Working paper

International Growth Centre

Trade Strategy Pillars for South Sudan

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May 2013

When citing this paper, please use the title and the following reference number:
S-52802-SSN-1

DIRECTED BY

FUNDED BY

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May 11, 2013

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Trade Policy Note prepared for presentation at an IGC-World Bank workshop to be held in Juba on April 25, 2013. I thank and Alan Gelb and Richard Newfarmer for insightful comments on a first draft as well as from participants at a seminar in Juba on April 26. .

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Glossary

Additive regionalism. The process of establishing a complex system of interlinking PTAs, as opposed to a single all-encompassing regional trade agreement. An example is the Tripartite agreement in ESA.

Customs Union (CU). A preferential trading arrangement in which partners have no tariff barriers among themselves and share a common external trade policy (including a common external tariff (CET)).

Deep Integration. Designates forms of integration going beyond tariff reductions to cover non-trade areas such as cooperation over common resources, harmonization of regulations, and the development of supra-national bodies in areas of common interest.

Effective Rate of Protection (ERP). A measure used to summarize the overall effect of the tariff structure on the profitability of an activity that uses intermediate inputs in its production.

Free Trade Area (FTA). A preferential trading arrangement in which partners have no tariff barriers among themselves, but keep their own external trade policy. This implies that rules must be established to identify origin (these are called RoO) to prevent transhipment via the partner with the low external tariff.

Generalised System of Preferences (GSP). Gives goods from developing countries a preferential margin in the tariff rates they face in the markets of developed countries. Entered into force in 1971. Since then has diminished in importance owing to the general reduction in tariff rates worldwide. In the case of AGOA and EBA initiatives, exports of qualifying countries (i.e. LDCs) enter duty free in the US and EU markets

Most-Favoured Nation (MFN). The rule that a country must give each of its trading partners the best treatment it gives to any of them in a given product. In the WTO, MFN is the binding general obligation that any concession must immediately be extended to all other members, with limited exceptions including FTAs or CUs.

Non-tariff barrier (NTB). (Sometimes called non-tariff Measure (NTM) Any measure that restricts trade that is not a price measure (ie, a tariff, export tax or export subsidy). Includes licensing requirements, technical norms, safeguard levies, variable import levies, tariff quotas.

Non-discriminatory trade policy. A trade policy in which a country adopts an MFN tariff with respect to all of its trading partners, with no preferential arrangements.

Open Regionalism. A form of regional integration emphasizing continued adherence to MFN principles and the promotion of open trade between the preferential zone and MFN partners outside the zone in the form of low external tariffs. Membership is open to all.

Preferential Margin. The difference between the duty that would be paid under a system of preferences in an PTA of some sort and the duty payable on an MFN basis.

Preferential Trading Arrangement (PTA). A trade arrangement under which one party agrees, either unilaterally or through negotiation, to grant one or more other parties preferential treatment in trade in goods or services.

Quantitative Restriction (QR). A limit or quota on the amount of a particular product that can be imported or exported during a given period.

Regional Economic Community (REC). A term used to signify an FTA, CU or other cooperation arrangement between countries. Mostly used in the discussion of regional integration in the African context. Used interchangeably with RTA.

Regional Trade Agreement (RTA). An FTA, CU or Common Market consisting of two or more countries.

Rules of Origin (RoO). A set of laws or regulations applied by governments to determine the country of origin of goods, services or investment. Preferential ROOs determine the eligibility of goods for preferential tariff under PTAs and are usually spelled out in voluminous annexes to the trade agreements.

Subsidarity principle. Subsidiarity is a principle stating that a matter should be handled at the smallest, least centralised level capable of addressing the matter efficiently.

Tariff escalation. The setting of a tariff in such a way that it rises with the increasing transformation of a product. It is used to favour the import of simple manufactures in order to promote an increase in domestic manufacturing.

Tariffication. Conversion to and binding of tariff equivalents of non-tariff measures.

Technical Barriers to Trade (TBT). Regulations, standards, administrative or licensing requirements that raise the cost of producing or importing foreign goods. The distinguishing characteristic of TBTs is that while they raise costs like tariffs and NTBs, they do not create rents.

Trade Creation (TC) . One of the criteria used for assessment of FTAs or CUs. A preferential reduction in tariffs by a country with respect to a trade partner leads to Trade Creation when the partner was the efficient supplier and was exporting to the country before the tariff reduction.

Trade Deflection. Occurs when an FTA member having the lowest external tariffs serves as port of entry for the whole area, thus reducing tariff revenue for other members.

Trade Diversion (TD). One of the criteria used for assessment of FTAs or CUs. A preferential reduction in tariffs by a country with respect to a trade partner leads to Trade Diversion when there is a shift in the sources of imports from the Rest of the World towards the (inefficient) partner.

1 Trade Integration to alleviate isolation

Barely two years into statehood, South Sudan (SSDN) has many difficulties to confront: secure its borders to the North, work towards a resolution of the transit of oil via Sudan, at least until an alternative route is possible, and put together a long-term development strategy starting from scratch. If SSDN is to take inspiration from the highly successful experience of Rwanda and some other post-conflict countries, trade will be one of the pillars of this development strategy.

The IGC has prepared two notes to help elaborate that strategy. Both are on the implications for SSDN of joining the EAC and other alternatives or complementary measures. Recognizing that regional arrangements are more about politics than about economics but that to survive, they must have a solid economic foundation, Sauvé (2012) raises a list of 15 'hard' questions the Government of South Sudan (GoSS) should try to answer in assessing the desirability of EAC membership. He concludes taking the sensible position that the GoSS should explore all the 'variable geometry' possibilities explored across regional integration compacts around the world.

Frischtak (2012) reviews the objectives for joining the EAC (including strengthening political ties with the EAC countries) and discusses the opportunities and challenges from a legal perspective. She analyzes the Treaty's main protocols looking for the possibility of membership without taking on all the obligations. On the challenge side, she concludes that the adoption of the CET might present some problems because of the 'Sensitive Item' (SI) list and that the Common Market Protocol will raise political problems for the movement of workers even though the country desperately needs skills through the EAC provisions on the free movement of services and capital. In late 2012, the EAC has decided that SSDN (and Somalia) had not yet met all the governance and other prerequisites for membership.

Both notes recognize that the adoption of EAC-certified free-market disciplines would contribute toward much needed economic development by promoting trade, pushing the country to adopt important trade facilitation measures, such as the harmonization of standards and laws..

This note complements these earlier assessments. It develops the case for a trade strategy that recognizes that the time to obtain WTO membership (perhaps up to 10 years) will be long and that for the foreseeable future SSDN will trade with its neighbors so the strategy should be built at the regional level which will allow SSDN to benefit from the disciplines associated with EAC membership on the grounds that private producers are inclined to believe that the government will abide by internationally agreed and enforced rules that convey some certainty to the private sector on the rules of the game.

