPA regions.

It is however important to pursue this goal with some caution, as it may be a politically sensitive issue with African partners. In the past, there had been concerns that, through the EPAs, the EU was trying to bring in all issues that had failed in the multilateral context (the so-called Singapore issue), and trade facilitation was one of them, although many recognise that there (in Singapore) addressing these bottlenecks is a necessary measure, primarily to deepen regional trade, although it is important for foreign investors as well.

7.4 Way forward

After twelve years of difficult negotiations, the EPAs finally concluded with EAC, ECOWAS and SADC were made possible, largely in part, due to the strong political leadership shown on all sides in order to ensure the smooth trade relationship with the EU and to maintain regional unity and solidarity. Although not finished, and not free of challenges, the agreement provides some degree of flexibility and policy space for African RECs and their member states to pursue their own development path.

Looking forward, the EPAs must now be placed in a broader perspective, notably in a larger strategic EU-Africa relationship. This means that both the EU and the African regions that have concluded EPAs will now have to mainstream EPAs in their own economic dynamics. For ECOWAS, EAC and SADC, this will entail ensuring that countries make the most of the market access to EU, not only by using as much as possible all ways and means to deepen their trade ties with Europe, beyond their current and traditional exports, but more importantly by using EPAs to deepen trade ties among themselves, notably through the development of regional value chains.

For the EU, it means mainstreaming EPAs in the broader EU-Africa relationship. This has so far not been the case, mainly because the African Union (AU) was not part of the EPA negotiations. It is however necessary to address this missing element, if the EU-Africa relationship is to be made more relevant in the future, beyond development cooperation, as otherwise it will be difficult to conceive a business relationship at the political level between the two continents without a key instrument such as trade. Given the tensions

related to EPAs between the African Union Commission (AUC) and the European Union (EU), this requires political leadership.

Finally, a trade agreement, however well negotiated and flexible, is not a magic bullet. It requires other measures to unlock its full potential, and this can only be done if countries and regions are supported in their efforts to implement their agreements. Support can take financial forms, but to be sustainable in the long-term, more importantly it will require in-depth business-to-business linkages, in particular to empower the African private sector, so that African business can reap the full benefits of access to European markets.

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Unit 3: Global Value Chains and Regional Impacts in Africa

Global Value Chains and Regional Impacts in Africa – An Introduction

Karl Wohlmuth

1 The Issues

How can Africa develop capabilities and preconditions for a beneficial integration of its producers into global value chains?

In order to be successful in integrating producers in Africa into global value chains, *various capabilities and preconditions matter*. Capabilities have to be developed and preconditions have to be created. A lot can be learned from Asian and Latin American countries how public and private sectors have collaborated to support the integration of their producers into global value chains. Six major capabilities are required to become an effective producer and partner within global value chains (see Banga 2013, Banga 2015). There is a need to improve simultaneously these six basic capabilities, in order to avoid that a weak link retards or prevents the effective integration into global value chains. First, “informed producers” are needed as only these producers, managers, and entrepreneurs will demand technical innovations and will produce new products. In order to generate technical innovations, skill development is needed, but without adequate infrastructure and finance skill development will not lead to value generation. Only appropriate institutions and domestic regulations will allow it that firms can appropriate value from the value chain interaction; otherwise other actors in the chain (foreign and larger firms) will generate the value. On the basis of these institutions and regulations, market orientation and market intelligence will lead to “informed producers”.

This feedback system of six basic ingredients for an effective integration of local and small firms into global value chains has to be understood in order to design respective public policies. Only within such a feedback system is it possible to evaluate the reasons for the often unsatisfactory capacity in African countries to benefit from an integration of producers into global value chains (see Banga 2015 on this feedback system). Looking at African conditions, it is easily observed that immediate action is needed around all these six capabilities. However, some countries were more successful on this way and irrespective of the income level. Five countries stand out as particularly successful (Ethiopia, Kenya, Seychelles, South Africa, and

Tanzania); these countries have increased the share of foreign value added in their exports by 5 or more per cent in the recent two decades (IMF 2015, p. 59). More than mentioning this mere statistical fact of increasing integration, most important is the observation that the sector expansion in these countries is going along Africa's comparative advantages (land, labour, natural resources, and beauty of nature).

Agriculture and agro-business benefitted in Ethiopia and Seychelles, (light) manufacturing in Tanzania, but also textiles, transport, and tourism have to be mentioned. These African countries have in this regard similar successes as Poland and Vietnam, countries which are cited as the success cases of integration into global value chains (IMF 2015, p. 59). So, these five countries have managed to translate the comparative advantages into competitive advantages. Some success stories in Africa (such as horticulture and flowers in Kenya) are however to some extent artificial, as the absence of some of these six capabilities is compensated by an internalization strategy. Large producers (with capital and political connections) generate the capabilities within their industrial conglomerate (see Wohlmuth 2011 on this internal route to create capabilities in agribusiness). Such an internalization strategy may be costly and may limit the expansion of production. Public subsidies, exemptions and tax advantages for these ventures may affect other firms and especially smaller producers in the country. If the internalization route is not working, then all depends on national and local strategies to invest in these six capabilities.

A lot can be learned from Asian and Latin American countries how they supported their producers (see Banga 2015, pp. 47-52). In these countries, industrial associations and networks of small producers have contributed a lot to inform the entrepreneurs about product options and market niches, especially about international quality standards. A pro-active public sector role contributed to this progress. Technical innovations were promoted in a specific way, by linking producers and producer associations to extension services and public research. Important elements of the value chain, such as logistics and product development, were supported. Also, small producers got incentives to cooperate with large firms acting as lead firms, also in the form of joint ventures with foreign firms. Public research was related to improvements of the quality characteristics of the produce, and targeted subsidies played a role in various forms (for credits, inputs, logistics, market information, extension services, etc.). Skill development for strengthening the role of producers in global value chains is important. But specific skills are needed to strengthen the role of informed producers in the chain and to introduce technical innovations for adding value of the firm in the chain. A specific training infrastructure (training institutes, design studios, demonstration farms, extension agents, mentors and coaches, etc.) is needed

but has to be related the specific demand of the producers in the value chain. Regional collaboration in training can support producers in regional value chains (ECA/AU 2009). Africa is not exploiting the existing opportunities, neither the instruments of regional cooperation nor the public training institutions more fully (Wohlmuth 2011, 2015).

Infrastructure provision and adequate finance instruments are important for the integration of producers into global value chains. The capability to organise for these key inputs is crucial. Trade facilitation is an area of importance, as global value chains depend on logistics, communication and across-the-border trade exchanges. The limited progress in Africa with regard of integrating producers into global value chains (GVCs) has a lot to do with these two factors and the insufficient capability to overcome these constraints. Even in regional economic communities (RECs) in Africa cross-border trade and connections to ports are impeded by so many barriers. Obviously these logistics problems do more harm than non-tariff barriers which still exist in the RECs of Africa. Transport, logistics and telecommunications services play a key role for integrating producers into global value chains. Innovative approaches are needed to remove these bottlenecks. Lead firms in value chains and foreign investors can be helpful, but also targeted public investments play a role. Despite of ambitious infrastructural plans for connecting Africa regionally and globally (PIDA/Programme for Infrastructure Development in Africa), the results are so far insufficient. An internalization strategy of large African conglomerates may work in some cases, but is limited in effect; this strategy may also be economically costly (Wohlmuth 2011).

Finance is a crucial factor at all stages and levels of the global value chain, and integration of producers depends on removing this bottleneck by creating the respective capabilities. Innovative approaches are needed what requires that demand for working capital and investment finance is assessed at all stages of the value chain which are in the reach of the African producers. Case studies from agribusiness sectors in eight African countries show that this can be achieved (Wohlmuth/Kormawa/Devlin 2012), that innovative solutions could be implemented, also by public-private partnerships. Lead firms of value chains and specific funding windows of African governments and local banks can help in this situation. But, a new role of the African banking system towards supporting productive sectors and the integration of local producers into global value chains is needed. Examples show that central banks, development banks and commercial banks in Africa can create such capabilities.

Two other basic ingredients matter: Appropriate institutions and domestic regulation and Market orientation and market intelligence (Banga 2015). Appropriate institutions in the context of global value chains (GVCs)

are first of all those institutions which are responsible for product and process standards (in health, safety, quality, environment, resource-saving, etc.), and all those institutions which are needed to enforce these standards in production and sale (exports). The best way - as practised in Latin America and in Asia - is it to make the entrepreneurs develop their own standards by self-regulation; and the best way is it to develop standards which fit the many export markets, such as the Good Agricultural Practices (GAP) as developed by Chile. Such a GAP system allows the producers to meet the standards of USA, European and Asian markets at the same time. Although Africa has developed its own standardization organizations and the respective infrastructure, much has to be done with regard of harmonization and implementation as much is on paper and not made relevant for the producers (Wohlmuth 2015).

Also with regard of domestic regulations, their impact on integrating into GVCs is great. Countries in Asia and in Latin America have successfully managed to link in regulations FDI inflows with stronger backward linkages, technology transfers, local content, etc., but in flexible ways which were not discouraging the inward flows. Countries being more pro-active with regard of appropriate standards and regulations have better chances to be involved in GVC's operations. The problem in Africa is that even in the RECs the standards are not harmonized so that trade is impeded by this (and many other) forms of behind the border barriers. Paradoxically, African countries may be more interested and capable in meeting global standards than standards of their neighbour countries. The same is with domestic regulations; African countries may be more flexible in their attitude to global FDI investors than to regional FDI investors. A change of this attitude is necessary.

The last factor of importance is market intelligence. How to inform the producers about market trends, market developments, market dynamics, new market niches, etc.? Some African countries, like Mauritius, have developed this capability since decades. The country became a famous case of adaptation to global market trends; and the capability to adapt to new market developments, new opportunities and new constraints was tested various times and has led to structural changes in industry (such as the electronics sector, the agro-industry sector, the textiles and clothing sector, the sugar sector, and various high tech sectors). But not many other success cases are known. Regrettably even the large companies in Africa have failed to develop such capabilities. Only few African companies have a global orientation; the so-called "African Challengers" with above average business returns are not that many, and are concentrated in few African countries, such as South Africa (Wohlmuth 2014). New technologies (mobile phone apps for price, labour market and weather information) and new institutions (such as

the Warehouse Receipt Certificates/WRCs enabling the farmer to store staple crops after harvest so as to benefit from price cycles and to get finance on this basis in advance of finally selling the crop) allow it also small producers to react to price trends.

Market information is not only a problem at international markets (extra-regional trade); even in intra-regional trade market information is limited. However, even in the African RECs market opportunities barriers are not known to local producers, and the situation is not so different between intra-regional and extra-regional trade. Market information needed is however different between these two destinations. While in extra-regional trade outside of Africa standards are the major problem, in intra-regional trade and extra-regional African trade barriers of all types are prevailing (logistics and transport problems inefficiencies, border delays, rules of origin, non-tariff barriers, taxes and duties, etc.). Informing the African entrepreneurs about standards, market barriers, market niches and market trends is therefore a public good to be provided, and supplying this public good can be achieved best via a public-private collaboration strategy. RECs like ASEAN have much better worked in this regard, creating much earlier awareness about the opportunities of intra-regional trade and investment agreements and linking pro-actively market information to action (market penetration and market sharing). This factor is also important for linking, governing and upgrading the (regional and global) value chains (Banga 2015, p. 52).

Beside of these key capabilities for integrating producers into GVCs policy environment factors and structural characteristics of countries play a role. In order to make use of these capabilities and/or to develop these further certain policy and structural preconditions matter. Industrial policy plays a key role for GVC participation; industrial policy orientation can be leaned either towards increasing the share of domestic value added in particular industries or towards increasing the volume of GVC-related trade as measured by backward and forward linkages (see Banga 2015; OECD/Kowalski P. et al. 2015). This requests open markets so that industries can integrate into GVCs by a) exporting products with high domestic value added but using also substantial imported inputs and b) by exporting commodities and services within GVCs which are inputs to process goods in other countries for export (see Banga 2015 and OECD/Kowalski P. et al. 2015 on the relation between backward and forward linkages in GVCs in various regions).

Policy matters with regard of both types of linkages in GVCs –backward and forward linkages. To source foreign inputs for exports in the case of an African country can be as profitable as exporting commodities and inputs to foreign partners for their export production (not only commodities but also services, such as IT services, and certain tasks, like in the construction field,

could benefit the country when contributing to the exports of the importing country. While the debate about import substitution versus export development centred on final products, the African countries can now deliberately make policy decision with regard of these two types of linkages. Important is also the acknowledgement that structural characteristics matter in industrial policy design (OECD/Kowalski P. et al. 2015). Three structural variables matter most for participation in GVCs (size of the country, geographical location, and share of the manufacturing sector), but also the size of companies and the role of the informal sector play a role. So, African countries may benefit from two types of integration into GVCs.

Important is also how deep the country is integrated regionally. Deep integration offers the possibility to benefit from linkages at the regional level, by integrating firms into regional and global value chains. The political steps towards deeper integration as discussed now (EPAs, TFTA, CFTA, and going beyond free trade agreements in the RECs) give new chances for a higher participation in GVCs because all these steps may help to eliminate cross-border barriers in RECs and between RECs in Africa. When these barriers (at the border and behind the border) are removed, the working of regional and global value chains is improved. But Africa's handicap is the low and even declining share of intra-regional GVC penetration, while Southeast Asia has a high and even increasing intra-regional share (OECD 2015). A further determinant of GVC integration is openness toward inward foreign investment, but openness does not mean that foreign investment should not be regulated. In the contrary, openness means both that all the border barriers and behind the border barriers are removed which discourage foreign investors and that clear regulations and coherent policies guide the investors to sectors with market opportunities. Regrettably, most of the policy areas being of relevance for a deeper regional integration in Africa are not part of the current negotiations (this is true for TFTA, CFTA, the RECs, but also for the EPAs with EU). These key areas (trade facilitation and logistics performance, intellectual property protection, competition policies, rules of origin, services liberalization, quality of trade infrastructure and trade institutions, behind the border barriers, etc.) are not really part of the current negotiations; they are postponed. But these are the important areas for a deeper Regional Value Chain (RVC) and Global Value Chain (GVC) penetration in the RECs of Africa.

What do we know about the depth and the forms of Africa's integration into regional and global value chains?

What do we know about the effects and the impacts of the GVC participation of African countries and firms? All major international and regional

organisations have done researches on the issue. There is now much *more knowledge available about the overall trends and the country groups being more successful with regard of Africa's participation in GVCs* (see especially: IMF 2015; OECD/Kowalski P. et al. 2015). This is due to new data sources found in input-output multi-regional studies. However, there is evidence limited to regions (Sub-Saharan Africa, Middle East and North Africa, Western and Central Africa, Eastern and Southern Africa, etc.).

Sub-Saharan Africa (SSA) is just starting the integration into GVCs, as the share of foreign value added in the production of exports (measuring the backward integration into GVCs) is only at 15%, while other developing and emerging countries have a share of around 20% (IMF 2015). Also, the depth of integration has not increased since the mid-1990s, and neither the diversity of products nor the quality of products have increased as measured by complexity and quality indicators. And, forward integration into GVCs is still dominating, as Africa's commodity exports become inputs into the exports done by foreign countries (IMF 2015: pp. 56-58). All this has to do with particular characteristics and major differences between country groups in SSA. The oil exporters have even seen a decline of the foreign value added share of their exports, what implies that export diversification has even declined.

A majority of SSA countries has made some modest progress, mainly the non-commodity exporters, but most of these countries (mentioned are Burkina Faso, Central African Republic, DR of Congo, Ghana, Guinea, Niger, Sierra Leone, and Zimbabwe) have a lot of development problems – from fragility to civil war and to increasing macroeconomic imbalances. Cases of some success are seen in Africa region-wise, as EAC and SACU/SADC have made more progress with regard of GVC-participation than CEMAC (Central Africa regional integration) and WAEMU (West African regional integration). This may be an indication that deepening consequently the regional integration progress, such as in EAC and SACU/SADC, may positively impact on integration into GVCs. Five countries are outstanding in their performance (Ethiopia, Kenya, Seychelles, South Africa and Tanzania. Most important is the fact that just these countries are on the way of exploiting their comparative advantages by GVC integration. Labour, land, climate, and nature are the factors which are mobilised by GVC integration (IMF 2015). This is good news as Africa is affected by a continuous de-industrialization trend, so that job creation and living standards depend also on GVC participation. The continent and also SSA has to look at services as an opportunity for GVC integration beside of manufacturing. But, studies show that African countries, like Kenya, are even outsourcing IT services and other services components which are needed for

servicing end consumers, manufacturing sectors and other sectors (see Wohlmuth 2015).

Examples show that regional cooperation in Africa can do a lot to stimulate GVC integration (see the implications of the fictitious example of Mali, Ethiopia and South Africa on regional and global value chains for shoes ultimately intended for the world market; this example highlights the negative impact of Africa's absence of deep regional integration; see IMF 2015, pp. 60-61). Another important issue is which countries could be anchor countries for Africa's GVC integration. South Africa has the greatest potential, and Egypt is at distance number two, while Nigeria and Algeria share the problems of the oil exporters (group of countries). The SANE (South Africa, Algeria, Nigeria, Egypt) countries have therefore a rather limited role (with the exception of South Africa and a mere potential role of Egypt, Nigeria and Algeria in the future after drastic reforms) as GVC anchor countries. South-South cooperation (especially with China and India) is often mentioned as an opportunity for more outsourcing to Africa, but so far there is more hope in this than facts (IMF 2015, p. 61). Policy conclusions drawn from econometric exercises for SSA and GVC integration come to the point that human capital and availability of credit may speed up Africa's GVC integration, while high tariff levels and difficult business environments may hinder a deeper GVC integration of Africa. The greatest impact may come from a reduction of tariff levels, then from better access to credit, and then from improving education and the rule of law (IMF 2015, p. 61). This issue of tariffs (including equivalents for non-tariff barriers and behind the border barriers) brings up again the great role of TFTA, of CFTA and of more effective RECs in Africa.

We now know more about the role of intra-regional GVC participation (see OECD/Kowalski, P. et al. 2015). When contrasting South East Asia with Africa, one can see that the deep integration in Asia also allows for a high intra-regional GVC participation as measured by the share of foreign value added in exports. The share was even increasing in South East Asia from the high share of 56% in 2001 to 58% in 2011, while GVC participation in Eastern and Southern Africa was only 16% in 2011, and down from the 21% in 2001 (OECD/Kowalski P. et al. 2015). The share for Eastern and Southern Africa is much lower although the integration is much deeper there (in EAC and SADC/SACU regions than in other African regions. Western and Central Africa regions and MENA (Middle East and North Africa) regions lag behind with below 10% in 2011 in intra-GVC participation, reflecting the low level of regional integration.

Most important in order to benefit from trade is export competitiveness, and competitiveness depends also on the ability to import and to export intermediate products which can be used in regional and global value chains.

In order to source suitable inputs, global sourcing should not be discriminated by regional sourcing and vice versa. Trade in intermediate inputs is an important indicator of GVC participation, and new evidence is available showing the rather weak position of Africa in general in contrast to developing Asia (OECD/Kowalski, P. et al. 2015). However, the data also show great differences in Africa in this respect and reveal a specific role of South Africa, again highlighting the importance of this country as an anchor country for GVC participation in Africa. Other key factors for GVC participation are the pattern of inward FDI, openness to inward FDI, trade facilitation and logistics performance, intellectual property protection, quality of infrastructure and institutions, etc. All these factors are rather weak and neglected in most RECs of Africa, but have importance for a deeper regional integration and for an increase of the participation in GVCs. A balance is indeed needed between deepening regional integration (as a form of learning by doing and preparing for competition in international markets) and more openness towards global trade (so as to avoid trade diversion and reduce the cost of sourcing intermediaries). Industrial policy and trade policy at the national and the regional level should aim at such a balance.

The low level of trade in processed intermediate inputs in Africa is particularly worrisome. The positive relationship between a higher share of imported intermediate goods in overall imports and export competitiveness holds also for Africa. In order to increase export competitiveness, importing high quality and cost-effective intermediate inputs for further processing in the country is a key factor. The anchor role of South Africa in terms of GVC participation and as a hub for the import and export trade of intermediate goods to African countries should be strengthened. Also Kenya, Mauritius, Ghana, and Nigeria have a potential role in this regard but it is not yet exploited. So South Africa may have a lead role and an impact on SACU/SADC and EAC countries, but also on these four countries with potential when they deepen their GVC participation (OECD/Kowalski P. et al, 2015, p. 65). In contrast to this, Western and Central Africa need to stabilize first their bilateral trade relations as export success in the region is not enough consolidated; only few bilateral trade relations survive. In order to diversify exports export successes need to become less vulnerable, what requires new policies to support exporting sectors and firms; this can be done especially by creating the capabilities and the preconditions for GVC participation in Africa. To some extent countries in Eastern and Southern Africa are an exception in Africa as also the potentials for a GVC participation in services are great (OECD/Kowalski P. et al, 2015, p. 70).

FDI openness is very important for building and consolidating regional and global value chains. FDI openness is however quite different between African countries (in this respect Rwanda is quite closed while Zambia and

South Africa are quite open; and some countries like Ethiopia are in the process of further opening the country for inward FDI). It is acknowledged that FDI openness could change much of the GVC landscape in Africa. But within RECs and between RECs in Africa FDI flows are insignificant what limits the development of regional value chains (RVCs). Related to this factor is the burden of trade costs. Firms in Africa have a huge burden when trading within RECs and between the RECs in Africa. The cost of trading intra-regionally in Africa (in Eastern and Southern Africa and in Western and Central Africa) is about twice, three and six times the equivalent cost of transporting goods within MENA, the European Union, and North America (OECD/Kowalski P. et al, 2015, p.45). Also related to these factors is institutional quality and intellectual property protection (measured by various indicators); only few countries have an outstanding performance in Africa.

Are the sub-regional and local development impacts of Africa's participation in regional and global value chains gainful?

For studying the impacts of GVC participation, it is useful to look at the transmission channels as there are many. A proposed classification (as presented by World Bank/Taglioni and Winkler 2014) shows that large positive developmental effects can be expected, if some conditions prevail: pro-active government policies at national, sub-regional and local levels are the most important precondition for any economic and social upgrading through GVC participation. This implies that the government supports the creation of the six capabilities mentioned above, and that it is also involved in screening the structure of the respective GVC so that the transmission channels can be positively and sustainably impacted on. Four major groups of transmission channels of GVC participation are distinguished (see World Bank/Taglioni and Winkler 2014, pp. 6-8):

First, linkages (backward and forward linkages) play a role; sales of GVC-intermediaries to the local economy for further processing and productive use (forward linkages) matter as well as GVC-linked purchases of local inputs (backward linkages). It is argued that there is a “demand effect” as lead firms demand better and more inputs from the local economy, and there may also be an “assistance effect”, in case the lead firms assist the local producers (with knowledge/technology transfers, advance payments for working capital, and training, etc. As a sequence, these linkages may have technology spillovers and will improve the productivity of local firms. It is assumed that there may be a “diffusion effect”, because assistance leads to diffusion of knowledge, and availability and quality effects as GVC participation may positively impact on the availability and quality of inputs.

Second, GVC participation may help in restructuring markets and industries, thereby leading to increased competition. Not only the firms for participating in the GVC may benefit, but also unrelated firms. It is assumed that there is a “pro-competition effect” as the competition for scarce resources increases in the country; and there may also be a “demonstration effect” as local firms will learn to imitate and/or to start even “reverse engineering” of GVC products, processes, business models, etc.

Third, minimum scale achievements will occur, such as an “amplification effect”, as pro-competition effects amplify with the effect that investment in infrastructure and in specific services is amplified. The newly built infrastructure will then stimulate local production further. The minimum scale achievement via GVC participation will also have “sustainability effects” as the new logistics and transport infrastructure may lead to a more sustainable GVC participation of the country.

Fourth, there are also labour market effects as the demand for skilled labour increases (“demand effect”) from the side of the MNCs and of other GVC participants. It is assumed that local firms catch up and improve productivity and demand for skills also. It is further assumed that there is a “training effect”, meaning that local firms receive more training in skills than others not being participants of GVCs. With a “labour turnover effect” the knowledge of the workers moves to other local companies and industries.

What is the reality in Africa, and to what extent can the African firms exploit these effects of participating in GVCs. Do these transmission channels lead to “economic upgrading” (by gaining competitiveness in higher value added processes and by raising labour productivity and skills)? And, does GVC participation lead to “densification” (by creating more and better jobs, spillovers from FDI, and by engaging more local firms in the GVC networks)? And is there any “social upgrading” resulting from GVC participation in terms of living standards, income redistribution, and progress with democratisation, human rights, labour rights and gender equality, etc. (World Bank/Taglioni and Winkler 2014, p. 6)? The many international reports and case studies dealing with these issues bring a huge amount of materials, but not so much clarity. Even new questions emerge.

Concerning the role of GVCs for Africa’s industrialization, the African Economic Outlook 2014 (see AfDB et al. 2014) is a valuable source of evidence. A main issue is what Africa can do to improve the GVC participation of its Least Developed Countries (LDCs) from the lower end (with low value addition and limited upgrading and densification effects). It is also not clear how to include the poor and the marginalized people better into GVCs, in terms of land, financing, education and training, and how to increase their productivity and their resilience. Another issue is how to make low income and middle-income countries benefit more from GVC

participation. Obviously regional integration can play a role as LDCs as well as low income and middle income countries are part of the African regional economic communities (RECs). In both cases, for the LDCs and for the other African country groups, it is not so clear how the key capabilities can be strengthened and what pro-active policies can achieve so as to open the many transmission channels in Africa which were mentioned above.

So far, the impression is that all this works only in a few country cases, such as in South Africa and in Mauritius. Although the African Economic Outlook 2014 emphasizes that Africa is participating at a relatively high level in GVCs (compared to its exports), the links are mainly of the forward type, as Africa supplies mainly raw materials to exporters of processed goods in other countries. Africa is so involved in many global value chains in the form of forward integration, while backward integration into GVCs is much more limited. But, the empirical evidence also shows that African countries with a higher share of foreign value added in its exports (meaning backward integration) experience higher productivity growth and more structural change than other countries. But the opposite is true for countries with a low backward integration and a high forward integration into GVCs. These countries show negative links with measures of structural change and diversification (see the summary results by Conceicao, P. et al., 2014).

Social upgrading is not strong as revealed by employment figures (Conceicao, P. et al., 2014). Some countries go for better (such as Ethiopia as with apparel), but others lose by GVC participation, and even some of those with a higher level of GVC integration (South Africa and Egypt). Overall, the number of jobs created directly by GVC participation is quite limited so that all would depend on the full working of the many transmission effects on the local economy. Other countries show thriving export sectors (such as Tunisia in textiles, apparel and electrical machinery, and Cabo Verde in tourism), but the linkages to the local economy are rather weak or non-existent. Also, GVC participation is associated with the risk of countries to become more vulnerable to shocks (such as sudden slumps in global demand). Countries have to manage these risks what also has cost. Social protection policies are important in this regard, but are not everywhere in place.

The power structure in GVCs is important and differs largely between buyer-driven and producer-driven GVCs. The buyer-driven GVCs (such as apparel and horticulture) have close links between producers and consumers via supplies to retailers, and so the role of middlemen can be minimized. Upgrading into higher value added niches is easier in the case of buyer-driven GVCs. Kenya's export of flowers is considered a success story but quality standards are important and create entry barriers to smaller producers and small and medium enterprises (SMEs), so that social upgrading may be limited. Also environmental problems may be part of this GVC participation.

Producer-driven GVCs (such as cocoa or coffee in agriculture, automobiles and microchips in manufacturing, and extractive industries) offer fewer possibilities for upgrading into higher value-adding stages in the GVCs as the production processes are strictly controlled by lead firms (Conceicao, P. et al., 2014). South Africa's automobile sector is considered a success story as the country has developed upstream capabilities by research and development, supplier services and component development and manufacturing. Ethiopia, Kenya and other countries did well with organic and fair trade types of cocoa and coffee. But the effect on employment may as well be quite limited.

In order to overcome the three key impediments for a deeper GVC participation (quality standards, high costs of transport and energy, and poorly trained workforce), action at the level of regional economic communities (RECs) is needed. A stronger and more diversified service sector can be developed on this basis and is needed for a deep GVC participation. Africa's share of global service exports is decreasing, while being so important for manufacturing export successes in other parts of the world. It has to be recognized that on average 30% of the value of manufacture products globally is added in the form of services (Conceicao, P. et al., 2014). The inadequate provision of public and private logistics, business and extension services restricts the expansion of small firms, as design, R&D, marketing, after-sales care, etc. are limited. More than pursuing conventional skill development policies, future-oriented skill development policies are requested, but so far even in South Africa such policies are scarce. Despite of so much emphasis on regional value chains in Africa, only Southern and Eastern Africa incorporate in their exports a reasonable share of imports from other African countries. This also reveals that Global Value Chain (GVC) participation and Regional Value Chain (RVC) participation are related to each other and are not crowding out each other. The two forms are complementary.

A new policy framework for a deeper GVC participation in Africa rests on trade policy reforms (to facilitate trade of intermediaries and of final products), on fiscal policy reforms (to remove unnecessary investment incentives and to concentrate on public infrastructure investment, workforce skill development, security and rule of law, education and health), on entrepreneurship development (to increase the entrepreneurial base), and on public-private collaboration so that better policies and better laws support a deeper GVC participation (Conceicao, P. et al., 2014). Business associations play in this context a great role and should be activated. The Ethiopian Textile and Garment Manufacturers Association (ETGMA) is now, based on the success of the industry, considered as a critical partner for government

and for international lead firms like H&M. Also the Kenyan Flower Council (KFC) is credited with such a role.

Recently, the literature on GVC participation in Africa is presenting a lot of advice regarding pro-developmental public policies for African countries (see for example: AfDB et al. 2014, ACET 2014, AfDB 2013, UNECA 2013, AfDB 2014, AfDB et al. 2015, AfDB Group 2013, DBR 2014, Draper/Lawrence 2013, Ramdoo 2014). The advice has to be applied to countries with substantial differences in their development paths and their development opportunities. Also the role of strengthening global trade rules and regulations in a manner facilitating GVC participation is strongly emphasized, as this may benefit Africa's development (see: OECD/WTO 2013a, 2013b, UNCTAD 2013a, 2013b, WTO 2014, WTO/Jansen et al. 2014). It is not so clear how Least Developed Countries (LDCs) can benefit from such national and global reforms, and under which conditions (according to Piorebelli 2008 in this country group there is not only a need for pro-active public policies but also for capacity building in trade, industry, technology, etc.). So, the literature is listing a lot of development potentials for Africa by GVC participation, if public policies are reformed and if global system reforms take place. The case of South Africa, a country seen as a hub and an anchor for GVC-related developments, shows also actual developments in various sectors, areas and countries, not only potentials (see: AfDB et al. 2014, Afrbiz 2014, Muchopa 2013, OECD 2013, Staritz/Morris 2013). However, also in South Africa there is a need for pro-active policies to strengthen the GVC participation.

2 The Contributions

In this Unit 3 to the volume 18 three cases of value chains are presented – the case of diamonds, the case of sesame, and the case of shea butter. These are cases where forward linkages to processing actors in other countries matter. So far, raw products and only slightly processed products (diamonds of Botswana, sesame of Sudan, and shea of Ghana) dominate the value chains in the origin countries, but for all the three cases it is true that there is potential to process the raw products locally in the three countries. However, these three case studies also show that there are quite severe constraints for local processing. Nonetheless the local production is important for employment and poverty reduction, but much more value added could be generated and employment opportunities for skilled labour could emerge. These products are important for the local economy, for job creation, for the generation of public revenues, for the employment of women (as in the cases of sesame and shea), for the employment of poor segments of the population, and obviously

there is potential to restructure these value chains so as to make them generate more value added for the economy and higher profits for the local businesses.

In the first contribution to Unit 3 of this volume 18 of the African Development Perspectives Yearbook with the title “*Technological Innovation and Export Diversification through the Development of Diamond-Processing Capabilities in Botswana’s Diamond Cutting and Polishing Industry*” the author *Letsema Mbayi* emphasizes the important role of a specific capability for improving the diamonds value chain in Botswana towards a more effective integration into the global value chain of diamonds – namely, technological innovations. Also, a new industrial policy is recommended so as to broaden the export basket of Botswana – namely, a coherent strategy of export diversification. Botswana is the world’s largest producer of diamonds by value and since independence diamond revenues have contributed significantly to the country’s development. The country became known for its prudent use of diamond revenues, as accountability and transparency characteristics of public sector management were praised for long. However, Botswana is still a country with a quite narrow export basket and with a low level of sophistication of its export products. Also, the problem of diminishing resources (of diamonds) and the high cost of developing new productions sites for diamonds had impacted on government policies. Two strategies were followed –first, increasing the share of processing by cutting and polishing raw diamonds, and second, establishing a more elaborate policy framework for export diversification by promoting other and more sophisticated export goods to be included in the export basket.

Because of the importance of a single global actor in the diamond sector, Botswana had to come to terms with DeBeers, the giant corporation in the sector. In light of the imminent resource depletion in Botswana, already in 2005 the Government of Botswana signed an agreement with the country’s largest diamond producer, DeBeers, to add value to diamonds by beneficiating them locally. This agreement was not easy to reach, but has brought with it some changes at the national and at the global level for diamond producers. By June 2014, 20 cutting and polishing firms, known as Sightholders, had been licensed and were operating in Botswana. A Sightholder is a firm on the De Beers Global Sightholder Sales’s (DBGSS) list. The list consists of authorized bulk purchasers of rough diamonds. This list is definitely controlled by the De Beers Group, which is the largest producer, holder and processor of rough diamonds in the world. Previously, GBGSS was known as the DTC (Diamond Trading Company). The study by *Letsema Mbayi* is exploring the new relationship between Botswana and DeBeers on the way to guarantee the country a higher share of revenues by

cutting and polishing raw diamonds in Botswana. In this process of building a new relationship between the government and the transnational corporation a number of issues had to be solved and still lead to further negotiations.

These firms, named sightholders, receive regular rough diamond allocations on a number of conditions, including training locals with cutting and polishing skills. Traditionally the cutting and polishing skills in the country were learnt as a craft through long apprenticeships. However, the technological revolution that started in the industry in the 1980s has changed fundamentally the nature and the mix of skills used in the cutting and polishing process. This technological revolution since the 1980s had tremendous impacts on the industry in Botswana. In order to generate more local value added, the implications of the technological revolution had to be understood first, in order to enable the government to design and implement policies of technology acquisition, skill development, transfer of technologies, and IT development.

