

## **Africa Region Trade Progress Note**

### **I. Objectives of Trade-Related Work in the Region**

Over the last three decades, Africa has been marginalized from world trade. Africa's share of world exports has dropped by nearly 60% from 3.5% in 1970 to 1.5% by the end of the 1990s. This dramatic decline in Africa's export market share represents a staggering income loss of \$70 billion annually, an amount equivalent to 21% of the region's GDP and to more than *five times* the \$13 billion in annual aid flows to Africa. Poor export and trade performance has been closely linked to the low growth of per capita incomes in the region. Export expansion and diversification are essential if African economies are to grow and Africans are to have a chance to earn better livings.

The objective of the Africa's region work program on trade is to support the integration of African countries into the world and regional economies and improve their trade performance – and its linkages to accelerated growth and poverty reduction – through an appropriate mix of activities at the country, the regional, continent-wide, and global levels.

### **II. Main Trade-Related Issues Facing the Region**

Reforms in the world trading system in order to increase Africa's export opportunities and provide incentives for domestic reforms are essential for accelerating growth and poverty reduction in Africa. Particularly important for Africa are:

- Reducing tariffs and tariff escalation on agricultural products and labor intensive manufactures;
- Eliminating trade-distorting agricultural subsidies;
- Preferential market access for African exports;
- Access to affordable imported medicines;
- Reasonable international product standards; and
- Restraints on monopolies/cartels in international air and maritime services.

Since the above issues are addressed in other Bank documents, this note focuses instead on the country and regional issues facing Africa and on the Bank's program to help address these.

#### **A. An Unsupportive Investment Climate**

Investment rates in Africa are low and need to be substantially raised in order to accelerate growth and poverty reduction. An unsupportive investment climate is still a major problem in most African countries. Behind-the-borders policies that restrain private investment and inhibit a supply response to improved market access and trade policies are serious impediments to growth and competitiveness. For example, in many countries:

- The legal, regulatory, and tax framework for business is unsatisfactory;
- Weak governance and accompanying corruption and inefficiencies undermine confidence;
- Infrastructure of all types is inadequate; and
- The transport, telecommunication, and financial services that facilitate trade are poor.

Dominance of key sectors by inefficient monopolies and dysfunctional labor institutions are additional problems in some countries. Hence, in order to provoke a strong supply response, trade reforms must be part of a broader package of measures to improve the investment climate. The relative priority and desirable sequencing of conventional trade reforms and other steps needed to improve the investment climate will vary from country to country.

## **B. Unfinished Liberalization**

Despite the significant progress made in liberalizing trade in the 1990s, African countries still maintain high levels of nominal and effective protection for import-competing industries; anti-export bias is strong; and liberalization is incomplete. Recently a few countries have started to follow more aggressive export growth strategies with encouraging results; but, on a continent-wide basis, export expansion and diversification appear de facto to be low country priorities. Although the unweighted average tariff is about 16%, the wide-spread practice of levying the highest tariff rates on virtually all domestically produced goods, while exempting the imported inputs used to produce these, leads to much higher protection for import-competing industries and resulting inefficiencies. Nominal protection rates for import-competing industry range on average from 30% to 35%, while average effective protection rates reach 70-80%. Very few countries provide exporters with effective access to import-duty and indirect tax free inputs. Inefficient and corrupt customs administrations are a substantial additional restraint on trade and competitiveness. As a result, anti-export bias is still quite high.

Unfortunately, at present, there is little recognition of the need for further liberalization; and many policymakers are skeptical of its benefits:

- They doubt that their small and underdeveloped economies will be able to compete on international or even domestic markets;
- They view the current world trading system as unbalanced and unfair because of market access barriers facing key products and agricultural subsidies in industrial countries;
- They see managing the adjustments from a protected environment to a more open competitive one as a daunting challenge with tariff remaining an important source of revenues and with low growth, weak institutions, volatile terms of trade, and limited safety nets.

### **C. Behind-the-Border Trade-related Reforms**

Within the broad range of issues, which need to be addressed in order to improve the business climate and supply response, two particular trade-related behind-the-border issues stand out:

1. Customs Reform. In nearly every country a major institution building effort is required to reform and improve customs administration so that customs facilitates trade rather than obstructs it.