However, lack of data prevents a more informed discussion of the long list of questions raised by Sauvé. The note proceeds from a few observations complemented from by Rwanda's experience while acquiring EAC membership. The first, and most important, observation is that SSDN is a small very isolated economy, surrounded by another four land-locked (LL) economies. This isolation is complemented by an unfavorable internal geography of very sparsely population and only 300 km of paved roads. Second, as a new country, SSDN has to take the time to discover its trading possibilities, both internal and external. In this environment, an economic geography perspective provides a useful framework for suggesting priorities in setting up its trade strategy.

The geography perspective leads to the conclusion that the first priority is to build the road infrastructure that will be necessary to start producing for markets beyond the immediate locality, at the national level first, then at the regional level. As discussed in section 2, building this infrastructure will also go towards linking the country with surrounding countries. Next, sections 3 and 4 discuss the merits of developing a trade strategy that draws lessons from Rwandan experience (as the nearest post-conflict country) around two pillars: a regional strategy around membership in the EAC and perhaps COMESA. Third, section 5 argues that SSDN should concurrently prepare for WTO membership which will bring added benefits to the country.

2 The Security Imperative and Discovering trading Possibilities

The 2008 DTIS for Sudan noted several times the lack of data for SSDN, especially with regard to international trade and indicators of infrastructure. The DTIS concluded that the trade strategy should build around four pillars: (i) raising productivity; (ii) reducing trade costs notably by improving hard infrastructure; (iii) rationalizing the trade regime which had one of the highest average tariffs in the world (20%); (iv) improving the trade institutions in the North and building them in the South where they were non-existent. The report also raised concern about the difficulty of managing fluctuating oil revenues and insuring the stability of the real exchange rate which had appreciated by 40% over 2005-06.

2.1 The Security Imperative

Five years on from the DTIS there is no change on the data front but in the meantime GDP is estimated to have fallen by half in SSDN in 2012 following the shutdown of oil exports (which accounted for 98% of government spending) with severe consequences for economic and social indicators. An agreement with the North on the sharing of oil revenues has been recently concluded and oil production is just resuming as or this writing (April 2013) in a highly suspicious climate of distrust. The most pressing need is still to normalize political and security relations with North Sudan, which will also help in shifting people from protecting the newborn nation to more productive pursuits.

This security imperative alone justifies the desire to join the EAC even though it is not going to help secure its northern border and it may take time to bring the expected public goods associated with 'deep' regional trade agreements. These include trade facilitation at the border (improvements in infrastructure and customs and regulatory procedures), harmonization of regulations and standards. The experience of the EAC so far (see below) is that 'deep' integration takes time so that these gains are yet to materialize.

However, to survive, any regional trade agreement has to bring enough gains to participants. Membership expansion will be problematic if the economic basis for integration is not sufficiently sound. This could be the case when the objective is 'deep integration' as in the case of EAC. Then the discretionary policy space at the country level is much narrower and the public good nature of the agreement becomes of the weaker-link type: integration will be as deep as what can be delivered by the least prepared members. This is why Sauvé remarks that in its assessment about EAC membership, SSDN also has to look at it from the standpoint of existing members.[1] SSDN's current security woes may well be perceived as a hurdle towards obtaining EAC membership.

2.2 Discovering Opportunities in a geographically isolated environment

The assessment of economic benefits and costs requires a minimum of data. At the time Rwanda entered the EAC, the entry decision was certainly heavily influenced by the politics of the situation, but a reasonable ex-ante assessment of the likely efficiency effects could be carried for Burundi and Rwanda before they joined the EAC (see e.g. Carrère and de Melo (2008) and others). The data were also sufficient to carry some ex-post estimates (see below) Right now, the data situation in SSDN is unchanged from the DTIS diagnosis which lamented the lack of data in SSDN (see the trade estimates from the reporter data in box 1.1 p.22).

Trade costs are very high, at least for trade with Uganda. Yoshino et al. (2011) analyze the pattern of trade between SSDN and Uganda. They reach six conclusions: (i) most trade is informal: (ii) as already pointed out in the DTIS, the range of products exported by SSDN has fallen drastically with timber the only export in the period since the Comprehensive Peace Agreement (CPA); (iii) costs at the border (and beyond in SSDN) account for the very large gap in prices between Kampala and Juba (figure 1 shows that maize (beans) in Juba is about 3 (2) times more expensive at the retail and wholesale levels as in the Ugandan cities); (iv) unit cost of behind-the-border trading cost (per km) are about 40% higher in SSDN than in Uganda (figure 2); (v) at the border, high costs (limited working hours) and poor customs infrastructure; (vi) high behind-the-border costs (very bad road condition, empty return trucks, nuisance payments, additional taxes imposed by the States in SSDN). As part of learning about trading possibilities and to help identify where the bottlenecks are greatest along the transport cost chain, more case studies should be carried out including a value chain analysis for some products that reach Juba by way of

[1] In November 2012, the EAC ministry invoked article III of the EAC which pegs approval of membership on the applicant's adherence to "universally acceptable principles of good governance, democracy, rule of law, respect for human rights and social justice" to temporarily bloc membership

Mombasa and other ports. Another way to speed up the collection of data is to extend the initially successful collection of data through mobile phones.[2]

