Chapter 8

More Trade and Fairer Trade

Summary

Africa will fail to achieve sustainable growth and poverty reduction, and fail to meet the Millennium Development Goals, unless it increases its diminishing share of world trade. Growing global competition makes this even more challenging than in the past. African countries and the international community, working together, can make progress possible, by:

- Increasing Africa's **capacity to trade**. The investments in infrastructure and the enabling climate for the private sector (described in Chapter 7) are at the top of the agenda. Further measures described here focus on **trade facilitation**, including: customs reform; removal of regulatory barriers, especially in transport; improved governance; air and sea transport reform; and regional integration.
- Removing the **trade barriers** in developed and other developing country markets that frustrate the fulfilment of Africa's trade potential. Progress requires the successful completion of an ambitious Doha Round, with specific and timebound goals for ending appalling levels of developed country protectionism and subsidies. Development must be the priority in all trade agreements, with liberalisation not forced on Africa.
- Providing **transitional support to Africa** as global trade barriers are removed. First, this requires making current preferences work more effectively – expanding schemes to cover all low-income countries in sub-Saharan Africa, and ensuring that rules of origin requirements are not vexatiously applied. Second, the rich countries must finance 'aid for trade' to help meet the economic and social costs of adjusting to a new global trading environment.

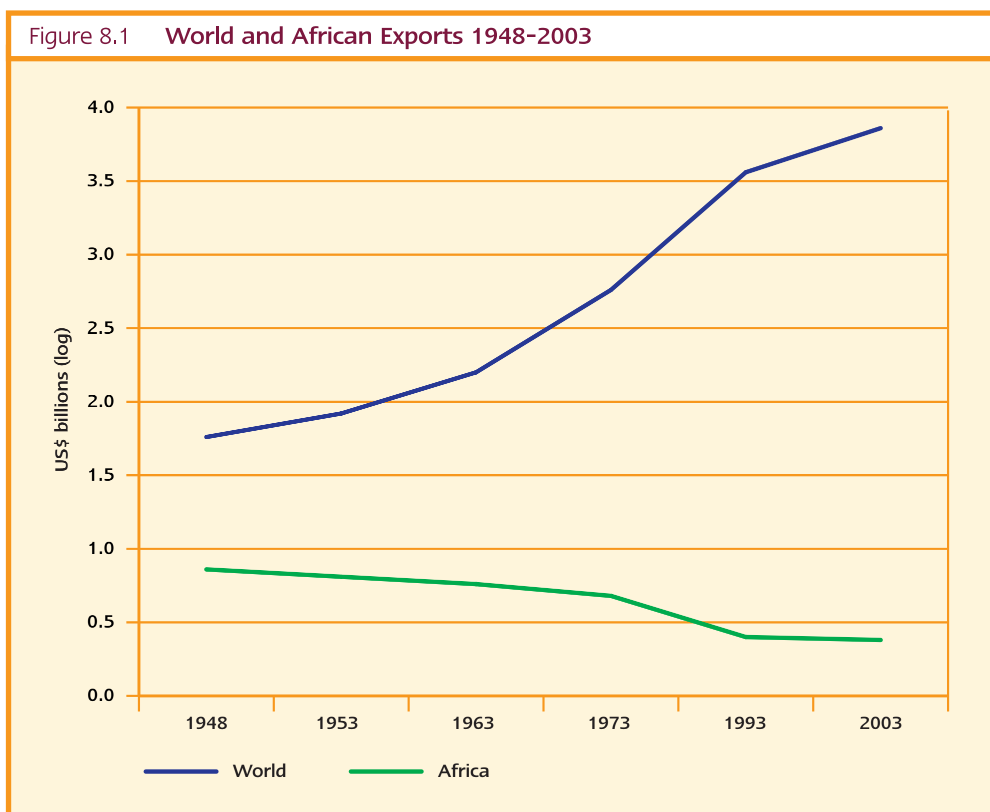
A list of the Commission's recommendations on trade can be found at the end of this chapter.

8.1 Introduction: The potential benefits of trade for Africa

1 Trade has been a key driver of growth over the last 50 years. As developed countries emerged from the devastation of the Second World War and the economic depression and protectionism of the 1930s, they began to open their markets. Trade among these countries expanded very rapidly, contributing to the strongest period of growth in their history. In the last twenty years, China and now India have seen rapid trade expansion contribute to their growth acceleration. They and other countries have broken into new markets: 80 per cent of exports from developing countries are now in manufacturing, whereas 20 years ago 70 per cent were in primary commodities[1]. The share of developing countries in world trade has risen strongly, with the share in manufacturing rising from 17 per cent in 1990 to 27 per cent in 2000[2].

2 In stark contrast the last three decades have seen stagnation in Africa. The composition of Africa's exports has essentially remained unchanged, and has contributed to a collapse in Africa's share of world trade, from around six per cent in 1980 to two per cent in 2002[3] (see Figure 8.1). These problems are reinforced by growth in other more dynamic regions which have managed to make major shifts into manufactures (see Figure 8.2 for current exports). Africa will not be able to achieve the Millennium Development Goals, nor set itself on a sustainable path to growth and poverty reduction, without increased trade.

Figure 8.1 **World and African Exports 1948-2003**



Source: WTO, 2003

3 Two very important diagnoses follow from this history. First, Africa's collapse in share of world trade has been partly due to its low capacity to produce and trade – in commodities, manufactured goods and services – and to do this competitively. In other words there are key problems in what economists would call the 'supply side', rather than the 'demand-side' issues of market access. Such capacity constraints have been reinforced by the disgraceful protectionism facing it in the markets of the developed world, and the need to compete with heavily subsidised developed country exports. Those barriers and subsidies are absolutely unacceptable; they are politically antiquated, economically illiterate, environmentally destructive, and ethically indefensible. They must go.

4 Second, the advance of other countries has made it much more difficult now for Africa to break into world markets, since their competitors from other developing countries have established strong competitive advantages. In its efforts to catch up, Africa faces an ever-steeper challenge. Moreover, Africa will face even greater

competitive pressures, as removal of global trade barriers continue to reduce the value of the preferences it receives.

5 The policies to foster growth in Africa's trade offered in this chapter follow from these two diagnoses. We focus first on the supply-side, in four related areas that are at the root of the problems: governance and the investment climate, including peace and security; infrastructure; African barriers and fragmented regional groupings; and skills and know-how necessary to diversify away from commodity dependency. Such problems have been compounded by the various economic crises that Africa has faced over past decades. Action on the first two of these has already been discussed at length in Chapter 7 on growth, and in Chapters 4 and 5 on governance and peace and security. The remaining trade-policy areas demand action mainly from Africa itself, much of which is easy to do, and relatively low-cost. With increased developed country support, rapid and substantial gains could be made.

6 While we have emphasised the importance of the supply side, there is also a great deal that developed countries can and should do on the demand side to enhance and foster supply-side investment and reform. They form the subject matter of the second part of this chapter.

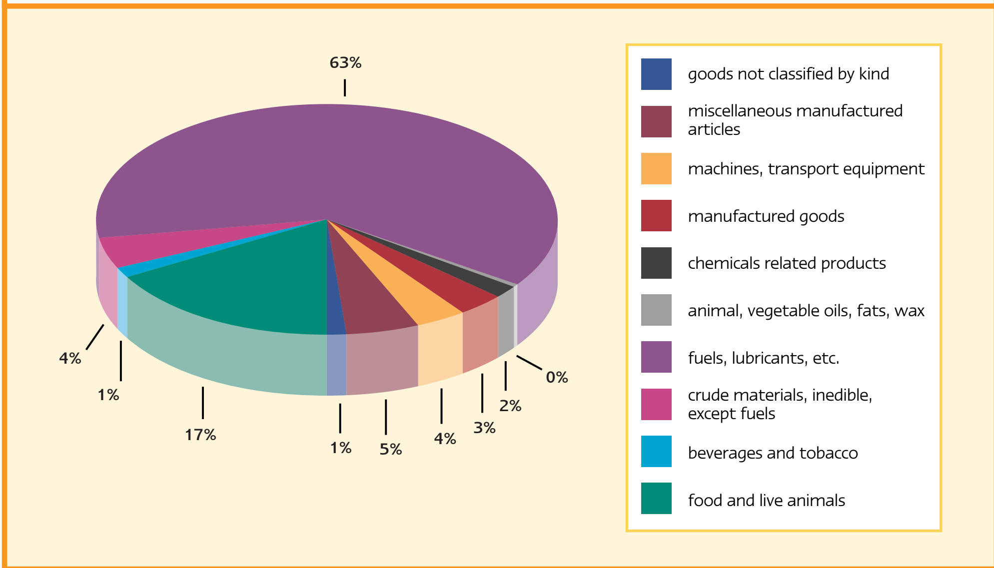
7 The demand side is in large measure shaped by developed-country policies on market access. Rich countries must accelerate the process of dismantling their trade barriers to give all developing countries, including Africa, a chance to expand exports. In particular, they should stop discriminating against goods in which developing countries, including Africa, currently have a comparative advantage, so that these countries get a fair return for their traditional exports. They must stop subsidising their own production, for example in cotton, and dumping their surpluses on world markets. These actions are essential to give Africa's producers a chance to compete in both traditional and new products, whether in African markets or elsewhere. Thus they must stop doing damage to Africa's prospects of achieving the Millennium Development Goals, and of raising growth.

8 Such measures come under the heading of 'first, do no harm', but developed countries can also take positive steps to encourage Africa in its attempts to break into new markets. Developed countries already give preferences to imports from Africa's poorest countries, including the EU's 'Everything But Arms' (EBA) and the USA's 'Africa Growth and Opportunity Act' (AGOA). They should extend the system of preferences from Africa's poorest countries to include the region's other very poor countries. And they should ensure that preferences actually do work. All too often they founder on vexatious application of rules-of-origin and other requirements.

9 Preferences must be transitional and temporary arrangements. Their purpose is to give a short term boost in market access, while trade barriers are progressively dismantled. They should provide short-run confidence to make investments but not long-run privileges that lead to inefficiency and lack of competitiveness. As global barriers come down, there are costs associated with the inevitable economic and social disruption as agricultural and industrial structures adjust to new international arrangements. Here too, there is much that rich countries can do to help Africa handle the costs of adjustment, beyond supply-side investments.

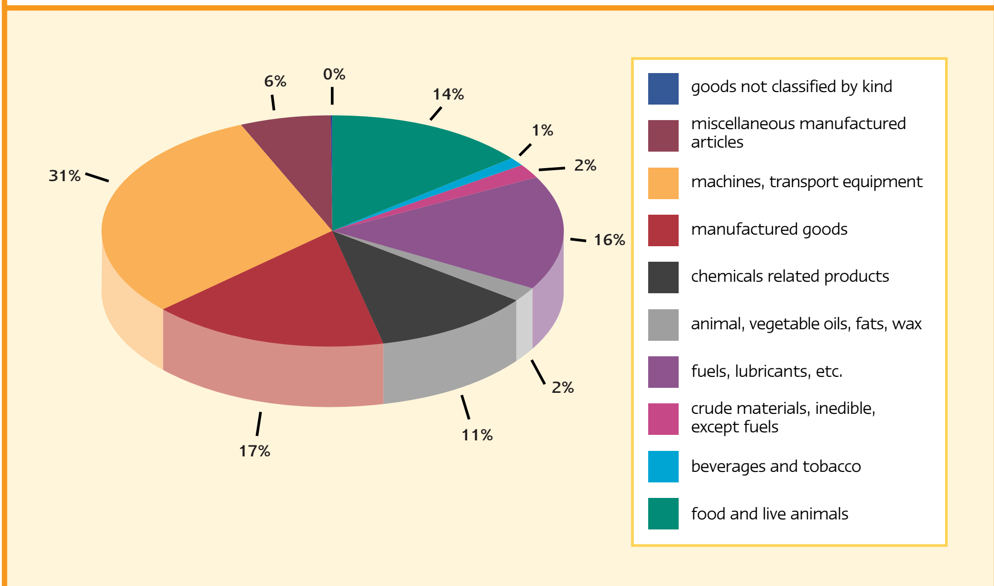
10 While Africa faces a substantial competitive disadvantage, the measures recommended in this report, if delivered, coupled with growing world trade fuelled by trade liberalisation, will provide Africa with an unprecedented opportunity to expand its exports, including to the rapidly expanding markets of Asia. These effects will be strengthened further if other developing countries help Africa in this process, especially by opening up to sub-Saharan Africa's exports.

Figure 8.2 **Sub-Saharan Africa Exports to the Rest of the World (Excluding South Africa) 2003**



Source: UN COMTRADE

Figure 8.3 **Sub-Saharan Africa Imports from the Rest of the World (Excluding South Africa) 2003**



Source: UN COMTRADE

11 This expansion of exports and the large increases of aid we advocate will greatly expand Africa's capacity to import[4] (see Figure 8.3 for current imports). Africa cannot make everything it needs and should not try – imports are as necessary and desirable for all countries as exports are, especially for small countries. They can bring down the costs of products consumed by poor people or be used for productive investments.

12 If this package of trade expansion is to work it must come with appropriate trade policies within Africa, including increased opening up – this is part of the whole economic logic of trade. But this process will need to be managed carefully, with proper sequencing of reforms, and attention given to the impacts on both producers and consumers. Historical progress in Europe and North America, and more recently in the Asia Tiger economies, shows us that a mix of openness and protection, provides a managed path to global integration[5]. As such these policies should not be dictated within trade agreements as part of mercantilist negotiations, or as part of World Bank or IMF programmes. Making special and differential treatment (SDT)[6] work in the WTO, means allowing Africa the flexibility to implement reforms, and must be a priority for any development round. Africa should not be forced to liberalise; the reforms should be chosen by African countries as part of the big push, and made more prominent in national development plans. Attempts to dictate policies, as we have argued throughout, are not only unacceptable as behaviour towards a partner and sovereign nation; they are also likely to be ineffective in generating real commitment and reform, let alone deliver the right solutions.

8.2 Increasing Africa's capacity to trade

13 A major problem Africa faces is its weak capacity to trade – driven by its low productivity and poor competitiveness, and rooted, in part, in a history of economic crises over past decades. These problems are compounded by the barriers it faces in global markets, including indefensible levels of rich-country protectionism and subsidies. The following sections cover the measures necessary to increase Africa's opportunities to trade, and break down these barriers. But we must underline that these measures will make little or no impact if Africa does not improve its competitiveness.

14 The long-term objective should be to ensure Africa is able to compete successfully on level terms in global markets for a diverse range of products and services. This may appear unrealistic, given the difficulties many sub-Saharan African countries currently face, and a huge challenge for some countries. Strong action on the measures outlined in this report will be vital in this regard – improvements in policy and governance in Africa; investments in infrastructure, in the heath and education of Africa's people, and in peace and security; all backed by a doubling of aid, and an end, once and for all, to Africa's debt problems. Recent history is encouraging: the Asian Tiger economies, and other countries such as China and Vietnam have made huge progress towards achieving this goal, despite weak starting points.

The preconditions of growth and building the capacity to trade

15 The fundamental prerequisites of a dynamic and competitive exporting economy are the same as for a dynamic economy, as covered in the preceding chapter on growth. Political stability and peace and security are a fundamental requirement. Beyond this, unleashing Africa's diverse private sector – from household farms to large firms – will require the same favourable conditions sought by investors anywhere. These include: functioning transport and communications infrastructure, a stable and predictable economic framework, an enabling regulatory and legal environment, well managed local authorities and effective public administration and service delivery, particularly in health and education. Improved governance is important, corruption and bureaucracy can increase costs considerably, and can easily make otherwise profitable products uncompetitive. All these elements must be addressed, to create an enabling environment for the private sector.

16 Infrastructure is a key component of such an environment. Delivering functioning markets with the necessary transport, communications, and energy infrastructure is a

major challenge. The scale and type of investment needed to overcome these current gaps is huge and varied: from multi-million-dollar roads to cheap but very difficult-to-implement reforms. The economic case for investment of this kind is very strong. The challenge is greatest for landlocked countries, home to 28 per cent of sub-Saharan Africa's population, where transport costs are 50 per cent higher and trade volumes more than 50 per cent lower than in similar coastal countries[7].

17 Improved trading capacity in Africa will depend on four areas of action: i) an enabling environment for the private sector, ii) infrastructure, iii) reducing Africa's barriers and iv) diversifying out of commodity dependency.