Technologies like laser, computer numerically controlled machines (CNCM), and computer-aided design (CAD) have increased accuracy and improved the quality of the polished diamonds. These technologies have simplified the skills needed by production workers and simultaneously enhanced the skills required in machine maintenance and IT use. The shift in needed skills and the need for IT skills are challenges also for higher education and further education in the country. It is obvious that Botswana can only generate a higher value added share on the basis of these new technologies, and the rush to the newest technologies in the field is continuing as progress is rapid with regard of these technologies. However, other capabilities for a more beneficial integration into the global value chain also matter, like skill development, finance, infrastructure, institutions, regulations, market intelligence, and informing the producers. It is not so obvious that the government is accepting these tasks as priority issues, despite of the dependence on this export sector. Also, industrial policy has to focus much more on a coherent export development and export diversification strategy. Despite of some institutions being responsible for this issue, their impact is insignificant as the study brings out. Botswana obviously is just starting to develop such an integrated strategy.

The author has collected primary and secondary data for this study in Botswana, Israel, India, and in the United Kingdom, and on this basis he argues that being a latecomer to the diamond cutting and polishing industry Botswana has immense changes to perform in the years ahead but may also benefit from leapfrogging to the most efficient technologies. But, leapfrogging is not without cost, as a certain environment is needed to leapfrog with regard of such technologies. Anyway, leapfrogging may help the country to build the diamond-processing capabilities, and there is

evidence of a strong growth in polished diamonds exports of Botswana between 2008 and 2013. The development of more sophisticated diamond processing skills is crucial if the country is to secure also in the future, after depletion of diamond resources, economic gains from the diamond sector. This means that the country could then even import diamonds for local processing. The limits of the diamonds processing strategy are discussed, as well as the role of needed capabilities and policy preconditions.

In the second chapter for the Unit 3 with the title “*Sudan’s Sesame Export Supply Capacity Constraints: A Value Chain Analysis*”, written by *Fadia Khalil Hassan*, an agricultural value chain is presented which as enormous importance for Sudan as major development regions and great numbers of households are affected. Sudan had a very strong position in sesame exports, but lost this position already before the Sudan became an oil exporter. The study presents empirical evidence by constructing a value chain analysis for the farmers and also one for the exporters. The data presented allow it to study the major constraints for competitiveness, and also the options for policy changes. Also, it can be seen on this basis how important the required six key capabilities for GVC participation in this case are and which policy preconditions for GVC participation matter most.

For decades Sudan has built a network of export channels and has successfully exported good quality sesame seed; Sudan was becoming one of the top exporter’s worldwide. However, the last decade saw a sustained loss in Sudan’s share in some of its key export destinations. In this context, using the Value Chain (VC) analysis approach, the chapter investigates the export capacity constraints to white sesame exports. The exporters’ VC found out that some key factors are responsible for this loss: the direct taxes are high and constitute 34 percent of the total cost of exporting one ton of sesame; the transport costs amount to 20 percent; the Central Bank of Sudan (CBoS) collects 10 percent of the export proceeds from the exporter; and the USA sanctions on Sudan are an additional burden for the exporter as about 2.5 percent of the export proceeds are extra costs of carrying financial transactions indirectly. Further analysis of the VC, using Nominal Protection Coefficients (NPCs), revealed that the border parity price at the official exchange rate is 36 percent lower than at the parallel rate. Lowering direct taxes would reduce the burden shouldered by the exporter quite considerably. Thus the chapter by *Fadia Khalil Hassan* concludes that major policy distortions impact quite negatively on the sector, and that the (official) exchange rate overvaluation taxes the exporter the most. So the government of Sudan is adding to the major production problems (cost of labour and low yields) by overtaxing the producers in various ways (high direct taxes, high transport cost, the CBoS tax on export proceeds, and the impact of sanctions on cost, etc.).

As for the farmer in the sesame sector the two most binding constraints are the high cost of labour and the low yields, the VC analysis shows that some distinct pro-active policies are needed. Farm labour changed from being abundant to becoming scarce, because of migration, oil sector developments, gold mining demanding labour, etc. Thus, Ethiopian labourers from across the border were hired, adding the burden of logistics for labour recruitment to wages and so pushing the share of labour input to 70 percent of total production costs. The use of mechanical harvesting, which was introduced recently, and being much cheaper than manual harvesting, has been constrained by a limited supply of harvesters. There is no national strategy for labour to support the sector (the areas of labour supply, qualification and further education, migration and recruitment, etc. are neglected). Another traditionally binding constraint is the low yield in sesame production. There is a severe lack of supporting systems (R&D, extension services, high cost of fertilizer, problems with infrastructure and trading systems, gaps with finance and agricultural innovation systems, etc.). Fertilizer use, although more than doubling the yields, is limited in sesame production; the large scale nature of the sesame farming system demands large quantities of fertilizers and makes its application costly and thus the use is very much limited.

Therefore the major conclusion of this chapter is that the present production and marketing structure with respect to sesame is non-optimal and that a concerted effort by the government is needed to provide a sound macroeconomic and financial environment together with adequate physical infrastructure so as to enhance sesame seed production and export. Sesame production can have strong income and poverty reduction effects, and can be scaled up again if the key capabilities for GVC integration are created and if the policy preconditions for GVC participation are introduced. Also the processing possibilities are underestimated so far, but steps forward request that informed producers emerge in Sudan and get support.

In the third chapter to this Unit 3 with the title “*The Global Value Chain of Shea Butter and Rural Producers in Northern Ghana*” the authors *Martha A. Awo and Felix Agyie-Sasu* draw the attention to a value chain which is of utmost importance for the rural producers in countries like Ghana, but also in other West African countries. The case is so important as shea production affects huge areas and a great number of rural producers, mainly women. These are affected by any decision of the lead firms of the GVC, but also by any change in demand occurring on the global market. In recent times, the shea sector has seen rapid growth with increasing demand for its products. This has various reasons, global and domestic ones. The shea tree grows in the wild in Northern Ghana and is a major source of livelihood support to small-scale producers and rural households. It is of great

importance in particular for small female producers who are traditionally the main producers. Thus, the collection and processing of nuts into butter is traditionally reserved for women, making it the only sector where women have the use right. The shea value chain is therefore of great interest for development organizations, for donor agencies, for women organizations, and for poverty alleviation NGOs. The shea sector also became a preferred area for public interventions so as to pursue a regional development policy for poverty alleviation, employment creation and rural growth. This sector seemed to be of interest for developing so far neglected areas, such as in Northern Ghana. Via this case the impact of a global value chain (GVC) on sub-regional and local community development can best be studied. Based on valuable information from and a fruitful cooperation with development organizations which are working with shea producers in Northern Ghana, the two authors have gained substantial insights about the developmental implications of shea production which is organized within a GVC.

However, in view of the current shea-butter demand explosion in the Global North, drastic changes are needed in the producing areas like in Northern Ghana. Following the high demand by cosmetics and confectionary industries in developed countries, there is now a growing concern about the ability of the rural woman in Northern Ghana to adapt to the new situation, and to engage competitively with the demand arising from large and growing global markets. As the global markets demand a secure (stable) supply of high quality produce, the impulses from the lead firms/lead traders in the value chain to the rural producers could be strong enough to modify the traditional production systems. The local production system is still basically oriented to supply produce for the local (residual) demand, while the global market demands stable supplies by volume and quality, but also with regard of delivery dates. This also affects the provision of infrastructure (storage, transport, production and communication technologies, market infrastructure, etc.) and the development of education and training systems in the rural areas. The key capabilities (as mentioned above) are not developed in Northern Ghana. Capabilities for participation into GVCs (with regard of product and process technologies, hard and soft infrastructure, local and global finance, market regulations, market institutions, market surveillance, etc.) and policy preconditions (for the production, trading and processing in the shea sector at all government levels) have to be created. And, the greatest weakness obviously is the fact that “informed producers” are rare in the shea sector. On behalf of the rural producers (most of them being uneducated) some development organizations make decisions. It is therefore necessary to start with a developmental transformation of the sector.

While the gap with regard of capabilities and preconditions for a deeper participation of the shea producers into the global value chain poses a serious

problem, another key issue is the severe imbalance in power structures between the global business actors and the local producing actors. This imbalance could so far not be reduced, despite of some development work at the local sites. The power structures which are seen on the global markets, in the shea value chain, and at the national, sub-regional and local levels in Ghana are investigated by the authors of this chapter so as to find out where pro-active policies could start. While the rural producers lack the key capabilities for participating more beneficially into the shea global value chain, at the level of national politics and with regard of the policies at local and sub-regional levels there is an awareness gap about opportunities, constraints and necessary reform options.

At the local level, the powerful business actors with their complex market strategies take advantage of the women's poor knowledge of the market. Despite of some Development NGOs being active at the local level, they could so far not do much to inform the producers about innovative ways to produce for larger markets. On the other hand, the rural producers are deliberately left uninformed, even by some of their own representatives (women's development organizations, development NGOs, local business people, and local government offices and officials). In order to rebalance the power structures much is needed (knowledge transfers, disseminating information about the markets and their dynamics, training, further education and extension, and more generally, creating the capabilities and preconditions for GVC participation). Key priorities should be envisaged and then implemented. Disseminating knowledge about market trends, market niches, marketing channels, quality assessment, new production and process technologies, and information about the functioning of the shea value chain could help to change the power relations.

In the global value chain of shea, the global market demand is increasing and changing, the market channels are becoming increasingly complex, and value addition at the producer level is an opportunity which can be realized by continuous quality increases and by steady supplies of the desired quantities. The authors *Martha A. Awo and Felix Agyie-Sasu* concentrate themselves in their analysis on the power relations within the Value Chain (VC), looking at them as a major factor impeding structural change at the level of the producers. It is argued that local development effects will come forth only when the power structure in the VC allows it to benefit from pro-active policies, as in the areas of the key capabilities for GVC participation and the preconditions at the policy level. Increasing the value added by the producers would require that they get beneficial access to the complex market channels. This can be achieved by taking over certain service functions, such as quality assessment, extension services, training tasks, and transport and logistics functions. But this is not the case so far; there is no

trade of adding value by increasing the bundle of services which can be supplied by the producers. A rebalancing in the value chain would mean that at the lower levels of the value chain new functions are taken on, leaving key management and logistics functions to the organs of the lead firms which are doing the market surveillance. So far the potential for value addition, increasing skill levels and raising quality standards is not exhausted; there is no trend towards an informed producer yet..

It is the general concept of a successful GVC, looked at from the developmental point of view, to disseminate welfare improvements by integrating the producers into the global market. Positive impacts on the rural shea producers are assumed to come in via backward/forward linkages, technology spillovers, market restructuring, minimum scale achievements, and via the labour markets. At the same time the country could take advantage of the transformational potential of shea by supporting economic and social upgrading of the rural processors/people. More public revenues, more exports, export diversification, and employment and income increases could result from all this. In principle, the sector should then become a key sector for poverty alleviation in the neglected North of Ghana. However, these transmission, transformation and upgrading effects did not show up yet. The developmental intentions are there, but the so far policies and actions could not change the power relations in the GVC and could not empower the small-scale producers by making them informed actors so as to be able to improve their livelihood.

In order to establish the linkages between the market dynamics, the GVC power relations and the working conditions of the small producers (mainly women) within the local context, the study employs both primary and secondary data sources so as to analyse the value chain processes, the perspectives of this rural industry, and the implications of the production processes under the GVC regime for the livelihoods of the rural people. The study comes out with a main conclusion: local development actions are not effective if not the whole structure of the GVC is considered and impacted by pro-active policies at the national, sub-regional and local level.

The three GVC case studies reveal important policy lessons. The linkages of the GVCs to the domestic economy are not strong, neither in Botswana (diamonds) nor in Sudan (sesame) or Ghana (shea). The backward and forward linkages are weak or non-existent; local industries are not supported and new services do not play a great role. In the case of Botswana there are ambitions in this direction, but not yet realized. With regard of diffusion of knowledge, technology transfers, and knowhow accumulation within the GVC, by lead firms and their intermediaries, evidence on substantial effects was not presented in the three case studies. Also other effects (market restructuring, minimum scale achievements, and positive

labour market changes) did not materialize in a substantial way. Because of all this the producers in these value chains are not becoming more informed and more entrepreneurial in the process.

Neither “upgrading” effects (gaining competitiveness in higher value added processes) nor “densification” effects (getting better domestic jobs, engaging local firms, benefitting from spillovers from foreign firms and lead companies) are prevalent. Also, it is not obvious that the integration into these three GVCs has led to an economic upgrading in a wider sense (of better working conditions, higher living standards) and to forms of social upgrading (in terms of human rights, democracy, gender equality etc. The assumed upgrading and transmission effects of the GVC participation are not becoming visible in the regions where the producers are living and working. While this is extreme in the cases of sesame and shea, also the diamonds case reveals quite limited effects. The three GVCs discussed in the Unit 3 also show that deliberate action at national, sub-regional and local policy levels can lead to change, so that local, sub-regional and national benefits of GVC participation are coming forth. However, without deep public commitment and new and more effective forms of cooperation with private actors these changes are not to be expected. It can also be anticipated that regional integration (as for these cases in SADC/SACU, COMESA, and ECOWAS) can have beneficial effects for the local producers in the future, by increasing the overall returns from GVC participation, but any form of regional integration will not be a substitute for action at national, sub-regional and local levels.

3 The Strategy

Developing the Key Capabilities for GVC Participation

GVC participation depends on six key capabilities. These capabilities have to be developed and strengthened. Most important is entrepreneurship development and the information of the producers about market opportunities - in terms of new products and regions in established and new GVCs. Entrepreneurs can benefit from the services of business associations, producer associations, farmer associations, women associations, and in general from a deeper public-private sector business dialogue. Also technical innovations and R&D can be promoted by strengthening the national innovation system (NIS) of the country, the sector-specific innovation systems (SISs) and the agricultural innovation systems (AISs). Skill development needs also much more of a concerted action between participants of GVCs and actors in the higher education, vocational education

and training institutions. For adequate infrastructure and finance national infrastructure and finance sector development plans are important. These can be linked with regional integration policies. Appropriate institutions and domestic regulation are key areas for successful GVC participation and it is necessary to specify which regulatory institutions are of key priority (such as those for technical standards, safety and health standards, labour and training standards, etc.). These institutions can be strengthened by concerted action between national and regional integration actors. Market orientation and market intelligence are issues for a deep sector-specific dialogue between GVC participants and public sector institutions (like export development agencies, trade promotion departments).

However, the examples from this Unit 3 also show that the basic policies have to be corrected first. If exchange rates are overvalued, if taxes are too high, if political instability affects production, if trade is not facilitated by building transport and logistics infrastructures, if there is no policy on stimulating competition between traders and processors, if commodity exchanges are not working, etc., then the GVC cannot work in the country.

Identifying the Power Structures within the GVCs

Power structures are unequal between the lead firms (and its intermediaries) and the low end producers (small farmers and workers). This is especially so in GVCs for agricultural products and for light industry products, but such power imbalances may also emerge in services value chains, like in tourism. Very strong are these power relations in the extractive industries. Power structures matter in buyer-driven and producer-driven value chains. The lead firms in retail business have a very strong market power, as they have direct access to millions of consumers. But the key lead firms in producer-driven GVCs are also strong because of the innovation capacity, the production standards, and the hierarchy of their organisation implying a very strict governance model. There is a lack of information about the plans and actions of the lead firms so that national governments, regional integration institutions and business associations are well advised to improve the dialogue with them concerning the planned expansion of production and of other activities in the country, the prospects for involving new actors and new sub-regions in the country, and the opportunities for higher value addition by the local producers. Lack of interest from the side of government institutions and also from the side of business associations to get such information is a problem. At the low end, the work of local development NGOs and of national, regional and international development organisations aiming to empower the producers, especially so the women, is not effective enough in strengthening cooperative action so as to improve the real situation of the

producers. The examples of GVC participation in Unit 3 show that the producers are not getting empowered by trade unions, development associations, cooperatives, etc. This has to change by pursuing a new concept of collaboration between GVC lead firms, public and private sectors, and the civil society.

Assessing the Relevance of the Various Transmission Channels

The knowledge about the many transmission channels from GVCs to “upgrading” (in the economic sense of adding more value and increasing productivity and in the social sense of contributing to poverty reduction and better working conditions) and to “densification” (by creating more and better jobs and involving more local firms into the GVC network) is too weak in most of the African countries where GVCs interact with the local economy. All the four groups of transmission channels need more awareness from the public sector and from the private sector, but also from the civil society: a) the backward and forward linkages and the related technology spillovers, b) the market restructuring effects, c) the effects through minimum scale achievements, and d) the labour market-related effects. It is not possible to devise and design strategies to maximize the benefits from GVC participation if this knowledge is not provided. For too long these effects were assumed to occur but empirical evidence was not presented. This then leads to inappropriate policy decisions, such as granting high investment incentives, applying in a lax manner labour laws and environmental laws, neglecting policies to strengthen the linkages of GVC participants with non-participants in the local economy, and not pursuing of coherent industrial, agro-industrial, skill development, education, technology, R&D, and competition policies. The GVC cases in Unit 3 show convincingly that there is no coherent policy on backward and forward linkages, no coherent policy on market restructuring the market economy and strengthening competition, no coherent policy on infrastructure and optimizing the scale of scale of production, and no coherent policy on labour markets, training and skill development. The GVC participants are left alone in their endeavours.

Using more fully the GVC Anchors and GVC Hubs in Africa

All the studies on GVC participation in Africa come to the same conclusion: South Africa is an anchor and a hub in the further development of GVC participation in Africa. This has to do with the strong participation of South Africa in various important GVCs: mining, agro-industries, beverages, finance, automobiles, tourism, etc. This extends to the regions of Eastern and Southern Africa, to the regional zones of SADC and SACU, but overall the

impact is wider, as foreign investments of South Africa also take place in other African regions. The potential for building regional value chains is great, and the opportunities for becoming an even stronger player in global value chains are considerable. Most of the globally competitive high profit corporations in Africa (the “African Challengers” and the “Global Challengers”) are located in South Africa. South Africa is building regional value chains in sugar, beer, retail shopping, finance, mining equipment, tourism, etc. All over Africa, the anchors and hubs play an increasing role for GVC participation. Regrettably, the other SANE countries beside of South Africa (Algeria, Egypt, and Nigeria) are not so successful in building regional value chains and also fail to become big players with regard of GVCs. Recent integration moves in ECOWAS and in EAC regions (already being customs unions) can contribute to forming regional and global value chains. But at the time these are ambitions and plans, not realities. Nigeria, Kenya, Ethiopia, but also countries like Algeria and Egypt, can play some role in building some regional value chains, mainly in the agro-industrial field, in the extractive industries, and in the light industries, but the key capabilities and the basic preconditions for all this are not yet there.

Making Regional Integration work for deeper GVC Participation

“Transformative regional integration” as discussed in Unit 1 will also support the building of regional value chains. As “transformative regional integration” is not based on a simple and linear model of regional integration but on a common strategy of structural transformation: by building regional infrastructure, by increasing cross-border investment and technology flows, by facilitating flows of skilled labour in the region, by designing and implementing common industrial, agro-industrial, and transport and logistics sector policies, common science, technology and innovation policies, as well as common competition, trade and investment policies, and by pursuing cross-border environmental policies and action plans to protect nature and to develop tourism. So this type of regional integration is supporting the build-up of regional value chains. As the case of South Africa in SACU/SADC regional integration shows, the country is with its important value chains in the process transforming regional integration. Regional integration in Southern Africa is far ahead of other regional economic communities (RECs) in being transformative.

Transformative regional integration also entails common standards (technical, safety, environment, and health) so that consumer goods and capital goods can be more easily exchanged in the region. The “retail revolution” in Africa is strengthening the role of quality standards in the economic regions. However, much more of a transformative regional

integration is needed, as even in the SACU/SADC region ineffective regional policies prevent the upgrading of smallholder farmers into regional markets so as to benefit from the retail revolution. Transformative regional integration should also involve smallholder farmers and SMEs, but for this to occur much more action towards regional cooperation is needed. Also, value chains in the region, such as based in South Africa, can be exploited for building regional value chains and for involving the whole region in global value chains.

The involvement of South African retail firms in the apparel sector of Lesotho (to supply the South African market) shows that regional value chains can be made to work in parallel with global value chains (as apparel sector investments took place in Lesotho by Taiwanese firms intending to supply via African Growth and Opportunity Act/AGOA arrangements the US market). This case also reveals that buyer-driven lead firms from South Africa and producer-driven lead firms from Taiwan can coexist in Lesotho's apparel sector to the benefit of the country. The region benefits from exploiting the retail revolution, but also benefits from capturing the gains from the AGOA agreement. Also in other African regional economic groupings the retail sector expansion can push regional value chains (not only in food and beverages). South Africa is strong in various other value chains (finance, tourism, mining, automobiles, etc.), so that this potential can be exploited for broadening the building up of regional value chains. Adding value in Africa's mining, gas and oil sectors is seen as a necessity at the political level and as a new economic opportunity which is increasingly observed all over Africa, not only in Southern Africa. However, so far these value chains could not be modified, although the Africa Mining Vision (AMV) is a tool to develop regional mining policies and codes. These political actions can support Africa in adding value in global mining, gas and oil value chains and in building regional mining, gas and oil value chains. As a conclusion, transformative regional integration and the building of regional value chains are important challenges for Africa.

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Technological Innovation and Export Diversification through the Development of Diamond-Processing Capabilities in Botswana's Diamond Cutting and Polishing Industry

Letsema Mbayi*

1 Introduction

Botswana has been one of the most successful economies in Africa and its rapid growth has hinged upon its abundant diamond resources, which generated over half of revenues in 2002 and nearly a third of fiscal revenues in 2012 (BoB/Bank of Botswana, 2013). Botswana is the largest supplier of gemstone diamonds, supplying about a quarter of world's gemstone diamonds by value in 2011 (KPCS, 2011). However, unless a major diamond deposit is discovered, the government expects diamond mining to cease in the country in the next two decades as a result of resource depletion (GoB/Government of Botswana, 2007:6). To make the most of the existing deposits and to prepare the country for a 'life after diamond mining', the government has an ambitious plan to turn the country into a diamond centre with downstream capabilities that will add more value to diamonds and that can continue to benefit the economy when diamonds are no longer mined in Botswana. The first and most important part of this plan is to create an economically viable diamond cutting and polishing industry. To date 20 cutting and polishing firms have been started in Botswana and these employ close to 4000 people (Khama, 2014), who represent over a tenth of the manufacturing sector's employment. These firms are assured rough diamond supplies on a number of conditions, including that they transfer skills to local workers.

Traditionally the skills used to cut and polish diamonds are craft skills that were developed over long apprenticeships, but as a result of a technological revolution that started in the industry in 1980s the nature and the mix of the production and of the maintenance skills has changed significantly. This paper aims to investigate how the technological revolution in the diamond cutting and polishing industry has changed the skills needed in the industry

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and whether these changes provide an opportunity for Botswana to build diamond-processing capabilities. The paper starts by providing the background on the role of diamonds in Botswana's economy, the beneficiation strategy and the development of the local diamond cutting and polishing industry (Section 2). The paper then reviews the literature on the nature and types of technological innovations in the sector (Section 3). This is followed by a description of the technological revolution in the cutting and polishing industry and a discussion on how it has changed the skills used in the industry (Section 4). The paper then presents the findings on technological adoption in Botswana's cutting and polishing firms and on the formation of production and maintenance skills in the industry (Section 5). This is followed by a section on the changing export composition with regard of diamonds and the perspectives for Botswana's export diversification (Section 6). Lastly, the paper concludes in Section 7.

2 Botswana and the Diamond Industry – the Background

Botswana is a landlocked country in Southern Africa with an economic development characterized by the discovery and exploitation of diamonds. Botswana has achieved independence from Britain in 1966 after becoming a British Protectorate in 1885. At independence Botswana had an overwhelmingly poor economy and its largely rural population depended heavily on the agricultural sector. The discovery of diamonds shortly after independence by a geologist working for the DeBeers group of companies and the prudent management of diamond revenues that followed enabled the development of the country. Historically all diamonds were mined by the Debswana Mining Company (DMC), which is a 50-50 joint venture between the Government of Botswana and DeBeers; it operates four diamond mines in Botswana¹. Botswana is open to other producers, and recently new producers like Lucara Diamond Corporation² and Gem Diamonds³ have respectively started or are

¹ See about the company: <http://www.debswana.com/Pages/Welcome.aspx>

² The Karowe mine is now owned 100% by Lucara Diamond Corporation which used to have a 40% shareholding in the mine until they bought out African Diamonds in 2010. See more details about the company: <http://www.lucaradiamond.com/s/Home.asp>

³ DeBeers and Xstrata, who initially owned the Gope diamond mine, sold it to Gem Diamonds in 2007. The mine is located in the Central Kalahari Game Reserve and has attracted a lot of media attention due to a dispute between the government and the indigenous people of the Kalahari, commonly known as the "Bushmen" or "San", who have inhabited the reserve for centuries. The government sought to move the "Bushmen" from the reserve, stating that their way of life was no longer compatible

developing new diamond mines in Botswana. Unlike the Debswana mines, the government has no direct ownership in the newer mines. Instead, these mines were licensed on condition that their rough diamond production is traded locally. Furthermore, the companies are required to pay a diamond royalty of 10 per cent on the gross market value of production from the mines. It is not clear why the government has changed its strategy in terms of the ownership of the new diamonds mines.

During the period of 1960 to 2005 Botswana was one of the fastest growing countries being one of only 13 countries that had a consistent growth rate in excess of 7% per annum for more than 20 years (CGD, 2008:26). The discovery of diamonds in Botswana was bolstered by political stability, mature democratic processes, good policies and strong institutions that underpinned effective economic management for over four decades (WTO/World Trade Organization, 2010:96). Diamond revenues were financing key infrastructure development, by building roads, schools and hospitals, and providing an extensive welfare system to the country's population of about 2 million people of which more than half is urbanized. Botswana's impressive natural resource management and growth record has seen it dubbed as an 'African success story'.

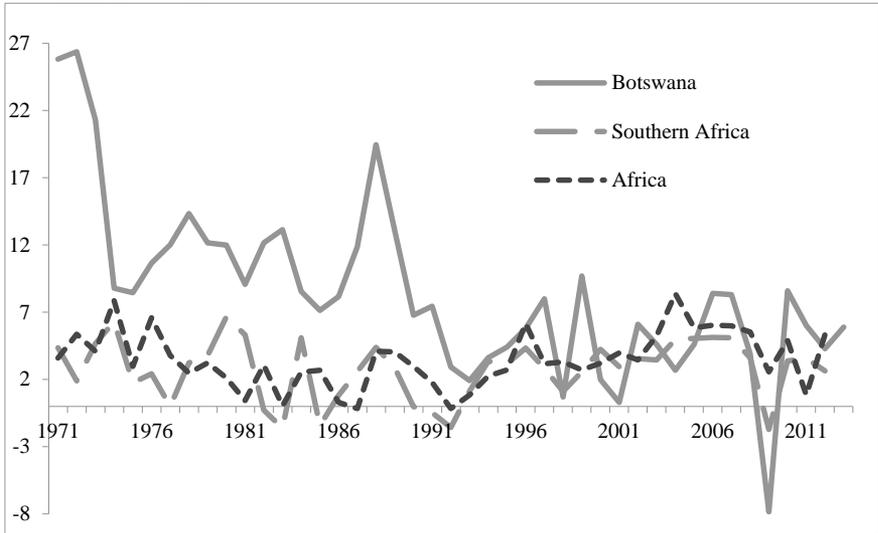
2.1 Diamond-Led Growth

It is commonly accepted that resource-abundant economies tend to grow less rapidly than resource-scarce economies, and the phenomenon is often referred to as the "resource curse" (Sachs and Warner, 1995). Botswana represents an exception to the "resource curse" rule by managing to transform mineral wealth from diamonds into economic growth and welfare quite well (see figure 1). From 1971 until the early 2000s, Botswana's gross domestic product (GDP) grew faster than the average GDP of African and Southern African countries. In the early 2000s, Botswana started growing slower than the average African country, mainly as a result of the maturity of the diamond industry and because of accelerated GDP growth in a number of Afri-

with wildlife conservation. The "Bushmen" subsequently took the government to court with the help of Survival Africa, which felt that the "Bushmen" were only being removed to make way for diamond mining. The "Bushmen" won the legal dispute and were let back into the reserve. Gem Diamonds was awarded a mining license early in 2011 and mining is set to commence in 2015. In July 2011, Gem Diamonds renamed the Gope Mine to Ghaghoo Diamond Mine, which reflects the local name for the area. Due to the thick sands of the Kalahari Desert this will be the only underground diamond mine in Botswana when it is operating. See more details about the company: <http://www.gemdiamonds.com/gem/en/home>

can countries. In the year 2009, for the first time since the 1970s, Botswana's growth was negative, as a result of the global economic recession that started in the third quarter of 2008.

Figure 1: Gross Domestic Product (GDP) growth in Botswana, Southern Africa and Africa



Source: Data from the World Bank Country Statistics for Botswana (1971 - 2007), Web Access: <http://data.worldbank.org/country/botswana>, and from the United Nations Aggregates Database for Botswana (2008 - 2012), Southern Africa and Africa, Web Access: <http://knoema.de/UNNAMAD2013/national-accounts-main-aggregates-database-1970-2012?location=1000530-botswana>, the chart by the author

Botswana's economic development process on the back of diamond mining was successful when looking at GDP growth, but was not altogether successful when looking at employment since employment indicators are rather disappointing. Unemployment rates in Botswana are very high for an upper middle-income country; the national unemployment rate is estimated to be 20% (Statistics Botswana, 2013a). Unemployment rates are particularly high among the youth, compared to other age groups, and overall unemployment is higher for females with 21.4% compared to the rate for males at 14.6% (Statistics Botswana, 2013a).

Despite the impressive economic growth rates in the decades following independence Botswana has to contend with a number of social challenges, amongst them the highly unequal distribution of income. The impact of eco-

conomic growth on the people has been highly uneven. Botswana is one of the most unequal countries, with a Gini coefficient of 0.645 in 2009/10 for household disposable income (Statistics Botswana, 2013). As a result of unequal growth one of the pressing challenges in Botswana is the pervasive poverty. The poverty rate of 19.1% is high for a middle-income country, and is even more severe in the rural areas (Statistics Botswana, 2013). Botswana also faces the challenge of the HIV/AIDS epidemic, with the second highest prevalence rate in the world. The Botswana Aids Impact Survey (BAIS IV) estimates the national prevalence rate to be 16.9% (Statistics Botswana, 2013a). The HIV/AIDS epidemic has taken the country backwards in terms of the human development indicators. As a result of these challenges the country is ranked 109th out of 187 countries in the Human Development Index (HDI)⁴.

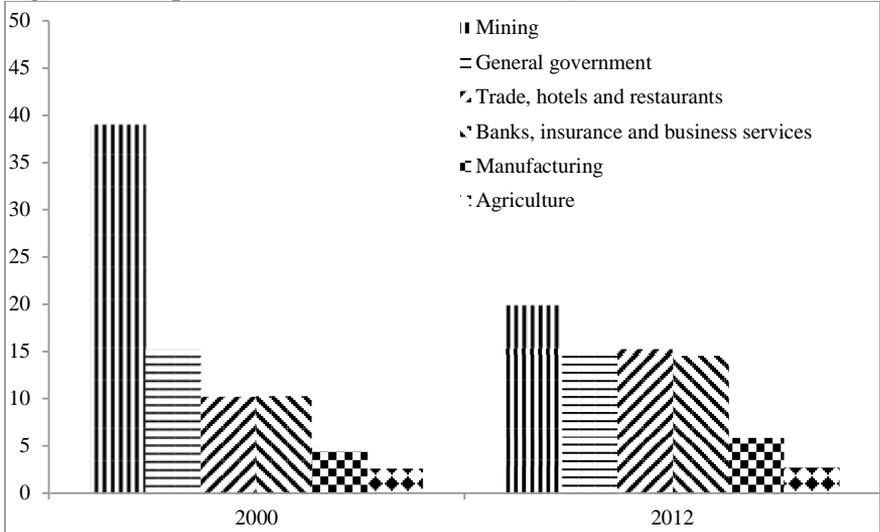
Botswana's diamond-led growth has resulted in an undiversified economy being dominated by diamond mining and public spending which is financed largely by diamond revenue. Before the recession that began in the last quarter of 2008 mining contributed to about 40 percent to GDP in 2000 and although this has since decreased to just over 20 per cent in 2012, mining activity is still the largest contributor to GDP (see figure 2).

Between 2000 and 2008, mineral revenues made up over half of government revenue of which most was sourced from diamond mining (see figure 3). Although Botswana also mines other minerals (like copper, nickel, gold, and soda ash), diamond revenues represent over 90 per cent of all the mineral revenues.

However, Botswana's diamond-led growth is under threat, according to the current National Development Plan (NDP) 10, as the Government expects diamond revenues to start decreasing in the next decade when opencast mining will come to an end and has to be replaced by the more expensive underground mining (Government of Botswana, 2009:6). Unless there are major new discoveries, government revenue from diamond mining will decline, at first slowly and then rapidly over the next two decades (see figure 4).

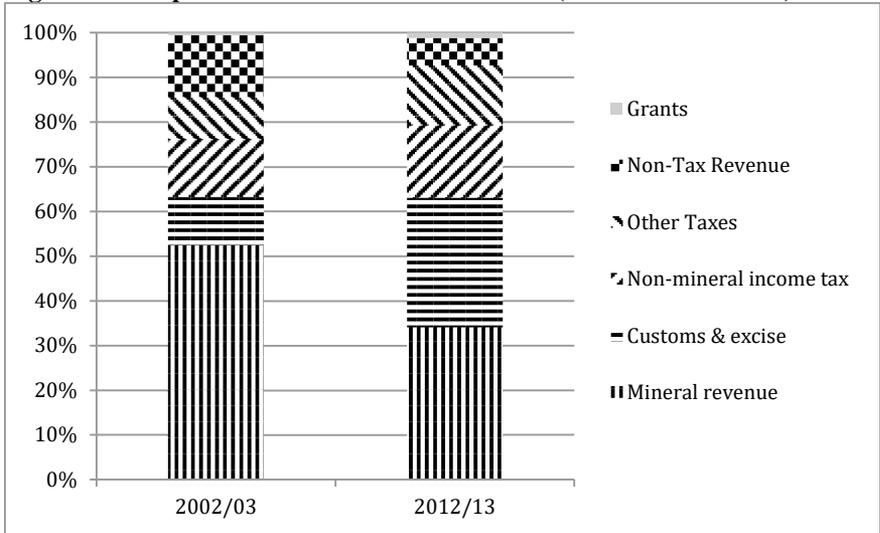
⁴ The index is available online at <http://hdr.undp.org/en/content/human-development-index-hdi-table>.