Figure 1: Prices of Agricultural Products in South Sudan and Uganda

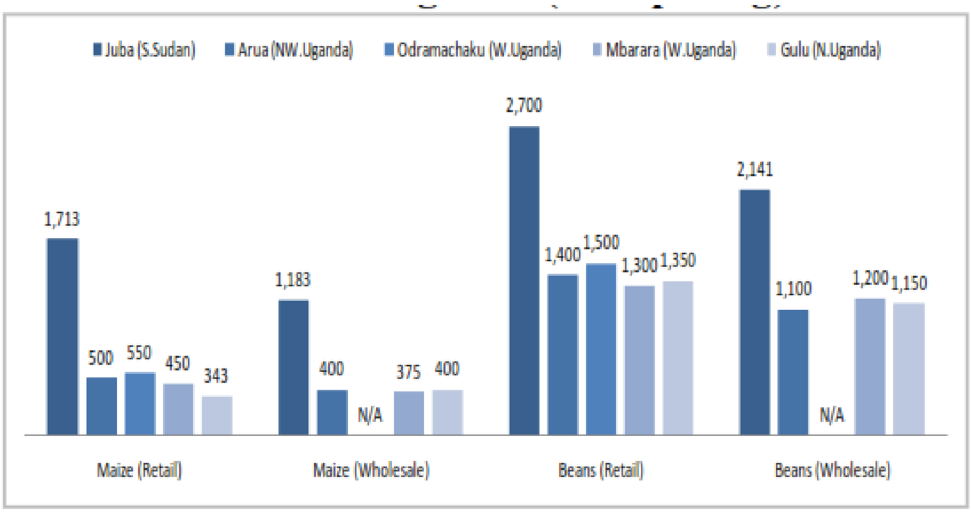
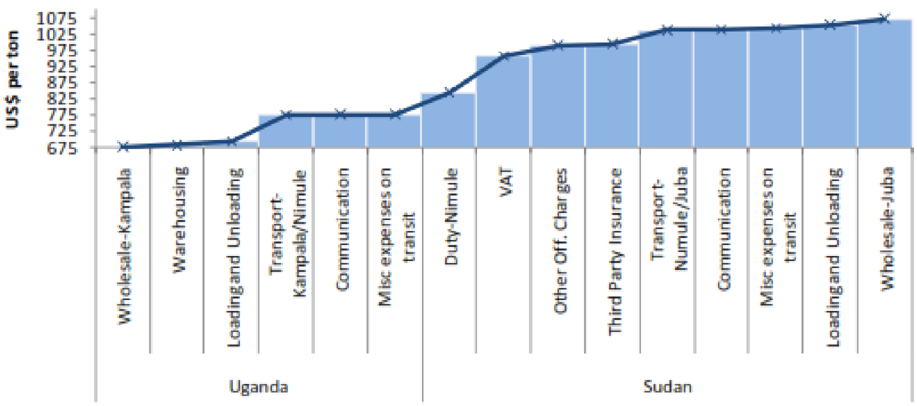


Figure 2: Costs of Trading from Kampala and Juba : Case of Beans



Source : Yoshino et al. (2011, figures 3 and 4)

These high trade costs reflect, and contribute to, the highly isolated situation of the economy in the region. With no transport infrastructure, trading costs within SSDN are also very high. An economic geography perspective explains the circularity resulting in this extreme isolation as the forces of dispersion largely dominate the forces of concentration. On the one hand, the low productivity of all economic activities results from a lack of scale as all markets are local because of high transport costs and low mobility of people (the low mobility of people comes from the multiplicity of ethnic groups at the national and regional levels) [3]. On the other hand, unable to realize scale economies in a

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[2] Croke et al. (2013) recount the highly successful mobile phone survey carried out in SSDN in 2010 where they collected information on prices, travel time, health, food consumption, etc....

[3] In addition to English, SSDN has 4 recognized languages and an estimated other 60 !

center (people don't move because of high moving high costs), the market is supplied by local small production units. The result is an extremely spread out economic landscape (no visible lights from satellites at night...).

This curse of geography is manifest both across a region of land-locked countries and within countries, but particularly so for SSDN where transport infrastructure is non-existent. Reducing transport costs, both at the regional and national level should contribute towards an increase in the concentration in economic activities with attendant increases in productivity.[4] How important the potential gains from reaping economies of scale through the concentration into sufficiently large centers to support activities beyond self-sufficiency is shown by a recent study of Ethiopian manufacturing by Soderbom (2012). He estimates that firms with 50 workers have productivity levels 10 times higher than firms with 4 workers.

2.3 Investment to tackle externalities and alleviate Isolation

Inspired by his visit to SSDN, Collier (2013) views SSDN as a small isolated economy where self-sufficiency is dominated by pastoralists akin to 18th century England where each enterprise was tiny and self-sufficient. In that environment, the small market size prevents firms from reaping economies of scale, and the forces of competition are largely non-existent. In this highly isolated environment, growth will come from entry into new activities (there are so few activities because of low scale and the impossibility of acquiring them from abroad because of high transport costs). Collier argues that the road to growth cannot rely on plugging in to the 'global value chain' but must start with new activities. These new activities require a pioneer investor that might come either through a 'self-discovery' process where information is generated along the way. But because the information gathered through the learning process does not accrue to the pioneer firm himself, pioneering will be under-supplied relative to its social benefit.

Beyond generalities about the need for supportive institutions and an enabling macro environment, it is difficult to come up with stylized facts about export success, particularly in low-income countries where idiosyncracy prevails. Easterly and Reshef (2010) report three stylized facts from their compilation of case studies for Ethiopia, Uganda, and Rwanda.
Concentration. First, around the world, including Africa, exports are concentrated into a few big hits. [5] In Rwanda, the proportion of top exports coming from the top 10 exporters has been increasing over the last three years,

[4] Experience shows that increasing hard infrastructure across Africa has not always been sufficient. The quantity of infrastructure is often adequate, but the quality is not because of poor network maintenance, the pricing of carriers, rent-seeking behaviour and sometimes insufficient demand as in Malawi in sparsely populated areas, a situation that might prevail in SSDN once a road network is built (see Raballand et al, 2011).

[5] At the HS-4 level (aggregation eliminates some of the measurement error in the data), Easterly and Reshef (2010) document that excluding extractable and commodities for 37 African countries the largest commodity accounts for 35% of exports (21% on average for the remaining 130 countries).

reaching 52% in 2010. This high concentration is is likely to apply to SSDN as well.
Churning. Second, everywhere there is churning in the top exports (another way of saying that the survival rates of exports are low) and the growth of the big hits is very largely driven by quantities, and not by prices as suggested by the large literature on booms and busts in commodity cycles.
Diversity. There is much diversity in the drivers of success, these ranging from the conventional (responding to trade liberalization, improving quality, exploiting ethnic networks) to the idiosyncratic (foreign aid, luck, passion of the entrepreneur). Of twelve success stories in the three countries, two were attributed to foreign aid, both in Rwanda which, arguably, was strongest on governance. Whether or not governance was the cause of foreign aid success, what is important is that these case stories conform to the widely held view that there are sufficient externalities in new export activities that they require some form of intervention.
Survival is positively associated with per capita income. Digging deeper into the export successes across countries shows that survival is important as there is a strong positive association between export survival rates and per capita income. The data also show that the probability of death of an export flow diminishes the longer the export flow survives. For low-income countries, the average death rate is above 50% while for high-income countries it is below 10% (See Brenton, Saborowski and Von Euxküll (2010))

3 Rwanda's Experience[6]

No country can participate in a market economy without a minimum of 'public goods' (health, legal system, etc.) and accompanying institutions. For entering successfully the world trade arena, sound policies and sound institutions will be necessary. SSDN faces two non-exclusive options:

- Joining one of the Regional Economic Communities (RECs)
- Joining the WTO (first on an observer status)

Both options will help designing its trade strategy. Both will also provide support to the government when confronted with pressures for redistributive policies that go against the general interest. But these options are in addition to pursuing sound policies unilaterally as shown by Rwanda's experience.

