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THE AFRICAN CONTINENTAL FREE TRADE AREA (AfCFTA) AND ITS ECONOMIC CONTRIBUTION

Sector Commentary

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The African Continental Free Trade Area (AfCFTA) and its Economic Contribution

1. Introduction

The African Continental Free Trade Area (AfCFTA) agreement is one of the biggest continent-wide projects aimed at economic integration and African industrialisation through increased intra-African trade. The agreement's Secretariat has launched an interim trading arrangement to test the agreement's provisions while negotiations are ongoing. National, regional, and continental institutions are also preparing for the AfCFTA by putting the necessary infrastructure and processes in place. Progress has been made on all fronts, and the agreement continues to enjoy significant political will.

The initiative to create a single African market has existed in the Pan-African political discourse for decades. The continent was set on the path to actualising the goal after the creation of the AfCFTA agreement was included in the African Union's (AU) 2063 agenda. The agreement was signed on 21 March 2018, came into force on 30 May 2019, and became operational on 7 July 2019. After delays caused by the COVID-19 pandemic, the Free Trade Area (FTA) was launched on 1 January 2021. The agreement aims to boost intra-African trade by eliminating 97% of tariff lines on goods and services as a pathway to industrialisation and prosperity on the continent. It will be gradually implemented at different paces for three categories of countries including Least Developed Countries (LDCs), non-LDCs, and the G6.

2. Objective

The general objectives of the AfCFTA are to:

- Create a single market for goods and services, facilitated by the movement of persons in order to deepen the economic integration of the African continent and in accordance with the Pan-African vision of "An integrated, prosperous and peaceful Africa" enshrined in Agenda 2063.
- Create a liberalised market for goods and services through successive rounds of negotiations.
- Contribute to the movement of capital and natural persons and facilitate investments building on the initiatives and developments in the State Parties and Regional Economic Communities (RECs).
- Lay the foundation for the establishment of a Continental Customs Union at a later stage.
- Promote and attain sustainable and inclusive socio-economic development, gender equality, and structural transformation of the State Parties.
- Enhance the competitiveness of the economies of State Parties within the continent and the global market.
- Promote industrial development through diversification and regional value chain development, agricultural development, and food security.
- Resolve the challenges of multiple and overlapping memberships and expedite the regional and continental integration processes.

3. Intra-African Trade

Table 1 shows that Africa's top three exporters in 2021 enjoyed significant trade surpluses. Eswatini, Zimbabwe, Senegal, Kenya, and Tanzania had the highest share of their total exports going to African markets. Of the ten, Zambia was the only country that imported more than it exported to other African countries.

Table 1: Top 10 Intra-African Exporters in 2021

	Country	Export Value to Africa (USD billion)	Trade Balance (USD billion)	Share of Total Exports (%)
1	South Africa	$26.19 billion	$17.01 billion	21.2%
2	Nigeria	$6.07 billion	$4.69 billion	12.8%
3	Egypt	$4.74 billion	$3.37 billion	11.7%
4	Zimbabwe	$3.57 billion	$0.56 billion	59.2%
5	Morocco	$2.89 billion	$0.67 billion	7.9%
6	Kenya	$2.79 billion	$0.70 billion	41.3%
7	Tanzania	$2.51 billion	$1.26 billion	39.3%
8	Zambia	$2.16 billion	$1.02 billion	19.3%
9	Senegal	$1.97 billion	$0.77 billion	43.9%
10	Eswatini	$1.92 billion	$0.32 billion	92.9%

Source: Trade Map

The AfCFTA is argued to have the widest income disparities among its member states. Countries such as Egypt, Nigeria, and South Africa account for more than half of the continent's GDP. Beyond incomes, however, is the question of productive capacity and industrialisation levels. Popular measures of industrialisation include Manufacturing Value Added (MVA) per capita or as a percentage of GDP. From that perspective, countries that are better positioned to dominate trade under the AfCFTA include Mauritius, South Africa, Tunisia, and Egypt, as shown in **Table 2.** While this domination is not negative in itself, it ties back to the notion of the "winners" and "losers" created by free trade.