- Inefficiency and corruption in customs administration raises the cost of both imports and exports and inhibits trade integration as well as causing revenue losses and undermining governance.
- As noted earlier, very few countries provide exporters with effective access to import duty and indirect tax (VAT) free input, often because customs is unable to implement tariff-rebates and similar measures.
- Poorly functioning transit arrangements are a serious obstacle to expanding trade in many of the region's landlocked countries.

2. Trade Facilitation. Improvements in trade-related infrastructure and provision of efficient, competitive trade-related services are needed:

- Key transport areas are roads, road transport, ports, and airline services.
- Particular care is required to avoid inefficient monopolies and other rent-seeking behavior so that essential service industries support rather than strangle export growth.
- An important related governance reform is the removal illegal roadblocks on internal roads that constitute a de facto tax on trade.
- Compliance with international standards is needed for African producers to effectively take advantage of market opportunities.

### **D. Regional Integration**

Currently, there is much greater political enthusiasm for regional integration than for unilateral trade liberalization. Most African countries are members of various regional trade agreements (RTAs) intended to promote trade among them selves. NEPAD has recently called for expeditious implementation of existing RTAs and the elimination of all internal trade barriers as a step toward integration into the global economy. It is also preparing a priority list of regional infrastructure projects.

Under certain conditions, RTAs can prove effective instruments for accelerating trade reforms and enlarging domestic markets. The main challenges for SSA in this area are to:

1. Ensure that RTA's have an outward-looking trade orientation to minimize trade diversion and increase economic efficiency. The UEMOA Customs Union established in 2000 is a good precedent: The average nominal external tariff in its

member countries went down from 25% (pre 1996) to 12% (2000), fostering international and intra-regional trade.

2. Rationalize and harmonize the complex web of overlapping and inconsistent regional agreements in eastern and southern Africa (SADC, COMESA, EAC) to facilitate implementation and avoid creating obstacles to trade.

3. Maximize the development impact of planned bilateral FTAs with developed countries (the EU FTAs with the ACP countries in the context of the planned Economic Partnership Agreements and the US FTA with SACU) and ensure that they are fully compatible with regional integration in Africa.

4. Overcome weak institutional capacity at the regional and country levels to implement RTAs.

5. Improve regional infrastructure and services, which support regional trade (transport, telecommunications, finance) and address institutional weaknesses (internal road blocks, corruption and inefficiency in customs, and transit facilitation). These steps are of particular importance for integrating landlocked countries into regional and international markets.

#### **E. Distributional Impact of Trade**

Because of the very low average level of income and high incidence of poverty in Africa, accelerated growth is essential for poverty reduction. Improved trade-performance is, in turn, critical for accelerating growth and is thus a key element of broad-based poverty-reduction. However, safety nets for protecting the most vulnerable are weak, increasing the difficulty of managing the transitions from closed to open economies. In order to both strengthen the linkage between trade expansion and poverty reduction and to better manage transitional impacts, the distributional effects of trade expansion are a standard feature of the Region's diagnostic trade integration studies. In depth analytical work and capacity building on trade and poverty reduction is planned for four western and central African countries (Benin, Burkina Faso, Senegal, and Cameroon).

### **III. Main Instruments Used to Support the Trade Agenda**

The Bank uses the whole range of trade-related analytical, advisory, and operational instruments to promote improved trade-performance in Africa at both the country and regional levels. Program priorities are determined primarily at the country level, although in some cases regional or global considerations are also important.

#### **A. Analytical and Advisory Activities (IF, ESW, and TA)**

Against the above background, Bank analytical and advisory work is undertaken to help client countries better understand the links between trade, growth, and poverty

reduction and to identify priority areas for trade-related reforms and programs in their development strategies. This work also underpins the design of the region's operational programs. Some analytical work is also undertaken to sustain the policy dialogue with client countries on regional or on continent-wide issues. Analytical and advisory work is carried out at three levels:

## 1. Country Level

a. *IF Diagnostic Studies of Trade Integration in the LDCs*. The Bank supported Integrated Framework for Trade Related Assistance for the least developed countries (LDCs) is a major regional as well as institutional initiative: 3/4s of the world's LDCs are in SSA, and these 33 countries account for 3/4s of the Africa region's member countries. The region, in partnership with the Trade Department, carries out 4 to 5 diagnostic trade integration studies per year; and this program is the largest single component of the region's current analytical work on trade. Each study includes an analysis on distributional impact of trade reforms.