Under recovery from civil conflict and landlocked, Rwanda has clocked one of the fastest growth rates in Africa over the last decade, with income growing at an average annual rate of 8%. Rwanda's growth strategy was directed around 6 pillars, 4 of which relevant for the design of SSDN's trade strategy. Also, Rwanda was also a latecomer in the EAC. Hence its experience offers potential lessons for SSDN in its bid to EAC membership.

This experience is summarized here as 'lessons', the first two being most important. The first is that Rwanda made much progress was from reforms carried out unilaterally outside the EAC. The second is that excellent

[6] This section draws on de Melo and Collinson (2011)

management of foreign aid was key to its success. Translated to the South Sudanese context, this means good management from oil revenues. Description of the other lessons shows the kind of data that is needed to carry out a cost-benefit analysis of a country's trade policy and how it is affected by a change in its trade regime such as joining a Customs Union (CU).

Lesson #1 Rwanda's trade regime has gained in transparency and efficiency partly through unilateral reductions in protection combined with improvements in trade facilitation. Joining the EAC led to further reductions in tariffs (mostly for intermediate goods) that had efficiency and distribution effects. However, when it comes to the elimination of NTBs, progress has been slower as many NTBs remain and some new ones seem to continue to appear. The adoption of the CET and the exceptions (or 'sensitive item' list) has been detrimental for the poor as most of the highly protected agricultural items on that list weigh heavily in the consumption basket of the poor.

Lesson #2. Another key to Rwanda's success has been its management of Aid funds, averaging close to 20% of GDP. This aid has been almost entirely channeled to investment, mostly allocated to a public investment program geared towards supporting investments in the AFT sectors. This required careful monitoring to avoid misallocation. It also required careful macro management to prevent an eventual loss of competitiveness resulting from real exchange rate appreciation. Newfarmer et al. (2012) document the detailed monitoring and accountability measures through a set of targets established in performance contracts reviewed at least twice yearly. Details of this evaluation process should be of interest to SSDN. While the lessons pertain directly to incoming aid flows, they apply even more importantly to use of oil revenues.

Key elements in the Rwanda public financial management system are "results based management", transparency, and zero tolerance for corruption. The results based management systems involve a clear statement of strategic objectives for the long term; carefully articulated (usually quantified) economic objectives each year; necessary projected policy measures needed to achieve the objectives, and a system of monitoring and reporting that is fed into the next year's objectives. This is accompanied by a system of performance contracts at each level of government, starting with the Ministers' deliverables to President. Each year the government holds a "National Dialogue" with the citizenry at large, taking call in questions to respond to specific concerns.

Rwanda's experience on these two fronts are particularly relevant for SSDN in designing its trade strategy, this because the most serious barriers to trade are likely to be behind-the-border and because good management of oil funds is necessary to build the needed 'hard' (roads) and 'soft' (institutions) infrastructure.

3.1 Customs/Trade Facilitation Reforms

Substantial improvements took place on several fronts. In 2009, administrative changes (e.g. increased operating hours and enhanced cooperation at the border, along with the removal of some documentation requirements for importers and exporters) have reduced the time to clear customs from 3 days in 2007 to 1 day 9 hours in 2008. Rwanda has moved to the GATT system valuation of imports (transaction value) for standardization and transparency. Main borders customs offices representing 99 percent of customs operations have been computerized in 2008. Road blocks from the Revenue Authority have been removed throughout the country. The cost of port and terminal handling has been reduced by liberalizing the warehouse services sector. Customs declaration points have also been increased to accelerate the process.

A new risk assessment system was put into service (with automatic channeling system based on an importer's track record and the type of shipment). Corruption is low and the incidence of corruption is very low and much lower than for comparable country averages. Duty collections & refunds are promptly processed. The ASYCUDA++ system has been streamlined and extended to almost all border posts in Rwanda. As a result of these measures, the number of days to export and import has decreased steadily over the last three years. [7] Yet, the costs of importing and exporting a standardized container to Rwanda are still among the highest in the EAC region. [8] Documents such as importation bank declaration and arrival notice have been abolished to facilitate trade.

In the EAC, Rwanda was the first country to abolish working permits for citizens of the EAC to promote free movement of labor. These and other reforms reduce transaction costs substantially. These policies have allowed Rwanda to tap into a global and regional talent pool that have augmented domestic technology and skills. They have certainly contributed substantially to reducing rade costs. As a result of these measures, Rwanda was ranked as the top global reformer in the WB 2010 DB Report.

3.2 The EAC Tariff Schedule and its exceptions

With potentially a few exceptions to be negotiated (see Frischtak (2012)), the EAC tariff schedule will be adopted by SSDN upon joining the EAC. It has a three-band tax structure (0% for , 10% and 25%) that was implemented among the EAC-3 in 2006. This tariff schedule largely reflects the tariff schedules of the EAC-3 (the initial founders). This tariff schedule will not change when SSDN becomes member. This 3-band tax structure is also to be adopted by COMESA when it implements its CET as it also moves towards a CU although the classification of goods, not yet finalized, would be according to the BEC classification while for the EAC the classification of goods is according to the HS system.

Exceptions (a total of 58 products) on the "Senstive items" (SI) list represent only 1% of import lines, and concern a small share of total import value, ranging from 3.2% in Tanzania to 5.4% in Uganda. Not surprisingly, the items on the SI list do not weigh heavily on the total import value of the EAC-3 (less than 5% of import value), but they weighed heavily in the total import value of the

[7] According to DB (2010) Rwanda, (p37) the time to export fell from 47 (2008) to 42 (2009) to 38(2010) and on the import side from 69 (2008), 42 (2009), 38 (2010).
[8] See revised DTIS (p. 101, figure III.6) and DB 2010 (p.37).

newcomers (Burundi and Rwanda). For Rwanda they accounted for over 20% of their imports! This meant a loss of tariff revenue for the newcomers, and presumably a subsidy to the EAC-3 partners where at least one (probably Kenya) produced these goods on the SI list. This pattern will certainly hold as well for SSDN.

Lesson(fact) #3. The EAC tariff schedule is characterized by reverse tariff escalation. Over all goods, because of high protection of agricultural activities (19.7%), the EAC displays reversed escalation by degree of processing: 13.5% for raw materials; 10.1% for semi-processed products, and 14.4% for fully processed products. This pattern of protection is unusual, but currently it gives a buffer for SSDN where burgeoning activities are likely to take place in agricultural products and raw materials. However, as manufacturing activities grow, there will be pressure to raise the CET towards non-members while maintaining the already high protection for agricultural activities rendering the tariff system more distortionary. For SSDN which will not be in a position to develop these manufacturing activities at the same time or at the same paces, this will represent trade diversion and a loss of purchasing power as they will have to pay higher prices for regionally-produced manufactures.