African Continental Free Trade Area (AfCFTA)

Creating One African Market

Table 2: Measures of productive capacity and industrialisation

	Country	Productive Capacity (2018)	MVA per capita – 2021 (US$)	MVA – 2021 (% of GDP)
1	Mauritius	37.39	1 036	11.1
2	South Africa	34.05	596	11.3
3	Tunisia	33.24	533	14.6
4	Egypt	29.39	588	14.9
5	Ghana	26.90	239	11.5
6	Kenya	25.73	145	8.9
7	Rwanda	25.42	71	7.9
8	Tanzania	24.23	8717	8
9	Cameroon	23.60	213	15.7
10	Nigeria	21.65	213	8.7

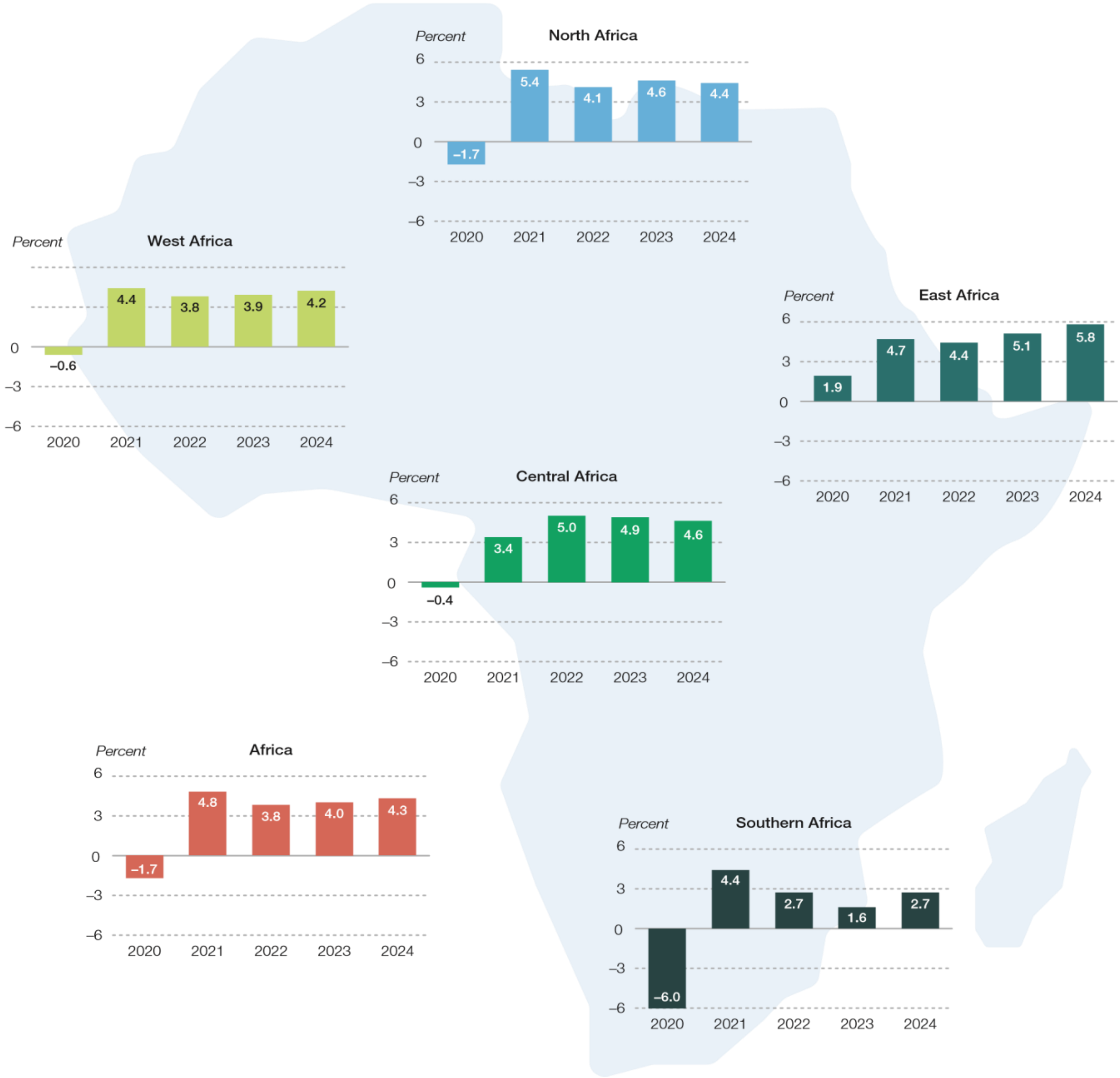
Source: UNCTAD, UNIDO Statistics Data Portal, and World Bank

4. Africa's Growth Outlook

According to the African Development Bank, African economies remain resilient amidst multiple shocks with average growth prospects to stabilise at 4.1% in 2023 and 2024, higher than the estimated 3.8% in 2022. According to the African Development Bank, the medium-term growth outlook is heterogeneous across Africa's regions, as depicted in Figure 1 below.