Figure 2: Composition of GDP in 2000 and 2012 (Selected Activities)

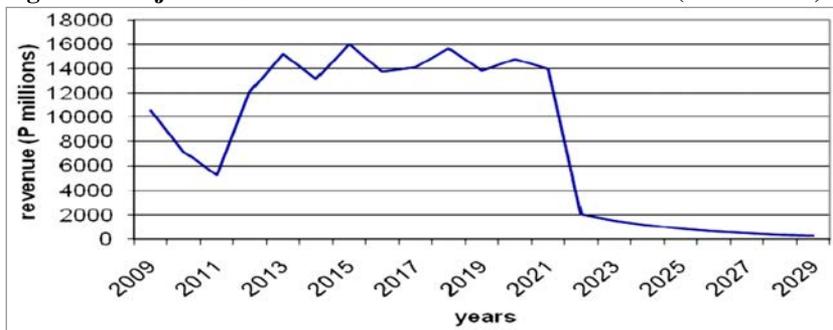


Source: Data from the Statistics Office (Statistics Botswana, 2013b), and chart by author

Figure 3: Composition of Government Revenue (2002/3 and 2012/13)



Source: Data from the Statistics Office (Statistics Botswana, 2013b), and the graph by the author

Figure 4: Projected Government Revenue from Diamonds (2009 - 2029)⁵

Source: Government of Botswana (2009)

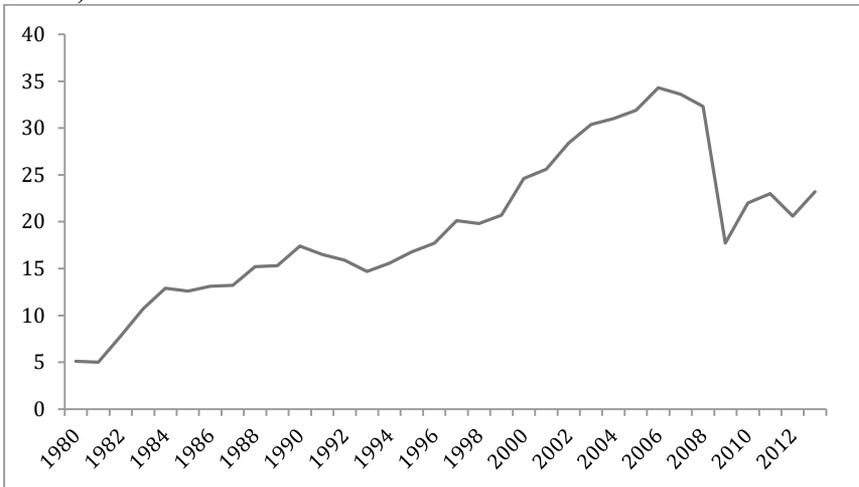
The government's projections are supported by DeBeers' recently published report (DeBeers, 2014) that states that the company expects that by 2020 many existing mines will begin to see decreased output and as a result the global supply of diamonds can be expected to decline gradually from 2020. Grynberg (2014) argues that depletion is more likely to take place in the 2030's or in the early 2040's mainly because Botswana's diamond production has not returned to pre-recession levels (pre-2009) of over 30 million carats per annum (see figure 5). Furthermore, the likelihood of new discoveries is high given current exploration activities (KPMG, 2014:23) and on-going projects⁶ to extend the lives of the current mines. These two factors together make it likely that depletion could take place later than suggested by Government's current projections.

In the light of the evitable depletion of Botswana's diamond reserves, the Government has decided that it is crucial that Botswana uses its remaining diamond resources to foster long-term economic growth through the private sector to create conditions of fiscal sustainability.

⁵ In Pula current prices; the Pula is the local currency which is roughly: 10:1 to the US\$1.

⁶ Debswana is currently undertaking the Cut 8 project to extend the life of the Jwaneng mine, the most profitable diamond mine in the world, by another 7 years and to ensure profitable and continuous production at the mine to at least the year 2025 (Miningmx, 21st March 2011).

Figure 1: Botswana's Diamond Production from 1980 to 2013 (in Million Carats)



Source: Kimberly Process Certification Scheme Statistics/KPCS various years

2.2 The Government's Beneficiation Strategy

The Government of Botswana holds the view that beneficiation, or the local processing of diamonds, provides a real opportunity for Botswana to grow the private sector and to create sustainable revenue. It is further argued that the local cutting and polishing of diamonds will promote local economic development, ensuring that a greater proportion of value derived from diamond exploitation will stay 'in the country' and will benefit local communities through increasing skills and employment. Botswana has benefited from the diamonds-based growth path through its partnership with DeBeers, with the Government of Botswana receiving over 80 per cent of Debswana's pre-tax profits (Even-Zohar, 2007:240), making the company the single most important source of government financing. The imperative question however is whether the country could have benefited more under a different arrangement with DeBeers that would have allowed for greater value added. This is especially due to the growth path's limited employment effects that mean that too many people still live in poverty despite the high GDP per capita and Botswana's classification as a middle-income country. Therefore, job creation is one of the factors driving the government's beneficiation policy. His-

torically, a number of government officials⁷ have questioned whether the DeBeers arrangement allows the country to take full advantage of its diamond resource and whether a beneficiation policy would not lead to greater local economic benefit through job creation.

Through the beneficiation of diamonds the government plans to prepare Botswana for a 'life after diamonds' by creating downstream competencies that can continue to be utilised when diamonds can no longer be mined in Botswana. The government's diamond beneficiation strategy is therefore a long-term one and a four pronged strategy that aims to create downstream competencies in the cutting and polishing industry, the jewellery manufacturing industry, the diamond trading industry, and in ancillary businesses. The first part of the beneficiation strategy and the focus of this chapter is the creation of a viable cutting and polishing industry. This is the base for the other three fields of competencies which are in the long-term interest of Botswana.

2.3 The Development of Botswana's Cutting and Polishing Industry

Even before resource depletion became such a prominent concern the Government of Botswana had already attempted to start a cutting and polishing industry in the early 1980s, mainly as a way of creating more employment opportunities in the diamond industry. At the time DeBeers did not support the government's ambitions, arguing that cutting and polishing activities were not economically viable in Botswana. However, according to policy directives to DeBeers led to the start of three cutting and polishing factories between 1980 and 1990. However, none of these factories ever reported a profit and critics have gone as far as saying that the companies reported a loss in order to keep perpetuating the DeBeers' notion that beneficiation was not viable in Botswana. For example Even-Zohar (2007:243) stated:

"In the past, De Beers has vehemently opposed such aspirations; it has given 'lip-service' to domestic beneficiation, assuring (and making this point even visible) that manufacturing would not be profitable. The company did everything it could to prevent the establishment of more than two or three token manufacturing units."

Despite the government's failed attempt at establishing a cutting and polishing industry the government continued to push DeBeers for beneficiation. Botswana's real opportunity came in 2005 when DeBeers' 25-year mining

⁷ For example David Magang, the former Minister of Minerals, Energy and Water Affairs in his speech at the 2nd Financial Times conference in 1997 argued for a greater value added to be derived in Botswana's diamond industry.

license was due for renewal. The government had a lot of bargaining power due to the significance of Debswana's production share in DeBeers' global production. In 2005, Botswana's Debswana production contributed about 60 per cent to DeBeers' overall supply of rough diamonds (Even-Zohar, 2007:46). The government insisted that - in order for DeBeers to renew its mining license for another 25 years - it should help Botswana in creating a viable cutting and polishing industry. DeBeers gave in to the government's demands, realizing that it could no longer hold back beneficiation in Botswana, and signed the new mining contract. The new mining contract included the following three agreements: (1) a renewal of the mining licences for Debswana for 25 years, (2) the sale of Debswana's diamond production to the Diamond Trading Company (DTC) International for another five years; and (3) the establishment of DTC Botswana (DeBeers, 2007)⁸. By signing the new agreement DeBeers also agreed to a Sales Agreement that requires De Beers to conduct rough diamond sales in Botswana instead of London⁹ and to allocate a portion of the diamond production to the local diamond manufacturing industry (Masire, 2014). The key difference in the current attempt at beneficiation is that DeBeers agreed to set aside a portion of the rough diamond supply for local processing, whereas in the past the factories had to find their own sources of rough diamonds.

After the new contract was signed the Government invited the world's most renowned cutting and polishing companies to establish factories in Botswana and to transfer cutting and polishing skills to locals. 16 companies were selected and licensed to operate in Botswana in 2005, and this number has since increased to 21 companies by 2011. DeBeers and the Government established the Diamond Trading Company (DTC) Botswana in 2008 which is a 50:50 Joint Venture. The construction of DTC Botswana was fully funded by DeBeers at a cost of US\$83 million and is the largest sorting and valuation facility in the world. DTC Botswana is responsible for the sorting and valuing of Debswana's production as well as for the local sales and marketing of diamonds to the 21 cutting and polishing companies and for the support and development of the cutting and polishing industry. The cutting and polishing companies, known as Sightholders, are only assured rough dia-

⁸ DTC Botswana has the function "to facilitate, drive and support the creation of a vibrant, sustainable and profitable downstream diamond industry in Botswana that will deliver additional value for Botswana's diamonds." (The Mining Insight Magazine 2012, Web Access: <http://www.themininginsight.com/diamond-trading-company-botswana/233>).

⁹ Previously, rough diamonds were exported to London from Botswana and from other DeBeers' producer sites where they were mixed and sold. These processes now take place in Botswana as a result of this agreement.

mond allocations on the condition that they hire and train locals with cutting and polishing skills. The firms also pay a lower corporate tax of 15% (offered to all firms in the manufacturing sectors) compared to a 25% corporate tax paid by other firms in other sectors. Furthermore, the firms are exempt from paying a training levy of 0.2% of their turnover.¹⁰ The Government has established a Diamond Office to support the Government's primary objective of beneficiation in Botswana's diamond industry. This office focuses on building strategic alliances, developing infrastructure, and enabling a favourable fiscal regime in order to support diversification in the diamond industry. The Diamond Office is located at Diamond Technology Park¹¹ and houses various ancillary businesses, which include banking, logistics, gemmology, security, and brokering companies.

In the years that followed the new agreement with DeBeers, Botswana has made considerable progress at establishing a local cutting and polishing industry. Employment has grown from 2,200 in 2008 to 3,750 in 2013. The Government's vision for the local cutting and polishing industry is to add value to larger rough diamonds which are bigger than one carat¹², in order to avoid competing with low cost cutting and polishing centres in India and China, which mainly process smaller rough diamonds. The costs in different cutting centres are shown in table 1. Costs are considerably lower in the low cost cutting centres in Asia and are higher in the older cutting centres. Diamond manufacturing can be divided into two categories that depend on the size of the rough diamonds being processed and this leads to different production methods (Watermeyer, 1980)¹³. Botswana's cost per carat is comparable to costs in older cutting centres. Older cutting centres generally cut and polish bigger stones (Even-Zohar, 2007). So, the most crucial part of the Government's plan is to successfully develop the downstream competencies needed to process bigger diamonds; the success of the cutting and polishing industry hinges greatly upon the development of these skills.

¹⁰ Other training companies have pay the training levy to enable them to get a 200 per cent rebate for their training costs.

¹¹ See about the role of the Diamond Technology Park (DTP) in the Government's beneficiation strategy; Web Access: <http://www.diamondtechnologypark.com/>

¹² Carat of diamonds is a measure of their weight, with 1 carat being equivalent to 0.2 grams; the heavier a diamond is the more valuable it will be.

¹³ The first production method is the manufacture of small diamonds of less than one carat in weight, and the second one is the manufacture of larger stones that have a weight of more than a carat. The first category is very depended on production cost, especially as diamond sizes become even smaller, making the production of small diamonds only profitable in low cost environments. In contrast, bigger stones are more dependent on skills than on production costs, and workers that process larger diamonds need to be trained to have a very high degree of skill (Watermeyer, 1980).

Table 1: Cutting and Polishing Costs and Employment in Different Cutting Centres

Cutting Centre		Approximate Cutting and Polishing Cost U\$/Carat		Approximate Total Cutting and Polishing Jobs	
		2008	2013	2008	2013
Producer Centres	Botswana	45->125	60-120	2,200	3,750
	Namibia	45->125	60-140	1,500	970
Older Cutting Centres	Belgium	120	150+	1,000	150-200
	US	110	300	100	80-100
	South Africa	60-100	130-150	1,800	1,000
	Israel	47->55	140->300	2,000	400
Low Cost Centres	Far East	15-35	20-50	29,000	10,000
	India	6-50	10-50	850,000	800,000

Source: Data from DeBeers (2014), and table compiled by the Author

3 Research Questions and Methodology

The following section investigates the extent to which technological innovation is aiding Botswana to build diamond-processing capabilities in the cutting and polishing industry and how this is impacting on the composition of diamond exports. Main issue is how technological advances in the industry impact on Botswana's export competitiveness in higher value added products.

3.1 Research Questions

The research questions are as follows:

1. How has the technological revolution in the cutting and polishing industry changed the mix and nature of skills in production jobs and maintenance jobs?
2. Are the Cutting and Polishing factories in Botswana adopting the most efficient technologies?
3. What progress has the industry made with the creation of production and maintenance skills in the industry?
4. Has Botswana managed to diversify the composition of its diamond exports overtime?

3.2 Methodology

The principal methodology used to address these research questions involved primary and secondary data collection in Botswana. Desktop background research was conducted to identify the key participants in Botswana's cutting and polishing industry. Preliminary fieldwork was then conducted in June 2009 to understand the development of the industry and the key constraints faced. Further fieldwork was conducted from October to November 2009, in May 2010, and from January to May 2011. Interviews were conducted with managers and workers in 12 of the 16 cutting and polishing firms that were licensed at the time of fieldwork, with six suppliers, including technology suppliers, as well as with key industry players¹⁴ in the government, the private sector and academia. Fieldwork was also conducted in India (Mumbai and Surat), London and Israel (Caesarea and Tel Aviv), with the parent companies of four of the locally-based companies, technology suppliers, service providers like brokers as well as consultants, and training schools. In some instances full working days were spent in the factories to understand the manufacturing process and the operations of the factory. Interviews were conducted in English and Setswana using a semi-structured questionnaire. The data collected were of both a quantitative and qualitative nature.

In order to build a theoretical framework for understanding the technological revolution in the cutting and polishing industry, the next section reviews the literature on the nature of technological change and the role of knowledge codification in technological change. The purpose is to understand the technological dynamics affecting the diamond industry.

4 The Nature of Technological Change and Knowledge Codification

There is a general consensus in economic theory that "...technical change is the most important source of dynamism in capitalist economies..." (Freeman, 1994: 463). The earlier evolutionary, neo-classical and Keynesian theories of technical change and economic growth¹⁵ attempted to explain the relation-

¹⁴ The key industry players are: the Diamond Hub, the Diamond Office, the Diamond Trading Company, the Botswana Export Development & Investment Authority (BEDIA), the International Financial Services Centre (IFSC), the Citizen Entrepreneurship Development Agency (CEDA), the Local Enterprise Authority (LEA), the Botswana Institute for Policy Analysis (BIDPA), the Department of Minerals, Grant Thornton, a leading independent assurance, tax and advisory firm, academics from the University of Botswana and private consultancies.

¹⁵ For example Schumpeter's long-wave theory and Solow's growth model have to be mentioned.

ship between technical change and economic growth. But these theories did not deal with the specifics (such as the nature and types) of technical change, which is a very complex process. Early studies (see Freeman and Perez 1988) constructed a taxonomy of innovations which was based on empirical research; it shed considerable light on the nature of technological change. This taxonomy distinguishes between four types of innovation: (1) incremental innovation, (2) radical innovation, (3) new technology systems, and (4) changes of techno-economic paradigms or technological revolutions. This taxonomy is very useful as it takes a closer look at the process of technical change and the nature of the different types of technical change.

Freeman and Perez (1988) describe *incremental innovations* as the types of innovations that take place continuously in an industry, not necessarily as a deliberate result of research and development, but as a result of improvements made by employees directly involved in the production process. These improvements result from 'learning by doing' and 'learning by using', processes which are leading to a steady growth in productivity in the organisation rather than a sharp increase in productivity. The authors describe *radical innovations* as the types of innovations that are discontinuous and take place as a result of deliberate research and development activity done by firms, by government or by universities. Examples of radical innovations are nuclear power, laser technology, or synthetic materials. Radical innovations include product, process and organisational innovations. These innovations cut across different sectors as they can be applied in a number of industries. For example, laser technology is used in many industries such as the medical industry, in many manufacturing processes, in the military industry, in the research sector, for commercial products like printers and CDs, and even in the cosmetic industry.

Freeman and Perez (1988) state that the third type of innovations results in changes of the '*technology systems*' because they cause far-reaching changes in technology that affect several parts of the economy and result in completely new industries. This is so because these innovations are based on a combination of radical and incremental innovations as well as organisational and managerial innovations. These innovations result in a cluster of innovations, such as: "the cluster of synthetic material innovations, petrochemical innovations, machinery innovations in injection moulding and extrusion, and innumerable application innovations..." (Freeman and Perez, 1988:47). Last to mention, the authors describe "*technological revolutions*" as such changes in the technology systems that have a large impact by altering the whole economy. Their inescapable economy-wide impact is the key distinguishing factor of truly revolutionary innovations. A good example of this type of a radical innovation is electronics, which swept across the whole economy and altered many industries. Revolutionary innovations result in

new products, services, systems and industries as they "...also affect directly or indirectly almost every branch of the economy, i.e. it is a "meta-paradigm" (Freeman and Perez, 1988:47). Revolutionary innovations correspond with Schumpeter's definition of creative destruction, which he popularized in *Capitalism, Socialism and Democracy* (1942), because these innovations destroy the profits that established companies enjoyed from previous technologies.

Freeman and Perez's typology of innovation is very helpful for understanding the nature of technological changes and the impact that different types of innovations will have on production processes. The next section investigates the role of the different forms of knowledge, tacit and codified, in fostering technological change.

4.1 Codification of Tacit Knowledge and Technological Change

The codification of the tacit knowledge is of key importance to technological change as it creates a form of knowledge that is separate from the worker and can therefore be used in the creation of new technologies. One of the most accepted definitions of knowledge is by Michael Polanyi who defined two types of knowledge in his book on the *Tacit Dimension* (Polanyi 1966), namely explicit knowledge and tacit knowledge. Explicit or codified knowledge can be expressed in words and numbers, for example data, scientific formulae, specifications, manuals, and so forth. This kind of knowledge can be easily passed on between individuals formally and systematically. To define tacit knowledge, Polanyi (1996:4) stated that 'we can know more than we can tell' because most knowledge cannot be put into words. This is because tacit knowledge is highly personal and is deeply rooted in a person's action and experience as well as their ideals and values or emotions. This makes this kind of knowledge difficult to share with others; it can only be learned by experience and communicated indirectly.

Nonaka and Takeuchi's (1995) explain that there are two dimensions of tacit knowledge, technical and cognitive. The *technical dimension* encompasses the kind of informal personal skills or crafts referred to as "know-how". For example, a master craftsman develops a wealth of knowledge after years of experience but is often unable to articulate the scientific or technical principles behind what he knows. The *cognitive dimension* consists of beliefs, ideals, values, schemata, and mental models that are deeply engrained in people; this dimension of tacit knowledge is often taken for granted. The cognitive dimension is even harder to articulate and this dimension of tacit knowledge shapes the way we perceive the world; it can be referred to as the "knowing what" dimension compared to the "knowing how" dimension of knowledge.

The codification of tacit knowledge is important because “[t]he process by which knowledge or information evolves and spreads through the economy involves changing its nature between tacit and codified forms” (Cowan & Foray, 1997:595). Codified knowledge is easier to diffuse than uncoded knowledge because it is not embodied in the individual. New knowledge starts in a tacit form but over time it becomes more codified (Cowan & Foray, 1997:595). “As it is explored, used and better understood, less of it remain idiosyncratic to a person or a few people, and more of it is transformed into some systematic form that can be communicated at low cost” (Cowan & Foray, 1997:595). The codification of tacit knowledge has been identified as key to technological development because it allows for the mechanical replication of the skills possessed by those workers who have the relevant tacit knowledge.

The next sub-section discusses the technological revolution that shaped the modern global diamond cutting and polishing industry.

4.2 The Technological Revolution in the Cutting and Polishing Industry

“The history of diamond cutting and polishing is poorly documented because the art remained a trade secret for many years” (Klein, 2005:39). It is believed that the craft originated in India dating as far back as the tenth century and was developed further in Europe over many centuries. It is a very difficult and precise craft that requires a high level of skill and knowledge, as well as specialised tools and equipment in order to reveal the “hidden beauty” of rough diamonds (Klein, 2005). In comparison to a polished diamond, a rough diamond is dull looking and could be mistaken for a piece of broken glass or a pebble. Polished diamonds are cut to specific shapes depending on the shape and crystal qualities of the rough diamond. “Just like a log determines the wood products that a carpenter can make, so does a rough diamond determine the polished diamond or diamonds that can be made from it” (Interview, Gaborone, May 2001). Polished diamonds either fall under round cuts, like the ideal cut, or fancy cuts, such as emerald, pear and marquise cuts. 98% of rough diamonds are cut into round cuts (Watermeyer, 1980:110). Before rough diamonds are processed they are studied and planned to determine the most economical way to process them. This process is different for each diamond as each of them is different. Once they are planned they can be sawn or cut into one more stones depending on their crystal qualities. Next they are polished using different processes that shape them by carefully polishing facets (flat polishing surfaces), which enable the diamonds to absorb and reflect light, giving them their beautiful sparkly finish.

Traditionally the knowledge and skills used in diamond processing were craft skills that were a trade secret that was passed down through close relations, like father to son, from one generation to another. Diamonds were polished in cottage industries, which were usually family owned businesses, so that the knowledge and skills could be closely guarded in an industry well known for its secretive culture. As described by Joan Younger Dickson in 1965: “Different ways still prevail in different centres, different secrets in different families. It is a clannish world, this world of diamond cutters, the kind of society which sociologists call primitive because of its reliance upon tradition, rituals and relationships rather than books, laws and officials” (in: Watermeyer, 1980:4). As part of this culture, the skills and knowledge used in the cutting and polishing process were largely tacit and nothing was written down. So for many centuries the cutting and polishing process was seen as a “black art” which was not widely understood by outsiders (Interview, London, August 2011, and Klein, 2005:39). Even when early innovations took place in the industry they were closely guarded:

“In the centuries that followed, there have been individual carefully guarded innovations in cutting machinery and methods, resulting in a much higher quality end product. As might be expected, the flush of innovation in Europe and the coming of the Industrial Revolution in the nineteenth century brought radical changes in lapidary¹⁶ machinery. And yet, individual lapidaries and cutting guilds managed to keep the nature of this new machinery as well as the techniques for using it very secret” (Klein, 2005:29).

The early innovations that took place as a result of the industrial revolution included the use of steam to power the machinery used in the cutting and polishing process. Steam power was a revolutionary technology, which had an economy-wide impact. The early innovations also included transferring production away from cottage industries to factories. This change was also experienced in other industries such as the textiles industry. This enabled the creation of mass production innovation in the factories, such as benefitting from the increased division of labour. The increased division of labour in the factories decreased the level and variety of skills needed by the individual worker. The breaking down of the production processes into a number of detailed jobs meant that work could largely be performed by unskilled labour, hence making the costs of production in factories cheaper (Matthews, 1989). Therefore:

¹⁶ Lapidary is the art of cutting and polishing precious stones.

“Today’s method of operation is a far cry from the talent shown by individual diamond fashioners of past centuries. Back then, one man fashioned a beautiful diamond by doing all of the work required in cutting and polishing – from the rough stone to the completed gemstone. Very few diamond cutters today ever achieve this level of talent.” (Klein, 2005:90)

In today’s modern mass production factories workers in diamond cutting and polishing factories specialise in a specific process in order to reduce the costs of training. Apprentices who needed to know everything would need to be trained for over 5 years but because workers only need to master one process an apprenticeship is not necessary; instead a probationary period is sufficient for them (Klein, 2005:91). However, for larger diamonds, bigger than one carat, the skills of the individual worker remain important. So in conventional factories that process larger stones, workers are still trained to a very high degree in long apprentices because the diamonds that the workers work with are very costly (Watermeyer, 1980:110). So, after the change in the organisation of production from cottages to factories, the production of smaller diamonds moved to low cost production centres, such as India, China and Thailand, whilst the production of larger stones remained in traditional, high cost cutting centres like Belgium, Israel and United States of America.

The change in the organisation of production led to incremental innovations that resulted in new processing techniques. The secrecy around these new techniques often delayed their development. For example, when the sawing technique was developed to cut diamonds, using diamond dust applied on a spinning blade, it took over a century to develop because the technique was kept secret:

“So secretive is the world of diamonds that it was only about 60 years ago that diamond cutting firms understood and introduced sawing, yet the art had been practiced for over 150 years, its secrets had jealously been guarded by diamond cutting families. This meant that for centuries sawing was never developed and its true potential never realized... Today sawing has reached its full potential and it would be difficult to imagine diamond cutting without sawing. There is no doubt that sawing has changed the whole concept of diamond economics, shapes and faceting.” (Watermeyer, 1980: 33)

After these early innovations, the cutting and polishing process changed little for decades and it was not until the late 1970s and 1980s that a quiet technological revolution took place as more of the knowledge in the industry became codified. As a result, the cutting and polishing industry advanced more since the 1980s than it did in the preceding 100 years (Caspi, 1997:102). This revolution changed cutting and polishing processes by introducing radical

and revolutionary technologies to the industry, such as laser, computer numerical control (CNC) tools, and computer aided design (CAD) and automation systems. Today diamonds can be cut by using laser technology, can be designed by using CAD software, can be manufactured by using CNC tools, and can be polished by using automated machines. Technological change in the industry is still very dynamic, with new technologies being developed at a rapid pace. For example in 2013 Sarin, a diamond technology developer, introduced the Galaxy 1000 Scanner that is used in diamond planning to scan through diamonds to show their internal structures and flaws¹⁷. Previously, planning machines were only able to give a 3D scan of diamonds, and a “window” facet would have to be polished onto the diamond, which the planner would use to look inside the rough diamond. This was a time consuming process that also decreased the value of the diamonds by reducing its weight. However, with the new technology, the profitability in the industry has increased and also has enabled manufacturers to process such diamonds that would not have been possible to process by using the traditional manufacturing techniques (Caspi, 1997:102). By improving the quality of polished diamonds produced by the industry, the new technologies have enabled manufacturers to meet changing consumer demands towards higher quality polished diamonds.

But these technologies have also changed the skills mix required in labour force. New skills like computer skills, laser optic skills, and new maintenance skills are now needed. Automated technologies have also changed the role of the worker in the manufacturing process, with the worker playing the role of a controller more than an actual processor. Watermeyer (1980) argues that automated technologies have complicated techniques that in many cases have produced machine operators and not diamond cutters. Nonetheless, with automated machines the role of the worker is still very crucial as the worker monitors the machines to ensure that diamonds are processed according to the firms’ standards. With the new technology, the tacit knowledge that was possessed by the worker in the traditional manufacturing process has been converted into codified knowledge that is stored in the machine. This has not only enhanced value in the industry by enabling the industry to make more informed decisions but it has also reduced the amount of tacit knowledge that needs to be transferred to production workers during training.

¹⁷ Sarin is the world's leading developer, manufacturer and marketer of advanced evaluation, planning and laser marking systems; Web Access: <http://ena.idsonline.co.il/site/page1004.aspx>

The key disadvantage of the new technologies for the firm is their cost. “The capital investment required to start a modern factory is usually 10 times more than that needed to set up a traditional factory” (Caspi, 1997:121). Due to the cost of the new technologies they are mainly used in the production of larger, more valuable stones. So unlike the earlier innovations that enabled the use of low skilled workers in the production of smaller diamonds, the current technological revolution is changing the skills mix of workers in the production of larger diamonds. At the same time, the new technologies are changing the maintenance skills needed by the industry. Maintenance and repair workers need to be able to work with the new technologies, and they also need to be adaptive to the changing technologies.

The next section discusses the technological adoption in Botswana’s cutting and polishing industry and the development of production- and maintenance-related skills in the firms.

5 Technological Adoption Processes and the Development of Production and Maintenance Skills in Botswana's Cutting and Polishing Industry

Apart of three factories that were created during the government’s first attempt at creating a cutting and polishing industry in the 1980s -1990s, the 17 other factories were started in the 2000s. Since the factories were new and the skills of the workers were yet to be developed this allowed the firms to create state-of-the-art factories using the latest technologies, which could be used for production and training workers. The companies operating in Botswana have strong financial ability¹⁸ and thus they were able to provide the capital required to start modern factories equipped with sophisticated technologies. Indeed a manager at one of the firms said, “sourcing technology is not a problem as long as you have the money” (Interview, Gaborone, November 2009). The firms imported technology from technology suppliers like Sarin and OGI¹⁹, which are based in developed diamond centres like Israel and Belgium. These technology suppliers have global supply relationships along the diamond value chain. The factories in Botswana use sophisticated CAD planning machines, laser machines, automated polishing machines, and

¹⁸ “Financial ability” was one of the requirements for the firms to become licensed in Botswana.

¹⁹ OGI Systems Ltd provides latest technology for manufacturing diamonds; Web Access: <http://www.ogisystems.com/>

CNC tools. Two of the factories have already introduced Sarin's Galaxy, the most sophisticated planning machine²⁰.

Botswana's industry has been able to leapfrog to the most efficient technologies by skipping inferior and less efficient technologies and by moving straight to the most advanced technologies. The leapfrogging literature in industrial development deals with the question of how latecomer countries can catch up with industrialised countries and their level of industrialisation. Soete (1985:416) defines technological leapfrogging as:

“...the opportunities offered by the international diffusion of technology to jump particular technological paradigms and import the more if not most, sophisticated technologies that will neither displace the capital invested nor the skilled labour of the previous technological paradigm, constitute one of the most crucial advantages of newly industrializing countries in their bid for rapid industrialisation.”

A production manager at one of the firms in Botswana, which also has a factory in India, said, “The technology is changing and in Botswana you can train people on new machines, while in India people are stuck with old technologies” (Interview, Gaborone, May 2011). However, the key constraint to technology adoption in Botswana is infrastructure. Botswana has constraints in the provision of electricity and reliable and fast Internet supply. Most of the firms have centralised information and technology systems that are administered in other countries and are accessed through the Internet. Unreliable electricity supply is a problem that affects the whole economy and not just the cutting and polishing industry. The cutting and polishing equipment and technology is operated with electricity and without a generator, power cuts would stop the production in the whole factory and possibly damage some machines. Most of the factories have generators to ensure electricity supply. This, however, increases the costs of doing business and also constrains the firms' ability to use the latest technologies efficiently. However, the government has implemented plans to improve Internet and electricity supply by laying deep-sea fibre optic cables and by building a new power plant that was completed in 2012, so that the infrastructure constraint is expected to ease over time. But, the infrastructure gaps put limits on the chances of leapfrogging not only in Botswana.

The cutting and polishing factories are currently responsible for training local workers with cutting and polishing skills. The cutting and polishing factories, according to the conditions set out by Government to ensure a skills

²⁰ See on the sophisticated Galaxy 1000 system for diamond cutting and colour grading; Web Access: <http://www.rtc-vision.com/case-studies/sarin/>

transfer, have to recruit locals to train them for technical and skilled jobs that include: markers, bruters, sawyers and diamond polishers, computer programmers, and laser operators. These jobs are involved directly in the production of polished diamonds in the factory and they represent the majority of employees in the industry. The locals recruited for technical and skilled jobs only require a low level education (as low as primary or junior secondary certificate), good English communication skills, good eyesight, good dexterity, and a basic knowledge of mathematics, physics, and computers. Experienced expatriates are training locals within segments of the cutting and polishing process in technical and skilled jobs through on-the-job training in the cutting and polishing factories. The factories recruit the highly skilled expatriates from their global operations to train locals and some hire expatriates from other companies. The government assists the cutting and polishing factories by granting work permits for these highly skilled foreigners. The idea is that, over time, more locals are becoming more skilled and experienced and will be able to train other locals in different processes. Technical expertise is gained through experience in the industry; therefore a low labour turnover is critical amongst locally recruited workers. The firms have been producing in Botswana for a number of years and training is on-going. The firms that were interviewed said that they were happy with the rate at which training has taken place; for example, a production manager at one of the firms explained that training is going on at a much faster rate than he had expected, adding “I think we have all been surprised by how quickly the locals are learning” (Interview, Gaborone, June 2011).

All the interviewed firms have workshops in their factories to conduct routine maintenance and repairs on the tools and equipment. However, the firms have to outsource maintenance skills for specialised technology mainly from their technology suppliers. The interviewed firms all said that sourcing these maintenance skills in Botswana is a major problem due to the lack of people with specialised knowledge needed for the task. Subsequently, firms fly in maintenance technicians from other cutting and polishing centres such as neighbouring South Africa, but also from India, Israel and Belgium - for as little as half a day work. The firms have to obtain visas for the technician, which are, however, not always approved by the Department of Immigration. This problem is expected to ease in future as more companies provide the industry with technical support offices opening in Botswana. For example in 2012, one technical support company, Indochine, which was established in Botswana in 2010, opened a Galaxy servicing centre in Botswana²¹. Alt-

²¹ Indochine Botswana provides services for the local diamond industry (investment and management consultancy, technology services and supports for the diamond industry); Web access: <http://indochine-botswana.com/services.php>

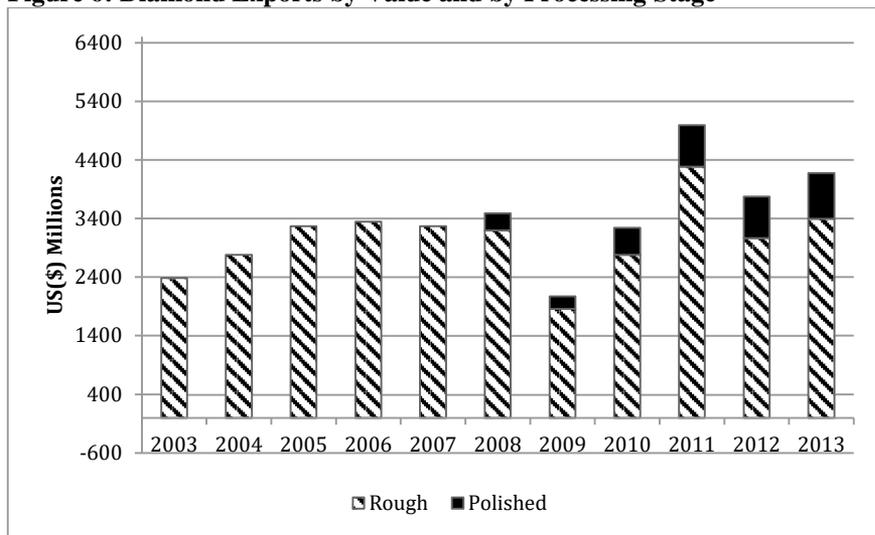
though there is progress with regard of providing skills for technology adoption, a full evaluation of the progress is not yet available.