Lesson #4. Moving to the CET has stimulated exports and reduced the purchasing power of the poor. Using firm level data, Garth (2012) estimated that the fall on the average tariff of goods imported by exporting firms decreased from close to 5 percentage points upon joining the EAC. When all factors affecting exports are taken into account, he estimates the average decrease of 5 tariff percentage points on imported inputs associated with the CET resulted in an average increase of exports of between 5% and 10% across all firms. This led Garth to recommend that Rwanda reduce the tariff on semi-finished goods from the current 10% to 5% which of course it cannot do since it is bound to the CET. Not yet a member of the EAC, SSDN could carry out choose zero tariffs on intermediate goods. This would at least partly compensate for the costs associated with bonded transit.

Garth also compared the effect on the cost of living of moving to the CET for the poor and rich households for 19 major consumption goods that accounted for 72% of the total consumption of low-income households. For example, the pre-CET tariff for sugar in Rwanda was 14.6% but 42.1% post-CET. Aggregating up across categories, Garth estimates that the move to the CET resulted in a 3.8% decline in real income for the bottom decile but no decline for the top decile.

Lesson #5. Tariff revenue has fallen (combination of loss of revenue from EAC members and shift of calculation to the point of entry in EAC). Adopting the Common Market Protocol implies that the CET is calculated on the including freight up to the Rwandan border while after CET adoption, the c.i.f. values were calculated including freight to the CET border (Mombasa or Dar Es Salaam). Garth estimates that of the drop in half of the tariff revenue in 2009-10 relative to 2008-09 (a period of world-wide recession), about half was from the loss of tariff revenue on goods previously imported from EAC partners and the other half from the lower base on goods coming from outside the EAC.

Lesson #6. Limited exceptions to the CET are available but for a limited period. When Rwanda joined the EAC, in June 2010, it applied for national exemptions from the CET for a period of one year requesting lower or zero tariffs (vehicles, tractors, construction materials, cement and wheat grain), on goods produced by partners but not by Rwanda. The exemptions say a lot about the efficiency implications of the tariff regime. It is easy to imagine that SSDN would want quite a few exemptions from the EAC CET as well, which it can under article 12 (see Frischtak (2012)).

3.3 NTBs in the EAC are still high

Lesson #7. NTBs are the subject of close monitoring. Since EAC members have committed to eliminate all NTBs to intra-regional trade, their evolution has been monitored closely. For example, the following had been identified for immediate removal in 2010: non-recognition of SPS certificates by Kenya for tea imports; the non-recognition of EAC rules of origin (RoO) by partners; multiple weighbridges along the Northern corridor and road blocs; Cotecna inspection certificates requested by Tanzania for imports, etc. While some NTBs were being eliminated, others were being imposed. For example, in January 2013, new measures have been reported (Tanzania, re-imposing a visa charge of $200 for business persons; Kenya restricting cut flowers from Tanzania to Europe, etc…)[9] An important benefit for SSDN is that, upon entering the EAC, it will be subject to this ongoing monitoring. This should dampen any intentions by SSDN to impose NTBs of its own on intra-regional trade.

Lesson #8. Arbitrariness in the application of the rules remains. These examples all point out that there is still substantial arbitrariness in the application of EAC rules. For SSDN, becoming a member will carry costs and benefits. On the cost side, the estimates could be non-negligible if the objective is not to have any NTBs. Melo and Collinson (2011) estimate that the tariff equivalent of NTBs for tariff lines with NTBs is high. For example, Kenya has 96 HS-6 tariff lines with non-automatic licensing. The average tariff on these lines is 14.2% while the average tariff equivalent on these lines is 40.3%. In other words, the estimated reduction in import volumes from non-automatic licensing is estimated to be equivalent to the reduction in import volume that would have occurred if there had been a tariff rate of 40.3%.

4. The Regional Integration Challenge

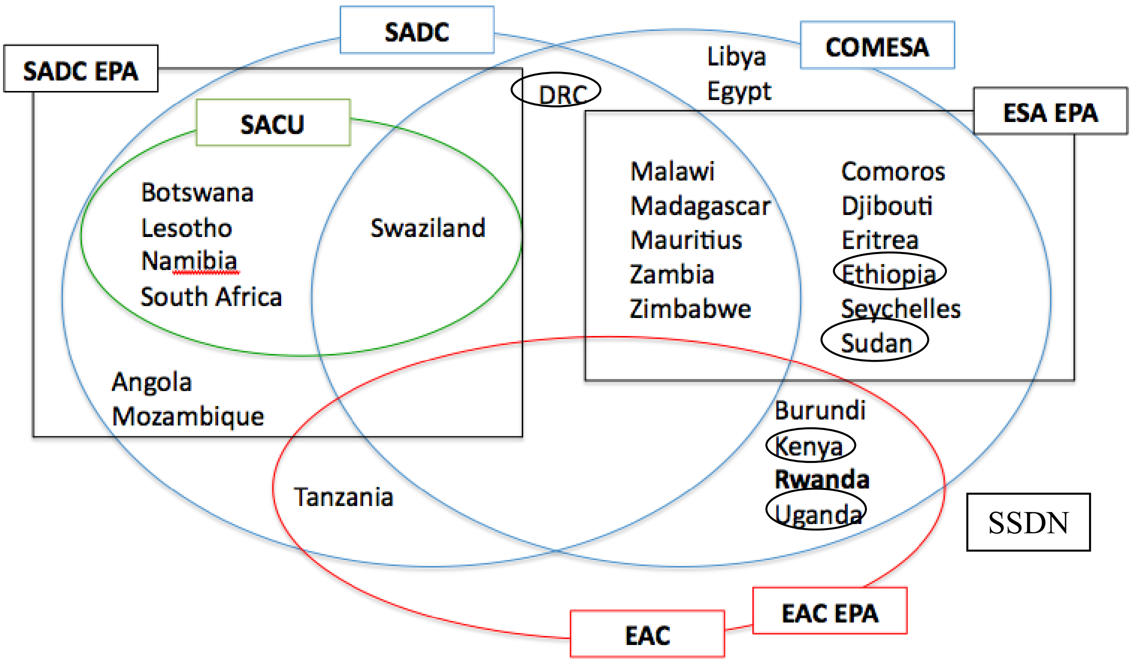
4.1 The RECs surrounding SSDN

Figure 1 shows the different Regional Economic Communities (RECs) in East and Southern Africa. By descending order of integration, SACU, founded in 1910 is the most advanced with a revenue sharing scheme (customs revenue shared according to each member's share in intra-SACU trade and the excise tax according to GDP share). The EAC is the second most integrated community with a functioning CET with few exceptions and the implementation of a