b. *Diagnostic Trade Studies in the non-LDCs*: In addition to its 33 LDCs, the Region contains 14 other low and middle income countries that face difficulties in integrating into the world economy and expanding and diversifying their exports. In the second half of FY03, the region initiated a parallel program of trade diagnostic work in African non-LDCs, beginning with Kenya, Nigeria, and South Africa.

c. *Other Trade and Behind-the-border and Country Studies*: In addition to the IF programs of trade diagnostic studies for the LDCs and the parallel regional program for the non-LDCs, various analysis of trade and behind-the-border issues are undertaken in response to client requests as part of the region's regular country programs. For example:

- Comprehensive analyses of export competitiveness have recently been completed for Ghana, Ethiopia, and Zambia.
- Some Country Economic Memoranda (CEM) include or will likely include trade chapters, like the one for Kenya, Mauritania, Lesotho and Zambia)
- Agricultural trade facilitation studies to assist with export diversification are in progress in eight countries (Senegal, Ghana, Uganda, Ethiopia, Tanzania, South Africa, Kenya, Ivory Cost).
- The research program in enterprise development's (RPED) investment climate surveys are being accelerated (Eritrea, Mozambique, Ethiopia, Uganda, Kenya, Zambia and Tanzania).
- Analytical work on standards in several African countries: 5 studies carried out by the DEC trade group in partnership with USAID are completed and will be published shortly; three other studies (Kenya, Senegal, Burkina Faso) will be available in FY03/04 with recommendations which could be translated into operations.
- The Bank also participates in IMF work on customs issues in some countries (Angola, Benin, Burundi, Congo (B), Congo (D.R.), Mozambique, Rwanda).

## **2. Sub-regional Level**

In FY02 the region has established a separate program to support regional integration and cooperation with its own staff and budget and work closely with other donors, in particular the EU. Analytical support regional integration in Africa has increased significantly in response to demand from regional organizations and client countries.

- The region carries out a proactive program of ESW and TA in each of the major sub-regions, to assist their customs unions and free trade areas to improve their trade policies and performance and strengthen their institutional capacities.
- Some of this work is carried out jointly with regional organizations as is the case with the joint analysis with SADC/COMESA of trade policies and trade performance in Southern and Eastern Africa.

## **3. Africa-wide Level**

The region's technical departments also carry out a small program of analytical work on trade-related issues of Africa wide importance.

- Recent examples are the study of cotton trade in Western and Central Africa, an assessment of the overall progress of trade reforms in Africa, and initial work on customs reforms in Africa as an input into a future Trade Department study.
- The Region also supports capacity building of African expertise on trade issues: in partnership with WBI and other Bank networks, technical support is provided for African research centers such as AERC and SATRN, the Africa Union and UNECA, and NEPAD work on trade issues.

## **B. Strategy Work**

The main instrument for operationalizing the trade agenda is mainstreaming the findings of the various pieces of analytical work in the development strategies of the client country and in the Bank's own country and regional assistance strategies.

### **1. Poverty Reduction Strategy Papers**

The first round of the region's PRSPs and HIPCs focused on interrelated problems of debt relief, governance, public expenditure management, and the delivery of public services, particularly in health and education. Growth and trade received relatively less attention at this stage. As subsequent PRSPs move towards growth promotion as part of a strategy of sustained, broad-based poverty reduction, the role of trade should become increasingly more prominent. Concerns about debt-sustainability and the resulting need for export expansion are pushing in the same direction.

## **2. Country Assistance Strategies**

CASs reflect country strategies and priorities, and for this reason have tended to follow the same trend as PRSPs. With the increased interest in trade and the analytical work on it, the content of region's CASs is likely to evolve in the same direction as that of its PRSPs.

## **3. Regional Integration Assistance Strategies**

In response to the strong client interest in regional integration in Africa, the region has developed a new instrument: the regional integration assistance strategy (RIAS). Assistance strategies are being prepared for each of the major Africa sub-regions at the pace of one every 18 months or so (West Africa in August 2001, Central Africa in February 2003). Because of the existence of a number of regional customs unions and free trade areas, and the political interest strengthening these, trade policy and facilitation have been central concerns in the RIASSs. Much of the policy dialogue about trade reform now takes place in the context of discussions about regional integration.