The next section will use diamond trade data to see the extent to which the development of diamond processing capabilities in Botswana has resulted in export diversification within the diamond sector.

6 The Changing Composition of Diamond Exports and the Perspectives of Botswana's Export Diversification Policy

Over the last decade there has been a significant change in the composition of diamond exports, transforming Botswana from a traditional exporter of rough diamonds to an exporter of both rough and polished diamonds. In 2003, Botswana exported about US\$2.4 billion worth of rough diamonds and virtually no polished diamonds (see figure 5).

Figure 6: Diamond Exports by Value and by Processing Stage²²



Source: Data from Bank of Botswana (2013); Chart by the Author

Although some diamond cutting and polishing was taking place in the country at the time, this was happening at a very low level, with the industry employing a few hundred people and as stated previously, none of these factories ever has reported a profit. Furthermore, the exports of the three cutting

²² The data excludes re-exports.

and polishing factories that existed at the time did not report polished diamond exports separately from rough diamond exports. The export of polished diamonds (as officially recorded) only started in 2008 because most of the factories that were licensed after the 2005 agreement only started its production in 2008. In 2008, Botswana exported close to US\$3.2 billion rough diamonds and for the first time the country reported US\$292 million worth of polished diamond exports. In 2009, both rough and polished diamonds decreased to US\$1.8 billion and US\$215 million, respectively, as a result of the economic recession that started in the last quarter of 2008. Apart from 2009, polished diamonds have been growing over time and in 2013, Botswana exported US\$3.4 billion worth of rough diamonds and already US\$800 million worth of polished diamonds.

Although this is a valuable development in terms of production and export, these data have to be compared with the values for other products exported by Botswana. The dynamics of the exports of polished diamonds relative to the exports of other manufactured products matters for export diversification. Before this is done, Botswana's diversification policy will be discussed in order for the country's export performance to be put into context in terms of policy.

6.1 Botswana's Economic Diversification Policy

From 1970s onward, the government started implementing macroeconomic policies to respond to the threat of the Dutch Disease (where growth in the mineral sector can undermine the performance of the non-mining exports and import substitutes through upward pressures on the real exchange rates, thus effectively decreasing their competitiveness) and to prepare the country for the eventual end of the mineral era (by export diversification policies). The government pursued an exchange rate policy that aimed to prevent that the monetary inflows from diamonds appreciate the nominal exchange rate. The government also runs the balance of payments at a surplus and has been accumulating foreign exchange reserves. In addition, from the mid-1970s until the mid-1980s, the government tried to encourage investment by keeping interest rates low (Jefferies, 2014). Apart from accumulating savings, the government also invested mineral revenues into accumulating other assets such as human capital and infrastructure, to drive diversification of the economy through investing in public goods and by increasing overall productivity. Although in general terms there have been great improvements to the infrastructure, there are still challenges and gaps in the provision of some infrastructure sectors. Supply-side issues have resulted in certain gaps as the demand for electricity and for water often could not be met. Productivity remains a key constraint to competitiveness despite of considerable amounts

of resources spent on education and training. For example, from 2008 to 2011, Botswana's global competitiveness ranking dropped 24 places, and in 2013 Botswana's competitiveness was ranked 74th out of 148 countries (World Economic Forum, 2013). A skills mismatch is often blamed for the high unemployment rates (see Botswana Training Authority/BOTA, 2010), but to blame is also an economy that simply does not produce enough jobs to absorb the growing labour force.

According to conventional wisdom countries should avoid resource dependence and secure long-term growth by industrialising their economies through creating competitive manufacturing sectors. Botswana started promoting industrial development soon after independence with the first Industrial Development Act of 1968. This Act laid the foundation for the subsequent industrial policies. The objective of Botswana's industrial policy is to build up the private sector through supporting and incentivising entrepreneurial development (Sekwati, 2010).

Overall, Botswana's industrial policies promote export-led industrialisation. There have however been exceptions, with the 1984 Industrial Development Policy (IDP) promoting import-substitution through the production of goods for the local market. Already in 1982, Botswana has introduced the Financial Assistance Policy (FAP) to promote trade through enterprise development. FAP provided financial grants to manufacturing, non-cattle agriculture, tourism and small-scale mining enterprises, both for start-ups and expansions. In 2001, FAP was cancelled after a fourth review of the programme found that it had not achieved its mandate because the projects that were funded had a high failure rate. Also funds were abused, and the cost per job were unacceptably high (BIDPA, 2001). In 2001, the Citizen Entrepreneurial Development Agency (CEDA) replaced the FAP. It was different from FAP in that the capital provided is not a grant but instead a loan which is given at subsidised interest rates. CEDA provides financial support and technical support for business development with the aim of creating viable and sustainable citizen-owned business enterprises. It is however hard to measure how successful CEDA has been at achieving its mandate because to date no reviews of CEDA have been conducted.

Currently, the key policy driver for industrial development is the Economic Diversification Drive (EDD). The first component of the EDD is a short-term strategy that aims to leverage the Government's purchasing power to stimulate local production and consumption by procuring from locally based manufacturers and service providers by using a preferential sourcing system. Local preference in government sourcing goes back a long time with policies such as the 1976 Local Preference Scheme (LPS), the 1997 Local Procurement Programme (LPP) and the 1982 Reserved Sectors Policy (RSP). The second component of the EDD is a medium-to-long term strategy that

aims to diversify the economy through a holistic and systematic development of globally competitive enterprises that need little or no Government protection and support. Its specific objectives are to develop globally competitive sectors; to diversify exports and export markets through a vibrant and globally competitive private sector; to develop competitive goods and services that comply with local and international standards; and to develop an entrepreneurship culture for business growth and enhanced citizen participation in the economy.

Botswana Development Corporation Limited (BDC) is envisioned to have instrumental role in the EDD by undertaking big projects that are high risk ones and have a strategic importance for Botswana. BDC was established in 1970 to be the country's main agency for commercial and industrial development by filling in gaps left by the then very small private sector. The Corporation, however, ended up neglecting industrial development and instead transformed itself into a major property developer. Successful implementation of the EDD will require BDC to refocus on its original mandate²³. Apart from BDC and CEDA, other key institutions in the current diversification strategy are the Local Enterprise Authority (LEA), the Botswana Investment Trade Centre (BITC), and the Botswana National Productivity Centre (BNPC). In 2004, the LEA was established to facilitate enterprise development amongst small, medium and micro enterprises (SMMEs). LEA Support Services include encompassing training, mentoring, business plan finalisation, market access facilitation, and facilitation of technology adaptation and adoption. The BITC resulted from the merger of the Botswana Export and Investment Promotion Agency (BEDIA) and the International Financial Services Centre (IFSC); its mandate is to provide a one-stop-shop service centre to investors and exporters, thereby reducing time-consuming, bureaucratic procedures and improving service delivery. The BNPC was established in 1993 to support and to promote improved productivity in all sectors, but productivity continues to be major concern in Botswana. So, all these institutions need a further strengthening and capability-building towards the task of promoting export diversification of Botswana.

Agriculture and tourism are seen as key industries that can drive diversification. Historically, the agriculture sector benefited from a number of policies such as the 1970s Arable Lands Development Programme (ALDP) and the 1982 Advanced Rain-fed Arable Programme (ARAP), the 1975 Tribal Grazing Lands Programme (TGLP). The Botswana Meat Commission (BMC) has preferential access to the EU market. Despite this, last year the

²³ See on the envisaged new roles of BDC: <http://www.bdc.bw/>

BMC faced a financial collapse²⁴. Current policies that support agricultural development include the Integrated Support for Arable Agricultural Development (ISPAAD) that aims to increase grain production and to commercialise agriculture. Policies aimed at developing the tourism sector are still being formulated. Again, a deep restructuring of institutions towards the task of promoting competitive export production is requested. Not the number of institutions counts, but the quality of the institutions in terms of supplying services to producers and traders.

Privatisation is another way when the government is trying to grow the private sector. The 2001 Privatisation Policy led to the establishment of the Public Enterprise Evaluation and Privatisation Authority (PEEPA), which promotes public private partnerships through the 2005 Privatization Master Plan²⁵. Despite the institutional framework since 2001, and attempts at privatization even before 2001, little has been achieved in terms of privatisation. In 1998, the privatisation of the national airline, Air Botswana, was unsuccessful. The National Development Bank (NDB) is yet to be privatised since the cabinet has approved its privatisation already in 2011. Currently, the privatisation of Botswana Telecommunications Corporation Limited (BTCL) is at an advanced stage with shares expected to be available for the public to purchase in November 2014. In both cases - the NDB and the BTCL – the government will retain a 51% majority.

6.2 Export Diversity

Export diversification is an important aspect of the production diversification policy. Export revenues are particularly important as exports are a source of foreign exchange that is crucial for maintaining the balance of payments (i.e. exports earnings enable a country to pay for imports). Exports are also a way for countries to benefit from the international division of labour. Botswana's economic diversification model needs to be export-led. Diamonds are currently Botswana's largest foreign exchange earner. With the high risk of diamond resource depletion over the medium term, new sources to generate foreign reserves need to be found in order to maintain Botswana's positive balance of payments. Botswana's relatively small domestic market naturally limits any inward-focused growth path. Despite Botswana's efforts at diversifying the economy, very limited diversity has been achieved so far.

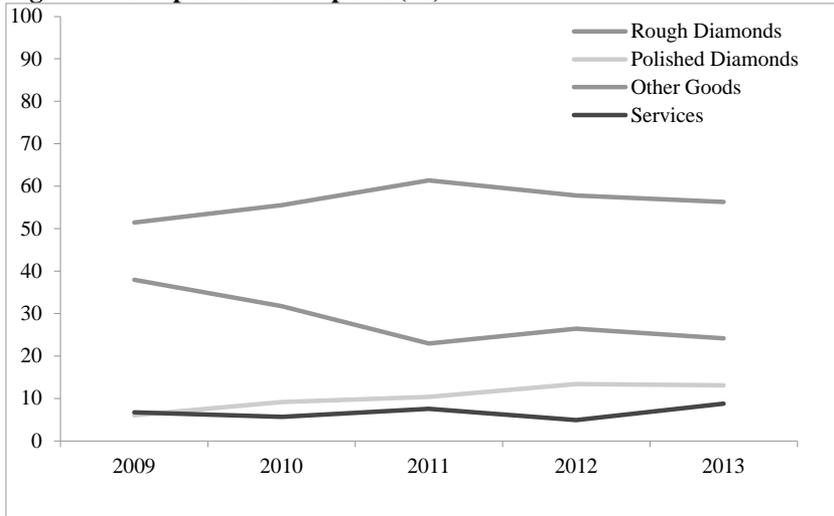
Even though diamond mining has slowed down in recent years, rough diamonds continue to be Botswana's biggest export, significantly exceeding all

²⁴ See more about the Botswana Meat Commission (BMC) at: <http://www.bmc.bw/>

²⁵ See more on the Privatization Master Plan of 2005: <http://www.peepa.co.bw/node/37>

other exports (see Figure 7). Rough diamonds, as stated previously, are currently generating earnings of above US\$3 billion, being comparable to pre-recession levels, and representing around 55% of the total exports.

Figure 2: Composition of Exports (%)



Source: Data from the Bank of Botswana (2013), chart by author

The Government's efforts to beneficiate diamonds have made polished diamonds Botswana's second largest single export item in the last three years, overtaking Copper and Nickel exports (see Table 2 and 3) and earning close to US\$800 million in 2013 what makes up around 13% of the total exports. Textile exports used to be Botswana's third largest export commodity, but their performance started to decline in 2007 to current levels of less than US\$100 million, representing in 2013 less than 1 percent of the total exports. Other principal exports, beef, soda ash, and gold have not seen significant increases since 2009, and all these export items beside of beef have fallen below the value of US\$100 million. While beef represents 2% of total exports, soda ash and gold each represent only around 1% of the total exports. Although Botswana is not faring well in terms of product diversity, service exports are now playing a bigger role in Botswana's export composition. It is important to note that service exports are more difficult to record than product exports, and the figures reported by the Bank of Botswana may underestimate their actual value. The value of recorded services exports is over US\$500 million in 2013, which is a significant increase from almost Pula 250

million which were recorded in 2009. Service exports now represent over 8% of total exports (see tables 2 and 3).

Table 1: Value of Exports (US\$ millions)

	Rough Diamonds	Polished Diamonds	Copper and Nickel	Gold	Meat & Meat Products	Salt & Soda Ash	Textiles	Other Goods	Services
2009	1,839.9	217.3	527.02	75.5	115.0	44.2	201.5	395.4	241.4
2010	2,807.6	461.8	632.5	79.7	161.8	92.9	166.6	469.7	286.8
2011	4,166.1	701.3	428.3	78.8	51.5	66.6	257.8	674.8	510.6
2012	3,057.6	709.0	451.2	84.4	67.2	59.4	81.2	652.9	260.3
2013	3,376.7	786.7	558.5	55.9	123.4	59.2	43.4	610.2	525.5

Source: Data from the Bank of Botswana (2013), table arranged by the author

What is clear from this analysis is whilst GDP has become slightly more diversified (as shown in Section 2.1), exports have not become more diversified apart from an increase in rough diamond exports and of service exports. In fact some diversity has been lost since 2009, for example as textile exports have fallen. Diversification efforts have resulted in more diversity in domestic production and in government revenues, but exports are still dominated by diamond exports.

Table 2: Share of Exports (%)

	Rough Diamonds	Polished Diamonds	Copper and Nickel	Gold	Meat & Meat Products	Salt & Soda Ash	Textiles	Other Goods	Services
2009	50.3	5.9	14.41	2.1	3.1	1.2	5.5	10.8	6.6
2010	54.4	9.0	12.3	1.5	3.1	1.8	3.2	9.1	5.6
2011	60.1	10.1	6.2	1.1	0.7	1.0	3.7	9.7	7.4
2012	56.4	13.1	8.3	1.6	1.2	1.1	1.5	12.0	4.8
2013	55.0	12.8	9.1	0.9	2.0	1.0	0.7	9.9	8.6

Source: Data from the Bank of Botswana (2013), table compiled by the author

Botswana has attempted to diversify the diamond industry by beneficiating diamonds. This effort has resulted in a diamond processing industry that employs some thousand people, representing a small share of the manufacturing sector employment. In 2013, reported polished diamond exports, worth around US\$800 million, represented around 13% of the total exports. It is, however, yet to be shown whether the downstream industry will build enough foundations of competitiveness so as to be sustainable. Beneficiation is becoming a central part of Botswana's mineral policy as the country is also planning to beneficiate base metals, coal and other mineral resources. There is considerable doubt amongst economists as to whether beneficiation is based on sound economic theory and whether it is a good policy framework to promote exports. The main economic argument for beneficiation is based

on transport costs, stating that in the case of high transport costs it makes economic sense for the commodity to be processed where it is mined. For example, Venables (1996) and Hausmann, Klinger and Lawrence (2007) argue that beneficiation is a bad policy and is completely inconsistent with international experience because the factors needed in different segments of the value chain are often very different. Thus capabilities in extractive industries will not result in capabilities in processing industries. Indeed, it is yet to be shown if beneficiation can be successful in creating sustainable export sectors in Botswana.

Since diamonds will eventually be depleted in the medium-term, it is important to understand which other exports outside of diamonds (rough and polished) are dynamic and could therefore foster long-term growth. In terms of dynamism, Table 4 shows the growth rates for the different export products relative to diamond exports. Here dynamism will be measured by using the average export value growth of a product or service between 2009 and 2013. The most dynamic product during this period was polished diamonds with an average growth rate of 44%; and services were the second most dynamic export product with an average growth rate of 37%. After services, rough diamond and beef exports followed with an average growth rate of about 21% each. Textiles were the least dynamic export product with a negative average growth rate of -19%. Other goods do not give too much hope with a growth rate of 13.2%.

Table 3: Growth Rates of Exports (%)

	Rough Diamonds	Polished Diamonds	Copper and Nickel	Gold	Meat & Meat Products	Salt & Soda Ash	Textiles	Other Goods	Services
2009/10	52.6	112.5	20.0	5.5	40.7	110.1	-17.3	18.8	18.8
2010/11	48.4	51.9	-32.3	-1.1	-68.2	-28.4	54.7	43.7	78.0
2011/12	-26.6	1.1	5.4	7.2	30.5	-10.7	-68.5	-3.2	-49.0
2012/13	10.4	10.9	23.8	-33.8	83.6	-0.4	-46.6	-6.5	101.9
Average	21.2	44.1	4.2	-5.6	21.7	17.7	-19.4	13.2	37.4

Source: Data from the Bank of Botswana (2013), table compiled by the author

Export-oriented industrialisation has been a tried and tested path to growth. Countries in South and East Asia, particularly China and India, have managed to grow their economies rapidly through a focus on industrial manufacturing using a state-led approach. In comparison, Botswana has been less successful at building a sizeable, competitive manufacturing industry. Globalisation has increased competition in the manufacturing sector. To be successful at manufacturing a country like Botswana, characterized by comparatively high wages compared to most of its neighbours, cannot compete at the

bottom end of the market, with costs being the key competitive factor. Instead, Botswana needs to build comparative advantages in more sustainable segments of the manufacturing value chains. Botswana can do this by finding its niche in the global manufacturing industry. In these segments marketing and strong brands, instead of costs, are crucial to differentiating products and sustaining value. The growth and employment potential of manufacturing requires Botswana to find a way of getting it right, by finding the right products, the right processes and the type of linkages that can take products to the global market. For example, Botswana's small manufacturing sector share in employment, which was 11% in 2001 and has decreased since to 9.5% in 2012, is a burden for employment creation (Government of Botswana, 2012). It is not easy to find niches for globally competitive manufacturing as the example of polished diamonds shows.

The recent emergence of services as the new driver of growth in Botswana presents an opportunity for Botswana to grow outside of manufacturing. But can services bring about the same growth prospects as manufacturing? Rodrik (2014:3) argues that the new growth path led by services is self-limiting because "individual services activities cannot expand without turning their terms of trade against themselves". So as services activities increase, their prices and profitability will decrease. While manufacturing and agriculture have the ability to absorb low skilled labour, tradable services are usually highly-skilled, creating less low-skilled jobs. Botswana's high spending on education has resulted in a relatively skilled labour force and this could be the key to gaining from a service-led growth model. Again, niches have to be identified, such as high value tourism.

Any growth model needs to be driven by productivity and competitiveness at the firm level. Raising productivity requires workers to have the right training and good work ethic. Botswana's vocational training model needs to be modified, so that it equips the workers, particularly the youth, with skills that are required in the labour market. Leveraging on technologies will be an impetus for export diversification. Technology needs not to be completely foreign but it can be localised to be more appropriate, taking advantage of indigenous knowledge. Technology can help firms to build competitiveness and technologies can also support the accumulation of the required human capital. The disadvantage of new technologies is that they often are labour-saving so that globally competitive niches are increasingly important for Botswana. However, this is a price Botswana will have to pay to have competitive exports in the future.

6.3 Can Beneficiation Create Sustainable Export Sectors in Botswana?

Botswana is also attempting, as was argued above, to diversify the diamond industry by beneficiating diamonds. It is, however, yet to be shown whether the downstream industry will build enough foundations of competitiveness so as to be sustainable. Beneficiation is becoming a central part of Botswana's mineral policy as the country is also planning to beneficiate base metals, coal and other mineral resources. For example, the Department of Energy Affairs (DEA) undertook a coal beneficiation study, and this effort led to the construction of a coal wash plant in 2007 by Morupule Colliery²⁶. The plant was commissioned during the first quarter of 2008 and it will enable the colliery to expand its customer base by supplying washed and improved quality coal (Government of Botswana, 2009). There is considerable doubt amongst economists as to whether beneficiation is based on sound economic theory and whether it is a good policy framework to promote exports. The main economic argument for beneficiation is based on transport costs, stating that in the case of high transport costs it makes economic sense for the commodity to be processed where it is mined. For example, Venables (1996) and Hausmann, Klinger and Lawrence (2007) argue that beneficiation is a bad policy and is completely inconsistent with international experience because the factors needed in different segments of the value chain are often very different. Thus capabilities in extractive industries will not result in capabilities in processing industries. Indeed, it is yet to be shown if beneficiation can be successful in creating sustainable export sectors in Botswana. The example of the coal wash plant however shows that producing higher quality products in extractive industries is a favourable direction as new customers can be got interested in the products.

7 Conclusions

This paper found that the technological revolution that started in the cutting and polishing industry over two decades ago has changed the skills mix of production workers and maintenance workers in the modern diamond cutting and polishing industry. For production workers, the new technologies come with codified knowledge while in traditional manufacturing it used to be tacit knowledge embodied by the worker. This has decreased the need for traditional craft manufacturing skills and has required that production workers

²⁶ Morupule Coal Mine (MCM) in Palapye, Botswana is the main supplier of coal to the Botswana Power Corporation (BPC), and the colliery is strengthening its competitiveness and economic success by establishing the new coal wash unit.

should be able to work with the new technologies. This has not only increased accuracy in the manufacturing process but has also increased the efficiency of training in the industry by reducing the amount of tacit knowledge that needs to be transferred to production workers during training. For maintenance skills, the new technologies have decreased the demand for workers who can repair and maintain traditional manufacturing tools and equipment, and have created demand for specialized workers who can maintain modern machines and equipment.

These changes have presented an opportunity for Botswana, a latecomer to the industry to leapfrog to the most efficient technologies in the industry and to use them to create sophisticated diamonds processing capabilities in the cutting and polishing industry. These capabilities have enabled Botswana to diversify its diamond exports to include more and more polished diamond exports and not just rough diamond exports, as it was previously the case. However, there are still infrastructure gaps impeding the development of the diamond industry in Botswana, and the dynamics of polished diamond exports has to be put in perspective by looking at the rate of development of other processed goods exports.

It was found that beyond of the increase of exports of polished diamonds not much has emerged in terms of new globally competitive export products, so that Botswana has to think about a new growth model, by combining extractive industries, manufacturing and services sectors. It was also found that most of the institutions to support this process have not worked according to the stated objectives. A new strategy and renewing institutions are key imperatives for the country.

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Sudan's Sesame Export Supply Capacity Constraints: A Value Chain Analysis¹

Fadia Khalil Hassan²

1 Introduction

In the wake of oil exploitation and exports towards the end of the 1990s, Sudan (the unified Sudan) was classified as the third largest oil-producing country in Sub-Saharan Africa behind Nigeria and Angola and also as one of fastest growing economies of Africa (WB, 2009). As a result of oil export revenues, the structure of the economy shifted over time from being predominantly reliant on agriculture for growth and exports to a heavy dependence on oil. During 2000-2011, on average, oil revenue accounted for about 84.6 percent of total export value and about 47 percent of government's revenue (CBoS, 2013).

However, as a result of the secession of South Sudan in 2011, the Republic of Sudan (hereafter Sudan) has lost around 75 percent of its productive oil fields and its main source of export income. The value of oil exports dropped from about US\$ 10 billion in 2010, the year before secession, to about US\$ 4 billion by the end of 2013. The secession shock slowed down the economy and created a number of challenges. Real GDP growth dropped from an average 7.3 percent during 2000-2010 to a negative growth of 0.8 percent in 2011 and to a slight recovery of 3.7 percent in 2013. The current account deficit deteriorated from an average of US\$ 398.7 million for the period 1999-2011 to an average of US\$ 2.9 billion in 2012-20 (CBoS, 2014). The economy also suffered from hard currency shortages in the official market as a result of the loss of oil export revenue to the extent that the parallel market has almost completely replaced the official market as a source of foreign exchange for private transactions (WB, 2014). The pressure of hard currency shortages is clearly seen in the continuous devaluations of the SDG (Sudan's currency) against the US dollar. In November 2013 the official rate was changed from SDG 4.4:1US\$ to SDG 5.7:1US\$ and again in January 2015 from SDG

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5.7:1US\$ to SDG 6.31:1US\$, the second such move in just over a year. However, the US dollar fetches SDG 9.15 on the black market (during March 2015) and is expected to exceed this rate in the future. So far, the loss of the contribution of the oil sector has been compensated partly by gold exports. Gold's contribution in export earnings increased from an average 1.5 percent in 2000-09 to 9 percent in 2010 and further to 14.8 percent in 2013. The gold sector is forecasted to remain one of Sudan's most important export revenue earners in the medium term, and its contribution is to remain at around 14 percent in 2015-18 (Economist Intelligence Unit/EIU, 2014).

Notwithstanding the globally falling prices of both oil and gold and the expectation that their downwards trend will continue for some time (EIU, 2014), substituting the gold sector for the oil sector as the main driver of growth will not achieve the kind of economic transformation that will put Sudan on the right track for inclusive growth unless aided by sound policies for efficient and effective allocation of these resources. A high growth which is driven by the extractives sector, such as oil and gold, if not effectively managed to diversify the economy, generates limited benefits for the population at large (AfDB, 2014a). Truly in the case of Sudan, during the decade of oil extraction 2000-2010 and when it was cited as one of the fastest growing countries, the incidence of poverty in Sudan was about 47 percent with 26.5 percent urban and 57.6 percent rural (IMF, 2013). Moreover, symptoms commonly exhibited by resource curse economies were apparent in the pattern of growth of the economy and in the composition of the trade account (WB, 2009). Thus indeed, unless the gold resource is well managed in the sense that it is geared towards reversing the downwards trend of the agricultural sector, revitalizing the manufacturing sector and diversifying the economy it will end up in a resource curse just like oil. A legitimate question to pose then is: does Sudan need to iterate the same kind of development strategy of dependency on a natural resource to stimulate the desired growth and development for the economy? Experience shows that countries such as Ethiopia, Mozambique, Kenya, and Tanzania, some of the countries which effected the citation of Africa as the fastest growing continent in the world, have managed to sustain high growth which was not fueled by natural resources but through structural transformation in their economies by moving from lower to higher productivity activities and by creating more productive forms of agriculture through improved farming practices (Kanu, et. al., 2014; AfDB, 2014a, b).

Recently, in recognition that urgent actions are needed to broaden the country's export base by increasing growth and efficiency of the agricultural sector and by developing agriculture-led industries (keeping in mind that the fourth pillar in Sudan's Interim Poverty Reduction Strategy Paper (IPRSP) pin-pointed agriculture to be one of the main sources of growth, employment

creation and poverty reduction), the Government of Sudan presented its ARP (Agricultural Revitalization Program) in 2007 (MoAaI/Ministry of Agriculture and Irrigation, 2008). Four of the key success-indicators proposed by the ARP and being relevant to this paper are: (1) capacity building of producers and institutions; (2) reforming agricultural land-tenure systems; (3) developing support services and modernizing agricultural systems; and (4) implementing quality control and safety measures. The report noted that "The strict and serious implementation of the ARP will induce a sustainable growth in agricultural and industrial production." (MoAaI/Ministry of Agriculture and Irrigation, 2008: 98). Regarding sesame under the ARP vision it is stated that sesame area, productivity and production were projected to reach 6,300 thousand feddans, 225 kg/feddan and 576 thousand tons by the season 2010/2011. Unfortunately, contrary to the expectations and despite sesame's high and increasing demand globally, Sudan has recently been losing some of its key traditional export markets. Moreover, in spite of agriculture being an acknowledged leading growth driver for Sudan's economy, excessive taxation has been one of the major impediments causing the slow growth and development of the farming sector (Konandreas, 2009; Maglad et. al., 2009; MoT/Ministry of Trade, 2008). As noted by Maglad et. al. (2009), beside of explicit trade taxation and the implicit tax of an overvalued currency, local taxes and fees put pressure on farm production costs and have offset the impact of tariff reductions so as to eliminate the anti-export bias as attempted by the Sudanese government.

In this context the paper shows that economy-wide policies, manifested in an overvalued exchange rate and direct excessive taxation have been among the main export capacity supply constraints for sesame, the top agricultural export commodity over the last two decades. Sudan comes third in order after China and India in sesame production and is known for its good quality white sesame. However, as we are going to show in the paper, in the last decade there has been a noticeable diversion of trade away from Sudan's sesame in some of its key export markets, causing a drop in its rank from being the top exporter to the third in line. The paper uses the Value Chain (VC) analysis approach to better understand the constraints which the sesame sector faces along its supply chain up to the final target of exports. The analysis will be focused on white sesame as about fifty percent of its production is destined for the international market. Moreover, as the emphasis of the paper is on export supply capacity constraints, only the export part of the white sesame value chain (WSVC) will be considered. It is hoped that the findings of the paper will help in identifying what the needs for enhancement of sesame exports are, and what might be done to satisfy them.

Aside from this introductory section, the paper is structured into four sections. Section two provides a profile of the sesame seed sector. This section

presents the evolution of sesame cultivated area, production and productivity. It also shows the sesame exports, the direction of its trade, and the status in the main export markets. Section three develops a value chain (VC) for sesame, showing how its supply chain operates, and identifies the main constraints that its production and exports face. Section four, drawing on the value chain findings, interviews with stake holders, and relevant literature, identifies the main constraints and challenges that sesame production and exports face. Section five discusses some key interventions by the government needed to effect the changes and developments required to raise sesame quality and exports. Finally, section six provides some concluding remarks.

2 A Profile of the Sesame Sector in Sudan

This section provides an overview of sesame seed farming in Sudan, addressing in some detail cultivated areas, production, productivity performance and the contribution to exports.

2.1 Sesame Production Regions, Areas, Production, and Productivity

Agriculture in Sudan consists of three main farming systems: the rain-fed traditional farming system, the rain-fed semi-mechanized farming system, and the irrigated farming system. Sesame is cultivated in both the rain-fed semi-mechanized and the rain-fed traditional farming systems, which cover six states that extend from Eastern to Western Sudan, namely Gadarif, Blue Nile, White Nile, Sennar, North Kordofan, and North Darfur states (see the map of the sesame areas in Mahgoub, 2014). In four of the six states (Gadaref, Blue Nile, White Nile, and Sennar) production operations are dual in nature, using mechanization for land preparation and seeding and manual work for harvesting which earned this mode of production its name of semi-mechanization. On the other hand, in the other two states (that of Kordofan and Darfur) all production activities are carried out manually.

Sudan produces different types of sesame: white sesame which is the most internationally preferred type, reddish sesame, and mixed sesame. White sesame is mainly produced in the semi-mechanized farming system, while the dark types are produced mainly in the traditional rain-fed farming areas. Table 1 shows the distribution of sesame cultivated areas and the production figures for the six main production states. Of the three states producing white sesame, Gadaref is the leading producer, both in terms of area cultivated and production. Historically, Gadaref state has seen the start of semi-mechanized farming of sesame, and then, driven by the increasing international demand its large-scale cultivation was extended to the other states.

However, over time Gadarif state established itself as the hub of white sesame production, especially of the good quality types destined for export.

Table 1: Average Sesame Areas and Production by Main Producing States, 1995/96-2014/15 (Area 000 fed; production 000 mt)

Region	1995/96-1998/99	1999/00-2003/04	2004/05-2007/08	2008/09-2010/11	2013/14	2014/15
Gadaref						
Harvested area	920.2	780.5	586.0	453.0	390.0	960.0
Production	88.4	66.0	62.0	57.8	39.3	117.0
White Nile						
Harvested area	467.8	360.8	358.6	380.0	502.0	690.0
Production	42.6	35.8	34.8	50.0	45.1	77.0
Blue Nile						
Harvested area	395.4	340.0	228.8	212.3	410.0	500.0
Production	40.0	35.7	25.2	50.0	40.6	44.8
Sinnar						
Harvested area	740.2	664.3	537.4	241.8	310.0	720.0
Production	68.4	60.3	48.0	22.5	12.4	82.8
Kordofan						
Harvested area	1,256.8	1,349.2	1,364.4	1,363.6	1,280.6	2,200.0
Production	56.2	66.0	100.4	109.5	115.2	206.8
Darfur						
Harvested area	91.2	89.0	115.4	107.8	105.0	256.0
Production	10.4	8.0	8.6	8.0	2.4	24.3

Source: Harvested area and production data up to the 2010/11 season from the Ministry of Agriculture and Irrigation/MoAal (2013), and data for the last two seasons from Mahgoub (2014).

Note: Average yields in the six regions are: Gadarif=105.0 kg/fed; White Nile=110.0 kg/fed; Blue Nile=109.9 kg/fed; Sinnar= 85.9 kg/fed; Kurdufan= 76.9 kg/fed; Darfur= 82.5 kg/fed , where 1 hectare = 2.25 fed.

An observation that deserves notice in table 1 is the jump in sesame cultivated area in the 2014/15 season which is thought to be mainly because of good rains. However, the notable increase in the areas also reflects a typical Cobb-Webb supply response phenomenon. As we are going to show below last season's prices were higher than the norm, inducing abnormally high profit margins for farmers who had good harvests. Thus as predicted by the Cobb-Webb model farmers, in response to the previous year's high prices, drew more land into sesame cultivation, and good rains further encouraged large area expansions. Although the extent of increase in the cultivated areas in the 2014/15 season is unprecedented, this kind of supply response is recurrent in the rain-fed type of farming, as there are no regulatory legislations for land ownership and distribution and thus of boundaries for the schemes. Again as predicted by the supply response model and also confirmed by our findings, excess supply of sesame leads to a decrease in its prices, resulting in a drop

of farmers' profit margins and sometimes even leads to losses. Unfortunately, also a recurrent occurrence is that losses could be high to the extent that farmers be jailed because of default in loan repayments, whether because of loans from commercial banks or from the public Agricultural Bank of Sudan (ABS). Notwithstanding the importance of the above issue for the growth and development of the sesame sector, it is beyond the scope of this paper, which will be focused on the main constraints along the sesames value chain. The second observation is that all this vast sesame cultivated area of more than 5.5 million feddans just fetched about 5 thousand tons of sesame seeds what is reflecting a very low productivity rate. Annex table A-1 reveals that sesame's productivity in four decades did not change much and on average registered about 93.3 kg./fed (41.5 kg/hectare) for the 1970/71-2014/15 period. Low yield is not peculiar to sesame alone but plagues the entire farming sector in Sudan, and especially so the rain-fed farming production.