[9] See Africa Business Week (Jan. 2012) at http://allafrica.com/stories/201301142443.html

common market well under way. Next come FTAs where each member keeps its own external tariffs and trade policies are not harmonized. COMESA, still an FTA is intent on implementing a CU announced in 2009 with a long adjustment period and a long list of exceptions (the list is likely to be the compilation of country requests which will be large as interests among members differ widely (e.g. Egypt and Mauritius). It is to be based on same three-band tariff rates as for the EAC but with a different classification scheme (HS for EAC and BEC for COMESA). Finally is the Tripartite FTA which is to liberalize trade among the 26 members of the three RECs. It has three pillars; (i) market integration through removal of tariffs and NTBs and implementation of trade facilitation;(ii) apply the subsidiarity principle to infrastructure development to improve the efficiency of the internal and transport network (see box 1); (iii) industrial development. The tripartite FTA would bring free trade in an area that accounts for 58% of the Africa Union's GDP. For dual members, however, the impact will be uncertain as their preference margins will be eroded when entering the Tripartite FTA. For example, if SSDN is a member of the EAC, but Ethiopia is not, it enjoys market access in EAC partners that would be eroded upon COMESA (and hence Ethiopia) joining the club.

Figure 3 The network of RTA memberships in South Sudan's neighborhood



Notes: SSDN neighbors circled
EPA: Economic Partnership Agreements negotiated in bloc with the EU
SADC and EPAs are FTAs
COMESA and EAC are CUs with three-bands (and exception lists): raw materials (0%), intermediates (10%), final goods(25%)
SACU: only full CU with customs revenue sharing (i.e. no internal customs)
TRIPARTITE FTA membership: COMESA + EAC + SADC

Box 1 The Political Side of RECs

RECs have multiple objectives beyond increasing trade: these include democracy and human rights (SADC and MERCOSUR Treaties) regional cooperation and coordination (ASEAN), expansion of foreign direct investment (COMESA) and often the development of the least-developed members (SACU), and to move towards a monetary union and eventually a political union (EAC) This is why the introduction to a recent handbook on preferential trade agreements is entitled "Beyond Market Access" (Chauffour and Maur eds. (2011)) When joining the EAC, Rwanda stated that it was to promote 'regional integration <u>and</u> cooperation' (underline added).

Establishing a regional trade bloc also extends beyond security: if countries know each other better, notably because they trade more, they are more likely to have greater trust in each other (even if it is neighboring countries that typically go to war), and hence are more likely to accept the necessary delegation of authority to a regional body (referred to as the principle of subsidiarity in EU law) to build the institutions at the regional level that delivers regional public goods. The subsidiarity principle states that decision-making jurisdiction should coincide with a public good's spillovers (multilateral institutions for transnational public goods, regional institutions for regional public goods (like infrastructure especially for landlocked countries and emphasized among the objectives of the proposed Tripartite FTA) and national institutions for national public goods.

Recent developments in the many FTAs around the world support the view that economics and politics are complements (rather than substitutes as argued by the defenders of multilateralism). The reasoning is simple: because FTAs augment the volume of trade, they should reduce the probability of war. As political scientists have argued, when FTAs are sufficiently 'deep' in the sense that they go beyond the elimination of tariffs among partners, institutions are created in which countries not only negotiate on trade issues, but also carry out discussions that spill over to political issues that attempt to diffuse political disputes that could escalate into political conflicts. If in addition there are trade gains, the opportunity cost of war is higher (and conversely multilateral trade openness that reduces trade dependence on neighbors reduces the opportunity cost of war). At the same time, not surprisingly, experience indicates that countries that had a recent conflict are less likely to enter into an FTA as confidence needs to be rebuilt. So SSDN may not stay in COMESA, and certainly Sudan is unlikely to join the EAC as it has no common borders with any EAC member.

A group of countries in ESA are currently members of two FTAs. This would also be the case for SSDN if it joins both the EAC and COMESA. In any FTA, trade deflection will occur if discrepancies in tariff rates are important. This is why all countries in an FTA have rules of origin (RoO). These are often product specific reflecting that they are 'captured' by private interests and it is often said that preferential access is "giving away with one hand and taking away with another" as they are stricter for products with high preference margins. In any case, RoO are necessary for countries participating in an FTA.

Costly to implement, RoO would in principle be removed under a CU as is the case under SACU. But this requires a formula for revenue sharing, not likely to happen soon given the importance of tariff revenues in the budgets and the still important lack of trust among members. Revenue sharing, an application of the subsidiarity principle (see box 1) is only likely to take place when there is strong trust or there is a hegemon in the group as South Africa in SACU or Russia in its CU with Belarus and Kazakhstan. Moreover, in the end, EAC and COMESA will end up will largely different tariff structures in spite of some move towards convergence. RoO, themselves different across the RECs, will remain. More importantly for landlocked countries, goods in transit will have to pay bonding fees at port-of-entry and will be subject to rent-seeking activity along the transport chain.[10] Under 'deep' integration, these costs could be eliminated by a revenue sharing formula, a substantial advantage over an MFN-only based trade policy.

4.2 The Economic Side

At this early stage of Statehood, in developing its trade strategy SSDN faces a dilemma: on the one hand it would like to have leeway to maximize the gains from 'learning by-doing'; on the other hand, being a member to a regional integration agreement like the EAC is likely to give it policy-locking. In addition, with very scarce human capital, choices have to be made. Not all fronts can be tackled simultaneously especially once one factors in the resources needed to prepare for WTO membership (see below).

Table 1 takes a checklist approach to the two regional alternative open to SSDN. It is to be completed by policy-makers as they learn about trading possibilities but also to draw attention on areas to investigate (other items will come along as exploration proceeds). No column is added for membership in the Tripartite FTA even though it would allow resolving inconsistencies from overlapping membership in EAC and COMESA when COMESA will be a CU. Nor is there a column for WTO membership. In any event, any gain from membership in a REC (but also through WTO membership) would be through policies that deepen integration through a reduction in trade costs, benefits that it would free-ride on without participation in the negotiations.

[10] Arvis et al. (2007) show that transport regimes for LL countries across Africa are characterized by a high unpredictability of transport time with widespread rent-seeking activities along the transport chain.