8.2.1 Enabling environment for the private sector

18 Governance and an enabling climate for the private sector are addressed in Chapters 4, 5, and 7. Getting the investment climate right has already boosted growth and poverty reduction in a number of countries in sub-Saharan Africa. As mentioned in Chapter 7, in Uganda, for example, an extensive program of reforms began in the early 1990s, stabilising the economy and increasing private-sector participation. As a result, the share of private investment in GDP more than doubled between 1990 and 2000[8]. And Mozambique's impressive growth performance since the end of civil war in 1992 is explained not only by post-conflict reconstruction, but also by the government's efforts to cut red tape and streamline regulations. As a result, domestic and foreign investment has nearly doubled[9].

8.2.2 Infrastructure

19 Infrastructure constraints are addressed in Chapter 7 through proposals for a US$10 billion increase in annual infrastructure financing to tackle key bottlenecks, including those hindering trade and integration. Trade-related infrastructure includes rural and international roads, railways, ports and airports, efficiently managed small towns to act as links between local and international markets, and also telecommunications, energy, and water. In landlocked countries, transport costs can be three-quarters of the value of exports. Shipping a car from Japan to Abidjan costs US$1,500, but shipping the same car from Abidjan to Addis Ababa costs US$5,000[10]. Current cost estimates for infrastructure investment, including those based on a recent World Bank research paper, suggest a need for additional expenditure in the order of US$10 billion to US$20 billion a year, meaning at least a doubling of current levels[11]. This excludes spending on ports and airports, among other areas, and is therefore certainly an underestimate of need.

8.2.3 Reducing Africa's trade barriers

Effective national and regional trade policies

20 Trade must be made more of a priority in national development strategies and be properly integrated with other areas of economic reform[12]. African countries and regions need to chart out a vision for trade, and develop strategies to deliver it. Ministers of Trade must work more closely with their counterparts in finance, planning, agriculture and industry, to ensure that strong government efforts are directed at undertaking necessary reforms to secure both growth and trade, and to ensure that these contribute to poverty reduction (see Box 8.1). Such efforts are particularly important in order to maximise the gains from trade reform for both women and men, to ensure gender impacts are understood and catered for and that negative impacts from reform are properly addressed.

21 Africa has many trade barriers, both internal and external, that hamper its ability to grow its way out of poverty. Africa has made efforts to reduce its own tariffs, some of

Box 8.1 **Integrating Trade into PRSPs – Tanzania**

Tanzania's first PRSP did not include trade, the main focus was on the social sectors. The second revision of the PRSP (National Strategy for Growth and Poverty Reduction) addressed growth in more depth, including trade, with cross-cutting goals and strategies. For instance, the promotion of SMEs is seen as a measure to improve the private sector environment for growth, and also for trade. The Ministry of Industry and Trade works closely with the President's Office – Planning and Privatisation, on policies for SME promotion, and with Ministry of Finance on access to credit, microfinance regulation, and SME and export credit guarantees.

Source: DFID Staff[13]

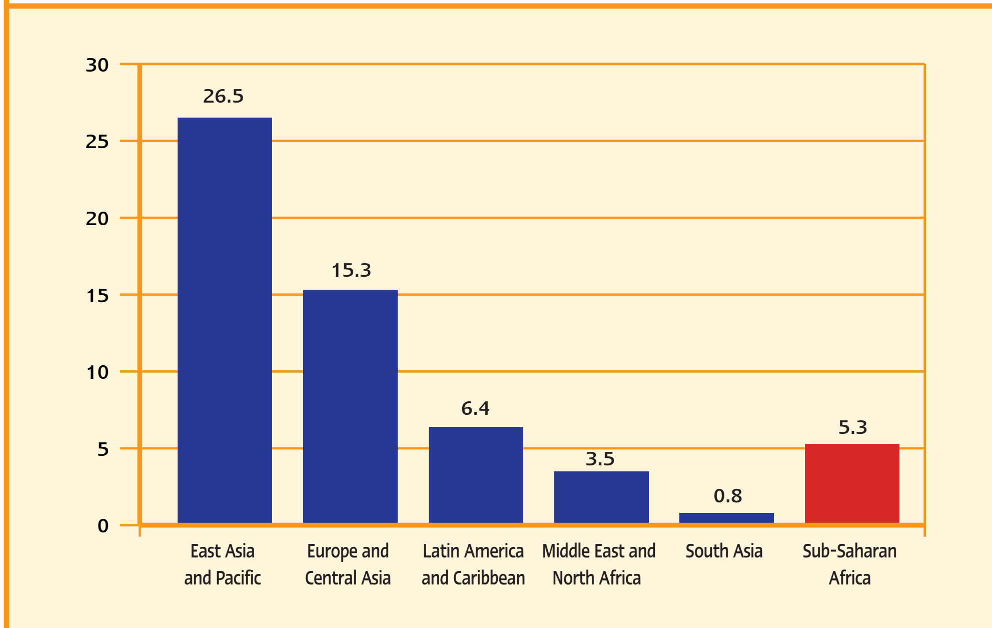
this through country-owned efforts at trade reform, and some through conditionality in IMF and World Bank programmes. The World Bank's Trade Restrictiveness Index[14] shows that Africa is relatively more open than South Asia and Latin America, and as such must be deserving of more credit in WTO negotiations for these past reforms. But Africa could also do more to reduce its own tariff barriers. In many of the economic models used to estimate benefits from trade reform, a large share of the benefits for Africa come from reducing its own tariff barriers. Such reforms bring adjustment challenges as there will always be winners and losers from reform: major investments in building the capacity to produce and trade will help producers gain from these new opportunities, and further assistance will be needed to help countries manage adjustment (see section 8.3.3). While estimates from these models rely heavily on assumptions and should be used with care, they do show substantial gains from opening up to cheaper imports, which can magnify the benefits of new markets abroad. A careful approach to opening should be taken, sector by sector, given the potentially damaging impact of opening up to subsidised agricultural imports. At a minimum, simplifying tariff structures, 'binding tariffs' – that is committing never to exceed a maximum level – at the levels currently applied, and seeking more tariff harmonisation, would remove distortions and provide substantial income gains for Africa.

Regional integration to promote sustainable growth

22 Historically, the African domestic market has been fragmented by high internal and external barriers. In 1991, the Abuja Treaty was adopted, establishing a timetable towards the creation of a pan-African Economic Community by the year 2025[15]. The existing Regional Economic Communities were to be the foundation. This is an ambitious objective, but the first building block must be the creation of free trade areas that can be the foundation for wider economic integration at the regional and continental level. Figure 8.4 shows the potential of intra-regional trade in more integrated regions, such as in East Asia and the Pacific.

23 There are huge challenges posed by the proliferation of regional economic groupings and protocols across the continent, characterised by overlapping membership[16]. However, progress has been made in the past decade. Most regions have now adopted a common external tariff structure (usually involving no more than three to four bands) – the most recent example being the EAC in January 2005 – while some, including CEMAC, WAEMU and 11 member countries in COMESA, have also removed custom duties among themselves (see Box 8.2). Recent ECA estimates[17] indicate that welfare gains from regional integration in sub-Saharan Africa alone, could be of the order of US$1.2 billion, reinforcing the view that Africa's own liberalisation offers major gains.

Figure 8.4 **Intra-Regional Trade as a Share of GDP (Per cent), 2002**



Source: UN COMTRADE

24 Research also suggests that enhanced regional co-operation can help reduce barriers caused by transport costs, 'rules of origin'[18], standards and other regulatory barriers, and poor customs administration – what is known as the 'trade facilitation' agenda. Making rapid progress in such areas will do much to build Africa's capacity to trade regionally and globally. And much more could be done by regional economic communities to encourage intra-regional industrial linkages and improved co-operation to address infrastructure and production constraints.

25 Building institutional capacity is important too, and this includes building intellectual capacity, promoting research and analysis to strengthen policy debate and reform. Strengthening data management and the development of consistent and coherent datasets across member countries should also be prioritised.

Box 8.2 **COMESA – Benefits of Trade Integration**

The COMESA (Common Market for Eastern and Southern Africa) Free Trade Area (FTA) was launched on 31st October 2000, with nine countries out of COMESA's 20 member states. These were Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia and Zimbabwe.

In 2004, two more countries – Burundi and Rwanda joined. The other COMESA member states, which are at various stages of tariff phase down are Angola, Comoros, Democratic Republic of Congo, Eritrea, Ethiopia, Namibia, Swaziland and Uganda. The countries in the FTA trade on duty-free and quota-free terms for all goods originating from within their territories, but continue to impose their own national tariffs on goods imported from the rest of the world.

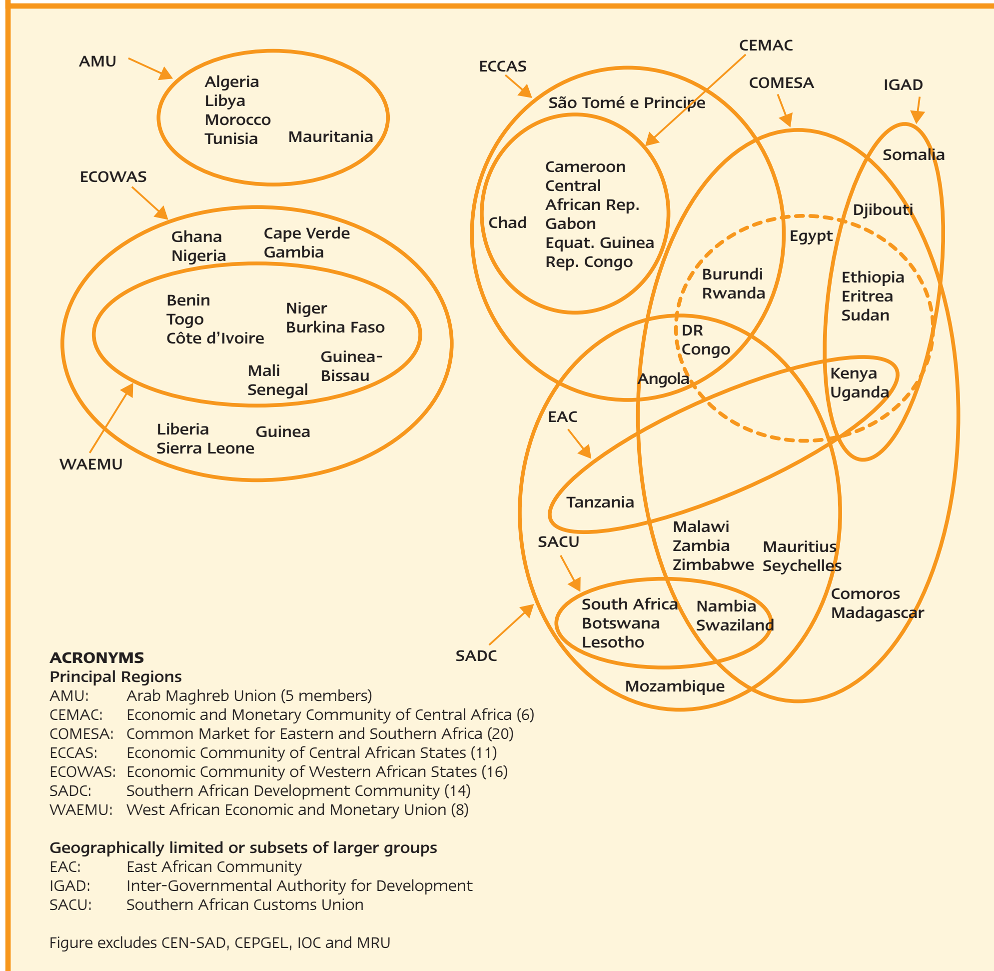
COMESA members aim to integrate their economies by strengthening their trade and investment links. The aim is to achieve full economic co-operation through a gradual process starting with the FTA, then a customs union, followed by a common market and ending with an economic community. The customs union, originally scheduled to be in place by the end of 2004, has now been postponed to 2005.

Trade in COMESA grew by 15 per cent from $4.5 billion in 2002 to $5.3 billion in 2003 as a result of the FTA, which increased the competitiveness of goods within the region, according to a statement in 2004 from the COMESA Secretariat. Another boost to COMESA trade has been AGOA, which had led to the growth of exports from US$457 million in 2002 to US$880 million dollars last year in 2003. Up to March 2004, AGOA exports stood at US$752 million. A major focus of COMESA is in the improvements in efficiency that deeper integration will bring in terms of increasing the size of the regional market and supporting integration with the world economy, for instance, by working with member states to undertake analysis of the implications of Doha and European Economic Partnership Agreements to better inform negotiating positions.

Source: DFID Staff[19]

26 IFPRI[20] has identified more than 250 agricultural goods for which one or more sub-Saharan African countries have a comparative advantage, a third of which are goods of which other African countries are importers[21]. Given that a quarter of Africa's cereals are imported, increased intra-regional trade could both provide opportunities for the poor rural agricultural producers and assist in partially alleviating Africa's food security problems. For example, Kenya has for the past decade imported grain from Uganda and Tanzania during periods of drought.

Figure 8.5 **African Regional and Sub-Regional Economic Communities**



Source: Adapted from the World Bank

27 Key issues include how to harmonise and rationalise the current regional economic community configuration[22] and at what pace to optimise their role as building blocks for an eventual continent-wide union as agreed in the Abuja Treaty. A variety of approaches exist[23], for example, the Cross Border Initiative has been used to accelerate regional integration in many of the COMESA countries[24], through the principle of 'open regionalism'[25].

28 Discussion with the EU on Economic Partnership Arrangements (EPAs) – see section 8.3 – will also affect the pace of regional integration. Currently there are four regions undertaking the negotiations – Central, West, East, and Southern. Rationalisation of existing blocs is taking place, for example, with Zambia, Mauritius, Malawi, and Zimbabwe negotiating their EPA through COMESA, not SADC.

29 Regional economic integration of various forms has been tried around the world, with varying degrees of success. African experience to date has shown that removing tariffs to create a free trade area or customs union is a challenging but feasible target. And a greater impact will be achieved when coupled with measures to improve trade facilitation. Achieving continent wide coverage may be feasible within a reasonable timeframe. An

African free trade area may deliver a substantial slice of the benefits of deeper economic integration far more quickly and efficiently than seeking deep integration all at once. If the regional groupings in Africa harmonise their approach to building free trade areas, it will then be possible for them to finally be joined together and form a pan-African economic union. Some regions have greatly strengthened their co-operation in recent years. For example, COMESA and SADC have recently agreed to adopt a common 'Common External Tariff' structure and co-ordinate their negotiations with the EU, while ECOWAS and WAEMU have plans to form a monetary union[26].

30 Deeper integration requires legal and regulatory harmonisation. This is very hard to achieve and extremely demanding of skilled input to shape and negotiate. The greater the number of countries and the greater their diversity, the more problematic the harmonisation process. European integration is perhaps the deepest and one of the longest standing economic unions. Even for the well resourced member states this has been a difficult process taking half a century, and the integration of newer states has required substantial financial transfers and technical support. For many African countries, reaching such a level of integration is far off. Countries belonging to the Franc Zone (WAEMU and CEMAC) could provide a good example of what is possible. Members of WAEMU and CEMAC share the same currency, the CFA franc, which is pegged to the euro, and have their monetary policy dictated by their respective regional central banks. Both regions have custom unions. In WAEMU, much has also been achieved in terms of economic convergence (with countries committed to reach specific 'convergence' fiscal and economic targets), but also in the harmonisation of business regulations and investment procedures. WAEMU also has a small but active regional stock exchange market.

Trade facilitation: Reducing Africa's non-tariff barriers

31 Despite very low wage rates, the costs and difficulty of moving goods across, between, in and out of some African countries can be far higher than in richer countries, undermining Africa's competitiveness. While African governments have been pressing for decades for the removal of OECD trade barriers, many of their own barriers to trade are relatively cheap and easy to remove, and can be, in some cases, more damaging than rich-country barriers (see Box 8.3).

32 The process of reducing these barriers to trade at borders is broadly called 'trade facilitation'. It includes addressing cumbersome customs administration procedures, excessive bureaucracy, poor governance and corruption, lack of transparent regulatory frameworks, lack of automated systems, and low levels of human capacity. African governments should make reforms in this area an extremely high priority, and integrate their efforts into national strategies.