A report prepared by the UNDP on the poverty profile in North Sudan based on the National Base Line Household Survey (UNDP, 2012) shows that the incidence of poverty in the above noted regions is: Gadarif (50.1 percent), Blue Nile (56.5 percent), White Nile (55.5 percent), Sennar (44.1 percent), Northern Kordofan (57.9 percent), and Northern Darfur (69.4 percent). The same report shows that the incidence of poverty among those whose source of livelihood is agriculture is 61.9 percent, of whom 64.2 percent are in rural areas and 31.2 percent are located in urban areas. Furthermore the report notes that, overall, the proportion of rural people engaged in agriculture accounts for about 56.4 percent of the rural population. The distribution of this latter group by economic activity revealed that 47 percent of them are engaged in crop farming and horticulture and that 66.1 percent of them are poor. What these figures imply is that about three out of every five people engaged in farming in rural areas earn incomes below the poverty line.

Juxtaposing the historically low yields characterizing sesame production and the high incidence of poverty among rural farmers one can deduce that most of the farmers in the sesame growing areas are poor. The low productivity-poverty vicious circle and the decreasing real returns to farm labor might be the reason behind the observed flow of labor out of agriculture and migration to towns to seek better opportunities in the informal sector, and more recently, in gold mining. This new trend, especially in the post-oil era, of agriculture's labor migration, has further exasperated the constraints sesame producers face by creating seasonal labor supply shortages and pushing up the wages. However this phenomenon should be considered as a natural process in the dynamics of labor supply. As noted by Johnson (1995:14), "Policy makers have failed to recognize that once agriculture is well integrated into the rest of the economy the elasticity of supply of labor to the sector becomes

very large, and that the return to farm labor is primarily determined by labor supply functions rather than by demand factors”.

It is evident that, not only for the welfare of the farming community, but also to secure an increasing and sustainable sesame seed supply to meet the growing international and domestic demand, productivity gains have to be achieved. The potential is there. The research outcomes show that farmers' yields of sesame in the different modes of agricultural production ranged between 31-85 percent of the yield achieved in field trials. Yields of white sesame produced in the Gadarif mechanized rain-fed areas are 60 percent of that achieved by research units. Table 2 below shows the yields of Sudan's sesame sector in comparison with the yields for some African and Asian countries. The table is structured in such a way that the first set of countries includes those which are mostly competing, as will be shown in the next section, with Sudan in its traditional export markets, namely Ethiopia, Nigeria, India, and Egypt. The second set of countries consists of two categories. One category, China and Myanmar, at some point in time competed with Sudan. Two of the remaining countries (Uganda and Chad) are fast rising players in the sesames global market and if things do not change in the domestic Sudanese sesame sector, there will be a further diversion of sesame trade away from Sudan.

Table 2: Sesame Productivity in Sudan and in Some Other Producing Countries, 2000-2008.

Productivity	Sudan	Ethiopia	Nigeria	India	Egypt
kg/feddan	97.5	301.4	211.8	166.2	546.0
	Tanzania	Uganda	China	Chad	Myanmar
kg/feddan	264.4	244.8	491.8	170.4	157.4

Source: Adapted from table (2), STP/Sudan Trade Point (2008); 1 hectare = 2.25 feddans

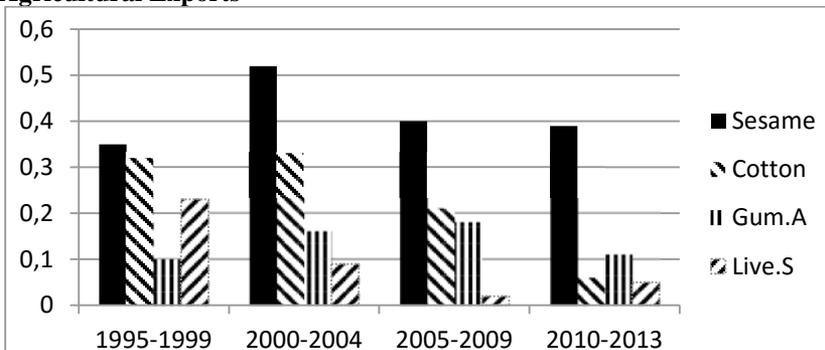
Table 2 shows that Sudan's sesame average yield is the lowest. The table also reveals the very wide gap between productivity in Sudan on the one hand and Ethiopia and Nigeria on the other hand, African countries which produce sesame under similar rain-fed climatic zones. Thus Sudan's productivity per hectare is about one-third (32.4 percent) and one-half (46.1 percent) of those of Ethiopia and Nigeria respectively. As for the second category of countries, yields of Sudan are about one-third to two-thirds of those reached in Tanzania, Uganda, and Chad.

2.2 Sesame Exports and Direction of Trade

Sesame's Contribution to Exports

Cotton was the dominant agricultural export commodity of the country followed by oilseeds (mainly groundnuts and sesame seeds) and livestock. However, as can be seen from figure 1 below, since the mid- 1990s sesame-seed has bypassed cotton and became the leading non-oil export commodity. The highest contribution of sesame has been during the 2000-2004 Millennium half decade where it fetched about fifty percent of agriculture's export revenue. Although its contribution had dropped - slightly - to less than forty percent it is clear that over time sesame has become by far the most important agricultural export crop.

Figure 1: Shares of Sesame, Cotton, Gum-Arabic and Livestock in Total Agricultural Exports



Source: CBoS/Central Bank of Sudan, 2013, 2014

Notes: 1- The available official published statistics for 2014 agricultural exports are up to September only; therefore it was not included in the series. 2- Shares are based on values of exports in nominal US\$. 3- Gum.A and Live.S stand for Gum Arabic and Livestock respectively

Demand for sesame seeds and oil in the regional and international markets has been growing, but unfortunately Sudan was unable to make use of these opportunities (Konandreas, 2009). As can be seen from table 3 below, for the last two decades sesame exports were almost stagnant. It is only from 2010 onwards that an upward trend is observed reflecting increases in international demand, mainly caused by China turning into a net importer position. Thus, for example, as table 4 below shows, Sudan's exports to China increased from an average of 1.2 percent of total sesame exports in the 1990s to 17 percent in 2013.

Table 3: Sesame Exports in Quantity and Value, 1995-2014

Year	1995-99	2000-04	2005-09	2010	2011	2012	2013	2014*
Quantity (000 Mt)	114.1	151.8	151.4	224.2	211.8	210.5	251.7	184.1
Value (US\$ ml)	141.1	205.3	132.7	167.3	223.6	223.5	468.6	283.9

Source: Central Bank of Sudan (CBoS) Annual Reports 2013, 2014. *The CBoS reports quarterly data, thus the available information is up to September only.

Direction of Sesame's Trade

Unlike cotton and livestock³, sesame seed exports are well diversified geographically as exports are destined to the Arabian and Middle Eastern markets, to the Asian market and to the European market (table 4). The Asian market is regarded as the largest and most important market for sesame with a growing consumption especially in China, which turned into a net importer position after being one of the top exporters, and in Japan, which tops the importing countries worldwide, and in South Korea. The Arabian and Middle Eastern markets encompass the most regular market for Sudanese sesame exports. Among countries of this region Saudi Arabia, Egypt, Jordan, Lebanon, Syria and Turkey are the main importers. The proximity of these markets to Sudan provides easier access and a large potential for increasing Sudan's sesame exports. The European market consists of Greece, Poland, Italy, and the Netherlands.

Some of these markets specialize, to a great extent, on exporting high quality organic sesame seeds for which demand is rapidly growing in developed countries. Thus they are involved in re-exporting high quality sesame seed and sesame- processed products for niche markets.

Sudan's Situation in the Global Market

Sudan has been one of the main suppliers of sesame seed to the global market. Historically the major exporters have been Sudan, India, China, and Myanmar. Figure 2 shows the order of the top five largest sesame seed exporters in terms of volume for the period 1990-2010. These figures show a number of important changes from the situation that prevailed in the early 1990s: first, Sudan lost its position not only as the leading exporter but also

³ Sheep exports go almost exclusively to Saudi Arabia. Cotton is shipped overwhelmingly to Egypt, and sesame oil to Saudi Arabia and the UAE (MoT/Ministry of Trade, 2008)

as the second most important exporter of sesame seed worldwide. The second new development has been the rise of Ethiopia as an important exporter of sesame seed. A third observation is that China has lost its position among the top five sesame seed exporters. In fact, one of the most significant changes in the global trade of sesame seed is the shift of China from an exporter of sesame to the one of the most important importers of sesame. Another observation is that Nigeria is becoming an important player in the global market for sesame seeds.

Table 4: Direction of Sesame Exports from Sudan in Some Selected Years (% of Total Exports)

Year	1995-99	2000-04	2005	2009	2011	2013
China	1.2	7.1	11.9	11.8	9.9	17.0
Egypt	10.7	16.4	26.2	8.1	6.6	6.4
Greece	5.0	2.2	6.1	2.4	1.9	2.5
Japan	9.9	3.2	3.3	0.7	0.3	0.8
Jordan	7.4	6.8	6.1	3.2	1.9	0.5
Lebanon	7.1	6.7	0.0	6.1	5.5	7.5
Saudi Arabia	9.7	11.5	0.0	9.4	7.0	1.2
Syria	7.2	11.9	11.0	7.8	5.2	1.7
Tunisia	3.2	4.3	5.5	4.4	4.3	3.5
Turkey	5.3	3.8	5.3	0.9	0.4	3.8
South Korea	10.1	11.8	14.9	5.5	0.0	1.9
Total	76.8	85.7	90.3	60.3	43.0	46.8

Source: MoF/Ministry of Finance, Customs Administration, Khartoum

What this tells us is that Sudanese sesame seed export has lost its prominence in some of its well-established markets (see table 4 above) and was replaced by more competitive exporters. The fact that two African countries, Ethiopia, sharing borders with Sudan, and Nigeria, have strengthened their positions as important sesame seed exporters in the global market may have serious implications for Sudan. Below (in figure 2) we show that over the past decade Sudan has gradually lost its stand in some of its key sesame seed export markets, in some cases to these two specific African countries, Ethiopia and Nigeria.

The drop in Sudan's position in the global sesame market implies that some of its traditional partners have diverted their sesame trade to other countries. In Table 5 the evolution of the share of Sudan in the total sesame imports by its top ten partners in sesame trade are presented. Column two of the table shows that the countries whose data are available for 1989, except Jordan, imported in that year more than eighty percent of their sesame seed

consumption from Sudan. For all countries, again for those whose data are available for the 1990s, the share of their sesame imports from Sudan dropped considerably. This is especially so for Egypt where the drop has been from 100 percent in 1989 to as low as 31 percent on average, and for Turkey and Greece, where the share dropped from 86 percent down to 21 percent and 51 percent on average respectively.

Figure 2: The Five Globally Top Sesame Seed Exporters, 1990-2010

Figure (i): 1990-1994

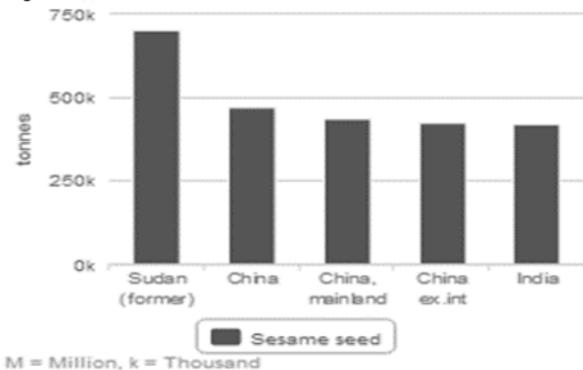


Figure (ii): 1994-1998

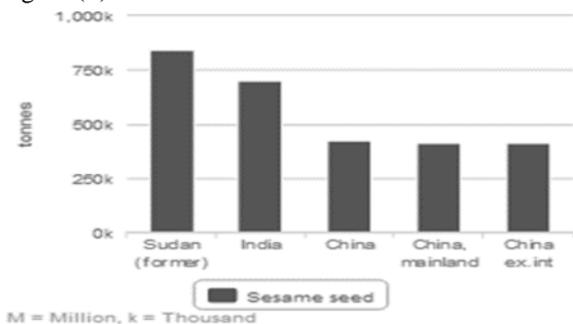


Figure (iii): 1998-2002

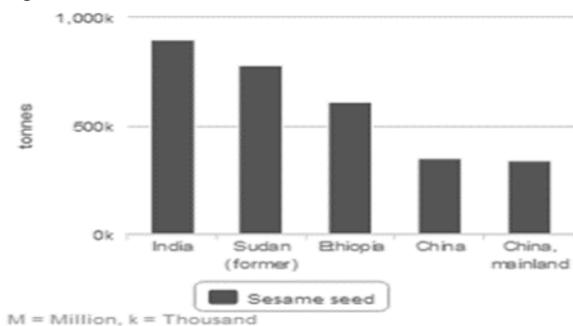


Figure (iv): 2002-2006

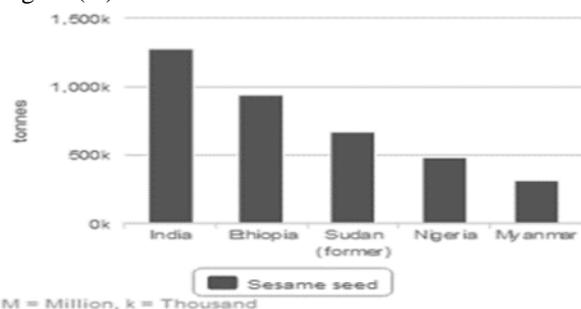
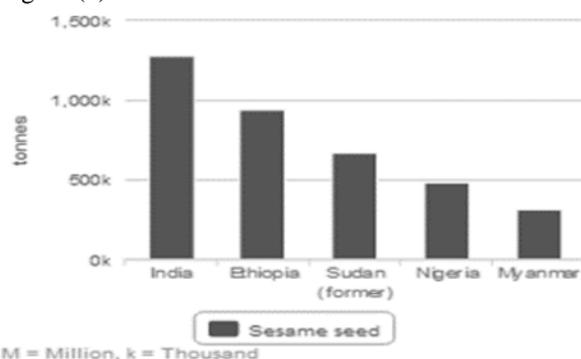


Figure (v): 2006-2010



Source: FAO (2010), FAOSTAT.

Note: The available statistics in the FAO database is up to 2010.

Comparison between 1989 and 2010-2011 shows the extent to which Sudan lost its share in some of its prominent markets, namely Turkey, Greece, Jor-

dan, Syria, and Egypt. A group of other countries such as Tunisia, Lebanon, and Saudi Arabia, although they encompass the most regular markets for Sudanese sesame exports, also show a slowdown in their demand. As for China, although it maintained its imports from Sudan, yet on average the share of Sudanese sesame did not exceed 39 percent of its total imports.

The last column of table 5 shows the countries competing with Sudan in each of the cited important markets. The countries are reported in the order of the magnitude of their market shares in each market. The three countries that appeared in all the cited markets are India, Ethiopia and Nigeria. Nigeria was the first most important competitor to Sudan in two out of the ten markets, the Turkish and Syrian markets, and the second one in the Lebanese market. Ethiopia was cited in eight out of the ten markets: it was the first most important competitor in the Chinese, Jordanian, and Saudi Arabian markets; the second competitor in the markets of Greece, Syria, and Egypt; and came third in order in the markets of Turkey and Lebanon.

Table 5: Evolution of Sesame Imports in the Most Important Markets for Sudan, 1989-2011

Country	1989 %	1990- 99 ² %	2000- 09 %	2010- 11 %	Competing Countries in Sudan's Top Ex- port Markets ³
Turkey	86	21 - 35	7 - 2	2 - 1	Nigeria (55), India (19), Ethiopia (13)
Greece	86	51 - 80	29 - 16	16 - 20	India (52), Ethiopia (12)
China	n.a	2 - n.a	35 - 39	39 - 37	Ethiopia (52), India (10)
Jordan	59	48 - 86	89 - 19	32 - 32	Ethiopia (51), India (14)
Syria	100	n.a - 62	44 - 23	25 - n.a	Nigeria (66), Ethiopia (7)
Tunisia	96	78 - 79	85 - 76	79 - 90	India (6), Egypt (4)
Lebanon	n.a	n.a-100	83 - 60	78 - 71	India (12), Nigeria (7), Ethiopia
S. Ara- bia	82	n.a-83	69 - 62	63 - 74	India (14), Ethiopia (9)
Egypt	100	31 - 27	54 - 62	n.a - 34	India (60), Ethiopia (3)

Source: FAO Statistics

Notes: 1- The latest reported statistics we found for imports of the above cited countries was for the year 2011. 2- The first figures in columns 2, 3 and 4 are the average shares for the indicated interval, while the second figures are the shares in the end of the decade year. In column 5 the first and second figures are the shares in 2010 and 2011 respectively. 3- n. a. stands for "not available". Figures are either not reported for the specific year or for a series of years such that the average cannot be calculated.

We noted earlier the dominant importance of the Asian countries in the sesame international market and that Japan, Korea, and later on China have become the world's leading importers of sesame seed. Thus it goes without saying that maintaining and promoting sesame seed trade with these countries

should be vital for Sudan. Moreover, for the Arabian and Middle Eastern countries, namely Egypt, Turkey and Syria, notwithstanding that they are among the most important sesame seed importers in the global market, the diversion of trade to other African countries has serious implications as it implies that Sudan has been losing the comparative advantage of its proximity to these markets.

3 A Value Chain Analysis of the White Sesame Market

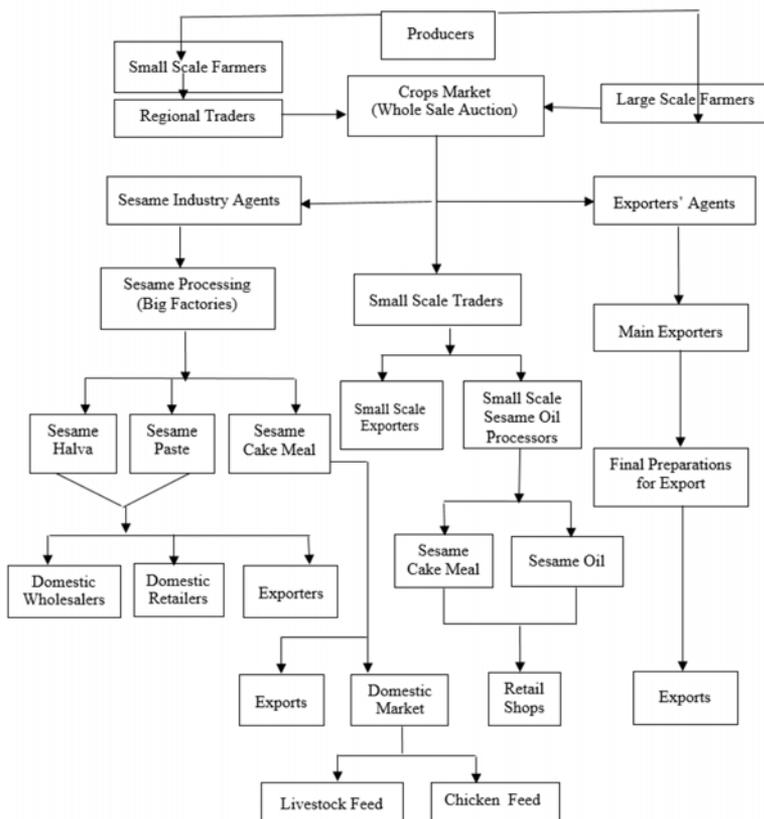
This section highlights the main constraints facing white sesame seed production and exports using a value chain analysis approach. The *value chain* analysis as defined by Kaplinsky et al. (2000: 4), “describes the full range of activities which are required to bring a product or service from conception, through the different phases of production (involving a combination of physical transformation and the input of various producer services), delivery to final consumers, and final disposal after use”. Thus the value chain analysis is seen as an essential tool to an understanding of the participation of different actors in markets, their relationships, and the critical constraints that limit the growth of a product and consequently its competitiveness. Examples of the value chain analysis reveal the wide application of the approach (see Munyua et al. 2013 on sesame, Fernandez-Stark et al. 2011 on fruits and vegetables, Pascal Liu 2009 on fresh fruits, Match Maker Associates 2008 and Tamasese 2009 on fresh fruits and vegetables, and Mather 2008 on banana and sugar).

In line with the methodology followed in the value chain analysis literature, first we construct a value chain map for sesame seeds that shows the different actors participating in the chain from its production stage to the eventual distribution into the market. As the emphasis of the paper is on sesame’s export supply constraints, next a gross margin configuration of costs incurred along the value chain is presented. In this respect the value chain is broken into two units which constitute the two main distinct process units along the supply chain, namely farmers and exporters. To get information to construct the value chain map and to estimate the costs to farmers and exporters primary data were collected from different stakeholders along the sesame’s supply chain. The data gathering activities constituted a visit to the Crops Market (auction) at El Gadarif and interviews with farmers, exporters, the Farmers’ Union, the traders, the Ministry of Agriculture and Irrigation, exporters at Khartoum, and at the Trade Point Unit/Ministry of Trade and Foreign Affairs.

3.1 Map and Main Actors along the Value Chain

The sesame value chain is composed of various actors who include small-scale and large-scale producers, traders at different levels, and small-scale and large-scale processors and exporters. Since the emphasis of this paper is on constraints to sesame seed exports, the actors outlined below are only those related to that part of the value chain being relevant to exports only (see also figure 3):

Figure 3: Layout of Actors in the White Sesame's Value Chain



Source: Compiled by the author

Crops Market: The Crops Market (whole sale auction) is a public managerial body developed since the thirties to supervise marketing of the main crops

produced in the semi-mechanized areas, namely sesame, sorghum, and more recently sunflower. Historically, the grain and oil seeds are sold in the market through the open outcry or manual auction system. In addition to managing the Auction the function of the Body is to register the quantities and prices of the crops on a daily basis and to supply the information to the other concerned entities such as Gadarif's State Ministry of Finance, banks, companies, and the State Information Network. To facilitate control and supervision of marketing of the grains produced in the vast rain-fed area surrounding Gadarif town, the organizing structure constitutes three other Sub-bodies covering the Eastern, Southern and Western sub-sections. Each sub-section constitutes about 4-7 main crops producing areas. Thus the Market has the function of surveillance, supervision, and monitoring of the movement of supply and demand of the crops in the production areas.

The bulk of sesame in the Mechanized Eastern area is delivered to Gadarif Auction, after which it is distributed between export and domestic market. Produce of small-scale farmers is typically taken to village wholesale markets or retail traders. A farmer can take his produce either directly or through middlemen, but mostly this is done by middlemen who have the capacity to buy larger quantities to sell in wholesale markets and to make the transactions. The large number of middlemen at this level of the value chain is at the expense of the small-scale farmers who do not really have access to the Auction.

Farmers: Sesame is produced by small scale, medium scale and large scale farmers. However, there is no distinction between the medium scale and large scale farmers and generally farmers with schemes of less than 500 feddans are categorized as small scale ones and those cultivating schemes above 500 feddans are defined as large scale farmers. In Gadarif region the majority of farmers, about two thirds, are large scale and one third is small scale farmers. To the contrary, in the other three regions of White Nile, Blue Nile and Sinar about seventy percent are small scale and the rest are large scale farmers. Small-scale farmers are grouped into associations of 100-200 members each to facilitate easier access to credit and renting of machineries to benefit from economies of scale.

Traders: Various kinds of traders are involved in moving sesame from the farm gate to the local markets in the different Sub-sections and to the main Auction market. They include: rural retail-shop-keepers, rural traders, and rural wholesalers. Other categories of traders move sesame from the Auction to either domestic processing firms or to export. Thus traders can be categorized on the basis of volumes handled and also on the type of market in which transactions take place along the sesame marketing value chain and so they constitute:

(i) **Rural traders:** Small rural traders buy sesame-seed from farmers during the harvesting season and move it from farm gate to rural assembly markets, i.e. local markets in the sub-sections. The accumulated stock is then taken to the Crops Market (Auction) in El Gadarif. As for large stocks, the grain is moved directly from the production schemes to the Auction market either by traders or by the farmers themselves. Moreover, rural retail shopkeepers supply credit to some small-scale and medium-scale farmers at the start of the season and take repayment in kind at harvest time. These shopkeepers also take sesame seed to the rural sub-markets or to the Crops Market.

(ii) **Wholesale traders:** This category of traders constitutes individuals or companies with the capacity to handle large volumes of sesame. They also handle other grains and crops produced in the area, such as sorghum and sunflower. They move sesame to exporters and to wholesale dealers all over the country.

Exporters: Exporters are individuals, domestically owned companies and foreign companies. Almost all exporters are found in the capital city Khartoum. They buy their sesame stocks through agents from the Auctions at El Gadarif Crops Market. For example, both Korea and China have domestic agents who act on their behalf. Exporters shoulder the responsibility of winnowing, cleaning and packing sesame ready for export to the different destinations. All these final preparation steps take place at Port Sudan.

3.2 Findings of the Value Chain

The information and data gathered for the 2014/2015 season from different sources were condensed to estimate the gross margins for sesame producers and exporters. All calculations pertaining to the selling price for the farmer and buying price for the exporter are average prices.

Farmer's Value Chain

As has been shown by the value chain map (figure 3) the first building block in the supply chain is the farmer. Table 6 below shows the value chain of producing one ton of sesame.

Table 6: Value Chain for White Sesame Production and Marketing up till Auction (2014/2015)

Item	Cost (SDG)/ Ton ¹	Percent of cost at farm gate	Percent of cost at Crops Market
1. Land preparation:			
1. Registration fees	14.00	0.10	
2. Labor input	200.00	1.45	
3. Other	680.00	4.90	
Sub-total	894.00	6.45	6.29
2. Cultivation:			
1. Seeds	200.00	1.44	
2. Other	239.04	1.73	
Sub-total	439.04	3.17	3.09
3. Weeding:			
1. Equipment	40.00	0.29	
2. Labor input	3760.00	27.12	
Sub-total	3,800.00	27.41	26.74
4. Harvesting:			
1. Equipment	160.00	1.15	
2. Labor input (cutting + winnowing)	5,770.00	41.61	
3. Pesticides	52.00	0.38	
4. Sacks and strings	194.00	1.40	
5. Packing	120.00	0.87	
Sub-total	6,296.00	45.41	44.30
5. Managerial Costs	725.60	5.23	5.11
6. Cost of Finance:			
1. ABS's profit margin	461.84	3.33	
2. Tax	64.15	0.46	
Sub-total	525.99	3.79	3.70
Zakat (tax) ¹ 1014.45	1,183.77	8.54	8.32
Total cost at farm gate	13,864.40	100	
Fertilizer ²	2,400.00	14.76	
Total cost at farm gate + fertilizer input	16,264.40		
Marketing:			
Transport to Crops Market	180.00		
Loading and unloading (labor input)	79.92		
Registration fees at Crops Market	88.80		
Sub-total	348.72		2.45
Total cost up till Crops Market without fertilizer	14,213.12		100

Source: Based on a Note by Farmers' Union on the cost of cultivating 1000 feddans at the productivity rate of 3qnt/fed or 1.5 tons/feddan for the 2014/15 season.

Notes: 1- All the costing at the production stage is carried out per quintals (qnt) , where 1 sack ≈ 2.0 qnt; 1 ton = 12 sacks. 2-Fertilizer application has recently been introduced in sesame cultivation, but because of its high cost it is not used by the majority of farmers; therefore we show cost with and without fertilizer.

Exporter's Value Chain

Prices generally depend on the timing of sale during the post-harvest season. Farmers who have financed the production operations through loans, whether from the Agricultural Bank of Sudan (ABS) or from local merchants, repay in kind immediately after harvest at the procurement price set by the creditors. Some farmers also sell at the start of the season, even if prices are low, to generate the needed cash to finance sorghum production which comes second in line in the crop rotation system after sesame. As for exporters, since all sales are done through the Crops Market, prices are set by the Auction and hence differ per auction and even within an auction day pending on the magnitude of supply to the market. The exporter's value chain is presented below (see table 7).

Other Findings

(i) The macroeconomic policy environment: According to the exporters the unstable and distorted exchange⁴ rate has been one of their binding constraints. Historically, sesame's export parity price and the export proceeds were evaluated at the official exchange rate. However this season sesame's international price dropped from US\$ 2,200/ton at the start of the season to US\$ 1700/ton⁵, which when juxtaposed with the overvalued currency and restrictions on the foreign exchange market, formed a huge burden on exporters.

(ii) Large number of intermediaries: As stated by the interviewees' one of the main problem of sesame seed marketing is the large number of traders or intermediaries who handle the product on the supply chain as it moves from farm to the wholesale market. Farmers who do not have access to the wholesale Crops Market are forced to sell to traders at the farm gate at lower prices. According to the Farmers' Union even when farmers take their produce to the Crops Market in most cases they are forced to sell to the intermediaries because of the long process needed to get the approval of displaying their sesame in the auction in terms of paper work and other arrangements.

⁴ The official exchange rate has been changed from SDG 5.7:1US\$ at the beginning of January to SDG 6.31:1 US\$ towards the end of the month. However, during the same period the parallel exchange rate was SDG 8.8: 1 US\$ and changed to SDG 9.05:1 US\$ and then again increased to SDG 9.15: 1 US\$ by end of February, which shows the extent of instability and currency overvaluation.

⁵ The high 2013/2014 season's prices induced unprecedented increases in sesame planting. Accordingly, aggregate sesame supply in the 2014/2015 season was estimated to be in excess of 1.7 million metric tons (m.t.) against an estimated demand of 1.4 (m.t.). Thus prices dropped from an average of US\$ 2,200/m.t at the start of the season to US\$ 1,700/ m.t. at a later stage in the production cycle (Huyton Group 2014).

Table 7: Exporter's Value Chain for White Sesame from El Gadarif to Port Sudan

Activities	Cost SDG/ton ¹	Percent of Cost at Indi- cated Stage	Percent of Total Market- ing Cost
Buying price of exporter from Crop's Market ²	1,2020.40		
1- Costs at Crops Market Stage:			
Weighing, inspection and quality control	14.13	4.30	2.01
Other local fees	55.65	16.94	7.90
Exports stamp	66.78	20.33	9.48
Crop Market's commission	69.01	21.00	9.79
VAT	28.38	8.64	4.03
Sacks and loading	94.61	28.79	13.43
Total cost at Crop's Market	328.56	100	46.62
Cost of one ton at Crops Market	12348.96		
Of which, direct taxes are		49.97	23.30
And indirect taxes (fees) are		21.24	9.91
2- Costs at Port:			
Transport to Port Sudan	138.61	36.85	19.67
VAT on transport to Port Sudan	28.39	7.55	4.02
Total cost of transport	167.00	44.40	23.69
Winnowing at Port	80.00	21.27	11.35
Sacks	60.00	15.95	8.51
Quarantine, inspection and safety measures	6.97	1.85	0.99
International inspection	1.90	0.50	0.27
Local transport and portering	30.00	7.98	4.26
Loading and other services	12.50	3.32	1.78
Port fees	17.80	4.73	2.53
Total cost at Port Sudan	376.17	100	53.38
Total Marketing Costs (1+2)	704.73		
Of which, direct taxes are		12.28	4.02
And indirect taxes (fees) are		5.17	5.30
Shipment Value at Port (SDG/ton) - FOB	12,725.13		
Ten percent tax collected by CBoS from export proceeds	1,272.51		
Total expenses to exporter	13,997.64		
Export parity price ³ (US\$ /ton	1700		

Source: Actual expenses incurred for the 2014/2015 season up till end of January 2015 based on interviews with Exporters. **Notes:** 1- All transactions at the stage of movement of sesame from farm gate to the Crops Market are carried in quintals (1 ton = 22.26 quintals, 1 sack = 1.84 ≈ 2.0 quintals). 2- The reported price in the table is an average price between the auction value of 11,130 SDG/ton (500 SDG/quintal) at the start of the season and the value of 12,910.8 SDG/ton (580 SDG/quintal) for the good quality white sesame. These are the prices that prevailed at El Gadarif Crops Market up to end of February 2015. The price differential reflects quality differences of sesame. 3- This is the border price at the time of analysis.

(iii) Inefficiencies increase costs: Based on observations of some traders, inefficiencies along the supply chain of sesame seeds from farm gate to the Port unnecessarily increase cost and cause delays. One example pertains to repeating the process of winnowing and packaging. The seeds are first packaged in 90/kg low quality sacks (jute) at the farm and then transported to the Crop Market. At the Crops Market, after all the measures of inspection, weighing and classification take place, sesame is repacked again in 50/kg jute sacks ready for the Auction. The seeds which are classified as good quality are transported from the Crops Market to the Port where again they are unpacked, winnowed, cleaned and repacked in 50/kg fiber sacks ready for shipment. Thus, during the supply chain from farm to export, the sesame seeds are portaged and packaged three different times what no doubt increases cost.

(iv) Climate change: According to the interviewed farmers one of the main problems that emerged in the last decade is the impact of increases in the temperature (because of climate change) on the duration of rainfall at the sesame cultivation areas. Previously adequate rainfalls started at the beginning of June, hence sesame's production season extended from early June to October. However, due to climate change adequate rains start in July, decreasing the range of the rainy season and the margins for sesame cultivation.

(v) Quality of seeds: Another farmers' observation is the lack of institutions, whether private or public, to proliferate high yielding varieties of sesame seeds. Usually farmers put aside part of the sesame seeds produced in each season (which they think is of good quality) to be used in the following season. But even the seeds bought from the market are not best quality.

(vi) Other constraints related to the supporting services:

- Lack of appropriate extension services.
- Inadequacy of specialized research on sesame and lack of an articulated and detailed long term national strategy for the promotion of its exports. For example, research results establish the possibility of cultivating sesame in irrigated farming where much higher yields (500kg/feddan) than in rain-fed farming could be achieved. However, trial production has only started very recently and on a very small scale.

4 Analysis of the Value Chain: Main Constraints and Challenges

In what follows we look with more detail into some of the main constraints to sesame production and exports that were emphasized by the interviewees and/or came out in the analysis of the value chain. We also analyze the ex-

porter's and farmer's value chains to show the impact of these constraints on their returns.

4.1 Constraints in the Exporters' Value Chain:

Taxes and transportation costs

Table 7 shows the share of each item of the exporter's value chain in costs incurred at each stage of the marketing process as well as its contribution to total marketing costs. The table 7 also reveals that costs incurred by the exporter at the Crops Market constitute about 46.7 percent of the total marketing costs of which about 21.2 percent are in the form of fees, which hereafter we denote by indirect taxes, and 50.0 percent are direct taxes. This says that 71.2 percent of the exporter's expenses at the Crops Wholesale Market stage are in the form of direct and indirect taxes, the bulk of which are the direct ones. These same taxes represent about 23.3 percent and 9.9 percent of the total cost of marketing one ton of sesame which all in all totals about 33.2 percent. Table 7 also shows that exporters' expenses at Port Sudan, which as we explained above is where the final preparation of sesame for export takes place, form 53.3 percent of the total marketing costs⁶ where about 12.3 percent constitute the direct taxes and 5.2 percent are the indirect ones. According to table 7 these direct and indirect taxes constitute about 6.6 percent and 2.8 percent of total exporter's expenses respectively. The other binding constraint to sesame exports which came out from the analysis of the value chain is transportation cost. The cost of transporting one ton of sesame from the Crops Market to the Port is about 24 percent of the total marketing costs inclusive of a VAT of 17 percent which amounts to about 4 percent thus leaving the net cost of transportation at 20 percent of total marketing cost⁷.