Table 1: **Benefits and Cost for SSDN from Alternative Memberships**

	EAC	COMESA
ECONOMIC		
(1) Scale and Competition	++	++
(2)Trade Diversion	?	?
(3) Tariff Revenue	-	-
(4) Trade Facilitation	+	?
Transit	?/+	?
Harmonization	?/+	?
(5) Cooperation	+	?
(6) Deep integration	+	-
Free Movement of labor		
.Right for Establishment		
Free Movement of Services		
Free Movement of Capital		
POLITICAL		
(6) Security	+	?
(7) Bargaining	+	+
(8) Policy lock-in	+	?/+

The table is split into economic and political effects. All the political effects are viewed as positive and are not commented here. On the other hand, the effects of entry on the economic side are harder to ascertain (this was even the case for Rwanda with much better data). Entries should be viewed more as a plea for data collection than illustrative guesses (the many question marks to be removed progressively as data becomes available to carry out the analysis). Starting with economic benefits, scale and competition benefits should be positive, though the extent will depend on the volume of trade generated, itself dependent on the extent of reduction in trade costs through trade facilitation measures (harmonization of measures and customs administration).

Nothing, even tentative, can be said on trade diversion until one knows SSDN tariff schedule and the origin of imports. The same applies for tariff revenues. Better data is needed.

Trade costs will continue to be high for SSDN even if, like Rwanda many unilateral measures to reduce trade costs along the lines described in section 3.1 are taken. How much extra reduction in trade costs beyond unilateral steps can one expect membership to one of the RECS? This is difficult to say, although it is likely that regional coordination will be greater under EAC than under COMESA. Monitoring trade costs regularly at the regional level as under the auspices of the West Africa Trade Hub would be very helpful.

The benefits from 'deep' integration should be positive. However, even for the EAC which has been existence for nearly 10 years, the benefits have been hard to detect. This is in part because the implementation has been slow but also because, while guaranteeing the free movement of capital is necessary, this does not mean that it will take place. Neither will this be the case if the measures are not applied as reported for the recent barriers to the granting of visas in the EAC.[11]

5 WTO Membership: Distant but worthwhile Gains

The WTO represents the international forum for establishing and policing the rules of the game for international Trade. Because of the 'Single Undertaking', obtaining membership requires signing all the WTO agreements that cover trade in goods, both agricultural and non-agricultural, and services such as banking, transport, tourism and telecommunications.[12] It also includes an agreement on trade-related intellectual property rights that will be of interest for SSDN. Recent experience suggests 10 years to complete the accession process since obtaining observer status.

Applying for WTO membership is a logical step in a country's process of re-engaging with the international community but, for reasons developed in this note - this is a long and complicated process that will be very demanding for SSDN scarce human resources. Indeed, several, but not all countries exiting from civil wars/conflicts, have applied for accession to the WTO. A case in point is Liberia whose civil war ended in 2002. Liberia started the accession process in June 2007 which is still ongoing. On the other hand, Timor Leste obtained independence from Indonesia in 2002, but does not yet have observer status. Sudan has an observer status and South Sudan has observer status since August 2012.

Since membership approval requires unanimity, because of the recent conflict there may be delays for both Sudans (see the Russia-Georgia conflict). SSDN might fear that if Sudan were to obtain membership first, Sudan might be objection to SSDN obtaining membership (which could also take place via third party objections). However, SSDN should not be worried about the consequences of an earlier accession of Sudan since it is highly probable that, like Armenia, accession for Sudan would be conditioned on a "constructive" position regarding the accession process of SSDN (see WT/ACC/ARM/22)).

SSDN is among 12 LDCs that have not acceded to the WTO as original WTO LDC members. Because only 5 LDCs had acceded to the WTO since 1995, recently the WTO somewhat simplified the complex negotiation process under the 2002 guidelines, issuing revised guidelines in 2012. However, as the only gainers would be the LDCs, they were in a weak bargaining position. The result was a new set of guidelines with very few changes. In effect, the LDCs gained very little beyond a binding for agricultural goods and manufacturing goods at a higher rate than the average for recently acceded LDCs.[13]

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[11] A survey of labour market agreements in Trade agreements shows that free movement of labor is usually included South-South trade agreements but that implementation has been spotty (see de Melo and Regolo (2013)).

[12] Cf.http://www.wto.org/english/thewto_e/whatis_e/tif_e/utw_chap2_e.pdf

[13] See IDEAS (2012) 5% of tariffs could be exempt from binding with average commitments for AG products at 50% instead of 32% and for NAMA at 35% instead of 23%. No benchmarks were

These warnings notwithstanding, applying to WTO with an aggressive push will open doors for the country beyond WTO itself - as SSDN will :

- become more visible on the international stage;
- discussions on membership will create much learning about trade, international trade policy,
- create momentum on aid for trade among donors

Because the process takes a long time, it is important if not urgent to start now.

5.1 Embark on WTO-compatible institution building….

SSDN should strive to draft WTO-consistent Laws. The accession process requires considerable administrative capacity for countries that have established institutions and an adequately developed legal system. Accession requires these countries to assemble and organize all the necessary information and laws, and some new laws may have to be drafted and approved. This adjustment can, and should be, avoided for SSDN. This is because within a number of years following accession, SSDN will have to implement fully the provisions of the Agreements on Sanitary and Phytosanitary Measures (SPS), Technical Barriers to Trade (TBT), Trade-Related Intellectual Property Rights (TRIPS), and Customs Valuation. [14] Complying with these agreements will help institution building, even if in many cases, they may not yet be relevant for SSDN. For example, implementation such as harmonization policies must recognize context-specificity.[15]

As an example, in anticipation of accession, SSDN could prepare its customs administration to satisfy most of the following obligations relating to the legal aspects of trade facilitation:

- Provide freedom of transit to other members (GATT Article V).
- Value imports based on the price paid or payable in the market rather than using arbitrary or fictitious values (Article VII).
- Any fees or charges (other than ordinary customs duties) that members impose on traded goods must be limited to the cost of providing a service; they cannot be used as a tax instrument (Article VIII). This would imply removing the additional taxes imposed by States (see Yoshino et al. (2011)

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established for Services and no progress was made on increasing the transparency of the bilateral negotiations or on S&D treatment or transition periods.

[14] National regulations which usually need to be modified where necessary to embody international standards, or else justified where they are more stringent, have not yet been designed for SSDN. SSDN should take inspiration from the WTO regulations when designing their own regulations (SPS; TBT, TRIPS, Customs valuation) to minimize any modifications to satisfy WTO requirements. In sum SSDN should embark into institution building that will be WTO compatible.

[15] An example of inappropriate standards is the case of standards for trade in milk adopted in the EAC. As discussed by Jensen and Keyser (2012), the adopted standards were close to those in the EU and way beyond those that would have been appropriate in the EAC.

- Publish all regulations, laws, judicial decisions, etc. and provide independent tribunals for appealing customs decisions (Article X).