## **4. Africa Assistance Strategy**

The region is also in the process of preparing an assistance strategy for the region as a whole, which is a logical vehicle for addressing issues of Africa wide importance, such as trade expansion and diversification.

## **C. Lending Operations**

### **1. Country Level**

Although the content of the Bank's operations in the region has been influenced by the same recent trends as its PRSPs and CASs, trade-related operations and components are still important in a number of countries. Adjustment operations and private sector development projects of various types are the primary vehicles for addressing trade issues.

For example, recent trade-related adjustment operations in the past few years focused on trade facilitation and competitiveness in Cameroon SAC 3 and reinforcement of customs revenue administration in Chad SAC 4. Uganda SAC 3 contains a significant trade liberalization component under which Uganda simplified its tariff structure and reduced its tariff protection. In Ethiopia, two budget support operations contain trade and investment climate provisions such as the establishment of duty- exemption schemes for exporters, implementation of an export credit guarantee scheme, simplification of export procedures, and revisions in investment codes. A programmatic structural adjustment credit in Tanzania, which aims at improving the business environment, will address investment facilitation and promotion of free crop movement within and across borders.

Private sector development operations have been the second important instrument for supporting trade expansion. For example, Gateway Projects in Ghana and Gambia have focused on institutional changes and physical investments that facilitate cross-border trade. Two investment projects in Senegal and Burkina Faso are supporting a range of measures to promote non-traditional exports, including physical plants. A mining sector development project in Uganda is geared towards improving the efficiency of the Ugandan mining sector, the performance of which will be measured by its impact on exports. In Senegal, a private sector development credit, now in the appraisal stage, was developed at the same time as the IF, and many of the recommendations in the IF have been integrated into the operations. It has components for tourism, primary export sectors, customs reform, and ISO standards compliance.

## **2. Sub-regional Level**

Although to date the Bank has had only a few sub-regional lending operations in Africa, these, like the RIAs, have tended to focus on trade-related issues. For 10 eastern and southern African countries, the Bank is financing a regional trade facilitation project which aims at establishing a credible export insurance mechanism. The Bank has also provided an IDF grant for a trade surveillance unit to monitor the implementation of UEMOA Customs Union. Operations to facilitate cross border payments in UEMOA and CEMAC have been financed. The Bank is working on the preparation of three operations on trade and transport facilitation in West, Central, and Southern/Eastern Africa to improve regional infrastructure and support physical integration in the sub-regions (mostly comprising transport components but also transit systems and customs procedures).

## **IV. Focus Countries and Sub-regions**

### **A. Two Countries Important for the Global Agenda and for the Region**

Two African countries have large enough economies that their trade policies are important for the development of the region as a whole as well as for themselves: South Africa and Nigeria. Both countries have historically followed fairly protectionist trade policies. Up until recently, neither country has been very interested in Bank assistance in the trade area, and their country programs have reflected this lack of interest. Nevertheless, special attention to analytical work on trade and policy dialogue with these countries is merited in light of the influence of their actions on other countries in the region and on Africa's position in the WTO negotiations. Analytical work on their trade policies will be initiated in the second half of FY03, and the two countries also figure importantly in the dialogues over trade liberalization in SADC and ECOWAS. In parallel, in response to the global agenda and requests from the countries in the region, the Bank also provides technical assistance to the Africa Group in WTO via UNECA, the Africa Union, and NEPAD.

## **B. The 33 IF Countries**

The Bank provides assistance in trade-related areas to the 33 LDCs in the region that are potentially eligible for the IF Program both through the implementation of this program and through its regular country programs.

IF diagnostic studies of trade integration have recently been completed for five African countries so far: Madagascar, Malawi, Mauritania, Senegal, and Lesotho. The follow-up consists primarily of integrating IF findings and recommendation in the national development strategy through consultation and dialogue with country authorities, as well as with donors, and then determining the priorities and the appropriate programs through which to support needed actions. Senegal, the most advanced country in this regard, has, as discussed earlier, incorporated a large number of IF recommendations in the Private Sector Development Credit that is currently under appraisal.