The above information shows that close to half (about 43 percent) of total cost of exporting one ton of sesame shouldered by the exporter are the direct and indirect taxes. As shown in the table the direct and indirect taxes in addition to the other expenses add to the free on board (FOB) price for export. Thus it goes without saying that higher taxes and fees increase the price offered for Sudanese sesame in the international market and undermine its competitiveness. For example, interviews with the Sudan Trade Point (STP) revealed that Nigeria, one of the main competitors to Sudan in some of its prominent markets, offers lower sesame seed prices than Sudan. As pointed

⁶ The MoT/Ministry of Trade (2008) report shows that charges at Port Sudan are the highest in the region.

⁷ Other studies (Maglad et. al., 2009) also found out that transportation in Sudan is of low capacity and high cost.

out by Lyakurwa (2007: 23), “The exporters distribution chain directly affects competitiveness for it is the efficiency of the supply chain that in the final analysis determines an enterprise’s capability to compete and its long term commercial viability.....It follows that any reduction in purchasing or logistics cost and time has a direct, predictable and often large impact on exports”.

Taxes on export proceeds

An extra burden to the exporters is that the Central Bank of Sudan (CBoS) collects 10 percent of the export proceeds to cover hard currency requirements to import medicines. This kind of policy on part of the Government is a disincentive to exporters and will also have a detrimental impact on their capacity to export. So much so, that some exporters try to hedge against this extra load in different ways. According to interviews some exporters under-invoice their exports, while others smuggle their sesame across the border to Ethiopia, where there are no export taxes, and export it as an Ethiopian product.

Additional Marketing Costs

Another binding constraint to exporters is the difficulty of doing cross-border business because of the USA sanctions. Sanctions restrict banks abroad to carry transactions with Sudanese banks. Without going into details, exporters together with their counterparts are forced to follow indirect means in their financial transactions. According to the interviewed exporters this causes them an extra cost equivalent to about 2.5 percent of their export proceeds which is not small money to lose. This problem if not resolved will hamper Sudan’s capacity to export (Huyton Group, 2014) and might well be one of the reasons why demand for Sudan’s sesame has been slowing down as we have shown above.

4.2 Constraints in the Farmers’ Value Chain

The analysis of the main constraints to sesame production is based on the farmer’s value chain (table 6). Various factors emerged as major constraints.

Increases in Labor cost

Labor shortage and its high cost has been cited as one of the main problems the farmers face in particular for the very labor-intensive harvesting activities, as manual harvesting causes less shattering of sesame seed heads and loss of the seeds than mechanical harvesting. Another critical factor in labor demand for harvesting is that the time between ripening of the sesame seeds and their shattering is very short (7-14 days); thus the timely and adequate

availability of seasonal labor input is a decisive factor in determining the amount of production. For decades an abundant seasonal labor supplied the demanded labor for all the operations along the production chain. However, according to the interviewed farmers due to the increasing cost of living and the lower real returns to agricultural labor, young laborers migrated to the capital city or to other big towns to work in the informal sector in search of better opportunities and for higher returns. Moreover, the post oil-era and the advent of gold mining led to fundamental changes; gold extraction attracted a considerable number of agricultural laborers, thus adding to the causes of seasonal labor shortages and resulting in a considerable increase in its cost.

Corroborating the farmers' complaint the Value Chain for the Farmers (table 6) shows that indeed labor input for weeding and harvesting stages alone constitutes about 70 percent of the total production costs. This figure shows to what extent sesame production could be sensitive to changes in labor cost. The huge jump in labor cost as shown by the figures in table 8 speaks for itself. One of the causes of the drastic increase in the cost of hired labor is that now farmers, in order to fill the gap created by the shortage of Sudanese laborers, resorted to replacing local labor by Ethiopian laborers from across the border. Thus, in addition to the wages farmers incur the extra cost of paying for passports, visas and transport from and back to the border.

Table 8: Cost of Labor Input per one Ton of Sesame, 2010/11-2014/15

aq	2010/11- 2011/12 (SDG)/ton	2014/15 (SDG)/ton	Rate of Increase (%)
Wage/labor for harvesting one ton	420.0	4,800.0	1,042.9
Wage/labor for weeding	400.0	3,200.0	700
Total	820.0	8,000.0	875.6

Source: Own calculations based on information from interviews. The reported values are cost of labor time net of food and transportation costs.

Some of the interviewed farmers used mechanical harvesting instead, which though in their view is less efficient, but it is much cheaper than manual harvesting. Mechanical harvesting has been introduced three seasons back on a private sector initiative, yet at very small scale. For example, the Farmer's Union informed the researcher that this season about ten percent only of the total cultivated areas were harvested mechanically, the reason being insufficient numbers of the harvesters to meet the increasing demand.

Low productivity

Section two above showed that sesame yields are low by all standards, whether compared to other producing countries or to trial research findings. Among the causes cited by interviewees is the inability of some farmers, especially small scale ones, to carry the appropriate farming operations because of high cost of some of these operations. For example, the high labor cost is a burden for farmers. Unfortunately, there are no statistics to show the distribution of numbers of farmers between those who follow the recommended package of input use and production operations and those who do not. Nonetheless, the persistence of average low yields is indicative of the inability of the majority of farmers to follow the optimal recommended package. Another yet cited cause of low productivity is the quality of seeds used. Usually, even if improved seeds are available, their quantity is not enough to cover the demand. Farmers are used to putting aside part of their produce in each season to be used in the following season.

Because of the vast areas under mechanized farming the obvious option of fertilizer application to raise the yields was not introduced in earlier periods. However recently, induced by the increasing international demand for sesame, some farmers have started the application of fertilizer. According to their experience, sesame production in the rain-fed areas proved to be highly responsive to fertilizer input; for example in this season yields have more than doubled (table 9, below). Yet, despite the positive impact of the fertilizer application the use in sesame production is limited because of its high cost⁸. The farmer's value chain above showed that fertilizer indeed poses a very high cost as it stands at around 15 percent of total cost incurred by the farmer, leaving only wealthy ones being able of affording its application. In this respect the Farmers' Union has been calling for the Government's support, either by subsidizing fertilizer or by availing adequate finance and collateral to facilitate all farmers' access to its use.

Table 9: Gains in Sesame Productivity due to Fertilizer Application

Type of Farming	Average Yields (quintal/feddan)	
	2013/14	2014/15
Traditional Farming	1.5	2.0 – 3.0
Farming using fertilizer	3.0	4.5
Fertilizer constitutes about 15 percent of total cost of producing one ton of sesame*		

Source: Farmer's interviews, * Farmer's value chain.

⁸ Although detailed statistics as to the number of farmers who applied fertilizer is not available, the Farmers' Union at El Gadarif ascertained its limited application.

The current sesame yields of 3-4 sack/feddan (1.2- 1.6 sack/hectare) make it difficult for the farmers to service their loans. High sesame yields, because they reduce the costs per unit of output, should form a major technological challenge for the government. In the wake of the Asian Green Revolution technological breakthrough in its various forms has made a major contribution. To improve productivity in the sesame sector of Sudan will require concerted effort to facilitate the adoption of modern techniques of production and marketing by at least the majority of farmers; this requires financial resources that, in most cases, are not within the reach of many farmers. Consequently the access to credit by the farming community is very important. It is hoped that the Agricultural Bank of Sudan (ABS) and the commercial banks not only increase credit in real terms to farmers, but are as well easing the conditions to improve the cash flow situation of the farmers what requires more flexibility on their side. Thus, a strategy to develop the sesame sector, that takes into account the physical, economic, and institutional problems faced by the farmers, is essential.

Price Risks and Variability in Farmers' Returns

Interviewees informed the researcher that some farmers were obliged to opt for distress selling at earlier post-harvesting periods to repay loans and to cover costs which results in lower returns to farmers, although sustainable practices rely in part on adequate returns from their production and on marketing efforts. For example, the farm gate price set by the ABS, as a supplier of credit to farmers and for in-kind repayment, at the beginning of the season was SDG 7,791.0/ton (SDG 350/quintal) which subsequently, as a result of the pressure from the farmers, was raised to SDG 11,130.0/ton (SDG 500/quintal). Comparison of this upper bound price with the cost of producing one ton of sesame shows that the farmer who carries out the production operations as shown in the Value Chain, even if no fertilizer is applied, incurs a loss being on an equivalent to US\$ 441 per ton. This implies that farmers either defaulted on their loan payments or had to cut their costs by carrying through sub-optimal production operations, such as reducing weeding to once instead of twice, ending up with lower yields, quality and returns. The interviewed farmers also noted that in seasons like the current one, where ample supply caused auction prices to drop from more than SDG 17,000/ton last season to a range of SDG 11,130.9/ton - SDG 15,136.8/ton, it is a common thing that farmers be jailed because of inability to repay loans, especially so when the break-even prices for the farmer as shown by the Value Chain are SDG 16,264.40 and SDG 13,864.4 for production situations with-without fertilizer application respectively.

The above presented analysis clearly points to the stylized fact that sesame production is inevitably faced with production volatilities and hence price

risks which entail government intervention to mitigate these risks through stabilizing market interventions. Notwithstanding the debate regarding the pros-and-cons of government intervention, the importance of sesame for growth of the agricultural sector and the economy as a whole necessitates such an intervention. Some studies related the riskiness in production and markets facing farmers reveal that a high degree of risk at low-income levels is a deterrent to agricultural and overall growth. These studies pointed out that successfully implemented price stabilization via government intervention was a key ingredient of fast agricultural growth in the EU and in Asian countries (Sarris, 1995).

4.3 The Extent of Taxation to Sesame Exports

The value chain of sesame seed exporters' revealed that two of the main current policy induced constraints to its exports are excessive taxation and the overvalued exchange rate. Thus, in this section we analyze the consequences of these constraints and we want to see to what extent these policies create a disincentive to sesame exports, but first very briefly we outline the methodology we are going to employ in our computations.

Methodology

Following Tsakok (1990), our methodology is to calculate the margin of returns to the producer and exporter with and without the two constraints and to compare the outcomes according to the following steps:

Step 1: Calculating the Gross Nominal Protection Coefficient (NPC):

This is the ratio of a commodity's domestic price to its border price (the foreign price in domestic currency). Thus the NPC compares the observed price to the efficiency price that would prevail in the absence of the domestic market distortion:

$$\text{Gross NPC} = \frac{p^d}{p^b}$$

where:

P^d = domestic price

P^b = border price = F.O.B price x OER (foreign price x official exchange rate)

F.O.B = free on board

OER = official exchange rate

Step 2: Adjusting for currency overvaluation: When the OER is less than the parallel or black market exchange rate (PER), adjustment is needed because an overvalued exchange rate understates the border price of a traded

good in local currency. Thus the border price is corrected for overvaluation using what is known as the standard conversion factor (SCF), defined as the ratio of the official exchange rate (OER) to the parallel exchange rate (PER). The Gross NPC adjusted for currency overvaluation results in the Net NPC as follows:

$$\text{SCF} = \frac{\text{OER}}{\text{PER}} \quad (\text{in case of overvaluation } \text{SCF} < 1)$$

$$p^{\text{b adj}} = p^{\text{b}} \times \frac{1}{\text{SCF}}$$

$$\text{Net NPC}_{\text{exch}} = \frac{p^{\text{d}}}{p^{\text{b adj}}}$$

where the subscript 'exch' stands for exchange (rate adjustment).

Step 3: Adjusting for taxes: The relatively high taxes are one of the major factors that causes the price of a commodity to be higher in the export market and is undermining its competitiveness. Thus the Gross NPC is adjusted for taxes as follows:

$$p^{\text{d adj}} = p^{\text{d}} - \text{taxes}$$

$$\text{Net NPC}_{\text{tax}} = \frac{p^{\text{d adj}}}{p^{\text{b}}}$$

Step 4: The extent of distortion is measured by the Nominal Protection

Rate: $\text{NPR} = (\text{NPC} - 1) \times 100$.

If $\text{NPR} < 0$ the exporter gains and, conversely, if $\text{NPR} > 0$ he loses.

Impact of Taxes and Exchange Rate Overvaluation on Exporters

Exporters' profit margin depends on sesame's international price, the exchange rate for export proceeds, and the cost of production. Table 10 below gives the results of applying the above methodology to data obtained from the sesame exporters' Value Chain as shown in table (7). The results show that at the official exchange rate the exporter will shoulder a loss of SDG 2,185.13 (US\$ 352.4) per ton exported, in addition to another 1,272.5 (US\$205.2) because of the tax imposed by the Central Bank of Sudan (CBS). The value of the Nominal Protection Rate (NPR) shows that, at the prevailing marketing and exchange rate policies, the FOB price the exporter would be able to offer in the international market is 21 percent higher than the international price converted into domestic currency at the official exchange rate. Putting this another way, because of the current inappropriate policies the exporter is taxed by receiving a price which is 21 percent less than what he would have received without such distortive policies. This drastic situation is exacerbated by the additional burden to the exporter in the form of the ten percent tax by the Central Bank of Sudan (CBoS) which increases the overall tax including overvaluation of the currency to 33 percent.

Table 10: Gross Cost Margins and Returns to Sesame Exporters

	SDG/ton
FOB price	12,725.13
Border price = US\$ 1700 x SDG 6.2 (6.2 is the OER))	10,540.00
Loss to the exporter per one ton of sesame at OER	2,185.13 (US\$352.44)
Total expenses to exporter including CBS 10 percent tax	13,997.64
Loss to the exporter per one ton of sesame	3,457.64 (US\$ 557.68)
Extent of Disincentive to the Exporter:	
(i)	Gross NPC = $P^d / P^b = 12,725.13 \div 10,540.00 = 1.21$
(ii)	When adding tax by CBS: Gross NPC = $P^d / P^b = 13,997.64 \div 10,540.00 = 1.33$
This is to say that at the current policy situation the exporter can only sell profitably at a price which is 21 (or 33) percent higher than the world price, and thus the exporter is not competitive in the international market. Another way to interpret the figures is that they show the extent of taxation to the exporter.	
Correcting for policy distortions:	
1- Induced by overvaluation of the domestic currency:	
Adjusting the border price for exchange rate overvaluation: $SCF = OER/P = 6.3 \div 8.9 = 0.71$	
Adjusting border price for overvaluation of domestic currency: $P^{b\ adj} = P^b / SCF = SDG\ 10,540.00 \div 0.71 = 14,845.07$	
i.e., the price the exporter would have received if the exchange rate was not overvalued.	
- $NPC_{exch} = P^d / P^{b\ adj} = 12,725.13 \div 14,845.07 = 0.85$	
- $NPR = (NPC_{exch} - 1) \times 100 = (0.85 - 1) \times 100 = -15\%$	
i.e., the border price the exporter faces is 15 percent less than the one he would have obtained at the appropriate exchange rate.	
2- Induced by direct taxes:	
Adjusting the domestic price for direct taxes: $P^{d\ adj} = P^d - \text{taxes} = 12,725.13 - 192.56 = 13,997.64 - 1,465 = 12,532.57$	
i.e., the price the exporter would have received if direct taxes are removed.	
- $NPC_{exch} = P^{d\ adj} / P^b = 12,532.57 \div 10,540.00 = 1.19$	
- $NPR = (NPC_{tax} - 1) \times 100 = (1.19 - 1) \times 100 = 19\%$	
i.e., if the taxation policy is corrected the exporter still loses 19 percent.	
The exchange rate at which the exporter breaks even: $12,725.13 \div 1700 = SDG\ 7.485:1US\$$	
Adding the CBS tax: $13,997.64 \div 1700 = SDG\ 8.234:1US\$$	

Source: Own calculations applying the outlined methodology and based on table (7) above.

We also tried to look deeper into the impact of two of the most important constraints to sesame exports which became apparent from the value chain, namely direct taxes and exchange rate overvaluation. For this purpose we

build a counterfactual situation whereby these policies are removed by employing the methodology which we outlined above. The calculations reveal that of the two policy distortions the exchange rate overvaluation taxes the exporter the most. The overvalued exchange rate lowered the border price from SDG 15,130.0/ton (at the parallel rate) to SDG 10,540.0/ton (at the official rate), and hence the gross revenue that exporters receive as suppliers of sesame to the world market. When correcting for the exchange rate overvaluation the exporter's situation changed from one of shouldering a 21 percent tax to one of a 15 percent gain, i.e. an improvement of about 36 percent. On the other hand the counterfactual analysis shows, when the direct taxes as shown in the exporters' Value Chain are removed, this cuts the exporter's losses considerably from 33 percent to 19 percent, thus removing a tax burden amounting to 14 percent.

Using the FOB price and the border price of sesame one can see that the breakeven exchange rates for the exporter are about SDG 7.485: 1 US\$ SDG and 8.234:1US\$. Pressurized by this state of facts, this season the CBS removed exchange rate restrictions on sesame's exports whereby exporters are allowed to convert their export proceeds at the parallel exchange rate (PER). According to the CBöS regulations, previously all sesame export transactions and transfers of proceeds were carried through by commercial banks and the CBS at the official exchange rate. Now that the restrictions are removed, repayments to the commercial banks against loans will be at the official exchange rate (OER) and the extra profit margins occur because of conversion at the parallel exchange rate (PER). Thus the net profit margin depends on the percentage distribution of the amount of finance between loans from commercial banks and own resources to cover exports expenses. The above analysis clearly indicates that since the sesame sector operates in a specific economic environment, it is essential that the macroeconomic setting facilitates a sustained development of the sector⁹. Sound policies for foreign trade are imperative and, in particular, macroeconomic policy needs to maintain a stable and reasonably undistorted exchange rate. At the end of the day efforts to promote the sesame sector will not matter if the macroeconomic policy environment is not equally well-developed.

In our counterfactual analysis we only considered the impact of direct taxes but other components as shown by the Value Chain are also detrimental to sesame exports. Two such factors that stand out are the high cost of transport, which constitutes about 20 percent of total costs incurred by the

⁹ That poor macroeconomic policies and specifically an overvalued exchange rate are harmful for agriculture has been empirically established in the literature (see for example Krueger 1992; Schiff et al. 1993; Nasredin, et. al. 1997; Oyejide T. A., (1993); and Tshibaka, T. B. 1993.

exporter, and the various kinds of fees (indirect taxes) which form another 15 percent of total cost. To minimize the adverse impact of these policies on the sesame sector, a periodic assessment of such policies will be necessary.

5 Policy Recommendations for Revitalizing the Sesame Sector

The deteriorating current situation of sesame productivity and exports as described above necessitates immediate concrete actions if this crop is to regain and then to sustain its competitiveness in its key markets. To reverse the downward trends and to increase volumes and efficiency for sesame seeds a range of policy measures spanning the whole supply chain are required. We briefly outline some recommendations for policy interventions below:

5.1 Bridging the Information Gap

At the outset to formulate a strategy for the promotion of sesame production and exports there is a need to identify the critical areas of weaknesses in the sesame seed supply chain and also the impediments to its demand in the main export markets. This should be done at two levels:

(i) Supply Side Analysis

To carry out studies on the supply chains of sesame covering it is necessary for all the main production areas to collect detailed information on:

- The volume of sesame handled by the various actors along the chains as the crop moves from farm gate to the consumers, domestic processing, and export markets.
- The distribution of shares from sesame sales between different actors along the value chain, from the farm gate to the different destinations.
- The distribution of costs within the production chain.
- Access and sources of credit to the different actors along the value chain.

These studies should give in-depth information regarding the exact role played by the different actors along the value chain, especially the intermediaries. As noted by the interviewees two of the causes that increase the cost of sesame marketing were the large number of intermediaries and also the repetition of some of the processes, like packing, along the supply chain. Hence the kind of detailed information provided by the studies would help in developing a more efficient and cost-effective way of sesame marketing, more importantly that farmers get the highest share of returns from sesame sale.

(ii) Demand Analysis

In section two it was shown that Sudan has been losing its share in most of its traditional sesame export markets. If Sudan is to reverse this trade preference trend, challenges have to be taken seriously and addressed by policy makers. In this respect we suggest the following:

- To approach Sudan's trade partners, especially the top ten ones and those for which Sudan has the advantage of proximity, to understand the causes which created competition within these markets as well as shed light on other impediments to sesame imports.
- To carry sesame supply chain studies in the countries of these partners to complete the picture along the other side of the chain. These kinds of studies will shed light on the sesame seed exports' market environment, especially traders, which will guide exporters from Sudan and help them to make stronger trade partnerships and build confidence on their capability to meet the international demand and standards.
- To look into experiences of other sesame trading countries, especially the new players who recently achieved fast growth in its global market, to learn from their experiences.
- These kinds of surveys should be done on a regular basis to build a data base on the sesame seed exports' market environment which will guide exporters from Sudan and build confidence on their capability to meet the international demand and standards.
- To carry out surveys on the magnitude of demand and the direction of trade of processed sesame, namely halva and sesame paste, to look into the market possibilities and value addition opportunities for processed sesame.

5.2 Farmers' Institutions

The challenges facing farmers in the sesame sector have been exacerbated by a weak output marketing system, poor services, and limited access to credit. Farmers must be supported by the government to face these challenges by enhancing their skills and knowledge and by making appropriate technologies affordable. Building institutions or strengthening capacities of existing ones is therefore fundamental for farmers' support. These institutions can provide economies of scale in production operations, storage and transport, negotiating better prices for farmers and protecting them from market and production risks.

Promotion of Sesame Production and Exports: A Proposed Medium to Long Run Strategy

The farmers' and exporters' value chains have suggested an array of constraining factors to the sesame sector, such as lack of adequate physical infra-

structure, the risks of price and exchange rate volatility, and high marketing costs. The attainment of the objectives of sesame sector's promotion will hinge upon improving its performance. There is need for a fundamental re-examination of the current infrastructure of the whole sector. If we take marketing for example, the auction floor in Gadarif, like many such auction floors in Africa dealing in export commodities, have operated for many decades. Typically, it lowers search costs for participants and reduces market thinness, but it imposes costs for transportation and offers no services for warehousing, financing or price risk management. Many see, as we also suggest for the long-run, commodity exchanges as an alternative way to increase efficiency and to manage risks (UNCTAD 1997, 2005, 2007). The Commodity Exchange system provides a market place that serves all market actors, from farmers to traders and to processors and exporters. There has been growing interest in commodity exchanges on the part of governments in developing countries reflecting a drive to reduce transactions costs and a need for new commodity risk management tools. Nowadays there are about eleven such commodity exchange units in Africa and about thirty seven ones in Asia, all of which provide a rich experience that Sudan can draw upon. Commodity markets across the world trade in agricultural products and other raw materials (like wheat, sesame, cotton, cocoa, maize, coffee, milk products, etc.).

As noted by Rashid et.al. (2010:3), "By simply centralizing trade in a certain commodity, an exchange can facilitate title transfer, market transparency, and price discovery. Transaction costs are reduced because coordination through a centralized exchange can reduce costs associated with identifying market outlets, physically inspecting product quality, and finding buyers or sellers. By reducing transaction costs and enhancing the flow of information, an exchange can improve returns to market agents while reducing short-term price variability and spatial price dispersion". The Commodity Exchange system will ensure a secure and reliable system for handling, grading, and storing sesame seeds, and will also incorporate other related logistics services such as warehousing, transport, banking, and financial services, in addition to dispute settlement mechanisms. More importantly, the Commodity Exchange supports the farmers by availing warehousing and storage facilities which will encourage small-scale farmers to trade their produce through the Commodity Exchange where they will have full information on the prices and their trading opportunities and thus will have better negotiating powers.

The Commodity Exchange can be developed around an auction floor. Sudan historically has active auction floors not only in Gadarif but also in other main producing areas which, in addition to sesame, trade in other crops like groundnuts, sorghum, sun-flower and millet. However, from other countries' experiences (Rashid et. al. 2010; UNCTAD 2009, Onumah, 2007), the

successful establishment and sustainability of an exchange depends on a number of essential basic preconditions. Sudan with its accumulated experience meets a number of the conditions that enable the development of a commodity exchange, such as the sufficient and continuous volumes of trade. However, government's commitment and effort are required on the economic and policy environment front. As discussed by Rashid et al. (2010:9), these include "adequate infrastructure, efficient flow of information, a sound macroeconomic and financial environment, stable rule of law, and effective contract enforcement".

Establishment of a fully-fledged Commodity Exchange system might be looked at as a long-run strategy for addressing the constraints to sesame exports. In the short to medium term a number of the constraints could be mitigated through improving the market fundamentals: such as looking into innovative ways to broaden the financial services base for the farmers instead of restricting them to either borrowing from formal banks or local money lenders and the consequent distress selling at harvest time. Another market fundamental to be addressed is improving the transportation services to decrease the cost of moving the produce from locations to the auction and also to the Port. Another important prerequisite for the development of a market are sound macroeconomic and trade policies. Moreover, a developed communications infrastructure will not only avail information regarding prices, quality and quantities but can also be used innovatively for other purposes such as educating farmers. Lastly, the Government should recognize the important role played by producers' organizations and should improve their capacities to play more active roles in the supply chain, such as replacing the rent-seeking intermediaries in linking farmers to the auction and in communicating information on grades and standards which must be met.

6 Summary and Concluding Remarks

For more than a decade sesame has become Sudan's top agricultural export crop bypassing cotton which has traditionally been the most important one. However, the last decade has seen a sustained loss in Sudan's market share in some of its key export destinations. This paper is an effort to enhance our knowledge on the main sesame's export supply capacity constraints. In addition to descriptive analyses of the sesame sector in terms of area, production, yields, exports and export destinations, that provided important insights, the value chain analysis approach is used together with interviews with different stake-holders along the sesame's supply chain to investigate the export supply capacity constraints to its exports.

The data indicate that during the 1970/71–2013/14 period, nationwide sesame output and cultivated area grew at average annual rates of 1.63 and 13.79 percent, i.e. the ratio of annual growth in area to annual growth in output averaged 8.5, implying that any increase in sesame output was attained by bringing more land into cultivation while yields either dropped or stagnated. In fact sesame's productivity remained low compared to other main producers, some of whom are African neighboring countries. It was found that sesame seed exports are well diversified geographically. Another revealing insight identified by the analysis is the change in the composition of the top five sesame exporters in the global market, of which the most important for our concern is that Sudan dropped to the third order from being the top one during the nineties, which implies that sesame trade has been diverted away from Sudan. Another disturbing finding is that Ethiopia and Nigeria, who are relatively new players in the global sesame market, have substituted Sudan in some of its key markets including the Middle Eastern one.

The sesame supply chain map identified sesame producers and exporters as two distinct entities along the chain as the producers and exporters do not interact with each other directly, but all trade is carried through the wholesale auction market known as the Crops Market. Thus to capture the kind of constraints faced by each of the entities, the paper developed two separate Value Chains for the producer and for the exporter. The following constraints were identified from the Value Chain analysis for the 2014/15 season and by interviewees:

Regarding the Exporters' Value Chain the paper found out that sesame exports in the 2014/15 season suffered from high rates of direct taxes which constituted about 30 percent of the total cost of exporting one ton of sesame and indirect taxes in the form of different kinds of fees which amounted to another 13 percent of total cost. The other binding constraint to sesame exports was high transportation cost from the Crops Market to the Port which figured about 24 percent of the total marketing cost. The paper thus noted that since the FOB price of sesame is the purchase price in addition to the direct and indirect taxes and other expenses, the higher the taxes are the higher will be the price offered in the international market and the less competitive will Sudanese sesame be. Yet another extra burden to the exporters, and which is not part of the supply chain, is that the Central Bank of Sudan (CBoS) collects 10 percent of the export proceeds from each exporter to cover hard currency requirements for medicine imports by the Government. The interviewed exporters also cited the USA sanctions as impeding their chances of doing cross-border business. They informed the researcher that because of the USA sanctions direct financial transactions with the Sudan are prohibited, leaving the exporters obliged to resort to indirect ways which costs them another 2.5 percent of export proceeds.

Further analysis was done of the impact of direct taxes and the exchange rate overvaluation by using the standard Nominal Protection Coefficient (NPC). The results corroborated the Value Chain findings in that indeed the overvalued exchange rate highly taxed the exporter, as the export parity price at the official exchange rate is about 36 percent lower than what it would have been at the parallel rate. Removing the direct taxes would lower the burden on the exporter by 14 percent. Thus the paper concluded that the commodity-specific and economy-wide policies constitute parts of the binding constraints to sesame exports, and that of the two policy distortions the exchange rate overvaluation taxed the exporter the most.

Turning to the farming level, the Value Chain analysis and the interviews identified the high cost of labor as one of the main constraints. Some stages in sesame production, the weeding and harvesting stages, are labor-intensive and thus any increase in labor cost immediately translates into high sesame production cost and thus either lower profit margins or even losses to the farmers. In both cases the volume of sesame produced and exported will be affected. The increase in labor cost is not a transient one. As the paper showed, labor cost exhibited an increasing trend since four seasons back, the post-oil era, the reason being migration of domestic seasonal labor to big towns and more recently to gold mining activities. To solve the problem of labor shortage the majority of farmers imported the much more costly Ethiopian labor as a substitute. Others resorted to mechanical harvesting instead. In this respect one would expect the Ethiopian labor substitute would not be a sustainable one as its supply depends on the demand conditions back in Ethiopia. For example this season there was excess Ethiopian labor supply because heavy rains damaged part of the sesame crop cultivated in Ethiopia. On the other hand mechanical harvesting, although in the opinion of some farmers less efficient than manual harvesting, is much cheaper than manual harvesting. Accordingly we recommend that the government encourages imports of mechanical harvesters, which so far have entirely been a private business initiative, and intervenes to regulate their imports and distribution so as to ensure the availability of the harvesters at the required time and quantity and at affordable prices.

Beside high cost of labor, sesame production is also characterized by poor yields by all standards, whether compared to other producing countries or to potentials as based on research trials. Fertilizer use, which may more than double output, remained limited in application because of being too expensive to be affordable by the majority of farmers. Raising productivity in the sesame sector will remain a key prerequisite for enhancement of sesame exports. However, sustainable increases in productivity require systematic interventions by the government and by the private sector to strengthen the

technical and financial capacities of producers, especially the small and medium-scale ones.

To promote sesame exports and, for Sudan, to regain its position in the sesame's global market, a set of reform measures need to be implemented. Some of these measures could be seen as immediate to short-run interventions which could remove some of the constraints along the farmer's and exporter's value chains. An example is removing the tax burden where taxes could be transferred to other sectors where their effect is less distortionary. Moreover the paper showed that the sesame sector lacks institutional capacity to address the challenges it faces. For decades now, all the stages along the sesame supply chain have been carried through in the same traditional way. In this respect the paper recommended the establishment of a "Commodity Exchange" as a long-run strategy for addressing the constraints to sesame production and exports. Building on the experiences of other developing countries, especially the African ones, a Commodity Exchange can be developed around an auction floor after ensuring that essential basic preconditions are met.

Establishment of a fully-fledged Commodity Exchange system might be looked at as a long-run strategy for addressing the constraints to sesame exports. In the short to medium term a number of the constraints could be mitigated through improving the market fundamentals: such as looking into innovative ways to broaden the financial services base for the farmers instead of restricting them to either borrowing from formal banks or local money lenders and the consequent distress selling at harvest time. Another market fundamental to be addressed is improving the transportation services to decrease the cost of moving the produce from production locations to the auction and also to the Port. Another important prerequisite for the development of a market are sound macroeconomic and trade policies. Moreover, a better developed communications infrastructure will not only avail information regarding prices, quality and quantities but can also be used innovatively for other purposes such as educating farmers. Lastly, the Government should recognize the important role played by producers' organizations and improve their capacities to play more active roles in the supply chain, such as replacing the rent-seeking intermediaries in linking farmers to the auction and communicating information on grades and standards which must be met.

This paper considered only a part of the white sesame seed sector, namely that destined for export which constitutes about 50 percent of the total produce. The remaining 50 percent is processed domestically into sesame paste and halva, which absorbs about 80 percent of the seeds while the waste (the rest of 20 percent) is sold as sesame cake-meal to the animal and chicken feed industry. The bulk of processed sesame is consumed domestically and only a minimal portion finds its way to export markets. However, considera-

ble value added could be gained from sesame processing as highly purified sesame fetches 5 percent, sorted sesame fetches 10 percent, skinned sesame fetches 25 percent, and sesame paste fetches around 45-50 percent more than the price of raw white sesame respectively (Mahgoub, 2014). However, to the best of our knowledge there is only one company, a public- private joint venture, which uses advanced technology to sort and skin white sesame seeds which then are exported. Although we do not have information about the export markets for these processed products, it seems that the extent of value added gives potential for promoting the sesame sector in that direction. Such development calls for the attention and the support of government.

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8 Appendices

Table (A-1): Total Sesame Area, Production and Productivity, 1970/71-2011/2012

Period	Area ¹ Har-vested	Growth Rate	Coefficient of Variation	Production	Growth Rate	Coefficient of Variation	Productivity	Growth Rate	Coefficient of Variation	Area Har-vested to Planted (%)
70/71-74/75	2191.8	5.9	20.0	279.4	-14.3	10.0	130.0	-7.9	20.0	89.7
75/76-79/80	2001.0	9.4	16.1	221.4	7.2	13.9	111.4	-1.4	04.7	86.6
80/81-84/85	1856.6	4.7	18.2	187.2	-4.2	23.7	101.4	-7.2	16.9	85.6
85/86-89/90	2490.4	1.4	8.4	183.4	4.9	21.8	74.8	6.5	28.2	99.3
90/91-94/95	2545.8	34.1	44.7	157.8	31.6	42.0	68.8	-6.2	15.8	80.4
95/96-99/00	4100.8	11.7	17.9	324.0	5.3	16.8	79.8	-6.2	12.5	80.5
00/01-04/05	3506.6	6.5	24.9	275.6	28.8	32.4	77.6	10.5	19.8	80.9
05/06-09/10	3268.0	11.5	22.0	292.2	0.05	12.7	92.8	-0.6	19.6	76.5
10/11-14/15 ²	4540.0	38.9	20.3	275.0	-44.7	22.6	103.2	19.2	02.5	80.4
Average	2744.9	13.79	21.4	241.7	1.63	21.8	93.3	0.74	15.6	85.5

Source: Area, Production and Productivity are from Ministry of Agriculture and Irrigation (MoAaI). Coefficient of variations are own calculation.