33 In the 1990s, it cost about the same to clear a 20-foot container through the ports of Abidjan or Dakar as it did to ship the same container all the way to a north European port[27]. Sub-Saharan Africa suffers from the highest average customs delays in the world; for example Estonia and Lithuania require one day for customs clearance versus 30 days on average for Ethiopia. An average customs transaction in a developing country is estimated to involve 20 to 30 parties, 40 documents, and 200 data elements, 30 of which have to be repeated at least 30 times[28]. Costs and inefficiencies like these make it extremely difficult to get goods to market at a competitive price. These are all points strongly emphasised by the private sector in our consultations[29].

34 The growth impact of these reforms can be very high. An OECD study[30] makes a conservative estimate of almost *one per cent of GDP for sub-Saharan Africa*[31].

35 Unfortunately, trade facilitation has been associated with some of the new issues included in the Doha Round, the so-called 'Singapore issues'[32], which aroused considerable opposition. This has a more specific and limited focus (associated with GATT Articles V, VIII and X) than trade facilitation for development. While African countries should not be burdened with trade facilitation obligations they do not have the capacity to meet, their growth and trade will benefit from immediate and unilateral action such as publishing rules and regulations in a transparent manner, and eliminating informal road checkpoints.

Role of trade facilitation in regional integration

36 Africa has a long way to go before realising the full potential of regional integration. Intra-regional trade remains very low, at around 12 per cent of cross-border trade. Increased co-ordination between countries and regions is needed to accelerate trade facilitation efforts in Africa and reach the same level of commitment as in Asia Pacific Economic Cooperation (APEC) economies, where APEC committed to a five per cent reduction in transactions costs of trade by 2006[33]. The gains in annual real incomes of the reforming economies currently amount to an estimated US$17.1 billion increase in real incomes[34]. An APEC study shows that efforts to achieve its original commitment could raise APEC's GDP by 0.9 per cent (US$154 billion) a year[35].

Box 8.4 **The Case of the Trans-Kalahari Corridor (TKC)**

The TKC (road route between South Africa and Namibia via Botswana) went through major rehabilitation in 1999, but traffic reached only 15 per cent of expected capacity. In 2003, the TKC initiated a pilot to replace various existing documents with a single administrative document, which was complemented by a website with the details of the documentation process (developed by South African Customs). This led to a reduction in border processing time from an average of forty-five minutes to 10-to-20 minutes, leading to an estimated cost saving of US$2.6 million a year (USAID).

Source: World Bank Global Economic Prospects, 2005

Customs reform

38 To dismantle some of these barriers requires both skill and organisation. The reform of ports and customs services might involve management contracts like that between the Government of Mozambique and Crown Agents (see Box 8.5).

39 Customs reform should also appear prominently on the governance agenda (see Chapter 4), because of the substantial revenue sums at stake, and the potential for bribery and corruption. Its importance was strongly emphasised during our consultations with business[37]. The costs of customs bribes and delays seriously undermine Africa's competitiveness. In Côte d'Ivoire, it typically costs US$400 to get a single lorry through the country due to the 'costs on the road' (fees accumulated in bribes and official payments).

Box 8.5 **The Mozambiquan Experience**

After the civil war (1975-1994), revenue collection in Mozambique virtually collapsed, in part due to high levels of customs fraud and evasion. Almost half of all Mozambiquan traders surveyed had been solicited to pay fees that were not required by law or regulation. Most paid between US$4 and US$40 per transaction, but nine per cent paid between US$40 and US$400. In 1996, the Mozambiquan government strengthened custom procedures and implemented trade facilitation measures. Crown Agents were selected to manage custom operations, train staff, and provide other support. 130 members of staff were charged with serious offences. Goods are now cleared 40 times faster than the pre-reform rate, making Maputo one of the most efficient terminals in Africa[38]. Surveys indicate that 80 per cent of road imports and 62 per cent of imports by sea are cleared by customs within 24 hours of correct documentation[39]. In the first two years, although imports decreased by 0.2 per cent, customs revenue increased by 38.4 per cent.

Source: World Bank Global Economic Prospects, 2005

40 Improving a poorly administered customs administration can have a large impact on the investment climate. For instance, Intel decided to invest US$300 million into a micro-chip facility in Costa Rica only after the Government of Costa Rica had guaranteed rapid customs clearance[40]. Significant costs can be imposed on importing and exporting firms and also indirectly on firms that depend on imported goods or supply exporters. Delays in imports can prevent firms from adopting processes that depend on 'just-in-time' deliveries, raising their costs through forcing them to hold larger inventories.

41 Trade facilitation measures have been shown to substantially reduce customs delays and costs, while also increasing revenue (see Box 8.6). Customs revenues can provide up to a quarter of government revenue in Africa, and this dependence is often cited as a barrier to tariff reduction. But since duties and taxes are often not collected efficiently, revenue collection falls short of its potential and sometimes the cost of collection is greater than the revenue collected. It may be quite possible to reduce tariffs and maintain or even increase revenue[41].

Box 8.6 **The Lesotho Revenue Authority (LRA) Project**

The purpose of the LRA project was to strengthen 'sustainable, equitable and improved tax management by the LRA'[42], in part through re-organisation of government departments into one revenue body.

Trade facilitation at borders has improved: Waiting time at borders reduced from two to three hours for traders to typically 30 minutes, and for small-scale traders (who can at some borders represent 50 per cent of all trade) and shoppers from 20 to 60 minutes to less than five minutes. Equalisation of VAT rates with South Africa and other arrangements have impressively simplified VAT collection at the border.

Revenue collected at borders: Income tripled due to the reduction in smuggling and ease of compliance, revenue collection at the border has increased from around US$700,000 per month under Sales Tax, to around US$2.9 million per month, after the introduction of VAT.

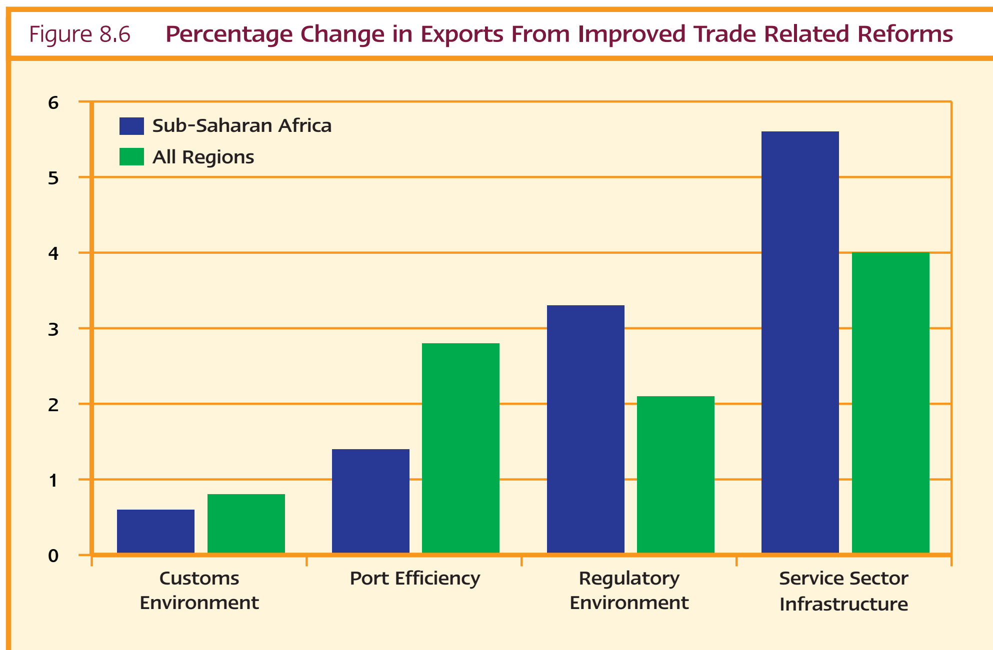
Threshold for VAT payment at border: To ensure administrative efficiency no VAT is collected where the total purchase value is less than 150 Rand. This means small traders/shoppers are allowed to pass through quickly without requiring customs clearance.

Source: Govt of Lesotho/DFID South Africa LRA Output to Purpose Review, 2003

Trade-related services : helping countries trade

42 These barriers are compounded by the lack of competition and distorted regulation in services, such as sea and air transport, which raise costs significantly. Trade-related service sector infrastructure (e.g. telecommunications, financial intermediaries, and logistics firms) provide the biggest gains[43] (see Figure 8.6).

Figure 8.6 **Percentage Change in Exports From Improved Trade Related Reforms**



Source: Wilson et al, 2004

43 Some major challenges lie in the areas of: sea transport, air transport, and new security measures.

44 *Sea transport:* Monopolies in sea transport give rise to excessive costs. Maritime deregulation that ensured proper competition among shipping services could reduce freight costs by 25-50 per cent[44].

45 *Air transport:* African air transport costs are higher than those of other countries, severely hampering Africa's ability to compete and to diversify, particularly in the case of landlocked countries. More than 20 per cent of African exports enter the US by air, and it is estimated that air transport costs can make up to 50 per cent of the value of exports to the US[45]. Although the Yamoussoukro Decision in 1999 prompted reform[46], most airlines in Africa are still protected. Moving immediately towards an 'open skies'[47] arrangement would lower air cargo freight rates substantially. This is a relatively cost-free option, and is in the hands of African governments to deliver.

46 *New security measures:* The introduction of new US security measures to combat terrorism at ports, may lead to further marginalisation of developing countries. Given that 13 per cent of African trade constitutes exports to the US[48], the new measures are expected to reduce African exports by further increasing the region's high cost of international trade. Security concerns could act as a non-tariff barrier and could undermine the benefits from preferential schemes such as EBA and AGOA. **Developed countries should assess the impact of new security measures** on African exports and support African efforts to satisfy security requirements.

Implementation

47 In order to be effective, trade facilitation measures have to be undertaken as part of a much broader process of domestic reform. No single package will meet the needs of all the countries. Bolivia financed a five year project for customs modernisation from several

sources costing around US$38 million (including US$25 million on institutional improvements, and US$9 million for computerised systems)[49]. Some areas of reform are technically demanding and require additional training and infrastructure investments. Existing efforts such as the ASYCUDA programme have huge potential (costs can range from US$2.5-5 million), but must be coupled with training of human resources (e.g. customs officials). But other areas, especially in early stages, can be covered by the normal operating budgets of custom agencies. These are quick and cheap wins: simple measures to streamline the communication infrastructure, address the inefficient bureaucracy, reduce duplication, and standardise documentation. Simple tools such as trade facilitation centres and electronic data interchange can also reduce border costs greatly.

Technical assistance and capacity building

48 Technical assistance provided by the Doha Development Agenda Global Trust Fund[50], is primarily concerned with strengthening the capacity of developing country officials to participate in WTO negotiations and to implement commitments. The WTO Agreement on Customs Valuation (including border customs reform), although signed by many countries was never implemented in the spirit of the agreement. It is estimated to cost countries between US$1.6 million and US$16.2 million to implement. Resources for implementing broad trade facilitation programs exists within the WTO, UNCTAD, the World Bank[51], the EC and regional development banks. But a more co-ordinated approach among donors is required. Given the vested interests of the private sector[52], they should be encouraged to contribute either financially or by providing expertise and sharing best practices with customs administrations.

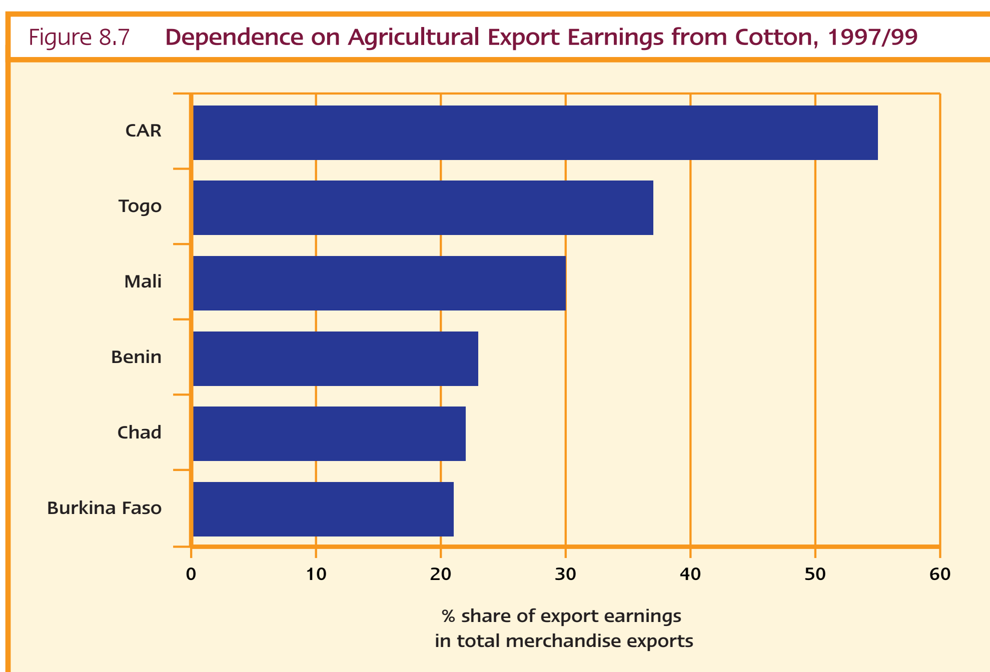
Recommendations – building the capacity to trade:

- **Africa must increase its capacity to trade. It should remove its own internal trade barriers between one African country and another. Developed countries should support African efforts to achieve this greater economic efficiency through regional integration and trade facilitation at both the regional and national levels. This should include budgetary support to regional institutions, capacity-building, and efforts to meet the needs of weaker members of regional communities.**
- **With support from developed countries, African countries should integrate trade facilitation into their national development strategies and urgently reduce non-tariff trade barriers by: undertaking reforms in air and sea transport, streamlining customs administration – including further revenue-raising efforts, and improving governance and reducing corruption. This should extend to assessing where regulatory simplification and service sector liberalisation may be beneficial. The Africa Peer Review Mechanism should become a tool for ensuring these key trade commitments are implemented in African countries.**
- **Developed countries should follow up on commitments to supporting trade facilitation made in the 2004 WTO July Framework Agreement, including helping to meet any new rules, and mitigating the possible adverse impacts of new security measures. The Integrated Framework should continue to be supported and expanded to all African low-income countries[53].**
- **Africa should do more to improve the economic environment for farmers and firms, backed by major investments of aid from developed countries to ensure Africa can produce and trade competitively. Funding for infrastructure should, in part, be spent on improving African transport and communications.**

8.2.4 Reducing commodity dependency

49 Many African economies are heavily dependent on only a few commodities dominated by traditional agricultural crops such as coffee, cotton (see Figure 8.7) and sugar[54], which currently accounts for 50 per cent of Africa's total agricultural exports[55]. Therefore adverse market conditions matter a great deal, and pose a high risk. An ambitious Doha Round, described later in this chapter, will expand Africa's market opportunities and allow diversification of exports by destination and product, including in higher value-added production. But the key domestic policy action is to develop a broader economic base in order to diversify and adapt to risk, so that market fluctuations can be managed. Progress must be built on developing a vibrant and responsive private sector – from household farms to large firms. But other measures described in this section can complement these efforts.