The growth momentum in **Central Africa** is projected to decline from an estimated 5% in 2022 to 4.9% in 2023 and 4.6% in 2024. Growth in **East Africa** is projected to strengthen from an estimated 4.4% in 2022 to 5.1% in 2023 and 5.8% in 2024, with the exception of South Sudan. In **North Africa**, growth is projected to rise from an estimated 4.1% in 2022 to 4.6% in 2023 and 4.4% in 2024. Growth in **Southern Africa** is projected to decelerate by 1.1 percentage points from an estimated 2.7% in 2022 to 1.6% in 2023. With appropriate policy interventions, growth could recover to 2.7% in 2024. The projected sharp decline in 2023 largely reflects continued growth weakness in South Africa, the region's largest economy and trading partner, from an estimated 2% in 2022 to 0.2% in 2023, as it grapples with the impact of high interest rates and persistent power outages on economic activity. Growth in **West Africa,** despite macroeconomic challenges in some of the region's large economies, is projected to rise from an estimated 3.8% in 2022 to 3.9% in 2023 and 4.2% in 2024.

Figure 1: Growth performance and outlook, by region, 2020-2024



Source: African Development Bank statistics

African economies continue to rely on exporting commodities, with most processing or manufacturing of those raw materials and the accompanying economic benefits taking place outside the continent. Africa is then forced to import the lion's share of its manufactured goods, many produced using African raw materials. This requires a paradigm shift as this hampers Africa to register high economic growth through beneficiation, industrialisation, and diversification. The inherited colonial era structures laid down the basis for most of Africa's trade patterns, with commodities exported to the colonial power and processed goods imported, with very little trade between neighbouring African territories.

5. The Benefits of Intra-African Trade

Overall Benefits

The benefits of regional trade agreements are expected to arise through access to cheaper products, resulting in more choices for consumers and producers, and access to larger regional markets for exports. In turn, expanded markets should encourage foreign and domestic investment and firm growth and with them rising employment and incomes, thus helping to reduce poverty. However, cheaper imports can also undermine local production as inputs for production may not be found in the region or continent, while demand in the region for a country's exports may be limited. Trade agreements must also be correctly implemented and utilised by the private sector for any benefits to accrue.

According to a survey conducted in 2022 by the Pan African Private Sector Trade and Investment Committee (PAFTRAC), the vast majority of African CEOs believe that the implementation of the AfCFTA will have a positive effect on the levels of intra-African trade.

The AfCFTA unlocks several opportunities for African and global businesses in the automotive industry. These include the enhancement of a more competitive market for local assembly and sourcing and market opportunities for electric vehicle and combustion engine vehicle manufacturers.

The unified market under the AfCFTA enhances the competitiveness of local assembly and local sourcing partnerships. This means opportunities for local and global businesses to enter or expand their operations in the automotive industry in Africa. The common market is a much more attractive dynamic for investors than fifty-four smaller economies, especially in a sector that requires economies of scale. It will allow companies to plant assembly locations in one country while being able to both target a greater consumer base across the region and take advantage of reduced tariffs on local inputs (for example, aluminium in Mozambique and rubber in Côte d'Ivoire). As companies relocate production steps and supply chains in African countries, these countries will be able to avoid losing out on revenue from value addition as they do when raw materials are exported. Currently, many regional economic communities apply a 25-35% value-added threshold for locally originated products. The AfCFTA's rules of origin will help to set common thresholds for value-added levels. If these common thresholds are progressively harmonised across regional communities, they will help stimulate trade.

There is significant political will among numerous African governments and private-sector players to develop automotive regional value chains because of the sector's historic contribution to knowledge-intensive industrialisation, and leadership is actively working towards improving the investment environment for the automotive sector specifically. For example, the African Export-Import Bank (Afreximbank) and the African Association of Automotive Manufacturers (AAAM) are working together to support the industry by helping to harmonise automotive standards, developing a focused training programme for the public and private sectors, and providing financing to industry players across the value chain. In addition, Afreximbank has committed $1 billion to supporting the industry through direct financing and partnerships.

Current and future demand is pointing to opportunities for new markets in electric vehicles and conventional combustion engine vehicles. Africa could be an important region for local and global companies to promote sustainable mobility and harness renewable energy. Electric vehicles make up less than 1% of sales in South Africa, but demand is growing across the continent as some of Africa's main trading partners have banned internal combustion engine vehicle sales as early as 2035. Already, there are pilot projects for sustainable vehicles in Rwanda, Egypt, and South Africa, and e-mobility start-ups have emerged across the continent. Africa has a great wealth of natural resources that are vital raw materials for vehicles that run on new types of energy, and several countries have their procurement markets for materials such as copper, platinum, cobalt, bauxite, and lithium. The market for motorcycles in Africa (especially in West, East, and North Africa) is significant, with the potential for more domestically produced inputs and domestic production. There are opportunities for electric two-wheelers to become more prevalent as the technology for electric motorcycles is simpler than it is for electric vehicles.