5.2 …even though gains from membership may appear distant.

Experience suggests that a country like SSDN with fledgling institutions could expect to gain from WTO membership because it represents a relatively strong external commitment to pro-growth policies (a unilateral commitment to pro-growth reforms is easier to reverse than an external commitment). From an examination of data for all developing countries between 1980 and 2001, Tang and Wei (2008) find that GATT/WTO accession tend to raise income temporarily (growth and investment accelerate for 5 years leading to an economy permanently larger by 20%), but only for those countries with poor governance.

Beyond this, the application process itself – both the preparation of the Memorandum on the Foreign Trade Regime (MFTR) and the subsequent negotiations - contributes to the provision of the needed public goods in the form or greater transparency and a wider and more open discussion of trade-related issues. It requires a compilation of all relevant laws—in the case of SSDN, working up to accession gives a road map on how to elaborate these laws.[16] These gains should translate into the permanently higher income found by Tang and Wei.

In addition, analysis of HS-6 bilateral trade data shows that the extensive (new products and or new destinations of existing products) and intensive (existing products or partners) behave differently upon accession to the WTO. Dutt et al. (2011) estimate that WTO membership increases the extensive margin of exports by 31% while it has a negligible impact on the intensive margin. .

Beyond the commitment and institution-building aspects that are likely to be important, WTO membership ensures access to the markets of other members through the guaranteed application of most-favored-nation (MFN) tariff rates. Membership also gives access to the dispute settlement mechanism which requires specialized legal expertise but for which there is extensive assistance through the Advisory Center on WTO law (ACWL). These advantages provide good reason for SSDN to press on with the process of membership accession but in the meantime since all trade (except oil) is likely to be regional for years to come, these gains would be in a relatively distant future.

Will WTO membership present more gains in terms of attracting FDI? At least for the next few years (i.e. in the 5 to 10 years it will take to complete the

[16] Should SSDN first acquire membership in EAC or COMESA, it could be that that adoption of EAC or COMESA laws would have to be amended to eliminate inconsistencies, as was the case with several East European countries when they became WTO members subsequent to signing the Europe Agreements with the EU. This is why countries participating in the EU Eastward enlargement have been urged to first become WTO members. For SSDN, this sequencing issue should not present a practical problem because of its negligible economic weight in the World Trading System.

accession process) it is unlikely that WTO-rule sensitive FDI will be forthcoming to SSDN, or at least that its volume would be influenced by WTO membership. FDI will be in the oil sector where deals are mostly bilateral, long-term and opaque, and outside the scope of the WTO.

Regarding the Customs Valuation agreement which is based on the principle that the declared valued of imports should be the basis for valuation requires a series of demanding steps to be followed before the use of a different price can be justified. This will require extensive training for Customs officials in valuation methods, and access to data bases with the needed pricing information, none of which exist in SSDN. [17] The experience in many other African and LDC countries suggests that it will be difficult to implement this agreement effectively in the short term, due to the high level of fraud and to capacity limitations.

Finally is trade facilitation. The current Doha negotiations are still not moving ahead even in the area of trade facilitation which is viewed as relative non-controversial. Negotiations on article V on Freedom of transit are of particular interest to SSDN. These rules are viewed as particularly burdensome by LL countries (these rules are allegedly to safeguard the interests of the transit country from potential fiscal –and other—losses). However, article V rules have never been interpreted by a WTO panel and the negotiations are at a standstill.[18]

Overall, WTO accession will not be a panacea for several of SSDN urgent problems (trade facilitation, attracting FDI) and present implementation difficulties (implementing Customs Valuation and other WTO agreements). The long process will be demanding on SSDN's scarce human capital resources, but the process itself will help develop these needed capabilities as well as help provide that needed external commitment to implement pro-growth policies.

6 Conclusions

As a small isolated economy, SSDN is dominated by largely self-sufficient activities where small market size prevents the realization of economies of scale and the forces of competition are largely non-existent. This internal isolation is exacerbated by a lack of infrastructure that impedes mobility which is already low because of high ethnic diversity is further magnified by surrounding countries that are also landlocked. Long-term investments in transport corridors across the continent will eventually break this isolation at the regional level.

SSDN's economic and political situation and experience elsewhere suggest two prerequisites and four pillars in the elaboration of its trade strategy, starting from its current observer status at the WTO (and in EAC?).

[17] Article VII of the GATT requires WTO members to apply customs duties on the value of an imported item based on the price paid or payable in the market, known as the "transaction value." The rule is meant to block the use by governments of artificially high or low "reference" prices.

[18] Among others, there is a need to clarify the provisions, for example « to further expedite the movement, release and clearance of goods, including goods in transit ».

Two prerequisites.

a) Reducing transport costs, across the country (and across the region) is the first prerequisites to developing a trade strategy. Lower internal trade costs will spur a concentration in economic activities with huge increases in productivity that will allow exporting activities to develop.
b) A stable and a stable real exchange rate that avoids large swings is the second prerequisite. [19]

Four pillars.

1) Learn about trading possibilities. Data needs to be collected about price differentials and their evolution over time (an indicator of trade costs and of exchange rate misalignment). Costs of keeping goods in transit and whether these can be lowered by participating in the EAC.
2) Take heed from Rwanda's successful development strategy which put emphasis on trade to break the vicious circle of a small domestic market. Seven 'lessons', some relating to Rwanda's entry into the EAC would seem pertinent for SSDN. Among the most noteworthy were the reforms taken by Rwanda prior and independently of EAC membership, a situation that applies for SSDN.
3) SSDN should prepare to join EAC, both for political and for economic reasons. Gains from COMESA membership will be less because the greater diversity among countries represents an obstacle to the deeper integration taking place under the EAC. Non-participation in the EAC would be greater isolation with attendant costs (higher trade costs among others). The list approach suggested in this note could serve as a basis for progressively further evaluation along the lines carried out by Rwanda.
4) SSDN should also prepare for accession to the WTO and not be concerned about the current status of Sudan in its current accession negotiations. This preparation is likely to be take a long time (probably around 10 years).
5) To expedite the application process, SSDN should seek WTO compatibility when drafting its laws as, for example while preparing the legal aspects of trade facilitation for its customs administration.

[19] Growth surges and export surges around the world are preceded, or at least accompanied by several years or undervaluation of the real exchange rate (see e.g. Freund and Pierola (2011)). This is particularly difficult to achieve in resource-rich environments like SSDN and is beyond the scope of this note though it is generally accepted that human capital and "governance or institutional capital", both of which are currently missing in SSDN, are needed. Without these, the country is more likely to experience a "resource curse" (see Gelb (2011)).

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