Figure 8.7 **Dependence on Agricultural Export Earnings from Cotton, 1997/99**

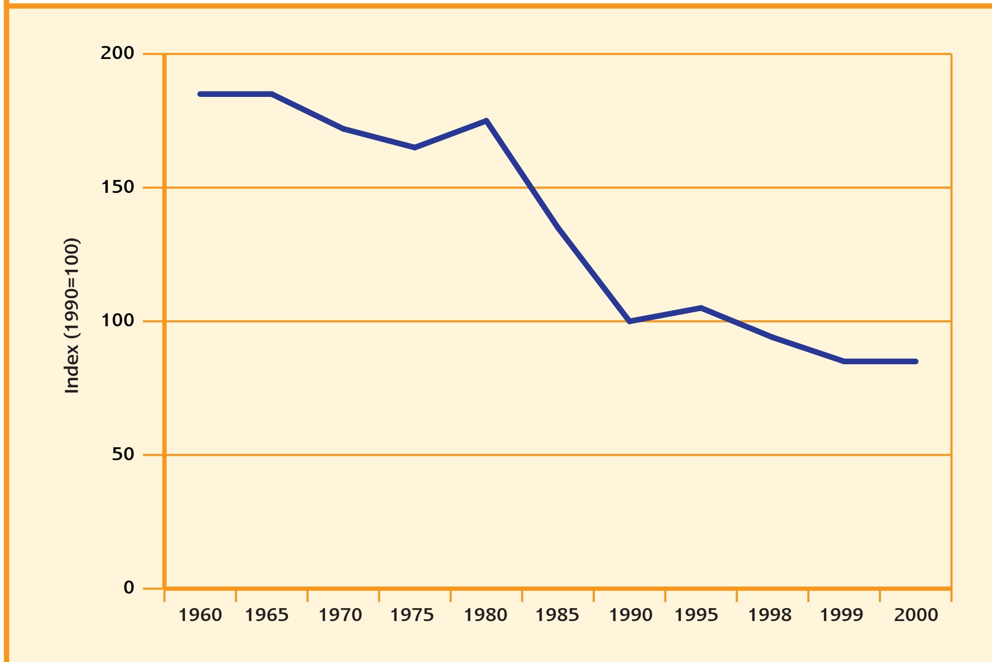


Source: UNCTAD

50 17 of the 20 most important non-fuel export items of Africa are primary commodities and resource-based semi-manufactures[56]. Many countries have begun to diversify into other areas, such as fish or flowers[57]. On average, African countries derive over 21 per cent of GDP from primary commodities[58] (including fuels), compared to around 10 per cent for developing countries overall, and less than three per cent in developed countries[59]. Almost all the countries that are hit hardest by falling commodity prices are also among the worlds poorest[60], with over half of sub-Saharan Africa falling into this category[61].

51 Sub-Saharan Africa has suffered the most from declining terms of trade – the price of exports relative to imports (see Figure 8.8). Increased export quantities have not been sufficient to cover the loss of purchasing power of commodity exports. The price of some commodities like coffee has been driven lower due to oversupply and intense global competition. The decline in world coffee prices alone produced a 40 per cent fall in Ethiopia's terms of trade, resulting in a decline in GDP of about six per cent[62].

Figure 8.8 **Decline in African Agricultural Commodities Terms of Trade, 1960-2000**



Source: UNCTAD

52 Commodity markets can be volatile, making it hard to distinguish long-term trends from cyclical price changes. However, prices for some commodities appear to be in permanent decline, for example, in sub-Saharan Africa, eleven countries face 'permanent' shocks to their terms of trade[63]. At the same time, the presence of short-term shocks, e.g. from the weather, create additional volatility. Although oil has an important role in African economies, there are currently only nine oil-exporting countries[64]. Estimates show that a one-dollar increase in international oil prices results in about US$900 million additional oil revenues for sub-Saharan African oil exporting countries and US$200 million additional costs for oil importing countries[65]. Compensatory finance can have an important role in mitigating the impact of price volatility, and the impact on government budgets and spending plans. However, existing mechanisms such as the EU FLEX mechanism are not particularly effective. What is required is a rapid disbursing grant facility that provides short-term support to cushion the impact of the shock, and stabilising the budget.

53 Diversification is a long-term strategy and will require structural transformation of an economy. However, past experience shows that this is possible, for example in Chile, Malaysia and Mauritius.

Current state of play at the international level

54 The management of commodity prices has been recognised as an international problem since the 1920s. However, after collective action by the international community at stabilising prices proved generally unsuccessful[66], the issue of commodity dependency disappeared from the international agenda. International commodity agreements[67] were used to minimise the effects of world commodity price shocks. There was much use of buffer stocks or export quotas as tools of market intervention to stabilise world commodity prices and raise returns to commodity producers. However, these failed in the 1980s and 1990s, as the cost of maintaining them became

unsustainable. Interest was renewed recently with calls by the EU[68] and UNCTAD[69] to address the specific challenges of commodity dependent developing countries. President Chirac of France reinforced this, by describing prevailing international action on commodities as a 'conspiracy of silence'[70]. These have been highlighted throughout this chapter. As recently recognised by the international community, an integrated and comprehensive international approach is needed to deal with the commodities problem, particularly given the link between commodity-dependency and poverty. A grant-based shock facility is urgently required (see Chapter 9). However given that liberalisation over the past few decades has introduced increased market complexities, past forms of cooperation involving international price stabilisation need to be avoided. Following the UNCTAD XI Sao Paolo Consensus[71] a new task-force of various stakeholders, looking into these issues should be supported.

Market opportunities for smallholder farmers

55 African agricultural production continues to be targeted primarily at export or subsistence farming. Some analysis suggests that markets in food staples will be the fastest-growing of all agricultural markets in Africa over the next 20 years, where the current value of domestic output is about US$50 billion[72]. Demand for food staples is projected to far outpace growth of export markets, doubling by 2015[73]. This means that the development of well-functioning local and regional markets should be a priority, including the development of micro-credit institutions, support to producer associations, and harmonisation of legal and administrative regimes. Urbanisation offers new opportunities not only for supplying food staples but the consumption of more high-value and processed goods.

56 To earn more from commodities, Africa will need to improve productivity, quality, reliability of supply, and also increased value-added production, particularly through agricultural processing. Progress in this area will partly come from establishing an enabling environment for the private sector, as discussed earlier, but African countries must also address the structure of production. The current structure – often through smallholdings or subsistence farming – hinders economies of scale. Larger firms or co-operatives may have access to services such as price risk management and specialist inputs that are not possible at the smallholder level. Government and donor aid programmes should support the development of producer organisations to help secure economies of scale and organise commercially. This would increase their leverage in markets dominated by national agri-businesses and multinationals. Programmes should also ensure that farmers have access to resources such as information, credit, and training needed to diversify into income generating activities such as higher value crops or agri-processing. Support to effective marketing arrangements in rural areas where market failure may be a problem, should be encouraged. Developed countries should also continue to support the International Commodity Bodies[74] and the Common Fund For Commodities[75] to improve the productivity and quality of African commodity production e.g. the Coffee Quality Improvement Programme[76]. Action on coffee is particularly important given the problems of over-dependency, over-supply and the very low prices that millions of farmers in rural Africa receive[77]. Increased funding from developed countries would help increase the participation of producer groups in 'fairtrade'. The demand for products carrying the 'fairtrade' mark is growing, but investment is needed in building the capacity of producer groups in Africa to meet the rigorous demands of developed country markets.

57 Export markets offer very lucrative opportunities but can be very hard to exploit. Large retailers such as supermarkets in Europe play a decisive role in structuring the production and processing of fresh vegetables exported from Africa. The top 30 supermarket chains worldwide control almost a third of grocery sales[78]. Their informal or private standards[79] can

be even more exacting than official ones – such as sanitary and phyto-sanitary (SPS) described later in this chapter – leading to the exclusion of small farmers and concentrating business in the hands of large firms. In 1997, approximately 70 per cent of Kenya's high-value horticulture export earnings were supplied by small-scale farmers. By 2000, the need to comply with international food standards meant this fell to 30 per cent[80]. It is estimated that the effects of the 2005 EU food safety regulations[81] could cost Kenya over US$400 million annually in lost export earnings[82]. If African countries do not meet these standards (see following sections), a shift in procurement from other regions, such as Latin America, could take place. Supermarkets should assess the development impact of their procurement and standard setting practices on smallholders and help them integrate into the supply chain; practices such as making payment within 30 days could increase their survival chances.

Risk and uncertainty

58 Increased productivity requires investment, but farmers will not invest if they are highly uncertain of their income. African countries individually and collectively have tried various marketing arrangements to address this problem. Many state marketing boards were closed down after failing to remain solvent or to offer farmers attractive terms. Effective institutional infrastructure can help fill this vacuum and assist in price risk management and 'price discovery'. Innovative ways to use information and communication technologies can provide smallholders with market information, e.g. the use of mobile phones as attempted in Uganda[83]. Governments can help by enforcing contracts to prevent defaults and by improved transparency in government food aid and import management. This will have the knock-on affect of improving incentives and activities of private traders in staple food markets[84].

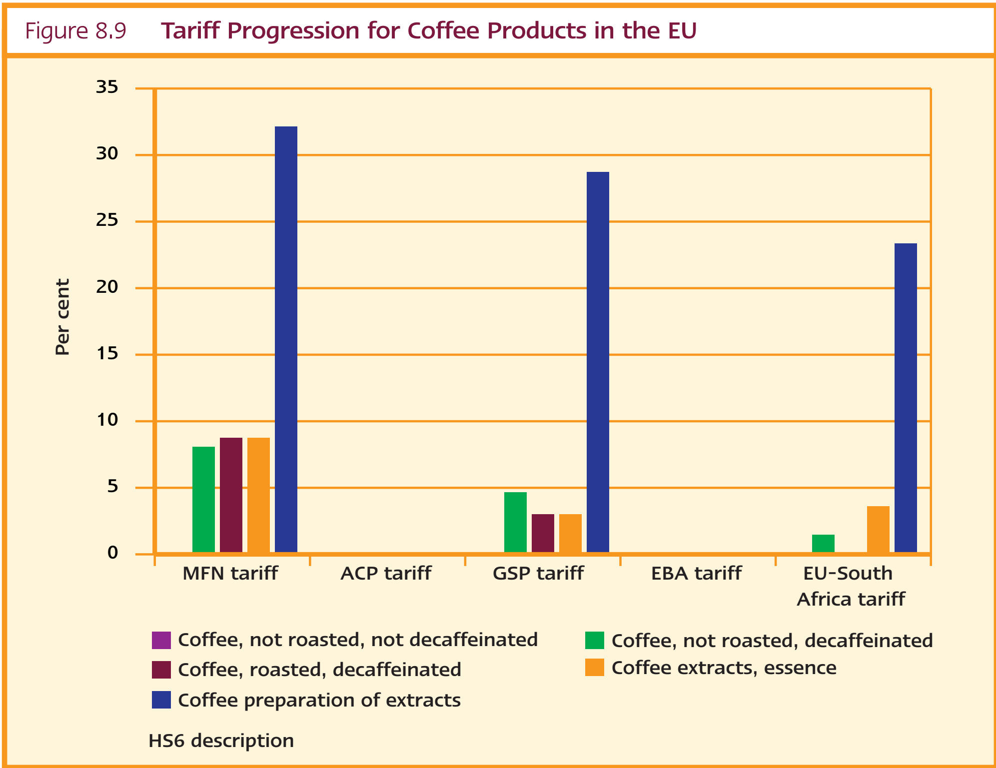
59 Commodity exchanges[85] can overcome problems of information and enforcement in the marketplace. The process of defining the price at these exchanges is transparent and market-driven. They also provide services such as transportation, storage, and information dissemination, in addition to conducting spot and forward transactions. The South African Futures Exchange is widely recognised as the 'price discovery' mechanism for maize in the Southern African region. There may be a case for similar regional commodity exchanges, such as an East African commodity exchange[86].

60 Market based solutions such as the World Bank's Commodity Price Risk Management project can give developing country producers access to developed world risk management products which use internationally traded markets. Market-based tools, while not a panacea, can provide better security for a number of commodities[87]. The futures market is best suited to manage risks resulting from short-term movement in prices, but not to deal with long-term price decline. Some African governments (e.g. Côte d'Ivoire and Ghana) have sold 'forward' their cocoa exports and many francophone countries, their cotton exports. But the use of market-based instruments is not widespread in Africa. Deeper use of international risk markets may be an option where there are shallow financial sectors and a limited number of unsophisticated financial products. However, widespread use is unlikely without technical assistance in building the required institutional infrastructure and expertise. The donor community can assist in providing more support to implement programmes in this area and help develop the capacity to manage commodity price instability, especially as part of rural development schemes.

Constraints to diversification

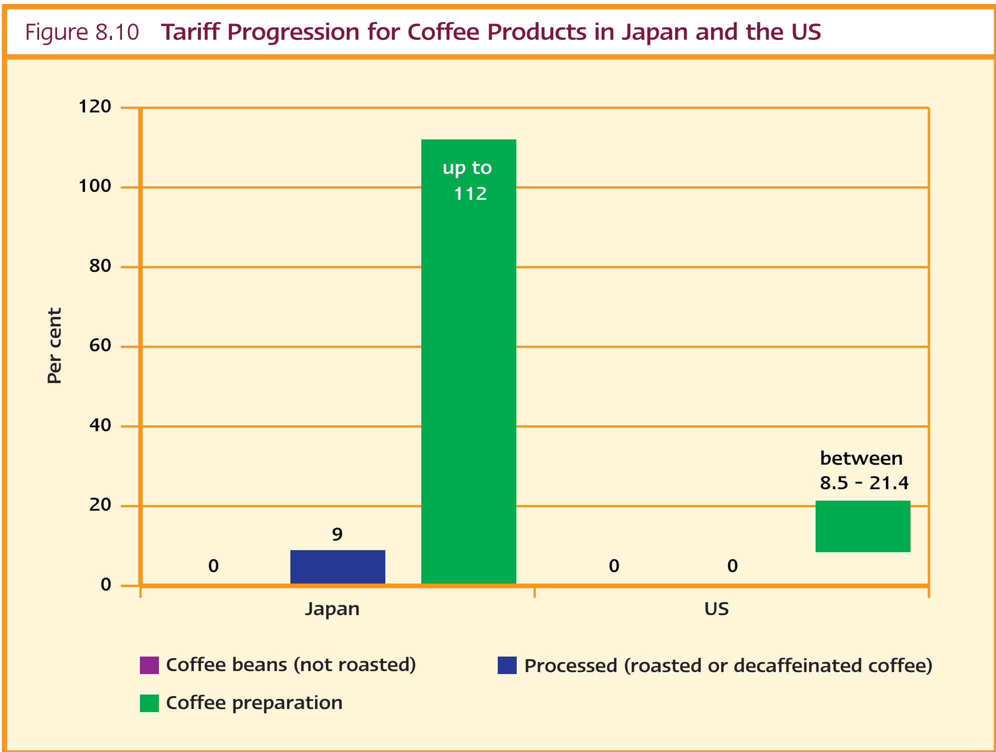
61 Many argue that the structure of tariffs in rich countries undermines processing in Africa. Looking at 'bound tariffs' – tariffs that apply to all WTO members – all sectors are affected by 'tariff escalation' (where tariffs rise with the level of processing). But given that African exports benefit from 'preferential' market access (see section 8.3.2), they face

Figure 8.9 **Tariff Progression for Coffee Products in the EU**



Source: Adapted from Bureau et al, 2004

Figure 8.10 **Tariff Progression for Coffee Products in Japan and the US**



Source: Adapted from Bureau et al, 2004

relatively *limited* tariff escalation in the EU and US markets[88]. However some escalation does remain where products are excluded from preference schemes. For instance, under AGOA, many products deemed 'sensitive' are excluded from receiving duty-free access. This affects products such as soya bean oil, sugar, cocoa, tobacco and cotton, which are of interest to Africa[89]. In the EU, for non-LDC African countries, affected products include meat (beef, pig meat and poultry); soya bean oil, groundnuts, sugar, cocoa, oranges and pineapples. The most commonly used examples to show tariff escalation are in the coffee[90] and cocoa sectors[91]. However, escalation for African coffee is evident only under the Japanese preference scheme and for elaborately prepared coffee in the US market (figures 8.9 and 8.10). For cocoa products, however, there is evidence of tariff escalation in some preference schemes in the *later* stages of the processing chain[92]. This is particularly pronounced under the Japanese scheme: cocoa beans enter at 0 per cent, cocoa paste at five per cent, defatted cocoa paste at 10 per cent, cocoa powder at 13 per cent and chocolate and elaborate products face tariffs of over 280 per cent.

62 The greatest concern, according to importers, is not tariff-escalation, but the need to meet with product standards, attain certification of origin and gain the trust of consumers for the product (see discussion of standards later in this chapter). However, while escalating tariffs are not a major problem, there is no reason why the remaining distortions cannot be eliminated.

63 Market conditions in some commodities are also controlled by a small number of large integrated companies, who capture most of the value of a product. In coffee, for example, 90 per cent of value goes to traders, processors and retailers[93]. Many African countries are tied into low value-added commodity production because of their lack of investment in processing equipment. African countries should be helped to diversify their production into dynamic and higher value added products through processing and moving into other sectors where they have a comparative advantage.