Notes: 1- Area: (000) feddans (1hectare = 2.25 feddans); Production: (000) tons; Productivity: kg./feddan. 2- The high growth rate in the harvested area in this interval is due to the jump in the area from about 4.5 thousand feddans in the 2013/14 season to 7 thousand feddans in 2014/15.

The Global Value Chain of Shea Butter and Rural Producers in Northern Ghana

Martha A. Awo*, and Felix Agyie-Sasu **

1 Introduction

Most African countries are endowed with resources that can contribute to economic growth if well harnessed. Naturally growing agricultural tree crops in particular can have a direct benefit for rural employment and to support livelihoods. On the international market various tree crops, such as cocoa from African and Asian countries, are known to contribute considerably to GDP and livelihoods in many countries. Aside cocoa, one of the naturally growing tree crops that are making significance on the international market is shea (*Vitellara paradoxa*). The shea tree grows in the southernmost part of the Sahel and the adjacent Sudan and Guinea savannahs in west and central Africa (von Maydell, 1986). It is found in a long narrow swath approximately 600 km wide and 5,000 km long across northern Sub-Saharan Africa. The products from shea have high economic and social significance, both at the rural and global markets. On the international market, butter from shea has been found to be a suitable substitute to cocoa in the confectionery and chocolate industry, being used as a cocoa butter equivalent (CBE). It is said to alter the physical properties of cocoa butter by increasing chocolate hardness at higher temperatures (Folds, 2000; AO, 1991). According to various authors (Dogbevi, 2009; Schreckenber 2000) there has been a high demand for shea butter-added chocolates due to its ability to stand environmental heat, and because it melts slowly when put in the mouth as compared to chocolates containing only cocoa butter.

In Ghana, the tree thrives on about a 1,167 square kilometres stretch of land with about 99% being located in the Northern part of the country. The remaining 1% is located in parts of Brong-Ahafo, Ashanti, and Eastern and

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Volta regions along the upper part of the middle belt of the country (FAO, 1988). It is estimated that 150,000 – 200,000 tonnes of shea kernels are exported each year from West Africa, while 50,000 tonnes (approx. 33%) are coming from Ghana alone (USAID, 2010). A compilation of the chemical components from different producing nations showed that butter from Ghana, particularly from the northern region, has high stearin oil content as compared to other producing countries (Maranz, 2004); this is an essential ingredient for confectionary and cosmetic industries. The Northern region, which is one of the poorest in the country, has the largest land area of 70,380 square kilometres that is capable of supporting agricultural activities. Nonetheless, the region is among the top three in the country that is said to be “food insecure”. This is because agriculture in the country is rain-fed and unlike the south that experiences two rainy seasons in a year the northern part of Ghana experiences one rainy season only with high erratic rainfall patterns. Such unfavourable climatic conditions do not only allow for just one cropping season in a year but increase the risks of crop failure. Furthermore, financial and technical constraints limit opportunities in the agribusiness industry.

The most affected group in the region are women whose position is compounded by traditional and customary practices that restrict their access to productive resources. These, in combination with enforced patriarchal family systems, further constrain women’s access to economic options. The region’s practice of patrilineal family arrangements, with preferences for males as heirs, reinforces women’s low status (Panuccio 1989). Under the patrilineal systems in Ghana and other parts of Africa, inheritance is through the father, but males are usually favoured because it is believed that they will perpetuate the family lineage. For example, the system permits women’s rights to land through a relationship with a male, the husband or the son. Such cultural practices affect inheritance and resource acquisition, thus putting women at a disadvantage in all spheres of the social space.

However, by tradition, women have access in the shea industry, making it the only economic sector where women have a use right. Over 600,000 women in Ghana are estimated to depend on shea for their livelihood (Stathacos, 2004). The picking, processing and trade in kernels provides the women with income to supplement household needs. A study by Hatskevich et al. (2011), to establish the potential of the shea industry as a source of income and poverty reduction in Northern Ghana, revealed that on average a picker’s monthly income ranged from 53-173 USD while that of shea butter processors were estimated to be 97-279 USD as compared to that of farmers which ranged from 50-100 USD. Oquaye (2007) provided evidence of the shea industry as a potential source of economic gain in Northern Ghana where it has been estimated to have the potential to reduce poverty by 60 percent. It was also further identified as a viable enterprise that offers an opportunity for

the economic empowerment of women in both urban and rural areas (Isahaku et al., 2012). Kavaarpuo (2010) identified a high potential of income and employment in shea products against the background of increasing international need for shea kernels and butter. This notwithstanding, literature on the sector using the value chain approach to conduct detailed socio-economic benefits to producers is limited. Rather, the increasing demand for the industrial use of shea has narrowed research to scientific investigations that seek to find the best chemical compositions.

However, it is a general knowledge that the global requirements for shea have changed the marketing dynamics in line with the assumption that the exchange patterns of rural resources change over time with increasing economic and social significance. Where resources attract international markets it can bring about strategic actors leading to intensive exploitation of the resource. It is therefore not surprising that in the shea sector, development agents and NGOs are very visible in the value chain, coordinating and forming women groups to consolidate processing volumes for target international companies. Within this dynamics, a broad scope analysis of the industry is needed since the principal constraints that actors face may be located within any part of the market system. In this regard, the paper uses the global value chain concept to explain the dynamics in the shea kernels and butter sector among small-scale producers. In order to provide deeper insights on the nature of activities, a holistic analysis of the sector will examine the market dynamics and the network of actors; these include producers (nut pickers and kernel processors), shea butter processors, aggregators (traders, agents, and transporters) as well as development practitioners who provide technical support and assist women groups in marketing. Specifically, the analysis looks at the social and economic implications as well as available opportunities for producers.

The paper is organized as follows: the next section 2 gives a brief review of the shea sector. An illustration of the value chain and actor network is used to explain the market structure, global demands, the categories of actors, and the dynamics of their activities. The research area and the methodology are presented in section 3. In section 4, the results discuss in detail kernel production and butter processing activities as well as the marketing of both products. A discussion of rural women's organisations is used to explain the dynamics of the local shea butter market. The quality specifications for kernels and butter are also examined. In the final section 5, the conclusions and policy recommendations are presented.

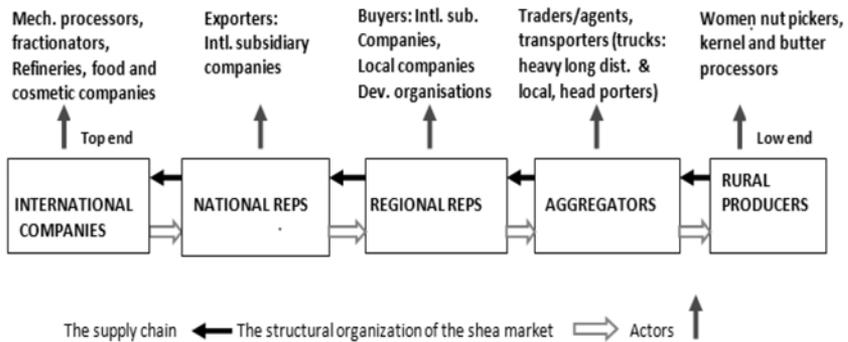
2 The Global Value Chain of shea butter and the rural shea producers in Northern Ghana

2.1 The Shea sector

Shea is an indigenous tree species that grows wild in many countries in Africa. It thrives in 20 countries from Senegal in the West to Sudan and Uganda (and in a small corner of Ethiopia) in the East (Ferris et al., 2001). It is an important economic sector that supports rural households. The season for shea in Ghana is the beginning of the crop farming season, around May through to harvesting period in August or September. During this period, many households experience food shortages; the critical periods are June and July. In such periods, husbands expect their wives to generate income from shea to support household needs. These sole responsibilities have made the women familiar with these tasks in June/July. The food shortage situation can be critical when there is no livestock that can be sold to support the household. This window period of food insecurity, coupled with the low income levels of the region, make shea to become an important resource. Within the context of a traditionally male-dominated society, this is a period where the woman gets recognition because the husbands look up to her to carry on with family responsibilities. The Ghana Living Standards Survey (GLSS) reports about the number of households which are involved with the harvesting and the processing of the shea nut (GSS, 2014). Traditionally the shea butter is used as cooking oil, as body cream, and for various medicinal preparations. It is also used in social and cultural activities such as weddings, births and funerals ceremonies (Addaquay, 2011; Lovett, 2005). At the international level, it is used in confessionalary and cosmetics industries where significant quantities are exported to Europe (the UK, Denmark, Sweden, Portugal, Ireland, and Russia), USA and Canada. Japan and India have also become a major destination of Ghana shea nut and butter on the Asian market (Lovett, 2004). The major international companies which operate in Ghana are: (1) L'Oreal, (2) L'Occitane, (3) AarhusKarlshamn (AAK) - in Denmark/Sweden, (4) Industrial Oxygen Incorporated/IOI Loders-Croklaan Edible Oils - in Holland, and (5) and Foods, Fats & Fertilisers - in India. Some of the companies partner with local companies such as Bosbel Industries, Ghana Nuts, Savannah Fruits Company, Senyo and Kafui Company Ltd (SeKaf), Ghana Specialty Fats Industries LTD and Olam International Limited. Since 1990 shea has been introduced as a cocoa butter equivalent (CBE) in the chocolate industries. According to Dogbevi (2009) and Schreckenber (1996), its unique property has made shea butter-added chocolates a much more demanded commodity in the world market than chocolates with only cocoa butter.

Since the sector integrated into the international market, the nature of exchange has changed from simple and direct transactions between producers and consumers at the local level to a more complex structure with significant actor networks in place which require the analysis of the entire value chain (see the figures 1 and 2) so as to understand the changes that have occurred. In figure 1, for instance, a hierarchy of actor relations is presented; the arrows to the right link actors, with the international companies being positioned at the top and the rural producers at the low end. The black arrows to the left illustrate the flow of supply, which is from rural producers through aggregators to regional buyers. The regional buyers ensure that exportable volumes are acquired and transported to the national level for export to international companies for processing.

Figure 1: The Supply Chain: Organisation and Location of Actors in the Shea Sector



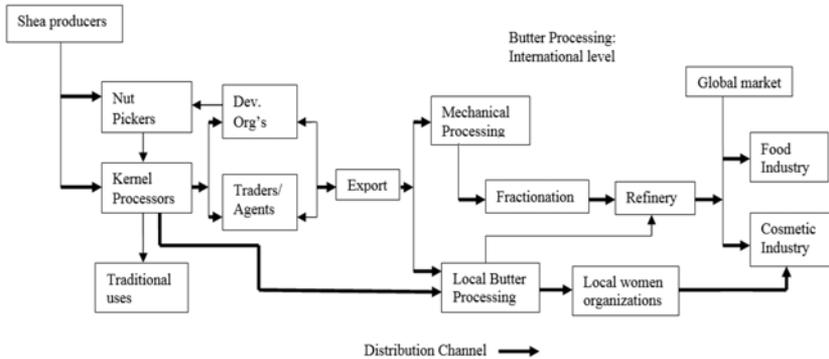
Source: Authors’ construction

In terms of structure and functions the figures 1 and 2 show an organised sector where networks of actors are involved in well-defined activities to facilitate procurement and an efficient supply chain. It can be seen from figure 1 that international companies are adequately represented at all levels in the country. Those at the national level who are mostly subsidiaries of international companies function as exporters. They ensure the smooth export of materials to their mother companies for industrial processing.

At the regional level, international companies have representatives who are strategically located at the source of the raw material to supervise buying and to monitor the transportation of the kernels to the national level for export. These are the regions with the bulk of the activities taking place and where the majority of the actors are located. From the regional level it is easy to have access to the producers in the communities. The dominant producers are rural women

who pick the shea fruits and process them into kernels. In terms of marketing of the kernels (see the detailed discussion in section 4), the major actors in the supply chain are the buyers on the side of the international companies represented at the region, the development organisations, and the local companies and aggregators (traders and agents) as illustrated in figure 2. About 99% of the shea kernels are exported for industrial processing, though also some local companies use mechanised methods to process for export. Local processing is largely undertaken by rural women who employ traditional methods. It is believed that local processing adds little value to a product; nonetheless, the discourse on value chain theories, with a detailed analysis of actors and their functions in the supply chain, reveals that significant benefits can materialise.

Figure 2: The Shea Global Value Chain



Source: Authors' construction

2.2 Theoretical Concepts of the Global Value Chain

In an attempt to ensure that developing countries get equal participation in the global market many various theories have been proposed. The New Institutional Economics (NIE) approach explains the organizational relationships to be found in the case of integration of producers into global trade (Rindfleisch and Heide 1997; Williamson, 1999). The theoretical foundations explain the operations done as a relation between two parties: one party, mostly foreign companies, delegates the work to another (the agent) with the expectation of a trickle-down effect to the ultimate performer (Eisenhardt 1989). This mode of operations was extensively used in studies on backward linkages with rural producers (Jones, 2011). According to studies by Dunning, there are positive contributions of foreign-owned companies by improving the standards of rural products and the productivity of rural production with beneficial spill-over effects on the operations (Dunning, 1992). However, though other studies have presented the

Transnational Corporations (TNCs) as monopolistic actors which outcompete local companies (see Kula/Downing/Field, 2006), nonetheless they remain a strong force in developing countries' markets. In researches the role of the TNCs had been viewed in different dimensions. The views have changed with regard of the role of TNCs, as it is assumed that they are sourcing valuable products from small-scale producers who will achieve the benefits of getting access to high value markets; such an agenda is now pursued by many governments as a poverty reduction strategy. In this approach, the need to understand production systems has increased considerably. In the process, the Value Chain (VC) had been identified as an appropriate analytical tool to understand how to facilitate processes of market integration (Porter, 1985; Lazzarini et al. 2001). The most popular versions analysed are the Global Commodity Chain (GCC) approach (Gereffi and Korzeniewicz, 1994) and the Global Value Chain (GVC) approach (Gereffi, 1999). This framework makes it possible to analyse other topics of interest, like the Supply Chain Management (SCM) and Actor Linkages (ALs).

The GCC analysis was developed as a framework to analyze the spatially isolated and complicated production networks that are fundamental in economic globalization (Bair, 2005). Concern was about opportunities and constraints identified in the various forms of integration and production of special commodities. In its analysis, two basic types of commodity chains were identified: producer driven ones (capital- and technology-intensive operations such as the automobile companies) and buyer driven ones (labour-intensive operations with design and marketing playing key roles, such as in garments and footwear industries). Ample literature indicates that the GCC approach has been widely used in the analysis of exports of garments from East Asia to the US (Gereffi, 1994, 1999; Bonanich et al. (eds.), 1994; Smith, 1996). Since the proliferation of international actors in low income regional markets, consumer demand has become more specific and the exchange processes have seen fundamental changes as developing countries participate in global market chains. For instance, in rural commodity chains like the shea sector, though producers are linked to international buyers, production is still rural-based. The use of traditional methods for production is largely manual and labour intensive. This situation calls for upgrading production modes which will need an appropriate tool, capable of analysing rural producer gains that focus on poverty alleviation. The search for suitable instruments of analysing the upgrading prospects of developing countries is still of importance. As a way forward, the GVC framework had been identified and embraced by many development analysts and practitioners (Gereffi and Korzeniewicz, 1994, and Humphrey and Schmitz, 2000) in developing countries. The GVC framework focuses on the sequences of value added within an industry, from conception to production and to end use and recycling. It examines the job descriptions,

technologies, standards, regulations, products, processes, and markets in specific industries and places (Gereffi and Fernandez-Stark, 2011). According to the authors, the GVC analysis provides a holistic view of international industries – looking from the top down (the governance structure of global firms and their affiliation with the supplier networks) and from the bottom up (questioning how such business decisions affect the economic and social upgrading and/or downgrading in particular countries).

With the complex interactions in global exchange, the GVC has become a useful tool, to trace the shifting patterns of global production, to link geographically dispersed activities and actors of a single industry, and to determine the roles they play in both developed and developing countries (Gereffi and Fernandez-Stark, 2011). The analyses of other related concepts, such as the SCM and the network theory (NT) as applied to logistics (Bowersox et al., 2013; Blanchard, 2010; Feller et al., 2006), have provided a deeper understanding to the value chain discourse. The supply chain approach looks at the logistics in order to optimize the flow of products and services through the chain. However, their wide variation depends on what they produce, how they are produced, and where they are produced (Humphrey and Schmitz, 2004, and Gereffi, 1994). These variations have brought into focus the management aspect, to ensure efficient supply systems from the producer to the final consumer. The interest of the customer/purchaser/producer/agent in effective flows of information and communication is of importance in these analyses (Bowersox and Closs, 1996; Cooper et al., 1997). The aim is to identify management constraints and to improve programs that help to integrate quality systems and to enhance timely supplies to the consumer (Francis, Simmons and Bourlakis, 2008). This has helped value chain analysts, particularly governance-oriented scholars, to focus on knowledge flows and power relations between market players (Gereffi et al. 2005; Kaplinsky and Morris 2002; Sturgeon 2001; and Gibbon et al., 2008). This is important in analysing the export of raw materials in developing countries where most rural people have to deal with unequal power structures and with information asymmetry.

In the shea sector, for instance, the study of the SCM has helped development organisations in their practical work (such as Foundation of Netherlands Volunteers Ghana (SNV), Northern Ghana Community Action Fund (NOG-CAF), German International Cooperation Corporation (GIZ), etc.) to provide appropriate training to producers in the shea sector. Such training allows it producers to respond to changes in demand, to enhance value delivery, and to secure their position on the market. In this context, it has been realised that the supply chain is not limited to only the producer and the buyer but recognises the functions of all actors. This is evident in the GVC literature that emphasises the importance of specific modes of governance in improving a firm's activity. For instance, Humphrey and Schmitz confirm the approach as

ensuring that clustered firms involved in some form of governance relations may experience rapid product and process upgrading (Humphrey and Schmitz, 2002; Schmitz, 2004). These opportunities clearly show the effectiveness and significance of the supply chain as an effective tool in identifying the roles of actors and finally in supplying products and services which are meeting the consumer needs. In this regard, the network theory (NT) has become a significant analytical tool in GVC analysis.

The analysis of the network theory (NT) approach brings into focus the net-chain concept (Lazzarini et al., 2001). This approach centres on horizontal linkages (networks) and on the interaction between horizontal and vertical coordination (Lazzarini et al., 2001; Neven, 2014). The concept presupposes that businesses are structured horizontally or vertically in multi-functional relationships with other support organizations. For example, a study referring to the development of the shea sector in Mali (by Edakkandi M. Reji, 2013, based on an earlier study by Lusby and Derks, 2006) found out that Action for Enterprise (AFE), with funding from USAID, has developed the shea subsector in Mali by improving its access to export markets, to the effect that a large number of rural women were benefitting when harvesting and processing shea nuts. Such studies on regional clusters have shown that efficient vertical and horizontal relationships can enhance business networks (Giuliani et al., 2005). Figures 1 and 2 above illustrate a similar structure in Ghana where development agencies have formed producer groups and associations who are linked to a cluster of actor networks.

According to Uzzi (1997), apart from economic analysis, the network theory (NT) also considers social networks, values and behavioural elements such as reputation, trust and power which have the potential to influence positive or negative interactions between companies. Indeed, rural economies have historically relied on networks of support and succeeded in market transactions and other productive activities. It is therefore not surprising that such cultural elements are important considerations in economic analysis. The interaction of these concepts allows the identification of the weaknesses and strengths of an economic sector in terms of access to valuable information, technical and financial support (Coleman 1990; Burt 1997) and proficient network partners (Humphrey and Schmitz 2002). The more developed the networks are, the more enterprises can specialize in certain skills to improve outputs. Though some studies challenge such claims (Nadvi, 2004), Fitter and Kaplinsky (2001) and Kaplinsky and Morris (2002) confirm that for commodities with low value addition the terms of trade with international buyers usually attract less profits. It has also been shown that effective networking enhances value addition in the supply chain; it is known to improve market access and to reduce transaction costs (Gulati, 1998).

In many small-scale enterprises, international buyers usually specify value addition as a condition to pay premium prices, thus making value addition the principal analytical feature of the Value Chain theory. However, the above discussions on previous studies have brought into focus the fusion of two different schools of thought: macro and micro levels of analysis. The former is looking at the entire industry and the latter on specific groups, where policy is more directed to local development. Through this analysis it has been possible to understand an entire product subsector to explain how governance is structured in a multidimensional market-driven system so as to assess efficient performance of rural producers. Efficiency in performance means unrestricted access to resources such as technological skills, available logistics, strong institutional support, reliable market information, etc. In the shea sector, producers are constrained by low levels of education, the use of rudimentary methods, and the lack of government support. Given the fact that shea production is rural-based yet the producers are linked to a network of complex international relations, such a holistic analysis has helped development organisations to explain critical issues. Issues are explained such as what drives the behaviour of individual stakeholders in their business interactions and how value is determined in end markets to achieve economic and social outcomes (Neven, 2014).

The understanding of these dynamics has helped the organisations to mitigate some of the challenges confronting rural producers by providing tailored training programmes to enhance producers' performance as well as meeting buyers' preferences (figure 2). For instance, Shea butter has historically been processed using local knowledge. The local knowledge base has been informally handed down from generation to generation and has been an important tool for survival at the local level. However, as such knowledge becomes integrated into global and more complex societies potential areas for improvement are identified; these are then addressed to increase the local community's resilience. Utilising such knowledge has helped the development community to interpret the social phenomena and to provide support by designing projects that emerge from the social group. A typical case is the establishment of local shea producers and processors associations who receive training and are able to supply quality kernels and butter to international buyers.

3 The Research Area and the Research Methodology for the Field Research in Northern Ghana

3.1 The Study Area

The study was conducted in the Northern Region of Ghana, one of the three regions (namely, Upper West and Upper East Region beside of Northern Region) which together make Northern Ghana. Tamale is the regional capital with 20 districts as at 2009. It is the largest of the 10 regions in terms of landmass; it occupies 29.5 per cent of the total land area of Ghana as it is shown in figure 3. The land is mostly low lying except in the north-eastern corner where the Gambaga escarpment can be found and along the western corridor. Geographically it is located near the Sahara regions. The main vegetation is grassland, interspersed with guinea savannah woodland. The climatic condition supports food production, making agriculture the main economic activity. It is estimated that the agricultural sector employs about 71.2 per cent of the economically active population (GSS, 2014). However, the majority of farmers are subsistence producers with barely up to 5 acres of land.

By tradition, patriarchal systems govern resource access. This system gives preferences to males, thus giving them advantages over their female counterparts. Males have large acreages of land and have sole decisions on their livestock. Females are allocated marginal lands for growing legumes or gardening. If women have the opportunity to keep livestock (small ruminants) at all, they have no control over the use, as decisions are made by the husband. By virtue of geographical location, the region experiences only one rainy season in a year; hence the producers have only one cropping season unlike the regions in the southern part of Ghana which has two cropping seasons in a year. This situation creates yearly food shortages in the North. The household food sources get depleted and husbands simply look up to the wife to provide the food needs of the household with proceeds from shea. Women are particularly very familiar with the production and survival conditions in this critical period of the year. In a focus group discussion it was revealed that this period is popularly known as June/July, a time when the husbands give up the household responsibilities to the women.

Apart from food crops the climate also supports drought-resistant trees such as acacia, baobab, especially shea trees which are of interest in this study. Shea grows wild on every piece of land and is of great economic value in Ghana and in the northern zone in particular.

3.2 The Methodological Approach

The study was conducted in the Savelugu and the Tamale Metropolitan Assemblies in late 2012. With assistance from Netherlands Development Organization/Foundation of Netherlands Volunteers – Ghana (SNV) five communities were selected¹. The predominance of shea trees and the high level of shea processing activities by women groups informed the choice of the districts. SNV have over the years been working in the shea sector in capacity building and market enhancement programs for women. They have facilitated the creation of shea women working groups in a number of communities in the region. Networking with existing organizations was very helpful as access to groups appeared difficult.

For quantitative data, questionnaires were developed and with the help of the Association of Church Development Projects/ACDEP's Tamale office 10 enumerators were engaged in the administration of the questionnaires. A total of 100 shea butter processors were targeted to be interviewed, but 85 of them were successfully interviewed which represented so an 85% response rate. For shea pickers, 300 shea pickers were targeted. However, the survey yielded 224 shea pickers as respondents what represented about a 75% response rate. Qualitative data were also collected using tools such as guided questionnaires, focus group discussions, field visits, and observations of activities. Visits were also made to the second largest market (Aboabo) to understand the dynamics of the shea market. The data were analysed using SPSS and Excel to generate simple regressions for tables and graphs for interpretation. Qualitative data was transcribed for detailed explanations.

4 Research Results and Implications for Integrating and Improving the Shea Butter Value Chain in Northern Ghana

This section presents the results and provides detailed discussions on the nature of activities in the shea sector. The production, processing and marketing of the 2 main products, shea kernels and butter, is discussed. The section starts with a presentation of the demographic characteristics of both kernel and butter producers. The products are then discussed in separate sections under producers,

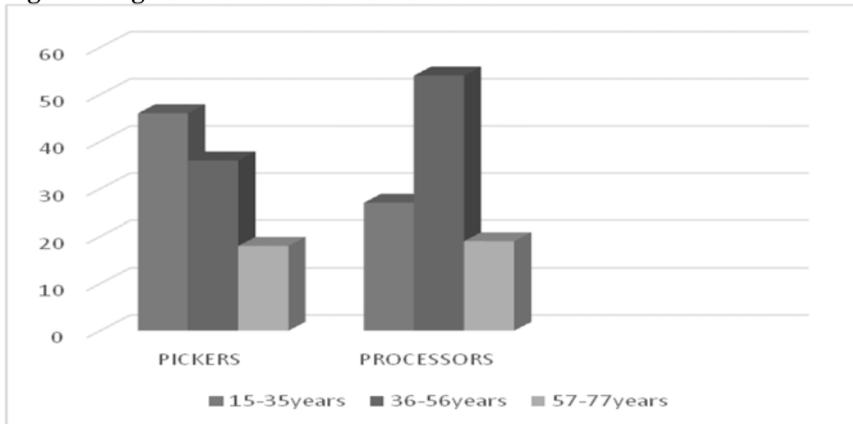
¹ SNV was established as the Stichting Nederlandse Vrijwilligers (Foundation of Netherlands Volunteers) in 1965; it was founded by the Dutch Ministry of Foreign Affairs. See the website of SNV activities in Ghana:
<http://www.snvworld.org/en/countries/ghana>

processors and marketing, which examine both the local and the international dynamics.

4.1 Demographic Characteristics of Shea kernels Producers and Butter Processors

Producers of shea refer mainly to rural women who pick shea fruits and process them into kernels. Butter processors are those who process kernels into locally hand-made butter. The demographic data about these groups of actors are similar, and hence the discussion in this section looks at both groups. The results show that about 83 percent of both pickers and processors are between the ages of 15 to 59 but 17 percent of the pickers and 21 percent of the processors were over 60 (figure 4). The minimum age of shea pickers was 19 years and 24 for shea butter processors. The mean age of the two women groups was around 40 years. In going by the definition of youth as people between the age bracket of 15-35 years in Ghana (GOG/MYS, 2010), it can be seen from figure 4 that the sector is dominated by older women, with more than 80% of the producers and almost 100% of the processors having no education as shown in figure 5.

Figure 4: Age Characteristics of Shea Women

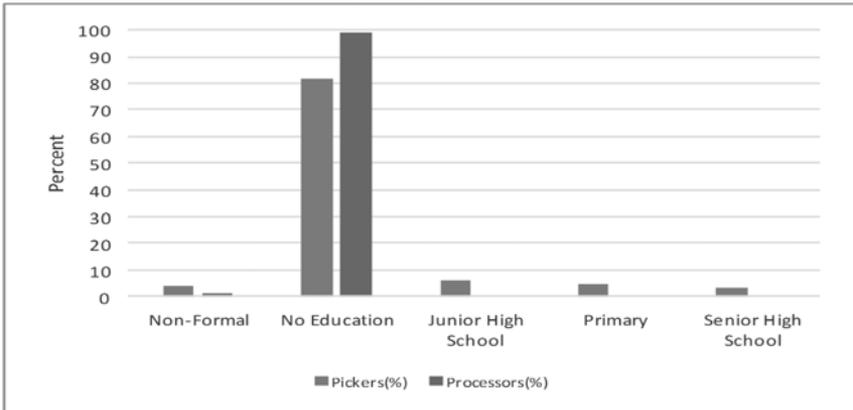


Source: Authors' construction from field data

In terms of household size, the average of a shea pickers' family was 10 persons with a minimum and a maximum family size of 2 and 25 persons respectively. For the processors, the average household size was 11 persons with a minimum and a maximum family size of 1 and 26 persons. Such large

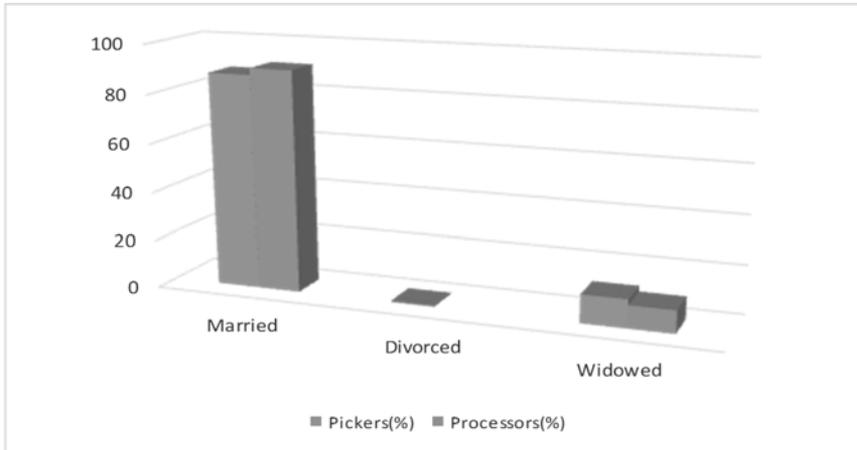
family sizes emphasise the importance of shea, particularly in the lean season, when women have to take care of the family.

Figure 5: Education Level of Shea Women



Source: Authors' construction from field data

As presented in figure 6, almost all the women in both groups were married except 10.7 percent of the pickers and 15.5 percent of the processors who were widows. The study found insignificant divorce rates: 0.4% among the producers and no divorce rates were recorded among the processors. This is due to the fact that in the case of traditional marriage, like in Ghana the customary marriage, husbands have superior rights over property of their wives so that wives rarely acquire property in their name. Therefore, for social protection and economic security, women tend to stay in the marital homes no matter how the situation is. This is confirmed in a study by Howland and Ashley (2014: page 19) in Tanzania that “wives rarely acquire property in their name during the course of the marriage, therefore, this rule combined with other rules related to dowry leaves women with little to no property protection upon divorce”. Marital status and age play important roles in shea production, considering the activities involved.

Figure 6: Marital status of Shea Women

Source: Authors' construction from field data

Married women have a lot of domestic responsibilities and therefore time for shea activities is an extra burden, whereas age may be a barrier to shea fruits picking particularly for those in the age group of 56 to 77 (see figure 4), because of the labour-intensive nature of kernel processing. Nonetheless, the active involvement of women in that age category signals the economic significance of the sector for their households. It also reflects the need to critically examine the labour-intensive nature in order to find supportive measures for the aged. For example, from the age of 50 to over 60, these groups of women could be very weak, particularly within the context that they have to walk long distances to pick the fruits and to transport the fruits to the house by carrying them on the head. These tasks put further strain on their physical conditions, which reduces the time and energy they have to spend on their own farms and for other economic activities.

4.2 Shea kernel Producers

Shea kernel processing starts with picking shea fruits, by processing them into nuts and into kernels. Cultural and traditional norms are an entrenched part of shea picking. The main sources of picking are the husbands' farms and the community forests as seen in figure 7. However, in some communities, it is a taboo for women to enter community forests which are reserved as a sacred place, believed to be the dwelling place of the gods and ancestors who protect the community. In such a situation, only the community chief priest or some recognised men are allowed to enter into such places. In

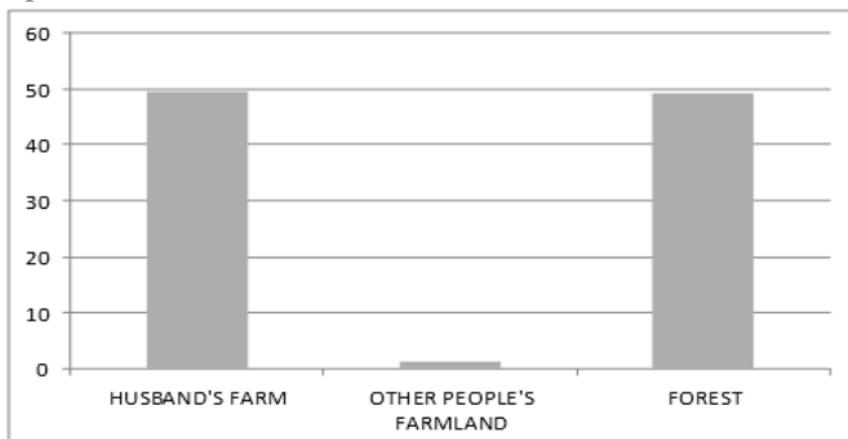
circumstances where a man has more than one wife (a common phenomenon in the region), a timetable is drawn for the women to have access to their husband's farm. This traditional arrangement introduces some form of exclusion, depending on the position of the woman in the household. This is very significant for the 25% widows (both groups) considering the large family sizes. The widows, most of whom are household heads, have the sole responsibility of caring for the numerous dependants. They have to compete for adequate quantities of shea given the fact that the community forest remains the only open access area for picking.

There are traditional arrangements that support the widows, but the quality of support raises concerns, making it seem to be mere symbolic. When a woman loses her husband, she is expected to marry the deceased's brother and may then have the advantage of continued care and support of the children by the new husband. This arrangement is not primarily intended for the welfare of the widow in question but the purpose is to ensure that the children who are considered an asset to the family of the deceased remain in the family house, as a lineage to their late father. The widow by this arrangement is not a substantive wife and so no special favour is accorded to her. As she is not a member of the family she has no right to pick fruits from her new husband's farm. This implies that the widows' children are not the biological children of the new husband, implying that the care for the widows is merely symbolic. There is more attention for his biological children than of his brother's, and particularly so if he has no children with the widow. In this case the widow has the extra duty of making sure that the children are well cared for. This can be achieved through adequate quantities of shea fruits picking; however, there is no doubt that the community forests being the only open access areas for picking see a lot of competition between pickers for the fruits. The new husband may take over the deceased's farmland or the family may decide to share it among the male members in the family. At best she may get a small portion of land, probably less than half an acre to grow legumes or vegetables for her upkeep. Furthermore, her portion is not a permanent asset but is influenced by the dynamics of the family, that is, if a son in the family marries then he is separated from his father and is given a portion of the family land and this can affect the widow's portion.