IF diagnostic studies are currently in the process of being prepared in four more countries: Ethiopia, Burundi, Guinea, and Mali. The most likely countries to qualify for IFs in FY04-05 currently appear to be: Angola, Comoros, Mozambique, Eritrea, Chad, Benin, Burkina Faso, and Guinea Bissau.

In addition to the IF program, the Bank also provides trade-related assistance to some of the 33 African LDCs through its regular country programs. For example, Uganda, which has not had an IF diagnostic study, expressed interest in expanding and diversifying trade as part of its development strategy. It is benefiting from several ESW/advisory activities and operations with trade components. Recently completed or ongoing activities in Uganda include a competitiveness study, an investment climate survey, an agricultural trade facilitation study, and a training/capacity building event on WTO issues. Uganda participates in the regional trade facilitation project (trade insurance) in eastern and southern Africa and in the analytical work on trade liberalization in EAC and COMESA. SAC 3 supported Uganda's trade liberalization program, and a mining sector development project will use export growth to measure performance as noted above.

Tanzania is another example on an LDC, for which an IF diagnostic study has not been undertaken but which has a fairly active Bank program in the trade area. Its programmatic structural adjustment credit under implementation has a tranche that is targeted at improving the business environment as noted above. ESW on exports is currently in progress, a RPED investment climate survey has just been launched, and FIAS is planning to conduct a study on administrative barriers to investment. The government's PRSP addresses trade and investment climate issues under the heading of accelerating growth, and the Poverty Reduction Support Credit currently under preparation is likely to include components in these areas.

### **C. The 12 Other Non-LDCs**

Trade-related work on the 12 other non-LDCs in Africa is funded from the region's parallel program of 3 diagnostic trade studies per year and from the regular country programs when given priority by the country concerned. A trade study for Kenya will be launched in the second half FY03, along with those on Nigeria and South Africa discussed above. Studies on Ghana, Cameroon, and Gabon, which are the larger economies in their sub-regions, are tentatively planned to start in FY04.

Kenya is an example of a non-LDC with a fairly active trade component in its country program. A CEM currently being prepared will assess the investment climate and trade policy regime and analyze the constraints facing export sectors in detail. An RPED investment climate survey was just launched, and FIAS study of administrative barriers to investment is planned. A PSD project under preparation for FY04 is expected to include reform of three enterprises which have particularly important implications for trade and the investment climate: telecommunications, rail transport, and civil aviation.

### **D. Regional Trade Areas of Special Significance for the Bank's Program**

Three regional trade areas are of special significance for the Bank's program: West Africa (ECOWAS/WAEMU); the Central Africa Economic and Monetary Community (CAEMC); and Eastern and Southern Africa (COMESA/EAC/SADC). As noted earlier, regional integration assistance strategies have already been approved for West and Central Africa. ESW and technical assistance on trade issues and trade facilitation projects figure prominently in the assistance strategies for both sub-regions. The dialogue over trade issues is equally active in Eastern and Southern Africa, but the regional integration problems there are more difficult because of the inconsistent and overlapping RTAs.

## **V. Constraints**

There are two primary interrelated constraints to moving more rapidly on the trade agenda in Africa. First, the lack of progress on the Doha development agenda creates a fairly negative environment for discussions of trade liberalization and contributes to skepticism in Africa about the potential gains from domestic reforms. Early action on the world trading system issues that are the most important for Africa would likely give a significant impetus to trade liberalization efforts in Africa.

Second, African countries ultimately decide on their own development priorities. Ownership of the trade liberalization program by the country concerned is essential: it is the only way to ensure that a country is committed to the reforms and to guarantee follow-up, continuity, and non-reversal in the reform process. Furthermore, in Africa trade policies and investment climate reforms compete for policy makers' attention with other immediate concerns, such as the HIV/AIDS pandemic, excessive debt burdens and continuing fiscal crises, and governance problems within a context of very limited

institutional capacities. So mainstreaming improvements in the trade and investment climate in the PRSPs and CASs of the countries that are not now actively interested in these issues is likely to take time. Hence, the trade reform process has to be seen as a long-term one requiring sustained effort over time.