64 Various diversification funds have been recommended by the international community, in support of structural change in commodity dependent economies[94]. A more specific, concrete proposal based on Africa's comparative advantage is the AU/NEPAD African Productivity Capacity Initiative[95], the policy framework for Africa's industrialisation effort, with an emphasis on the involvement of the private sector, including science and technology issues and innovation (see Chapter 4). It addresses constraints that prevent African economies from actively participating in global trade and investment flows and aims to shift production into more value-added areas. Priorities are both sub-regional and sectoral[96]. However, large scale investment is needed given that success is dependent on a range of policies and infrastructure. A flexible facility has been created for sourcing funds. Agro-processing has been identified as a sectoral priority for all regions, but given constraints, investments of up to US$75 million would be required in plant and equipment[97]. Assistance would also be required in marketing strategies to access newer markets such as India and China (a potential indicator of success could be an increase in at least 50 per cent in the value of processed fruit exports). Donors should provide at least US$70 million[98] (excluding loans and guarantees) to ensure the facility can become operational.

8.3 Opportunities for trade

Africa's trade

65 The previous sections discussed how to build Africa's capacity to trade and engage competitively in global markets. But Africa must be able to enter these markets on better terms than it can now. While rich countries preach the benefits of

free trade, they do not practice it, and this hypocrisy continually sours global progress on trade. The following sections describe how to ensure there is a more level playing field for African trade.

66 Multilateral agreements provide the main framework of rules and terms for trade. Starting in 1945, developed countries made efforts to eliminate 'beggar-thy-neighbour' trade barriers. Up until the Uruguay Round (1986-1994) developing countries had little voice in trade negotiations, and as a result virtually no attention was given to the products in which poorer countries specialised. Thankfully there has been progress. The Doha Development Round of world trade talks is aimed at bringing down tariffs and other barriers to trade on the products that are most important to developing countries. These talks broke down at the Cancun Ministerial in September 2003, mainly due to the lack of development ambition. After some delays, talks are back on track. The WTO July 2004 Framework Agreement set broad parameters for talks at the Hong Kong Ministerial in December 2005. Given the failure in Cancun, this year is make-or-break for ensuring that Doha discussions achieve development progress, and Hong Kong is where concrete decisions must be made.

67 From Africa's perspective, we believe that certain principles should drive Doha Round conclusions:

(a) Creating a fairer international trading environment that removes the obstacles Africa faces in exporting its products, including making preferences work;

(b) Ensuring that Africa can benefit from a rules-based system, including support in trade negotiations[99] and in taking forward legal cases; and facilitating increased African membership[100] (see Chapter 10);

(c) Ensuring that Special and Differential Treatment works for Africa, prioritising development without resorting to legal disputes, with sufficient flexibility to allow trade reform to be achieved at a locally agreed pace – not forced through reciprocity or IFI conditionality – with appropriate sequencing, and within a framework of national and regional development and trade strategies;

(d) Developing ever more transparent and inclusive decision making at the WTO;

(e) Providing substantial support for building Africa's capacity to trade, and assistance with adjustment to trade reforms.

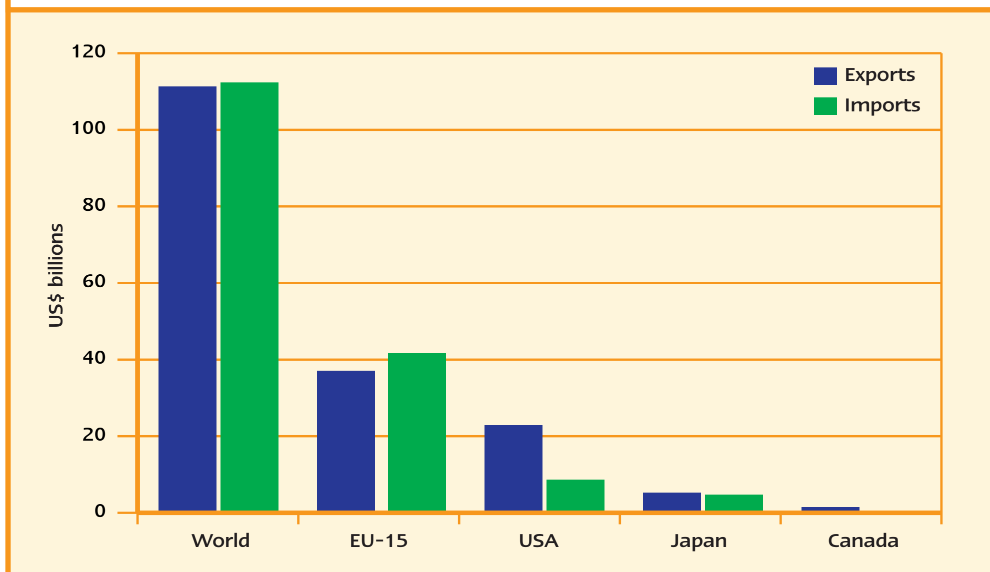
68 Ambitious achievements in the Doha Round will provide substantial gains to developing countries[101]. Gains to sub-Saharan African countries are relatively small in the short-term, but will increase in the long-term if the measures we argue in this report are put in place. In the short term, Africa needs to gain from improved access through more effective preference schemes – a relatively cost-free measure for rich countries to undertake, and receive 'aid for trade' to help it adjust to reduced market barriers. In the medium term, Africa needs to build its trading capacity, and this will have to be supported by sustained levels of infrastructure investment, amongst other things, as well as appropriate policies to design and sequence trade reform. High levels of support will be required from developed countries to assist Africa in these areas. Overall, Africa must boost its competitiveness to achieve greater benefits from Doha.

69 The potential of large gains reinforces the need for political will and leadership in achieving a successful development round. There are a wide range of estimates of gains from Doha, based on different assumptions, but all of these models show that only ambitious liberalisation in the Doha Round will provide significant gains for Africa. These gains will be enhanced if Africa further reduces its own trade barriers in appropriately sequenced ways, and if it can move quickly on a trade facilitation agenda. If the Round is

not ambitious, Africa may lose: serious barriers, particularly in so-called 'sensitive products' are likely to remain, while the value of Africa's preferences will be eroded.

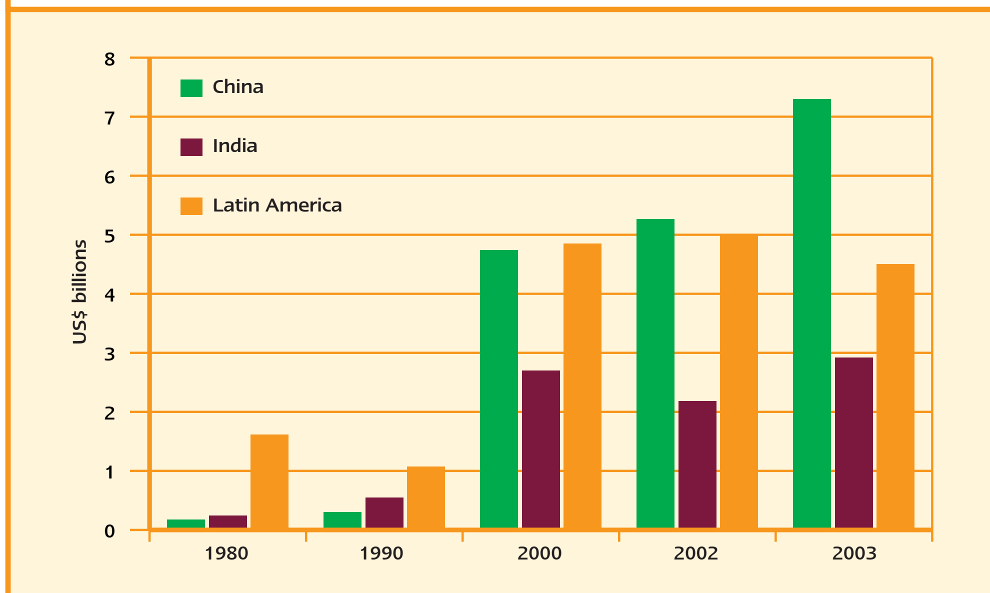
70 The misuse by developed countries of 'sensitive products' classification is a serious threat to Doha gains. It is estimated that if only two per cent of agricultural tariff lines in developed countries are classified as sensitive, receiving only a 15 per cent cut, then three-quarters of global welfare gains will be lost[102].

Figure 8.11 **Sub-Saharan Exports to the World and QUAD (EU, US, Canada, Japan) Countries, 2003**



Source: IMF Direction of Trade Statistics, 2004

Figure 8.12 **Sub-Saharan Exports to India, China and Latin America**



Source: UNCTAD Handbook of Statistics, online

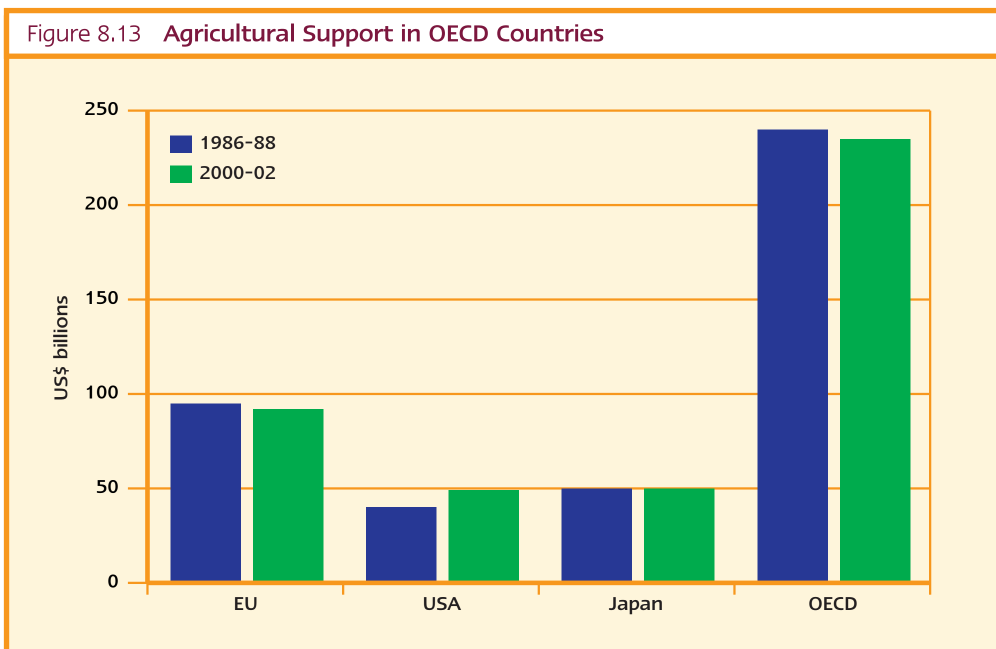
71 Africa also needs to move away from reliance on its old trade links with Europe, and expand its trade in other markets, particularly in the south (see Figure 8.11 for recent progress). As Europe expands its membership to include poorer nations, this relationship will change anyway. New markets are important, for example, in recent years trade between China and Africa has grown dramatically. In 2004 it reached over US$20 billion[103], an increase of more than 50 per cent from the previous year. South-South trade has been growing rapidly, and now over 40 per cent of developing country exports go to other developing countries[104] (see Figure 8.12). The US imports more from developing countries than it does from developed countries, and 40 per cent of its exports are to developing countries. This is what Brazilian President Lula has called the 'new geography of trade and economics', and thus his call for a 50 per cent reduction in tariffs between developing countries[105].

8.3.1 Agriculture in the Doha Development Agenda

72 Agriculture is the most important sector in the majority of sub-Saharan African countries, and for the majority of people, as discussed in section 7.3.3. The majority of African countries do not have valuable minerals to exploit – only nine are major oil exporters. Although the sector is relatively small in value terms for all of Africa (compared to oil and manufacturing), it makes up 70 per cent of employment[106] or more, and dominates the exports of most countries.

73 Agriculture accounts for 30 per cent of African GDP directly, and for a far higher proportion if activities related to agriculture are included[107]. It is an area of production dominated by poor people (see agriculture section in Chapter 7). In contrast, agriculture is not of great economic importance to most developed countries, accounting for a few per cent of GDP or less, and only around five per cent of the population depend on farming, in contrast to that in Africa. Yet the agricultural sectors of most OECD countries are the most heavily subsidised and protected sectors of their economies, and the situation has not changed much in the past few decades (see Figure 8.13).

Figure 8.13 **Agricultural Support in OECD Countries**



Source: OECD

74 Total support to farmers in OECD countries in 2003 was US$350 billion – US$1 billion a day[108]. Of this, US$257 billion was support to producers and US$52 billion was support to R&D, training, marketing and promotion. Most support to producers is provided through market barriers that keep prices artificially high – some US$160 billion – as opposed to the US$97 billion paid directly to producers. The EU, US, and Japan account for 90 per cent of total OECD support, and the bulk of this support is for milk, meats, grains and sugar[109]. This support is 16 times OECD aid to Africa (US$22 billion in 2002). Shifting one-seventh of these resources into aid would double global aid volumes.

75 These government hand-outs to farming come at huge expense to EU consumers and to tax-payers, as well as to farmers in poor countries. And worse still, these hand-outs go mainly to the rich, to companies and to landowners. Only four per cent of EU support goes to the 25 per cent smallest farms, and this is roughly the same in the US; the largest 25 per cent of farms receive over 70 per cent of support, reaching 80 per cent in the US[110]. The costs of the CAP are felt hardest by poor people (food items in particular consume relatively more of their income) – the equivalent of over US$1,500 added to the annual food bill for a family of four[111]. Consumers in rich countries, i.e. the public, have the most to gain from ending the waste of agriculture support and protection.

76 These concerns have all been raised strongly in our five regional business and civil society discussions in Africa, and in the majority of submissions we have received on trade issues.

77 Developing countries face a huge array of protectionist measures in developed country markets. These barriers include high 'tariffs', a tax applied at the border on imported goods. Average applied tariffs in agriculture in the EU are 22 per cent, and in the US 14 per cent, some three-four times higher than in manufactured goods. There is also substantial use of 'tariff peaks', or very high duties on specific products. These affect over 40 per cent of agriculture tariff lines in the EU and Japan. Maximum tariffs in the US on fruits and nuts exceed 200 per cent, and on meat in the EU, 300 per cent. 'Tariff rate quotas' limit the volume of imports and 'specific duties' on 'sensitive products' are particularly onerous[112]. 'Tariff escalation' is another barrier, which has been discussed earlier. For most sub-Saharan products, preferential access schemes reduce the impact of these barriers, although barriers still remain. Even within these schemes, the complexity of the remaining barriers undermine entry. That is why the simple and complete elimination of all of these barriers to African exports is so important.

US farm reform

78 In recent years, US agricultural reform has been reversed, with farm subsidies actually increasing, after earlier reductions. The US Farm Bill in 2002[113] institutionalised emergency support to US farmers – with a 10-year value of US$190 billion, an increase of US$83 billion over previous programmes. There are also stronger links between subsidies and production decisions. This approach leads to oversupply and dumping of agricultural produce; US policy on cotton is one extreme example of the harm this can cause to poor people in Africa (see cotton section that follows).

79 The US is also the largest user of export credits[114], which can provide the equivalent of subsidies, partly through reducing the cost of credit, and partly through reducing risk by providing government guarantees and credit insurance. These US programmes are estimated at around US$5.5 billion under the 2002 Farm Bill[115]. The 2004 WTO July Framework Agreement incorporates a commitment to eliminate export subsidies, although no date has been set for elimination.