Coming back to shea kernel processing, the fruits are picked very early in the morning. The women have to pick fruits that have fallen on the ground; harvesting is not advised as this affects kernel and butter quality. During the season it is common to see women trekking to farms and community forests as early as 3 am. This is to enable them to come back early enough to undertake other household chores and also to avoid the heat. The fruits are transported to the house by carrying them on the head. On arrival the fruits are to be parboiled immediately to avoid germination, which affects the quality of

the kernels and subsequently the butter. Women who are not able to parboil immediately may lose out on the market due to poor quality. After parboiling they are dried in the yard. Thereafter, the encapsulated hard cover of the nut is cracked to remove the kernel for further drying. This is a difficult time for the women because they have to rely on natural sun for drying. However, because the harvest takes place during the rainy season, the weather is mostly interspersed with rains and humid conditions. This means that the women have to be watchful so that whenever it threatens to rain the nuts are collected and brought back to dry when the sun comes up. The process of collecting the nuts in and out can go on for weeks until they achieve the acceptable moisture content of about 1.0% (as presented in table 4, in sub-section 4.5).

Figure 7: Sources of Shea Nuts for Pickers



Source: Authors' construction from field data

4.3 Shea butter processors

Processing of shea kernels into butter is done both at the international and at the local level; at the international level, it is highly mechanised and the final product (oils) is supplied to either the cosmetics or the food industries. Traditional shea butter processing is a reserve for rural women; the process involves the crushing of kernels, roasting, grinding, kneading, decanting and boiling (Table 1). Locally hand-made butter is sold directly to international buyers and to cosmetic companies through the assistance of local women organisations. Buyers of local butter use it directly or further refine it and supply it to food and cosmetic industries. Although with the high international demand some local companies use improved methods of processing, such as Bridge Press (BP) and

the Improved Shea Butter Processing Technology (ISBPT), the traditional method of processing is still preferable (Addaquay, 2011) particularly for the cosmetics industries. According to such companies the traditional method reduces the presence of metallic residues (iron fillings). Locally hand-made butter processing is a major activity of local women, as it was earlier mentioned that processing is highly labour-intensive, except for milling that is mechanized; about 98% of butter processing is done manually (see table 1 on the respective activities). Through the assistance of Local Women Organisations (LWOs), processors are able to establish processing centres, with basic equipment being in place, such as roasters, grinding mill, large cooking pots, water and drying space.

Table 1: Kernels and Butter Processing

Processing of Kernels	Processing of Butter
1 Picking of nut	10 Crushing
2 De-pulping	11 Roasting
3 Parboiling	12 Cooling
4 First drying	13 Milling
5 De husking	14 Kneading
6 Winnowing	15 Decanting
7 Sorting	16 Boiling
8 Second drying	17 Sieving
9 Storage	18 Cooling and storage

Source: Authors' construction

Good quality shea butter requires good quality kernels; the kernels are crushed by hitting with a mallet or pounding in a mortar. If a processor has to process for instance 85 kg of kernels, depending on her domestic roles, she will have to spend about 3-5 days crushing each kernel. The crushed kernels are then roasted. Most women still use the traditional method where large cooking pots are placed on the fire with some quantities of the crushed kernels inside. A woman has to sit close to the fire and using a long stick, turn the crushed kernels in the pot to prevent burning and to ensure even distribution of roasting. Other women have acquired roasters; these are cylindrical metallic containers that lie horizontal on the fire source. It is designed in such a way that it has an opening on one side (which can be securely closed) through which the crushed kernels are poured in and out of the roaster. Each side has a long handle and a woman sits at each end and rolls the roaster over the fire using the handle. This process is to prevent burning and to ensure that roasting is evenly distributed. The kernels are roasted till a golden brown colour is attained; it is then poured out to cool and milled at the grinding mill to a pasty consistency. The paste is then kneaded by pouring into a pan with a wide opening. Kneading is done by bending over the pan and

stirring with both hands or sitting on the floor using one hand to stir until it begins to turn whitish. The process needs large quantities of water because as stirring goes on air is incorporated and the paste gets thicker making it difficult to stir. When a colour change is observed then a process called decanting takes place. At this stage large amounts of water are added to the paste and as they stir a whitish butter-like substance is formed on top with golden brownish liquid underneath; the top substance is then removed into another container. The women keep decanting until it forms no more whitish substance. More fresh water is added to the decanted butter to clean it of any brownish colour or water. This can be done 3 or 4 times each time while adding fresh water. At the final stage of washing the substance is put in a big pot and boiled at very high temperatures to evaporate water and to melt the decanted substance into oil. When cooked, the oil stays on top and any non-butter substance becomes dark black and remains underneath the pot. At this stage the fire is removed to allow cooling after which the oil is fetched into containers. Further cooling at room temperature brings the oil to a butter state. At this state the butter can be molded or cut into different shapes and sizes. For marketing purposes, there are standard containers locally called “kruwa” (3kg) and different sizes of calabashes that are used locally. For the international market, most of the companies have designed 25kg boxes for packaging butter for export.

4.4 Marketing of Shea kernels and butter

The shea sector has over the years grown from local marketing of both kernels and butter to global marketing, thus functioning as an earner of foreign exchange and as an important source of employment for rural livelihood. The kernels and the butter have unique supply chains providing the African woman the opportunity to exploit both markets. However, shea trade shows a highly unregulated and open market system where anyone can enter and exit as and when it is convenient to do so. Marketing of shea products is done at all levels in the region; this can be direct from the picker or effected on the market.

The shea kernels market

At the local level, pickers rarely sell at the district market; more than 60% of the kernels are bought from the producers' residence and only 40% is sold at the community market (table 2). In order to avoid high transportation costs women prefer to walk to the community market; hence they find the district market unattractive because of the long distance. Most of the aggregators buy directly from the producers in their homes, but producers do not sell all their kernels in their homes, as some are stored for the market. In most communities and districts in Ghana markets are celebrated on designated days in a week; it could be once a week, every 3 days, etc. These are the days when neighboring communi-

ties bring their goods to the market for sale. On such days the prices of certain goods, example shea kernels, can be very cheap. Pickers simply carry their kernels on the head to the market to sell them. It is common to see women carry more than one item on a market day; in that case they cannot carry large quantities of kernels to the market. Buyers of kernels at community markets are mainly traders and community agents. Local women who were unable to pick nuts also buy kernels for traditional use, such as for funerals or as a contribution to social events like gifts to a newborn baby. It is believed that a woman who has kernels has cash. In this case women do not want to deplete their financial sources by selling all the kernels on one market day. One or two kuruwa of kernels is taken to the market each time the need arises. However, because the season coincides with the lean season much of the proceeds from shea go into food.

Table 2: Place of Sale

Point of kernel sale	Percent
Picker's residence	60.75
Community market	35.62
District market	3.61
Total	100

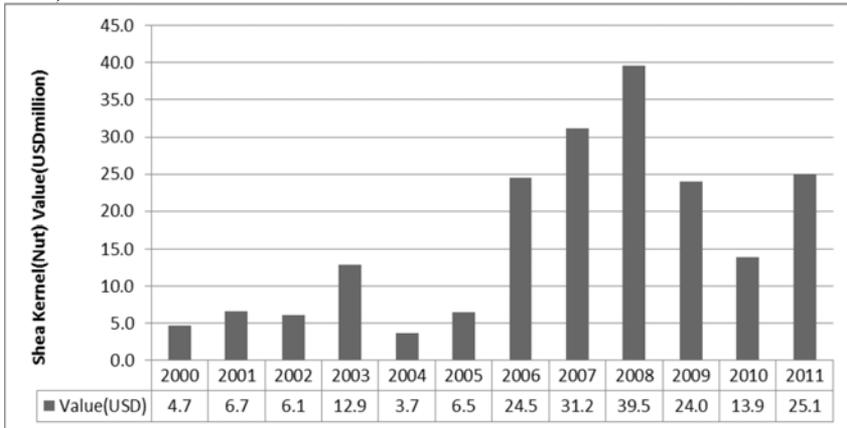
Source: Authors' own construction

The supply chain at the local level is simple; there are no visible complex networks. A buyer at the community market is most likely to buy directly from the producer. At this level, consumers do not demand beyond the traditional knowledge of the products use they have. However, at the regional market one can buy a simple item from a third or fourth level retailer. The forms of exchange are more complex at the international level. Figure 8 shows the trend development for the export value of shea nuts.

At the international market, producing countries in Africa, such as Burkina Faso, Mali, Ghana, Nigeria, Côte d'Ivoire, Benin, Togo and Guinea, are the major exporters. The total kernel production of these countries was projected to be about 600,000 tons in 2008 (USAID, 2010). Export levels were more than half of the total at 350,000 tons in the same year whilst local consumption was approximately 250,000 tons. The demand for shea kernels at the global market has seen an upward trend in value since 2005 as presented in table 8. An increase in kernels exported has also been recorded as the 50,000 tons in 1994 were rising to 150,000 in 2003 and finally to 350,000 in 2008 (USAID, 2010). The food and confectionary industries absorb about 99% of kernels, particularly in the chocolate industry, as Cocoa Butter Equivalent (CBE); that is processed fatty oils from kernels used to replace cocoa butter in chocolate formulation. In an interview with Aarhus Karlshamns (AAK) Company based in Denmark, it was stated that the increasing demand for chocolate in countries such as China,

India, Japan and Russia is seen to be a potential market outlet for the shea sector in Ghana. From table 3 it can be seen that among current international buyers in the sector, AAK is the biggest and dominant buyer (with a share of 60%), followed by others such as L'Occitane, IOI group (Loders-Croklaan in Holland), Feeds, Fats & Fertilisers (3FGroup) in India, and Ghana Specialty Fats.

Figure 8: Trends in export value of shea nuts in million US dollars (2000-2011)



Source: Combined export data from Ghana Cocoa Board (GCB) and Ghana Export Promotion Council (GEPC) (2013)²

Table 3: Major Shea Buyers

Major Shea Buyers	Estimated Buying Share	Tonnage	Export Type	Processing Location	Major Selling Market
AAK	60%	210,000	nuts	Denmark	EU, US, Russia, Asia
IOI/Loders-Croklaan	25%	87,500	butter	Ghana, Togo	NA
3F Group	10%	35,000	nuts	India	India, UK
Ghana Specialty Fats	5%	17,500	stearin	Ghana	Europe, Asia

Source: USAID, 2010

² Combined export data: 2006-2011 and 2000-2005, received from Ghana Cocoa Board (GCB), Shea Division, and from Ghana Export Promotion Council (GEPC) respectively, during an interview in 2013.

Buyers of shea kernels usually establish a supply chain that facilitates buying and ensures value addition at every stage. This starts from the national level through the regional level and then to the communities (see figure 1). At the regional level where the produce is aggregated and transported to the national level for export, the supply chain shows complex systems with many actors at every stage of the chain. Actors identified in the supply chain are: international buyers, local companies, development agencies, and aggregators (traders and agents).

Both traders and agents usually travel to the communities where they are in direct contact with rural producers. The agents are mostly males and they are categorised into regional, district, community, and zonal agents. Regional agents serve as a link between the producer and the regional buyer by aggregating the products from all sources that is, the producer, the rural markets, and the urban markets. At the beginning of the buying season the company gives each agent a quota, what is the number of tonnage required at an agreed price, but no financial commitment is made between the international company and the agents. This is done after supplies are made. At that level, a complex network of relations exists; in an attempt to be efficient regional agents cover a wide range, by establishing contacts with as many pickers as possible in the rural communities. The agents then create some sort of semi-formal contractual arrangements with the women by making part-payment to commit them so that they do not sell to any other buyer. They also establish networks of sub-agents at the districts, community, and zonal levels where they sublet buying to them. Buying is also done on the market days from bulk buyers and retailers.

Aside from the above arrangements, the buying companies also adopt various buying strategies due to competition to source for larger volumes. This includes collaborating with development organisations (figures 2) to reach out to producers. They take advantage of the development agencies' direct links with rural communities, by offering marketing opportunities and by supporting training of women to produce quality kernels. Edakkandi M. Reji's observation is confirmed that - as firms increasingly trade in products and services across boundaries - new forms of non-market coordination between companies and producers emerge in order to make standards and procedures compatible and to reduce transaction costs (Edakkandi M. Reji, 2013). Such strategies employed by the international buyers have seen the active involvement of the development community due to the nature of their activities and their development goals. Organisations such as (Foundation of Netherlands Volunteers) SNV Ghana, Northern Ghana Community Action Fund (NOGCAF), Japan International Cooperation Agency (JICA), German's International Cooperation Corporation (GIZ), Rural Intervention for Development and Employment (RIDE) are present and actively are providing support in various ways (Addaquay, 2011; Elias and

Carney, 2007). These organizations have helped both women pickers and processors to form cooperatives. An example is the Tungteiya Shea Butter Extraction Women's Association in the Northern Region supported by SNV³.

A typical case of development organizations' collaboration with buyers is the one by SNV and AAK. SNV is an NGO in the region and part of its mandate is rural women's empowerment. They aim to empower women through shea activities by organising them into various associations. The women receive support in the form of training and equipment for processing. In this process, AAK as a buyer has found SNV an important organization to partner with in order to enhance the consolidation of their activities in the communities. They also provide storage facilities in the communities for the group and may give them incentives, such as wellington boots, from time to time to win their loyalty and to ensure sustainable supply. In this case buying and storage is organized on behalf of AAK under the supervision of SNV. Through this support SNV has introduced the women to the Village Savings and Loans Association (VSLA), this is a savings and loan scheme that allows them to make contributions and to borrow from the scheme at low interest rates. It is a move to train women to acquire saving habits instead of using all their income on household expenses. Furthermore, some of the local companies, an example being Senyo and Kafui (SeKaf), being suppliers of TAMA brand products (local soaps and cosmetics)⁴, may double their purchases as kernel buyers during the peak season and later they sell volumes to the international companies. The companies compete with each other, and therefore they employ such methods of buying; the regional company is then able to organize enough quantities for export within a short time. Due to the unregulated nature of the market, it is also common to see individuals and groups engaged in small-scale export of shea kernels and butter during the season.

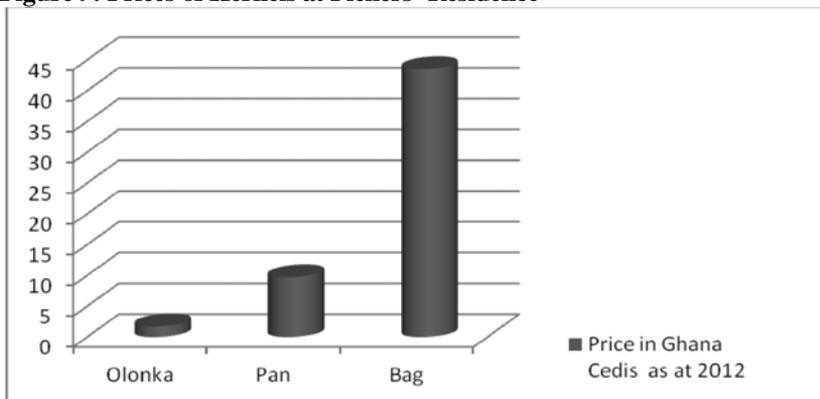
The price at which shea is bought is largely determined by the buyer and in some cases advance payments are made by agents at the ongoing price with the effect that the women when prices later increase have no room to bargain for higher prices. At the producers' end, agents buy 95kg or 100 kg at about 40 GHC (\$20.41); these volumes are later repackaged into a standard weight of 85 kg and then sold to the international company at 45GHC (\$22.92). On the local market, standard local containers, as presented in figure 9, as for example

³ Web Information: <https://www.flickr.com/photos/ghanadecides/7635905970> and <http://www.thebodyshop-usa.com/community-fair-trade/shea.aspx> and http://www.globalshea.com/uploads/files/shea_2014_conference_presentations_file_b/davis-shea_panel_gsa_2014_215.pdf

⁴ Web Information: <http://www.tamacosmetics.com/about-sekaf-ghana/>

Olonka (5kg), Kuruwa (3kg), Pan (10 kg), and bags (45kg) are commonly used. However, though these are standard units, the weights can differ depending on the buyer. Most buyers have skilled ways of measuring the kernels; the measuring units are heaped in such a way that in one measurement they can get an extra container.

Figure 9: Prices of Kernels at Pickers' Residence



Source: Authors' construction

According to a USAID report, raw shea kernel prices have seen an appreciable increase in recent years. The average price per ton was estimated at \$180 in the late 1990s; however, by 2008 the price rose to a peak of \$800, to settle at an average of \$450 (USAID, 2010). The report notes that due to other competing commodities the price has since fallen to about \$250 per ton. The report further estimates the export value of 350,000 tons of raw shea nuts to be \$87.5 million at current price. In projecting the future of the shea nuts and butter market, an expansion to \$500 million in the next five years is anticipated (USAID, 2010). Shea has for a long time been traded as a raw commodity however; with the demand from the food and cosmetics industries, appreciable quantities of locally processed hand-made butter are exported. The butter market chain has similarities with the kernels market chain but shows a completely different dynamics (see below).

The shea butter market

The demand for shea butter at the international market has been increasing in the past 3 years (figure 10), making butter trade a foreign exchange earner. It is estimated that 30,000 to 35,000 tons of butter exported to Europe and Asia are locally processed in Africa (USAID, 2010), though further refinement may take place at the final destination as illustrated in figure 2.

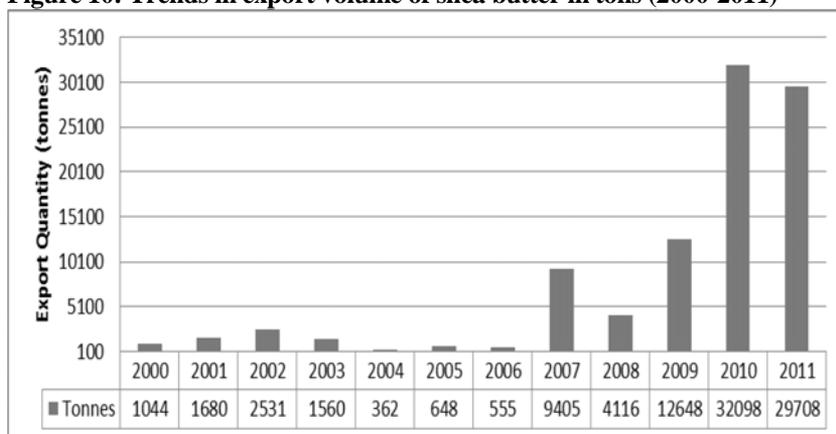
The shea butter market is highly controlled by buyers such as: StarShea Network, SeKaf, and a group of local women organizations, who are selling to Body Shop, now Laurel in USA or UK. For the dynamics that unfolds in the butter marketing, the case of the women organizations is used to discuss this section. In the butter sector, the local women, who are themselves chief executive officers (CEOs) of their organisations, are not just providing services but are business actors. They organize women into processor groups, and through such groups, they establish their development organizations in the form of NGOs, an example being African 2000 Network⁵ that has a processor group called Sagnarigu Butter Processors Association. Others establish themselves as Micro Finance providers, an example being PlaNet Finance⁶. They often state their aim as empowering women in shea activities through capacity building in a broad sense and by training them on the use of hygienic materials and quality butter production. The CEOs are well educated, some of whom are government employees, for example teachers, and hence they have a good knowledge of development work and of the shea market. Due to their educational background they are able to establish strong networks with other development organizations, such as Women's World Banking (WWB)⁷, International Fund for Agricultural Development (IFAD), Women in Development (WID), SNV, etc. Through these networks, they are able to solicit for support in the form of capital, equipment for processing, or training.

The marketing process confirms the findings of Bowersox and Closs (1996) and Cooper et al. (1997) that multinational companies operate with the support of networks of local partners that provide easy access to information and specialized business. It is so that the CEO is the only one in contact with the international buyer, and so she does the contractual arrangement, including agreements on price. Then at the local level the only information passed on to the processors is the required volume, the quality specifications, and the time of delivery. Usually the quantities are shared among a number of women in the group, particularly when the time for delivery is short. From figure 10 one can see the volatility of export volumes. So the management of the export changing volumes is part of the activity of the development organizations.

⁵ Web Information: <http://www.africa2000network.org/where-we-work/ghana/>

⁶ Web Information: <http://www.planetfinancegroup.org/>

⁷ Web Information: <https://www.womensworldbanking.org/>

Figure 10: Trends in export volume of shea butter in tons (2000-2011)

Source: Combined export data from Ghana Cocoa Board (GCB) and Ghana Export Promotion Council (GEPC) (2013)⁸

As micro finance organizations they establish themselves as development organisations but they are in contact with international butter buyers. They then collaborate with financial providers, such as Financial Non-Governmental Organizations (FNGOs). Through the collaboration they provide technical assistance to international financial companies (IFC). These arrangements enable them to disburse credits on behalf of the FNGOs to their women groups. The loans disbursed are in the form of a contract for supplying butter to their international buyers. A credit facility at this period is very attractive because, as earlier discussed, the shea season coincides with the period when the food sources of most households get depleted. The credits are given at an interest rate of 37%, what is higher than the ones on the financial markets. In order to ensure payments and to sustain the financial support SNV has assisted in developing four disbursement models (inventory, working capital, in-kind or input credit, and cash advance) that are operational among shea producers in the region.

i. The inventory model

The objective of the inventory model is to discourage shea producers from selling their produce at early stages of the shea season when the prices are

⁸ Combined export data: 2006-2011 and 2000-2005, received from Ghana Cocoa Board (GCB), Shea Division, and from Ghana Export Promotion Council (GEPC) respectively, during an interview in 2013.

very low. As earlier mentioned, the shea season coincides with the farming season, a period at which food insecurity exists. In this regard, producers tend to sell the produce at early stages to buy food for the household. The model provides producers with warehousing facilities; an amount of GHS 100.00 (\$51.04) or GHS150.00 (\$76.56) (depending on the scale of production) is advanced to the women. The women would then be expected to postpone early sales till later in the season, for example till the dry season when the prices are high. During the sales, an agreed interest rate of 37% is deducted from the sales revenues which the producers make. This model provides the women with three months grace period before they can pay the loan.

ii. The working capital model

This model is similar to the inventory model in that it supports the producers in the aggregation and storage of kernels for realizing a better price should the price appreciate in the future. The credit is a six-month facility, with a three months grace period for payments, and a loan size of GHS 150.00 (\$76.56) with 37% interest. The difference is that an amount advanced to the women becomes an automatic contractual arrangement in the sense that the women do not have the liberty to sell to another company.

iii. The in-kind or input credit model

This model is targeted at local hand-made butter processors with the aim of ensuring sustainable supplies to international markets. The processors are given a GHC/Ghanaian Cedi 300.00 (\$153.11) credit facility per annum and with a one-month grace period after which they are expected to pay back the credit within six months. Taking the loan means that an automatic contract is concluded with the loan provider.

iv. The cash advance model

This model supports the purchase of equipment. The loan size is also GHC 300.00 (\$153.11) per annum with a one-month grace period, payable within six months. Depending on the identified needs of the women, inputs such as grinding mills, roasters, drying platforms, and tricycles (for transportation), popularly known as motor kings, are provided. In the case of equipment support in some groups the women pay for milling roasted kernels at the grinding mill and the proceeds are gradually used to offset the costs of the equipment.

The marketing models used in butter marketing show a lack of information and transparency. As earlier mentioned, because the women organizations which are supporting the producers are business minded, they are very selective of the kind of information to give to the producers. In the shea sector, quality is a paramount condition for premium prices. Efforts to pro-

vide quality products have led to different specifications and to the use of high technologies to meet the buyer's requirements.

4.5 Shea kernels and butter quality specifications

In Ghana, the quality standards specified in table 4 are generally accepted at the global market. However, as demand increases, there has been a growing concern with regard of shea nut and butter quality standards. These concerns have the potential of reducing not only women's income but also Ghana's export revenue from the shea industry. Companies are more quality-conscious now, thus coming up with stricter quality requirements. Realizing these demands as potential threats, NGOs and development practitioners are supporting the producers by training rural women to produce quality nuts and butter. According to Addaquay (2011): "With some basic training it is possible to increase the shea butter yield of rural artisanal butter processors from 30 percent to 40 percent and profitability by about 20 percent" (Addaquay, 2011, p. 36). This is as result of their product receiving the premium price and be demanded on both the local and international market as a result of the improved quality.

Table 4: Shea kernels Quality Grading Parameters

Parameter #	Parameter	Grade A (1)	Grade B (2)	Grade C (3)	Analysis Type
1	Moisture Content	<8%	8% - 10%	>10%	Moisture meter Filed testing
2	FFA	<3%	3% - 8%	>8%	Lab Testing
3	Impurities	< 0.4%	0.4% - .5%	>0.5%	Weighing and Visual Inspection
4	Oil Content	> 50%	47% - 50%	<47%	Lab Testing

Note: For a sample to qualify for a specific Grade, all the results of the tested parameters must be satisfied.

Source: GSA/Ghana Standards Authority, 2008

The critical areas of concern are FFA (Free Fatty Acids) and moisture content. A classical case of how standards are specified by buyers is Olam International (OI) that partners with Star Shea Network (SSN)⁹ to obtain high quality butter as presented in table 5. The company OI insists on traditional hand-made

⁹ Web Information on the self-help groups of women which are organized into the SSN: <http://www.globalshea.com/resources/directory/47/Anna-Perinic>

processing techniques that preserve all the product's chemical components. In that process no chemicals or additives are used in production.

Table 5: Specification for Industrial Unrefined Shea Butter

Component	Value
Moisture Content	<1.0%
Peroxide Value	<7.0%
FFA	5.0mgKOH/g
Unsaponifiables	<8.0%
Insoluble Impurities	<1.0%
Melting Point	35.2-37.4°C

Source: Addaquay, 2011

As earlier mentioned, the production of quality shea butter begins with picking and processing only the best kernels. In order to meet the buyers' specifications, organizations such as SSN randomly test the kernels and the butter for compliance with quality parameters. Additionally, the organizations regularly evaluate the customer feedback, using traceability software developed by SAP, to take actions for continuous quality improvement. The search for quality has also led to the introduction of certification bodies, such as Fairtrade Labeling Organization (FLO), Organic and Ecocert (OE), American Shea Butter Institute (ASBI), and USDA-National Organic Certification Cost-Share Program, in the shea sector. At the domestic market, some local companies have certification contracts with Fair Trade and Organic Certification; an example is SeKaf which buys kernels from certified fields only.

5 Implications for Integration of Shea Producers in Global Value Chains

The discussion has provided insights on the shea sector and the dynamics of integrating rural producers on the international market. Through a holistic analysis of the value chain, it has been possible to identify actors and their functions, technologies which are used, standards applied, products and processes (as described in the methodologies by Gereffi and Fernandez-Stark 2011). According to the authors, the analysis of the GVC provides a holistic view of international industries, from top down and bottom up. It illustrates the benefits that local enterprises, like in the shea sector, would potentially gain by their dependence on larger businesses, thus confirming the findings that the VC approach ensures that clustered firms involved in some form of governance relations may experience rapid product and process upgrading (Humphrey and Schmitz, 2002; Schmitz, 2004).

The presence of development organizations, who are linking shea producers to markets and who are building their capacity by training them to produce quality products, supports the findings of the above authors. The production of quality products is very important for the women's sustenance and resilience on the market. They are able to get premium prices for their products and this can via generating income support the household food needs. Additionally, the SNV's VSLA (Village Savings and Loans Associations) program does not only enhance social cohesion, but leads to savings, skills acquisition and economic empowerment. Access to their accumulated savings has helped the women to raise income to meet their economic needs. Group membership has significant social benefits; it gives a sense of belonging and identification which is an important feature of welfare. The mutual support among the women and the ability to fulfil their social responsibilities are important elements. Meeting and interacting as a group of women enhances information-sharing and exchange of ideas what is known to improve self-esteem and to build their confidence. These support systems confirm the findings that positive contributions of foreign-owned companies – by improving the standards of rural products and the productivity of rural production – have beneficial spill-over effects (Dunning, 1992).

Through the analysis of the actor networks in this study, the statement by Coleman (1990) and Burt (1997) that the GVC concept allows the identification of the weaknesses and strengths of an economic sector in terms of access to valuable information, technical expertise, and financial support, was substantiated. In a well functioning market, actor relationships are a key factor in enhancing business opportunities among market players. Such relationships facilitate valuable information-sharing and stronger coordination, and assist the rural producers to get to know the opportunities available to them so as to engage on an equal basis with market players. However, these opportunities are sometimes truncated by women's organizations when they are restricting the access to valuable market information for producers. This is made possible because of the low educational level of the producers and because of the lack of government support. The studies by Bowersox and Closs (1996) and by Cooper et al. (1997) provide deeper insights on the importance of information for efficient operations. Turning women's organizations to become real development organizations is a way to improve the performance of the producers, and some experiences in the shea sector of Ghana give hope for further progress.

Some weaknesses of women's groups were becoming evident in the course of the field research. The intentional denial of information by actors in the VC restricts the bargaining power and limits the exploitation of market opportunities. This strategy by some women's organisations questions their organisational integrity and their aim to build the capacity of rural women. It is known that low interest rates enhance businesses and generate job oppor-

tunities. When interest rates are high, this can lead to stagnant growth of rural market actors whose economic activities are at subsistence level. Conditions of microfinance are therefore of importance and an appraisal of the systems is urgent. By virtue of being in groups, women in shea activities have the advantage of accessing other options, especially offered by the rural banks which have attractive packages for women's groups who are engaged in small-scale income generation activities. However, information on such opportunities is not made available to the rural producers. About 96% of the women interviewed were concerned about the high interest rates but according to them they have no other option. A quality improvement with regard of the workings of women's groups is therefore recommended.

The analysis of the supply chain presented evidence that the majority of the producers are rather old women, indicating that the sector is unattractive for the young population. This phenomenon has negative implications on the sustenance of the shea sector. The low level of education (figure 5) found among the shea producers (almost 100% for the processors) also implies that educated women do not find a job in the shea production attractive. Also, the limited areas of nuts picking do question women's access to adequate quantities that can support their livelihoods. More than 50% of the nuts are picked from the women's husbands' farms and about 40% are picked from the community forests. The community forests remain the only free access area for all women. This means that the 10% of widows among the rural shea producers, who are likely to be household heads, may not have sufficient quantities of nuts to pick so as to support their families since there will be competition on the forest areas.

A stronger role of women's development organizations and more public support in terms of education, training, health, market information, and infrastructure provision are crucial for the sustenance of the shea sector in Ghana.

6 Conclusions and Policy Recommendations

The paper provides information on the shea sector in Ghana. It uses the global value chain approach to explain the international market dynamics as affecting small-scale producers and processors in the supply chain of both kernels and butter. The market system identified fits the description that "it is a dynamic space, incorporating resources, roles, relationships, rules and results, where public and private actors collaborate, coordinate and compete for the production, distribution and consumption of goods and services" (Campbell 2014, page 2). The international buyers have brought with them significant transformations in the frame of marketing and supply processes. In terms of

international trade, the sector is private-led and controlled by international companies who operate through a network of actors being organized in various exchange relations. The presence of the development community in the sector has seen positive spill-over effects (Dunning 1992). However, the findings show that the women organisations take advantage of some weaknesses of the sector.

In conclusion, the (actual and emerging) opportunities and the (economic and social) impacts of the shea sector are better explained and understood in the context of a holistic analysis of the GVC. The analyses demonstrate that there are international market opportunities for both kernels and locally hand-made butter, which are translated into employment opportunities and livelihood support. The unique qualities of the kernels attract the confectionary industries that make up 99% of the market share. Additionally, the preference for locally hand-made butter presents an exclusive niche market for the processors. However, the dominance of uneducated old women in the sector threatens the sustenance of the sector, thus reflecting the need to step up training and capacity building of the women. Many more measures are needed to make the sector more attractive for educated and young people, also for small local entrepreneurs. This is important to meet the high quality specifications of both kernels and hand-made butter as requested by international buyers. In order to realise the full benefits of the shea sector, government needs to establish efficient institutions through a rigorous analysis of the value chain. The available networks and the producer-customer relations are very important for rural producers to strengthen their resilience on the international market. This is possible through stronger collaboration and the strengthening of Public Private Partnerships at the national level.

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Call for Papers

Volume 20 of the African Development Perspectives Yearbook with the title „*Science, Technology and Innovation Policies for Inclusive Growth in Africa*”

Invited are contributions for Volume 20 of the African Development Perspectives Yearbook with the title “**Science, Technology and Innovation Policies for Inclusive Growth in Africa**”. The contributions should be evidence-based and policy-oriented. High academic standards are requested and will be checked by referees. Non-technical papers with deep analysis, which are readable by practitioners in development cooperation and by media people, have a high priority in the selection process. The concept of the contribution and the methodological framework of analysis should be outlined in the Abstract which is submitted to the Editors.

Upon acceptance of the paper, the contributors will receive Editorial Guidelines and a Template. Accepted papers will be grouped into Thematic Units, and the respective Unit Editors will contact the contributors quite regularly during the process of finalization.

Guest Editors for various Thematic Units are also invited to apply. Editors of Thematic Units are also becoming automatically Volume Editors. Guest Editors are responsible for a Thematic Unit with 3 – 5 contributions and an Introduction. For specific themes see the Main Issues proposed by the Editors for Volume 20 as presented below.

See the context of the **African Development Perspectives Yearbook** and of the Africa Research Programme of the **Research Group on African Development Perspectives Bremen** at IWIM (Institute for World Economics and International Management):

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The Editors also invite publishers and institutes to send books and issues of periodicals as well as research discussion papers and documents being of relevance to the theme for use in the **Book Reviews/Book Notes Section of the African Development Perspectives Yearbook** (Book Review/Book

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Main Issues proposed by the Editors for Volume 20 (see below some examples of interesting themes for Contributions and Units):

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Informal Manufacturing Sectors in Africa and the Role of STI Policies

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- *Case studies of building competence in informal sector enterprises*

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- *Assessing the role of open innovation in manufacturing sectors of African countries*
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To the Contributors of Volume 20:

Please send an Abstract and a short CV not later than June 30, 2016 to the Managing Editor and to the Volume Editors (see below). The Editors will respond within 4 weeks to your proposal. If you have already contributed to a former volume of the Yearbook, please send only an Abstract.

To the Guest Editors of Volume 20:

Please send also a short CV and a proposal for one of the themes mentioned above.

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