Sectoral Opportunities

The automotive industry was identified as a key sector by the AfCFTA Private-Sector Engagement Strategy because of characteristics that will accelerate intra-African trade. The AfCFTA will help amplify this sector, providing opportunities for domestic and global businesses alike to invest in the automotive sector. Today, Morocco and South Africa are leading the way as major players in the automotive sector, making up 80% of African exports, with Algeria experiencing rapid growth. The AfCFTA will likely increase the competition and interest in North Africa as a nearshoring destination for European countries and as a manufacturing hub for local demand.

Agro-processing was named as a key sector for the AfCFTA's Private-Sector Engagement Strategy because of its exceptional potential for increasing intra-African trade, meeting local demand, accelerating GDP growth, creating jobs, and improving inclusivity due to its upstream and downstream linkages. The AfCFTA will expand participation in value chains and trade since countries will no longer have to rely on exporting only agricultural intermediaries with little value added. Agro-processing is a way to add value to an already competitive agricultural sector. Africa's common market can use regional differences in the strengths and competitiveness of African countries in food value chains. Increased intra-African trade through the AfCFTA will help reduce dependency on foreign agricultural inputs with positive effects on continental food resilience. There is also a great opportunity for new businesses to meet the input and infrastructure needs of the agricultural sector.

Pharmaceuticals is one of the four sectors seen to have the highest potential due to the feasibility of addressing barriers to trade and production in a short time frame, as well as the strong potential for meeting demand locally. Pharmaceuticals also have high product complexity, which can lead to greater opportunities for high local value-added production. The pharmaceutical industry is projected to grow at a 5.13% compound annual growth rate (CAGR) from 2022 to 2027 in Africa.

Transport and logistics represent a high-potential sector due to its role as an important enabler of the trade of goods and the fact that it is the largest contributor to imports (the value of imports of freight transportation to African countries – from within and outside of the continent – is $36.8 billion annually). Transport and logistics include passenger and freight transportation, third-party logistics, freight forwarding, and courier express and parcel services. Transport and logistics barriers have historically held African countries back as they have faced higher customs delay periods, lower percentages of paved roads, and a higher loss of goods due to limited cold chains compared to other regions in the world. All of these challenges are being addressed through the AfCFTA. The establishment of the AfCFTA is projected to increase intra-African freight demand by 28%, leading to demand for almost 2 million trucks, 100,000 rail wagons, 250 aircraft, and more than 100 vessels by 2030. Large logistics companies have historically been too expensive for African companies to use, but that is changing with the rise of new digital logistics companies.

6. Conclusions

The realisation and success of the ***implementation of AFCTA will be a credit positive for African countries in general.*** Participation in bilateral and multilateral free trade agreements like the AfCFTA, standards regimes, and related frameworks can help firms better mitigate their operating costs, navigate barriers to market entry, enhance compliance with non-harmonised standards and regulations across borders, and enable them to grow their industries more effectively in support of local and regional economic development and transformation such as beneficiation and diversification.

The decentralisation of global value chains (GVCs), which has been further accentuated by both the COVID-19 pandemic and heightening geopolitical tensions, could fast-track the development of regional value chains (RVCs) within the continent with the view to deepening firm-to-firm relationships and catalyse the production of manufactured goods to significantly increase both extra- and intra-African trade and support the implementation of the AfCFTA.

When combined with the geopolitical push for the decentralisation of global supply chains, the productivity and competitiveness gains associated with the ***AfCFTA provide the opportunity to deploy green minerals to ignite commodity-based industrialisation in Africa in the era of climate change***. They also have the potential to drive the process of industrialisation and development of RVCs to enable African countries to integrate effectively into GVCs through backward activities, while at the same time reducing the global carbon footprints of the shipping industry.

According to the Afrexim Bank Report (2023), the value of intra-African trade reached US$193.17 billion, growing by 18.6% in 2022. Intra-African trade, which has been given a boost through the implementation of the African Continental Free Trade Agreement (AfCFTA), is set to redefine Africa's economic fortunes for the future. The report reaffirms the belief that by lowering barriers to trade in goods and services, the agreement is providing great incentives for those looking to do business across the continent and reduce reliance on the global value chains while setting a new direction for the development of regional value chains. In this context, the AfCFTA, which represents a significant milestone in the journey towards addressing Africa's trade imbalance, is seen as the best economic recovery tool for the continent.

Key to AfCFTA's success will be the competitiveness of intra-African imports and their ability to enable a growth in demand and a preference for them over goods from outside the FTA. However, a significant element of the price of an imported good is the transaction cost of moving it from one country to another. These costs can include transportation, but also non-tariff related monetary and non-monetary costs imposed intentionally at borders or ones that are simply a result of inefficiencies. The inadequate road networks and high cost of air and sea transport are challenges that will need significant investment to overcome. In essence, as often happens in trade negotiations, the AfCFTA negotiations are witnessing a clash between continental aspirations and national interests.

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