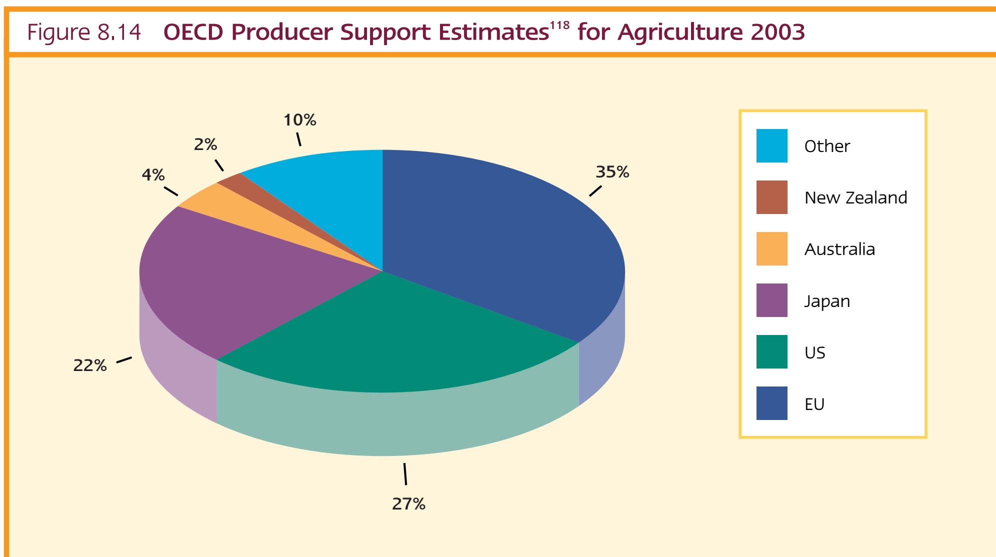
80 US support for agricultural exports is essentially 'welfare for farmers', but as in Europe, the main beneficiaries of these hand-outs are mainly the rich[116]. Worse than this, this welfare is also paid for by poor American consumers and taxpayers. It is estimated that tariffs cost the average low-wage worker in the US the equivalent of five days income[117]. The Farm Bill will expire in 2007, and discussions now, including recent measures to reduce farm payments made in the 2005 budget, offer opportunities for the US to reform agricultural support.

EU Common Agricultural Policy reform

81 EU policy on agriculture is guided by the Common Agricultural Policy (CAP), which arose in the aftermath of the Second World War, and was intended to promote food security through guaranteeing agricultural prices at high levels to stimulate production. But without credible and further reform of the CAP, the EU will not be able to contribute meaningfully to a development-friendly outcome in the Doha Round, and lack of progress in the EU will mean the USA and Japan will not feel pressure to address this politically difficult area.

82 As Figure 8.14 shows, the EU is the largest protector of agriculture in the world. The EU also accounts for 90 per cent of OECD export subsides in agriculture. Gross support from consumers and taxpayers to farmers constitutes only two per cent of farm receipts in New Zealand, but around 20 per cent in the US and Canada, 35 per cent in the EU, and 58 per cent in Japan. Japan spends 1.4 per cent of GDP on agricultural support, the EU 1.3 per cent, and the US 0.9 per cent.

Figure 8.14 **OECD Producer Support Estimates[118] for Agriculture 2003**



Source: OECD, 2004b

83 The CAP affects other countries in a number of key ways: by increasing world supply, thus lowering world prices[119]; by artificially raising EU prices; by excluding others from its markets; by heavily subsidising exports and by undermining world price stability[120]. While the EU on the one hand is being asked to assist countries facing commodity shocks (see Chapter 9), it also helps to create these shocks through its agricultural policies.

84 Because of its preferential access to EU markets, Africa has in some ways gained from CAP distortions. Beef from Botswana has not had to compete with beef from Argentina in EU markets, nor has sugar from Mauritius with Brazil's, and some African

producers gain from artificially high prices in the EU – in sugar, for instance, where prices are almost three times world prices[121].

85 These gains will end as global trade reform progresses. Ultimately the CAP and other OECD agricultural protection will reduce, and Africa needs to gear up for this. And while Africa has gained from CAP distortions and protectionism, it has also not yet faced the full measure of the impacts developed country protectionism creates in world markets, because its supply capacity is so poor. If Africa produced substantial export-quality sugar and beef, then it would be competing with heavily subsidised EU and developed country products in other markets. If Africa can build its supply capacity, as we argue it must, then CAP reform – as with other OECD agricultural reform – will quickly become a precondition of Africa. Without reform, African exports would be undermined by heavily subsidised EU and OECD production.

86 Problems with the CAP have been recognised, and the EU has undertaken a number of important and difficult reforms, making progress that provides the foundation for further reforms. These include 'Agenda 2000'[122], and then in 2003, the begining of the gradual decoupling of payments to farmers from production. Although the overall level of support to producers is projected by the OECD[123] to barely change, the new structure is intended to be less trade distorting. Further progress was also made when the EU agreed to phase out export subsidies in the 2004 WTO July Framework Agreement.

87 We believe that these reforms must be accelerated and that the completion of the Doha Round offers the best opportunity to do so. Given that the CAP absorbs almost 40 per cent (around US$40 billion) of the EU budget and that the EU economy is growing at only 0.8 per cent, it is high time that European governments paid more attention to the opportunity costs of this waste[124].

Protectionism in action: cotton, sugar, fisheries

88 Developed-world protectionism is much more damaging for some products than others. Cotton, sugar, and fish highlight some of the key problems.

89 *Cotton:* US support to its cotton farmers was US$3.9 billion in 2002, driving down world prices by 10-20 per cent, with annual income losses in West African cotton producing countries estimated at US$250 million[125]. This support is expected to stay at these levels for the next six years, ensuring that US farmers get twice the current world price for cotton. The EU provides up to US$1 billion in support to EU cotton production. These hand-outs have appalling consequences, undermining the incomes of more than 10 million people who rely on cotton in West Africa. Removal of US and EU cotton support is estimated to increase sub-Saharan Africa cotton exports by 75 per cent[126]. African farmers are much more competitive than their US and EU counterparts, producing a pound of cotton for 21 cents in Burkina Faso, compared with 73 cents in the US[127]. Brazil, with formal support from Benin and Chad, recently challenged US cotton support in the WTO, and a panel ruling in September 2004, to which Benin, Burkina Faso, Mali and Chad contributed, has found that much of US support to cotton is against WTO rules[128].

90 *Sugar:* Sugar is another commodity that is highly protected through tariff and quota barriers, and receives major subsidies[129]. OECD support for domestic sugar producers is roughly the same as the total value of developing country sugar exports. It is estimated that a move to free trade in sugar would raise world prices by something close to 40 per cent, and could generate around US$4.7 billion in welfare gains for the developing countries[130]. The EU, the biggest culprit, pays such high prices that sugar beet is grown in places where it is economically irrational and inefficient to do so. And while it provides preferential access to 1.3 million tonnes of ACP sugar, it dumps 4.1 million tonnes of

subsidised sugar onto the world market. In the US in the 1990s, the protection of just 2,300 sugar industry jobs cost US$800,000 each[131]. A complaint by Brazil, Thailand, and Australia, has led to a WTO panel ruling that the EU is breaking WTO rules in exporting excessive amounts of subsidised sugar. Reform to the sugar sector in the EU is expected to reduce EU prices and production quotas; this will benefit some developing countries but will lead to serious adjustment difficulties for others, including the sugar sector in Côte d'Ivoire and Madagascar[132].

91 *Fisheries:* Seafood exports have grown in importance in Africa in recent years, with exports in SADC quadrupling to US$892 million between 1998 and 2001. By that date, African exports to the EU had reached US$1.75 billion[133]. Yet the EU subsidises this sector heavily, at around US$1 billion annually: US$280 million of which supports 850 vessels to fish outside EU waters[134]. When coupled with highly onerous and perversely worded rules of origin (see section 8.3.2), African exports to the EU are even further undermined. Fishing agreements that allow European boats to fish African waters are often badly negotiated. They only return around US$0.8 billion in royalties, and EU tuna boats in five West African states pay less than one per cent of the value of the catch to these governments (the governance aspect of this problem is also addressed in Chapter 4). Transparent and competitive tendering, including more organised action at the regional level, could go some way to ensuring Africa gains from the contracts it offers. At the same time, the subsidised EU fleets have superior equipment, which means they can catch far more than the African boats.

Farm reform – a way forward for Doha

92 An ambitious Doha Round could provide global welfare gains in the order of US$80-250 billion[135], potentially lifting 100 million people out of poverty[136], depending on assumptions. Those who gain the most are consumers in developed countries, who will pay less for goods, and developing countries, in part because of their own tariff reductions. Two-thirds of global gains go to developed countries, who still account for the majority of world trade. Two-thirds is provided by agriculture reform, because it is the most distorted market. But such gains will only be realised if the Round is ambitious. For Europe, the US and Japan – there are few real costs, and huge gains; for their economies and for their public. For those affected, proper measures can be put in place to address rural development and environmental considerations, improving livelihoods, not harming them.

93 When the Doha Round was launched in late 2001, it was intended to be a development round; this should be the end result. Business as usual will not be enough. The Hong Kong ministerial, planned for the end of 2005, must not fail, as the Cancun ministerial did, for lack of ambition and for ignoring developing country concerns. The stakes are too high, including achievement of the Millennium Development Goals. Concerns that Doha's development ambitions will be too low have been raised many times during our consultations with civil society, with business, with African trade experts, and in the analysis done by the UN Millennium Project, the World Bank, the FAO[137] and others.

94 Africa will only gain from an ambitious Doha Round if this is backed by strong developed country support to building its capacity to trade, and helping it adjust to trade reform. Anything less will fail Africa. Lack of ambition on these three fronts – an ambitious Doha Round; building the capacity to trade; and support to trade adjustment – will lead to Africa losing, not benefiting from Doha[138].

95 While an ambitious Doha Round Round delivers substantial global benefits, immediate gains to sub-Saharan Africa are quite small, around US$0.7-1.5 billion[139]. This is primarily because sub-Saharan Africa's capacity to trade is so weak; in the short term it cannot make best use of these new opportunities. However, in the long term it can do

so, with dynamic gains of around US$4 billion, but only if supported by the measures described in this report. The history of past trade rounds should lead us to worry – past rounds maintained rich country protectionism, while aid levels actually reduced, and debt repayments grew.

96 But delivering a successful round will also mean addressing the challenges of adjustment necessary in order to take advantage of new opportunities and help overcome difficulties – in both developed and developing countries. Large reforms will be necessary in the agricultural sector of developed countries. But this does not have to be a lose-lose scenario. A win-win scenario would be one where the huge resources squandered on protection and subsidised production are re-allocated into an ambitious developed country agenda for rural development and environmental protection. This would build on current progress, for instance in Europe, to reduce trade-distorting support. Some of the resources saved should be used to help poor countries, including in Africa, to also adjust to a more open trading environment. In particular help should be provided to those countries in Africa that are hit hard from losing the value of their preferences, loss of tariff revenue, and those who would face higher priced food imports.

97 The kind of Development Round we describe will provide Africa with a more open global trading system with the right market incentives to develop its comparative advantages. Larger and more open markets in developed and developing countries will provide Africa with more opportunities. Increases in world prices that will arise in some products from the removal of subsidies and support, will provide Africa with the incentives to export rather than import.

Food imports

98 Overall Africa would benefit from a fairer trading environment, but reductions in OECD protection and subsides may have adverse effects in the short term[140]. Sub-Saharan Africa now needs to import food, with imports almost doubling over the 1990s to around US$10 billion (excluding fisheries) between 2001-2003; of which 25 per cent is in grain products such as maize, rice and wheat[141]. If substantial progress is made with agricultural liberalisation in the Doha Round world food prices may increase in the short-term, and some African food-importing countries could face a considerable adjustment challenge. In the long-term impacts will differ depending on the capacity of countries to take advantage of a more open and less distorted international trade system. Support to smooth the short-term transition will be important, and again, as we have said earlier, a wide range of measures is necessary to help build supply-side capacity, including in food production, storage and markets. Some countries will need temporary assistance to ensure that national food needs are properly met as food prices rise.

Trade in non-agricultural goods and in services

99 Liberalisation of trade in non-agricultural goods (Non-Agricultural Market Access – NAMA) is more advanced at a multilateral level than for agriculture, so average tariffs are already relatively low. For sub-Saharan Africa, the key issues now are developing appropriate industrialisation and manufacturing strategies, coupled with appropriate sequencing of trade reform, and building the capacity to trade, rather than only gaining access to markets. Chapter 7 covers a number of these issues, as does the later part of this chapter.

100 Trade in services is constrained not only by tariffs but also by a wide range of non-tariff barriers, and by the policy positions of countries. The liberalisation of trade in services offers potential benefits to African countries both as providers and users of labour intensive services. However, such liberalisation is best managed within national development strategies, rather than through multilateral trade negotiations in the

Box 8.7 **Trade Barriers – Standards**

If the EU used international standards, instead of its own, for traceability requirements and regulations on pesticide residues for agricultural imports, African banana exports could grow by US$410 million a year. By participating in international standards, Africa could gain up to US$1 billion a year in additional exports of nuts, dried fruits and other agricultural commodities[144]. Research shows that that when standards are set, impact assessments should be undertaken during the design of standards and following implementation.

New challenges include EU requirements for traceability of produce throughout the food chain. (EC Regulation 178/02). Although only applicable within the EU itself, private sector importers/distributors are requiring similar sophisticated tracing and tracking systems to be adopted down the import value chain to the farmer. The many smallholders who constitute the core African supply base for many horticultural products do not have the resources to comply with these demands.

The latest Regulation (EC Feed and Food Controls 882/04) however is likely to have the greatest impact on African-EU trade. This Regulation requires that the national authorities of exporting countries guarantee that their food safety control systems will in practice deliver a level of food safety, for exported produce, that is equivalent to that in the EU itself. This requirement will impact most severely on the plant related sector (as the animal, including fish, sector is already closely controlled).

Source: Various sources

105 Health standards such as sanitary and phyto-sanitary (SPS) standards can be serious barriers to trade. Even though the effect may be quite accidental, it can be highly damaging. Consumer concerns in rich countries, increased technological detection capacity and so on, have created SPS standards that are now major barriers to African exports. It is not unwillingness to meet these standards that is the problem, nor disagreement with their rationale. The problem is that poor countries in Africa are not equipped to meet these demands.

106 Two key actions are necessary to help Africa. The first is, while ensuring the health needs and consumer concerns of developed countries are met, to ensure that standards set are not unnecessarily stringent. A 'development test', including an impact assessment, should be applied to existing and new standards to ensure that the health and other gains are essential, and the impact on developing countries considered. African governments should be consulted in the design of such standards, with capacity strengthened in order to make appropriate inputs. The Standards and Trade Development Facility should be fully supported[145]. The scope to harmonise standards should be explored so that African exporters are able to best identify and meet such standards.

107 Secondly, help is needed in meeting these standards. Standards for different markets differ and the cost of demonstrating that they have been met is often punitively high. These include product standards which govern quality, and process standards which set conditions under which products are produced. Meeting these standards can also be an opportunity: compliance will mean African exports can enter markets throughout the world. The recent EU regulation on feed and food law (see Box 8.7), will apply from 2006 and will require countries and farms to have in place adequate hygiene protection, including food safety laws, an enforcement agency, a court system to adjudicate, and evidence that this works in practice. Africa will need substantial support to meet these and similar requirements[146]. Infrastructure investments (such as laboratories, inspections)

and training costs could be in the order of US$5 million per country, or more if the implications on the structure of production are taken into account. The cost of compliance with EU hygiene standards in the fish-processing sector in Kenya were over US$0.5 million alone. But a lower bound estimate of almost US$250 million for sub-Saharan Africa[147] could be made – a small investment for major gains.

Trade Related Intellectual Property Rights (TRIPs)

108 The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), negotiated in the Uruguay Round, introduced intellectual property rules into international trade. NEPAD has called on the WTO to ensure African countries are given sufficient technical assistance and advisory support to meet TRIPs requirements[148]. Although the role of TRIPs in preventing access to medicines for life-threatening illness is the most visible issue (see Chapter 6), there is another development dimension to intellectual property through the promotion of innovation, knowledge, and creative skills of poor people[149].

109 Piracy and the ability for artists to control reproduction of their works is an area of concern. For example, Kente cloth is a traditional Ghanaian form of weaving that depicts significant life events and reflects the history, philosophy, ethics, and moral values in Ghanaian culture. When a US supermarket chain reproduced the designs of a Ghanaian artist Gilbert 'Bobbo' Ahiagble, who works to preserve the tradition of Kente, he had no legal recourse since he had no legal protection for his designs[150]. Developed countries should increase technical support to African countries and regions for the extension of intellectual property rights to indigenous innovation and knowledge.

Free Trade Agreements (FTAs)

110 Recent years have seen a rapid expansion in Free Trade Agreements (FTAs). Over 170 are in force, some of them between developed and developing countries. For developing countries, the greatest gains will come from the Doha multilateral process, not through FTAs. While FTAs may provide benefits, it is important that they do not railroad developing-country governments into undertaking commitments that go beyond existing multilateral agreements. Recent FTAs negotiated by the US, for instance, include measures to extend patent protection beyond that agreed in TRIPs (so-called TRIPs +), or to relax capital account controls.

111 Developed countries should also ensure that sufficient time and flexibility are built in to FTAs to enable African countries to adjust to a more open trading environment, with careful sequencing. Reciprocal requirements should be reduced to the minimum, and without the additional burdens described above. This is a serious concern for Africa in the on-going Economic Partnership Agreement negotiations (see below). African countries should have the flexibility to implement reform at an appropriate pace, and in line with their own development strategies. Forced liberalisation will not work. A review of Article XXIV in the GATT which sets out requirements for reciprocal opening – currently for both parties to substantially eliminate all trade barriers between each other – may be useful in order to ensure the Article better meet the needs of developing countries and regions by allowing them the flexibility to protect sectors as necessary.

EU/ACP Economic Partnership Agreements

112 The EU is currently negotiating a series of such bilateral agreements – Economic Partnership Agreements (EPAs) – with the African, Caribbean, and Pacific countries. These EPAs will replace the current Cotonou preferences, which currently operate under a WTO waiver that expires at the end of 2007. The new agreements are opposed by many

stakeholders, who fear that EPAs will force Africa to open to EU exports, a genuine concern. The European Commission (EC), which acts on behalf of the EU on trade, must ensure that EPAs support development needs. This means: not forcing poor countries to liberalise; pursuing a non-mercantilist approach; allowing individual African countries to sequence their own trade reforms in line with their own poverty reduction and development plans; and providing additional financial assistance to support developing countries in building the capacity they need to trade and adjust to more open markets[151]. EPAs should be implemented in a way that reflects the principles set out above and changes will need to be made in order to do so. Any reciprocal requirements should not in practice cut across these principles - they should provide for substantial time-frames for all countries – over 20 years if necessary. We believe that if implemented in this fashion, EPAs will offer major opportunities for Africa. The EC should commit itself more explicitly to this development-orientated approach, rather than a 'trade negotiator' approach that seeks concessions from ACP countries. This would build more confidence in current negotiations, and accelerate development progress. The ECA estimates that if properly implemented along the lines we describe, with sequencing which provides immediate unrestricted access to EU markets, and strong support to regional integration and in Africa's capacity to trade, EPAs could yield gains of up to US$8 billion for sub-Saharan Africa, with gains of US$1.2 billion from regional integration[152].

113 The EC's approach to EPA negotiations should ensure that EPAs prioritise developmental needs, reflecting the points set out above. The development test of EPAs should be a commitment up-front to provide duty- and quota-free access to the African regional groupings (or implement this immediately if the current Cotonou waiver can be modified); to reform immediately its rules-of-origin to allow global cumulation and 10 per cent minimum value-added in country of origin, in order to maximise the developmental impact of its preferences (see section 8.3.2); to provide substantial parallel support to accelerate regional integration and build Africa's capacity to trade; and to ensure reciprocal requirements are reduced to minimal levels and with appropriate timeframes (e.g. up to 20 years if necessary for some products). A review of Article XXIV of the GATT to reassess and reduce reciprocal requirements in free-trade agreements in order to prioritise development needs may be useful. It will be in Africa's interests to open up to EU and other regional imports, in a managed way, as cheaper imports and technology transfer would benefit African growth and poverty reduction. But this should be in line with Africa's own development strategies, not bound in trade agreements.

Making Special and Differential Treatment (SDT) work for developing countries

114 Currently developing country needs are addressed through SDT, which through the 'enabling clause' agreed in 1979, allowed preferential market access, limited reciprocity to levels 'consistent with development needs'[153] and greater flexibility in use of trade policy by developing countries. Many argue[154] that these approaches have not worked well in meeting development objectives. The Doha declaration called for a review of SDT with a view to 'strengthening them and making them more precise, effective and operational'[155]. As we have said earlier, Doha must deliver a development agenda; one key route to this is to ensure that WTO rules can work for developing countries. A committee chaired by Ernesto Zedillo has been created to look into SDT of developing countries. One mechanism it is exploring is whether to make legal recourse to dispute settlement[156] conditional on applying a test of whether trade policy under consideration meets development objectives. This test would focus on the likely net effects of not implementing WTO rules in favour of more development orientated trade policy, and on negative spillovers, and would allow greater discussion of development concerns, rather than merely the implementation of the rule of law. There are other complementary approaches, and we discuss one, aid for

trade, later in this chapter. We fully support the efforts of this panel, and call on developing countries to closely engage and support the outcomes of the committee.

Recommendations – ambitions for Doha:

- **Developed countries should ensure that the Doha Round of world trade talks makes development its urgent and absolute priority, in order to help Africa, and other developing countries, achieve the Millennium Development Goals. Developed countries should do the following: at the December 2005 meetings in Hong Kong, they must agree to immediately eliminate trade-distorting support to cotton and sugar, and commit by 2010 to end export subsidies and all trade-distorting support to agriculture. An early commitment to this would provide a powerful impetus for the Doha talks.**
- **However, the greatest gains will come from reduced protectionism. At the conclusion of the Doha talks developed countries should agree to progressively reduce all tariffs, to all countries, to zero by 2015, and reduce non-tariff barriers. There are few costs, but huge gains from these measures.**
- **Higher income developing countries should also do more to reduce their tariffs.**
- **Developed countries should agree not to invoke exemptions for 'sensitive products', since this will eliminate gains from tariff reductions.**
- **The Doha talks should conclude no later than the end of 2006 in order to make an early difference to Africa and other developing countries.**
- **While Africa will benefit from reducing its own tariff barriers, making development the priority for both Doha and other trade negotiations, including Europe's new trade agreements with Africa (EPAs), means allowing reform to proceed at a pace set by Africa, sequenced in line with their own poverty reduction and development plans, with liberalisation not forced through trade or aid conditions. Reciprocal demands should be reduced to a minimum, and over appropriate timeframes, up to 20 years or more if necessary. A review of Article XXIV of the GATT may be useful in support of this.**
- **This will also require making Special and Differential Treatment work better, by making legal recourse to disputes conditional on applying a 'development test'. African countries, for instance, may need to protect domestic agricultural producers on the grounds of food or livelihood security, and sustainable rural development, by exempting some agricultural areas from liberalisation.**
- **EPAs should also prioritise development more clearly through up-front commitment to EBA for all sub-Saharan Africa and reformed rules-of-origin.**
- **Developed countries should apply a development test when designing product standards, to assess impacts and minimise barriers they may create, and should provide resources to help Africa meet them.**
- **Shifting the resources allocated to OECD agricultural protection (US$350 billion) away from waste and into rural development and environmental investments will provide huge benefits to the OECD public, and would provide a win-win situation for those affected by reform; an allocation of one-seventh to aid budgets would immediately double global aid volumes, including to Africa.**

8.3.2 Making preferential access work for sub-Saharan Africa

Preference schemes used by Africa

115 Contrary to popular belief, Africa has substantial access to northern markets through a range of preference schemes. The key issue, as we have already discussed, is Africa's capacity to trade and gain from this access, and to build its capacity to compete in a world without preferences. More can be done to improve the short-term help that preference schemes can give to African exports by making them work better. And as we argue in the next section, more can be done to ease the transition to liberalised markets.

116 Some developing countries argue that the value of preferences should remain, in part by retaining the protectionism in OECD markets that make such preferences so beneficial. However, whilst a small number of countries in Africa may benefit, most would lose. This is the wrong path for Africa. We have argued earlier that OECD market reform will eventually happen, and the value of preferences will erode. Africa will then have to compete in a global market place. A more competitive Africa will gain far more from a world without protection, than it will from preferences in a protected world.

117 Preferential access schemes offer developing countries additional tariff cuts below the 'Most-Favoured Nation' rates agreed in the WTO, (see Box 8.8).

Box 8.8 Preference Schemes Used by Africa

Africa benefits from a range of preference schemes – the GSP (Generalised System of Preferences); the EU Cotonou agreement for African Caribbean and Pacific countries (ACP); the US African Growth and Opportunity Act (AGOA), and various LDC schemes of the EU, Canada, and Japan. There are 33 LDCs[157] in sub-Saharan Africa, and 15 non-LDC African countries (Botswana, Cameroon, Cape Verde Côte d'Ivoire, Republic of Congo, Gabon, Ghana, Kenya, Mauritius, Namibia, Nigeria, Seychelles, South Africa, Swaziland, and Zimbabwe). See Figure 8.15.

EU Cotonou Scheme: Cotonou is a very open scheme, with enhanced preferences beyond those in the GSP scheme, and with protocols for bananas, beef, veal and sugar. This incorporates all of SSA excluding South Africa.

Everything-But-Arms (EBA): The EU offers duty-free and quota free access for all goods from LDCs under the Everything But Arms (EBA) Agreement, and is part of the EU GSP scheme, but for LDCs. This scheme was introduced in 2001 and is permanent. Full access for bananas, and for rice and sugar is being phased in by 2006, and 2009 respectively.

AGOA[158]: The US introduced this scheme in 2000, amending the US GSP scheme to reduce tariffs and offer improved access to some African countries for a limited number of products, including in textiles and clothing, up to 2008. In 2004, the scheme was extended to 2015. Low-income countries (defined by US as those with annual per capita income below US$1,500) can receive a waiver on restrictive rules of origin. This covers 24 LDCs and 13 non LDCs in SSA.

Canada: In 2003 Canada expanded its GSP scheme to cover substantially all products from LDCs, including textiles and clothing, with the exception of a limited number of products (eggs, poultry and dairy), along with liberal rules of origin.

Japan: In 2000 and 2003, Japan has progressively expanded the number of industrial and agricultural products from LDCs receiving duty-free access. This covers 31 SSA LDCs except for Djibouti and Comoros.

Source: Brenton, 2004a, b; Stevens, 2004b and others

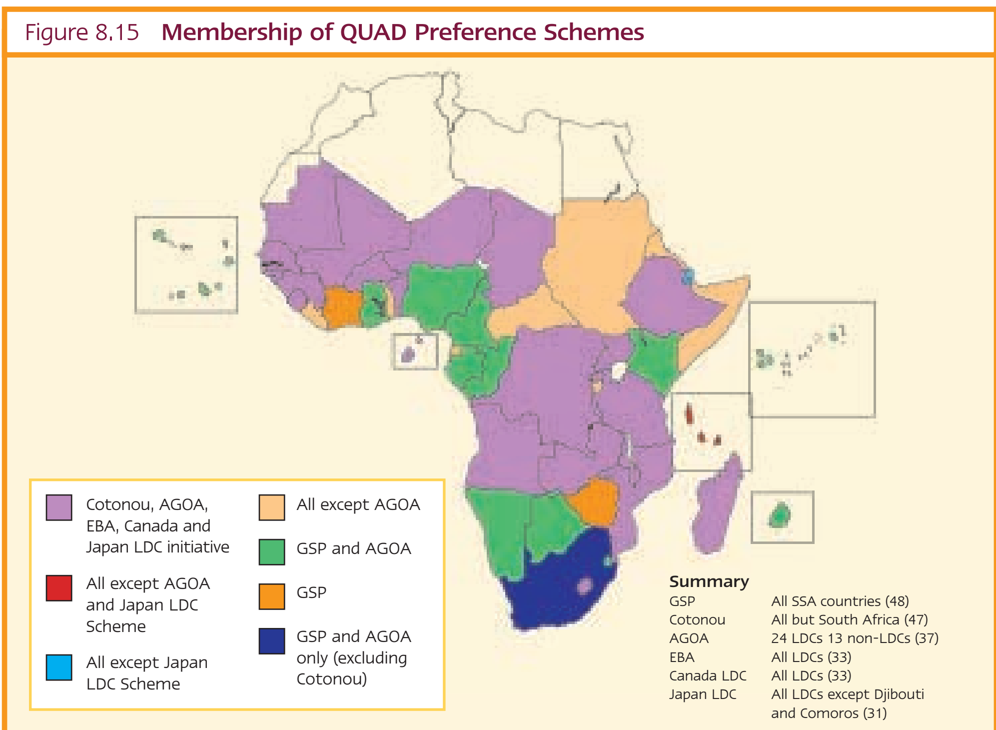
118 In the process known as 'preference erosion', the overall value of preferences will be reduced, as reductions in general tariff levels are agreed through the WTO, or other preferential arrangements are agreed, or changes occur in domestic market prices. In the long term, this will be good for Africa, as it will smooth the region's integration into the wider world trading system, lead to growth that will expand market opportunities, and stop the distortion of incentives within African countries introduced by the preference. Although in the short term, there will be costs, these can be overcome through a number of measures.

119 Firstly, making existing preferences work effectively would provide a temporary boost in access. When coupled with other measures to increase trade capacity outlined in this and other chapters, this access would help Africa expand its exports, build its competitiveness, and get ready to compete more effectively in a global market with reduced tariff preferences.

120 Secondly, such measures will need to be coupled with assistance to address the adjustment challenges arising from preference erosion (see section 8.3.3), as well as support to shift away from a reliance on preferences. These two areas of assistance would go some way to addressing the concerns of those African countries that are opposed to multilateral liberalisation, in particular those few countries who wish to maintain developed country barriers in order to continue to benefit from preferences. Such assistance could win African support for a successful Doha Round.

121 Gains from making these schemes work better are substantial, and a range of work has been done to look at the benefits of unrestricted access for sub-Saharan Africa to OECD markets. The World Bank has estimated yearly gains in income of nearly US$2 billion[159]. Recent ECA estimates are around US$4 billion[160] in annual income gains, and recent UNCTAD estimates are US$3-5 billion, including an increase in exports of around five to ten per cent[161], and a rise in government revenues of 10 per cent. While these are modelling estimates that

Figure 8.15 **Membership of QUAD Preference Schemes**



Source: Adapted from various sources

depend heavily on assumptions, and only show static gains[162], they do make it clear that gains are not negligible. It would cost developed countries relatively little – in the order of a few hundred million dollars – while gains could be a quarter of current aid flows.

122 The 2004 WTO July Framework Agreement called on all members to provide duty- and quota- free access to LDCs. This should be an immediate first step for developed countries and emerging economies. Expanding these schemes to cover non-LDCs is more complex.

123 One possible problem is whether offering improved access to low-income African non-LDCs is WTO-compatible. Differentiation between developing countries is generally not seen as compatible with WTO rules, and improved access for low-income African countries could be seen as unfair on poor countries outside Africa who do not benefit from it. However, EC negotiations on EPAs are intended to replace Cotonou preferences with WTO-compatible trade agreements, and in our view should lead to Cotonou/EBA-style access for all sub-Saharan low-income countries. Moreover, a recent WTO panel ruling on the EU's GSP in April 2004 offered an opening for additional differentiation. The panel pronounced that developed countries can offer different preferences to different developing countries, provided that the favoured countries meet certain objective and transparent criteria relating to their 'development, financial and trade needs' and that 'similarly situated' countries could also apply for these preferences.

124 Given Africa's current economic and poverty challenges, a strong case could be made for sub-Saharan African low-income countries to receive special treatment through preferences. On current trends, most people living on less than US$1 a day in 2015, will be living in sub-Saharan Africa, where they will make up over two-fifths of the population. By contrast, in South Asia the proportion below the poverty line will be 16 per cent, and in East Asia and the Pacific only two per cent.

125 The better-off developing countries – Brazil, China, India and South Africa, as well as Korea, Malaysia, and others – could contribute by increasing access to their markets. China recently introduced a preferential tariff arrangement with 25 African countries, with zero rates on 190 items (including food, textiles, minerals and machinery), which will apply from January 1, 2005[163]. The World Bank measure of trade restrictiveness shows that while sub-Saharan Africa is relatively open, South Asia and Latin America are less so, including towards low-income countries. As a first step they should offer duty- and quota-free access to LDCs in Africa.

Making preferences work

126 These preference schemes could be improved in four key ways: First by **expanding preferential access to cover other very poor African countries.** At the 2001 LDC Summit and again at Doha, developed countries committed to providing duty- and quota-free access for all products, to all LDCs; clearly this commitment is outstanding for the US, Japan and Canada and action should be taken. However, this is not enough. Other poor countries in Africa need this access too, if they are to achieve the MDGs. AGOA covers a mix of LDCs and non-LDCs in Africa, as does the EU's Cotonou scheme, while the most open EU and Canadian schemes focus only on LDCs. Allowing other low-income African countries such as Kenya, Ghana, Nigeria, and Côte d'Ivoire the same benefits would provide an important access boost, and assist regional integration. Extension of these schemes could draw upon the recent WTO panel ruling on the EU's GSP scheme to find ways of doing this that are WTO-compatible. This is a relatively cost-free and immediate way of assisting a region seriously off-track for achieving the MDGs. A strong case could be made in the WTO given the challenges faced by low-income sub-Saharan African countries compared to low-income countries in other, more dynamic regions. The EU could do this by committing up-front to

provide EBA-style access via the EPAs for all sub-Saharan African countries, not just LDCs, when this comes into force in 2008; the US could help by extending and improving AGOA; Canada and Japan by extending their LDC schemes.

127 Second by **relaxing rules of origin**. Preference schemes usually have a set of 'rules of origin' (see Box 8.9) that determine where products are deemed to have come from and therefore whether they are eligible for preferences. The rules of origin also specify the minimum amount of processing required on the imports of raw materials to confer eligibility. These rules can appear to be created purely to eliminate the benefits of the preference schemes, and can go to bizarre lengths in order to exclude products: for example, the EU fisheries rules actually specifies the nationality of the crew of fishing boats[164].

Box 8.9 **Trade Barriers – Rules of Origin**

Lesotho is a well-documented success story, with liberal rules of origin for textiles in AGOA leading to substantial growth in the garment industry and contributing to the creation of 40,000 new jobs. These gains show what may be possible in other sectors if rules of origin are relaxed. This success is possible because of massive protectionism in the textiles sector, where preferences therefore have high value. In 2002 Lesotho's exports to the US were some US$321 million, whilst exports to the EU were only US$18 million. The difference in flows is entirely due to more liberal rules of origin for AGOA, and more restrictive rules in the EU. The key difference is that the US allows Lesotho and other African LDCs in the scheme, to source fabrics globally ('global cumulation'), from the most competitive suppliers – a normal approach for EU firms, but not one allowed for Lesotho under EU rules. Origin under AGOA is conferred for simple assembly alone, leading to major development gains for Lesotho. This liberal rule is due to end in 2006-2007 however, with potentially devastating impacts for Lesotho and other African countries that now benefit, and with high social costs for their female textile workforce. The AGOA rule should be made permanent.

Source: Gibbons, 2003

128 Compliance with rules-of-origin under EBA and AGOA can impose costs on exports equivalent to tariffs of up to 10 per cent – enough to make the difference between being competitive or not. Only around half the products eligible for duty- and quota-free access under the EU's EBA scheme gain from this scheme, partly because Cotonou is only marginally less generous than EBA, partly because importers are used to using Cotonou, and partly due to rules-of-origin barriers[165]. These rules should be reformed so that they contribute to maximising country exports, while ensuring fraud does not take place. The Lesotho case shows what can be achieved in one sector. We recommend that all developed countries should allow global cumulation and specify a minimum of 10 per cent value-added in the country of origin.

129 Third by **increasing the product coverage to increase opportunities and remove distortions.** Many of the more sensitive products are protected to some extent under preference schemes; AGOA excludes some meat products, dairy, sugar, chocolate, groundnuts, tobacco and some prepared food[166]; LDCs have to pay full tariffs on 16 per cent of product lines in Japan's LDC scheme[167]; Canada excludes eggs, poultry and dairy; EBA currently excludes sugar, rice and bananas.

130 And fourth by **increasing certainty,** since uncertainty hinders investment. In making investment decisions, businesses are likely to look over a longer timeframe. Uncertainty over the longevity of preference schemes like AGOA or Cotonou increases risk and uncertainty about the likely return, deterring investment[168]. Predictability is important. Developed countries should overcome these problems by binding preferential tariff rates permanently under the WTO.

Recommendations – making preferences work for Africa:

Developed countries should immediately extend quota and duty-free access to all exports from low-income sub-Saharan African countries, simplify and relax rules-of-origin requirements, and work towards better co-ordinating their approaches. If all developed countries extended quota- and duty-free access to all low-income sub-Saharan African countries this could raise annual incomes in sub-Saharan Africa by up to US$5 billion, and would provide a temporary access boost to assist Africa while Doha reforms are implemented. Such provisions should be made in the context of an ambitious Doha Round, and be bound in the WTO to ensure predictability. Developed countries should allow 'global cumulation' and a minimum value-added of 10 per cent in the country of origin for all products.

8.3.3 Mechanisms to support trade adjustment and address preference erosion

131 The process of trade liberalisation, while providing overall gains to both developing and developed countries, also requires difficult processes of adjustment and short-term costs. The costs of these adjustments animate opposition to trade reform in both developed and developing countries.

132 Short-run adjustment costs will vary for different countries in Africa, but they include short-term export losses; balance-of-payments problems, including impacts on debt payments; loss of tariff revenue (where for some countries this is up to a quarter of government revenue[169]); impacts due to the end of quotas in textiles in January 2005; preference erosion; impacts of changes in world prices, particularly for food importers; new investment costs to support diversification; coping with the social costs of adjustment, including gender impacts, in sectors employing poor people and the impact of reduced income for some. Reduced income levels have knock-on effects, in that they can prevent poor people from meeting health costs or school fees. Strong support is vital in order to help Africa make these necessary adjustments, and major aid investments will be necessary to ensure that Africa can build its capacity to trade and gain from a more open world trading system.

133 The Commonwealth Secretariat[170] has calculated that US$1.7 billion will be lost annually in agriculture, textiles and clothing for Commonwealth countries now dependent on preferences (including African countries such as Botswana, Ghana, Kenya, Mauritius, Mozambique, Namibia, Swaziland, Zimbabwe).

134 The IMF[171] has proposed a Trade Integration Mechanism (TIM) as a way of providing IMF support to balance-of-payments shortfalls arising from implementation of WTO agreements – including preference erosion, expiry of textiles quotas, and changes in food terms of trade. The Fund estimates that Malawi, Mauritania, Tanzania, Mauritius, and Côte d'Ivoire would see losses in export values ranging between seven and two per cent, assuming a 40 per cent cut in preference margins as a result of multilateral tariff reduction. Support for adjustment would be through existing facilities such as the Poverty Reduction and Growth Facility (PRGF) or the Extended Fund Facility (EFF), and would provide increased predictability of finance. However, IMF resources would be

limited in size and scope, are relatively high cost, and adjustment caused by the country's own reforms are not covered.

135 OECD countries have well developed social security and welfare systems and are well placed to address the adjustment costs they face. This is not the case for African countries. Whereas in the UK and US spending on social safety nets comes to 10.5 and 14.1 per cent of GDP respectively, in sub-Saharan Africa the figure is 1.4 per cent[172]. At the same time, OECD countries would be able to shift resources from agriculture protection into rural development support and environmental investment; helping to support adjustment to trade reform, while investing in creating sustainable rural growth and employment.

136 Various ideas are being discussed to address the problem of developing-country trade adjustment. The committee chaired by Ernesto Zedillo, which is looking into Special and Differential Treatment of developing countries, is also assessing the case for additional support for trade adjustment and integration, and is reviewing various options for providing 'additional resources'. This work also includes recommendations on how most effectively to operationalise trade adjustment support and capacity-building.

137 The question of additional resources for adjustment and integration needs to be considered in the context of the huge net aggregate global gains that a successful Doha trade round would generate. One-seventh of the costs of OECD protection, if allocated to aid budgets, would immediately double global aid flows. Mobilising a serious trade support effort ('aid for trade' as well as 'aid for development') would not only help the negotiating dynamics but also the development relevance of the WTO. The recent work by the UN Millennium Project recommends an 'aid for trade fund', and we support this proposal. Efforts to support developing countries to date have been made on a best-endeavour basis and in a constrained environment for aid resources, trade-related issues have justifiably had to compete with priority sectors such as health and education. Recent reviews continue to indicate that 'aid for trade' remains limited, and so promises of additional support for trade have to be credible[173].

138 The 'Zedillo' group is looking at a range of options to provide additional resources, and should be fully supported in these efforts. Increasing direct assistance would be one of the best options but others include the engagement of the private sector, the International Finance Facility (IFF) (discussed in detail in Chapter 9), and setting aside an increment of tariff revenue on tariffs subject to reduction commitments agreed at the conclusion of the Doha Round. This last option proposes a transfer of an increment (say half a per cent) of currently raised tariff revenue in developed countries into an 'aid for trade' fund. Current levels of tariff revenue collection in OECD countries are around US$60 billion. Within the context of global liberalisation, as tariffs reduce, the levels of revenue collection will reduce, thus providing a time-bound framework and incentives to adjust.

139 In terms of an operational structure for support, building on the Integrated Framework makes considerable sense[174], expanded to cover all low-income countries in Africa (and elsewhere), not just LDCs. The Joint Integrated Technical Assistance Programme (JITAP) of the WTO, UNCTAD, and ITC may be another mechanism. The Integrated Framework builds on good practice for improving the quality of aid through greater donor 'harmonisation' and for additional aid to be provided in the context of a country's overall development strategy, but both could be better linked to build on the strengths of each.

Recommendations – delivering aid for trade:

Developed countries should agree, by the time of the Hong Kong ministerial at the end of 2005, to provide increased support to trade integration and the costs of trade adjustment so that sub-Saharan African countries can benefit from market

opening. Major increases in aid investments are necessary, as we have described earlier in this chapter, to build Africa's capacity to trade, particularly in infrastructure and communications. But assistance is also needed to address the impacts of preference erosion, loss of tariff revenue, social costs, and to provide support to efforts to undertake trade facilitation efforts and meet standards. This support would be provided through mechanisms developed over 2005/2006 and then implemented from the conclusion of the Doha Development Round. Access would need to be aligned with national development plans and poverty reduction strategies, and support would build on the success of the Integrated Framework rather than create a new mechanism.

8.3.4 Making trade policy consistent with aid policy

140 It is important that rich countries increase the coherence of their policies towards developing countries. What they provide in aid, is undermined by the appalling trade policies described earlier in this chapter, that hinder Africa's growth and poverty reduction prospects. However, trade policy could also become more consistent with aid policy. The Commission proposes elsewhere in this report that aid to Africa be doubled. Aid can be used only for imports, so the proposal has major implications for Africa's trade. Unless trade policy is properly aligned with this new aid policy, increased aid could actually have perverse effects on export diversification.

Aid is imports

141 Ostensibly, aid can be used to pay for anything – more drugs for health clinics or more teachers for schools. Generally, the drugs will be imported, but the teachers will be local. Imported drugs require foreign exchange, which aid supplies. By contrast, teachers need to be paid in local currency; aid comes in foreign currency and so must be sold to generate this local currency. People buy this extra foreign currency only if they want to purchase extra imports. Thus, either directly or indirectly, extra aid can be used only for extra imports.

The problem of real exchange rate appreciation

142 The problem posed by a quantum increase in aid is that people will normally want to purchase a lot of extra imports only if the imports get cheaper. As donors increase the supply of foreign exchange, this happens automatically: the local currency appreciates, cheapening imports in local currency terms. This is good news for consumers of imports in Africa – often the higher-income groups. But it is bad news for exporters – whose incomes go down: in Africa these exporters have often been small farmers.

143 Not only does exchange-rate appreciation have adverse distributional consequences; it also fundamentally frustrates export diversification. Indeed, exports are liable to contract, retreating into a yet narrower range of commodities. In Africa the classic example of this process came when foreign-exchange earnings from oil wiped out Nigeria's agricultural exports. It is vital that a big push on aid should not lead to such unintended consequences.

144 It is sometimes imagined that fancy strategies by the Central Bank – 'sterilisation' to use the technical term – can avoid the problem. This is an illusion. 'Sterilisation' in effect means the strategy of not spending the aid: just leaving it sitting in foreign exchange reserves. This is clearly not the best use of aid. Some developing countries are so scared of the effects of exchange rate appreciation on their exports that they even adopt a strategy of 'negative aid'. China is currently running what amounts to a huge aid programme to the USA, building up a stock of US Treasury Bills, to avoid allowing its exchange rate to appreciate.

Trade policy to the rescue

145 Yet there is a simple way of reconciling a doubling of aid with the maintenance of export competitiveness: aid policy and trade policy need to work together. Doubled aid means a big increase in Africa's *supply* of imports. To prevent exchange rate appreciation, this has to be matched by a corresponding increase in the *demand* for imports. This is what trade policy can do. By reducing tariffs and other impediments to imports, African governments can raise the demand for imports *without lowering the incomes of exporters*. This is why trade policy is preferable to allowing the exchange-rate appreciation.

146 By focusing on the barriers to imports, governments can also be more selective in who benefits. Whereas exchange-rate appreciation benefits the rich, selective trade liberalisation can be designed to benefit ordinary people. For example, tariffs can be reduced on bicycles and trucks, but not on cars. If customs procedures are simplified for inputs into the production process, costs of production will fall and jobs will be created.

Recommendations on Trade

Increased trade is vital to increased growth. Africa's share of world trade has slumped to just 2 per cent from 6 per cent twenty years ago, and Africa has fallen behind its competitors. Africa faces a huge challenge if it is to reverse this and catch up. African governments must drive this process and be allowed to develop their own trade policies. Action in three key areas by African countries and the international community, working together, could make this happen by: supporting African-owned strategies for building the capacity to trade; dismantling the rich world's trade barriers through the Doha Round of world trade negotiations; and providing transitional support to help Africa adjust to new trading regimes.

Improving Africa's capacity to trade

- Africa must increase its capacity to trade. It should remove its own internal trade barriers between one African country and another. Measures to facilitate trade will be key, including reform of customs and other regulations. And it must increase efforts to achieve greater economic efficiency through integration and increased co-operation within African regions. Some of these steps will be relatively easy and low-cost.
- Africa should do more to improve the economic environment for farmers and firms, backed up by major investments of aid from international donors to ensure Africa can produce and trade competitively. Funding for infrastructure should, in part, be spent on improving African transport and communications to bring down costs.

Improving Africa's access to the markets of the rich world

- Developed countries should ensure the Doha Round of world trade talks makes development its absolute priority at the December 2005 meetings of the WTO in Hong Kong. The Doha talks should conclude no later than the end of 2006 in order to make an early difference to Africa and other developing countries.
- Rich countries must agree to eliminate immediately trade-distorting support to cotton and sugar, and commit by 2010 to end all export subsidies and all trade-distorting support in agriculture when they meet in Hong Kong. At the conclusion of the Doha talks they should agree to reduce progressively all tariffs to zero by 2015, and reduce non-tariff barriers. By doing this they will cut massive wasteful spending, and provide huge benefits to their own public, and to Africa and other developing countries.
- Higher-income developing countries should also do more to reduce their tariffs and other barriers to trade with Africa.
- In making development a priority in trade talks, including in the new trade agreements Europe is currently negotiating with Africa, liberalisation must not be forced on Africa through trade or aid conditions and must be done in a way that reduces reciprocal demands to a minimum. Individual African countries should be allowed to sequence their own trade reforms, at their own pace, in line with their own poverty reduction and development plans. Additional financial assistance should be provided to support developing countries in building the capacity they need to trade and adjust to more open markets.
- Special and Differential Treatment must be made to work better for Africa and other developing countries, by making resort to legal disputes conditional on assessing development concerns. A review of Article XXIV of the General Agreement on Tariffs

and Trade in order to reduce requirements for reciprocity and increase focus on development priorities may be useful.

- Although Africa wants to meet developed country product standards, it is struggling to meet the costs of doing so. Rich countries should apply a development test, including an impact assessment, when designing these standards, to minimise the barriers they may create, and urgently provide help to meet them.

Helping Africa adjust to new trade regimes

It will take time to build Africa's capacity to trade, and to deliver reform in the Doha Round. During this period, Africa will need transitional support if it is to make progress.

- Developed countries should remove all barriers to all exports from low-income sub-Saharan countries, by extending quota and duty-free access to all of them. This will cost developed countries very little. They should cease to apply rules-of-origin requirements in a way designed to hinder rather than help African exporters, by allowing Africa to source inputs from anywhere in the world, and requiring only that they add a minimum of 10 per cent of value in their processing. Europe's new trade agreements with Africa must move quickly on this. If all developed countries extended quota and duty free access to all low-income sub-Saharan African countries this could raise annual incomes in sub-Saharan Africa by up to US$5 billion.
- Rich countries should also provide aid to help African economies adjust to a more open global trade regime, and to enhance the benefits to and limit the detrimental impacts on poor people.