

Getting the Most out of Regional Integration: Lessons from IGC Countries

Jaime de Melo

FERDI

Session 4: Trade Dynamics

Outline

- Preferential Tariff Arrangements (PTAs) are good politics, but to survive must be founded on a sound economic basis
- African countries should integrate regionally for efficiency, geographical and political reasons
- ...intra-regional trade has not increased because trade costs have not been reduced
- The IGC experiences of Rwanda, Liberia, South Sudan
 - Rwanda: Gains Overall from EAC membership
 - South-Sudan: Build WTO-compatible rules and regulations
 - Liberia: Beware of ECOWAS CET
- Conclusion: African PTAs still lag on outward-orientation, and improving design could improve competitiveness.

The Political Dimension

- **Economics and Politics are complements (not substitutes)**
 - Probability of war reduced by two channels
 - Opportunity cost of war up as countries stand to lose as they trade more.
 - Information asymmetries reduced so countries less inclined not to report true options to extract concessions
 - ..but with great heterogeneity across countries (assets, geography) sharp trade-off between benefits (address externalities with common policies) and costs (common policy is away from preferred national policy)

Large Potential gains from regional integration

- **Using PTAs to combat limits of African geography**
 - Small economies gives monopoly power → gains from integration.
 - Lack of large cities to reap economies of scale+ instability →integrate to reap productivity gains from larger cities and less instability
 - Diminishing returns to resource extraction: Double the size pushes back diminishing returns (which contribute to low supply response)
 - Diminishing returns to resource extraction + remoteness= large gains from integration for LL who gets access to rents in coastal partner (SSDN goods get to enter Kenyan market perhaps Sudanese to work in Kenya).

Political Economy conflicts in the way of realizing gains

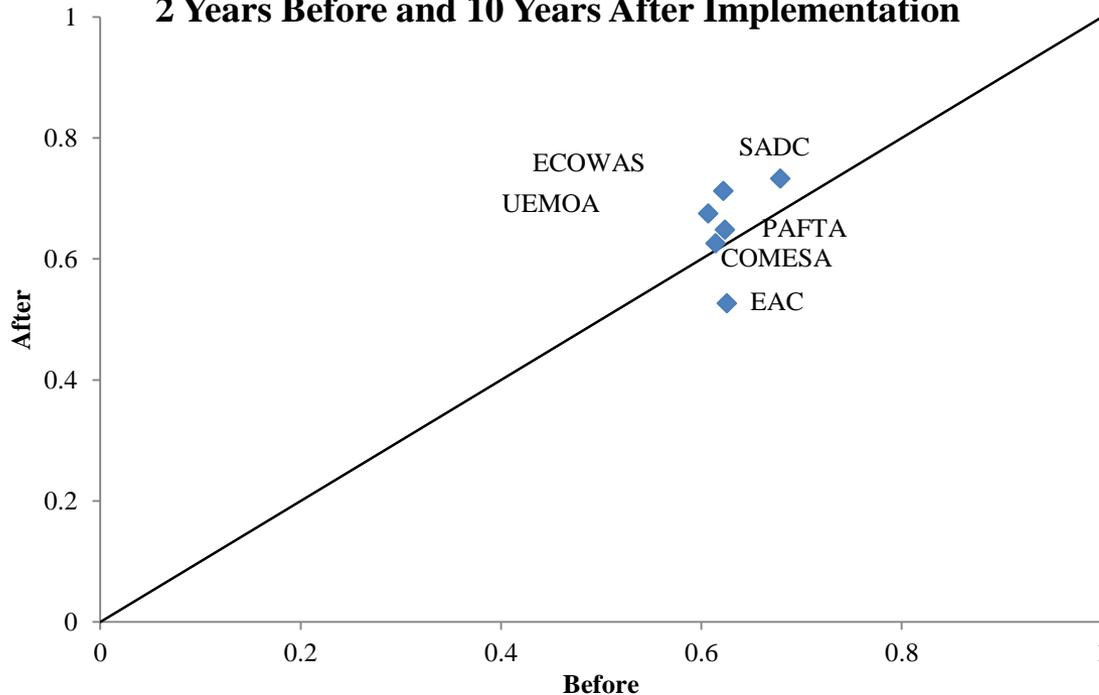
- Costs and benefits of common policies: trade-off between benefit of common policies to address cross-border spillovers and costs which depend on extent of policy differences that are very large across African RECs
 - Resource-rich and resource-poor are in same RTAs
 - Rich and poor/ large and small
 - Landlocked and coastal countries are in same RTAs
 - Large ethno-linguistic differences
- South-South FTAs would then lead to a divergence in GDP between countries (manufacturing goes to Kenya as Uganda shifts its purchases from ROW to Kenya while Kenya buys low-cost labor-intensive goods from Uganda).

The failure of first wave of African RTAs in the 60s and 70s was partly a result of the lack of adjustment funds for losers. Currently, asymmetry in interests and in power due to disparity in per capita income of partners accounts for the difficulties of countries to converge on a CET

Trade has not shifted towards partners (Except EAC below the 45° line)

Average distance of trade has not fallen

**Figure 4: Average Distance of trade
2 Years Before and 10 Years After Implementation**



Countries choose partners to minimize trade costs so if trade costs fall more for partners than non-partners, ADOT falls

A higher ADOT after signature indicates that trade costs have fallen relatively more with non-member trade partners.

ADOT only fell for EAC.

For these African RTAs, the ADOT ratios are generally higher 10 yrs after signature, suggesting little «deep» integration among members

Rwanda in EAC (I)

- #1. Most improvements in trade regime unilaterally: transparency, some reduction in protection + trade facilitation
- #2 .Excellent management of aid funds (20% of GDP) through targets in performance contracts «results based management», «national dialogue»).
- #3. Moving to CET stimulated exports (exports up by 5-10% because of lower tariff on inputs). [ex-post econometric estimates]
- #4 CET increased the cost of living for the poor (3.8% decline in real income) under assumption of pass-through of tariff changes (higher price for sugar and other items in consumption basket of the poor..).

Rwanda in EAC (II)

- #5. Tariff Revenue has fallen (shift of calculation to point of entry + loss of revenue from EAC members)
- #6 Rwanda benefits less than neighbors because limited exceptions to CET as latecomer with small power (lower tariffs on goods produced by partners but not Rwanda)
- #7. Monitoring of NTB removal is taking place but is slow (see next slide of the type of info. on NTBs)
- #8. ...but some arbitrariness in application of rules still remain in EAC and costs of NTBs are high.
- #9. CET exaggerates cost of distance for Rwanda, especially sensitive items list.

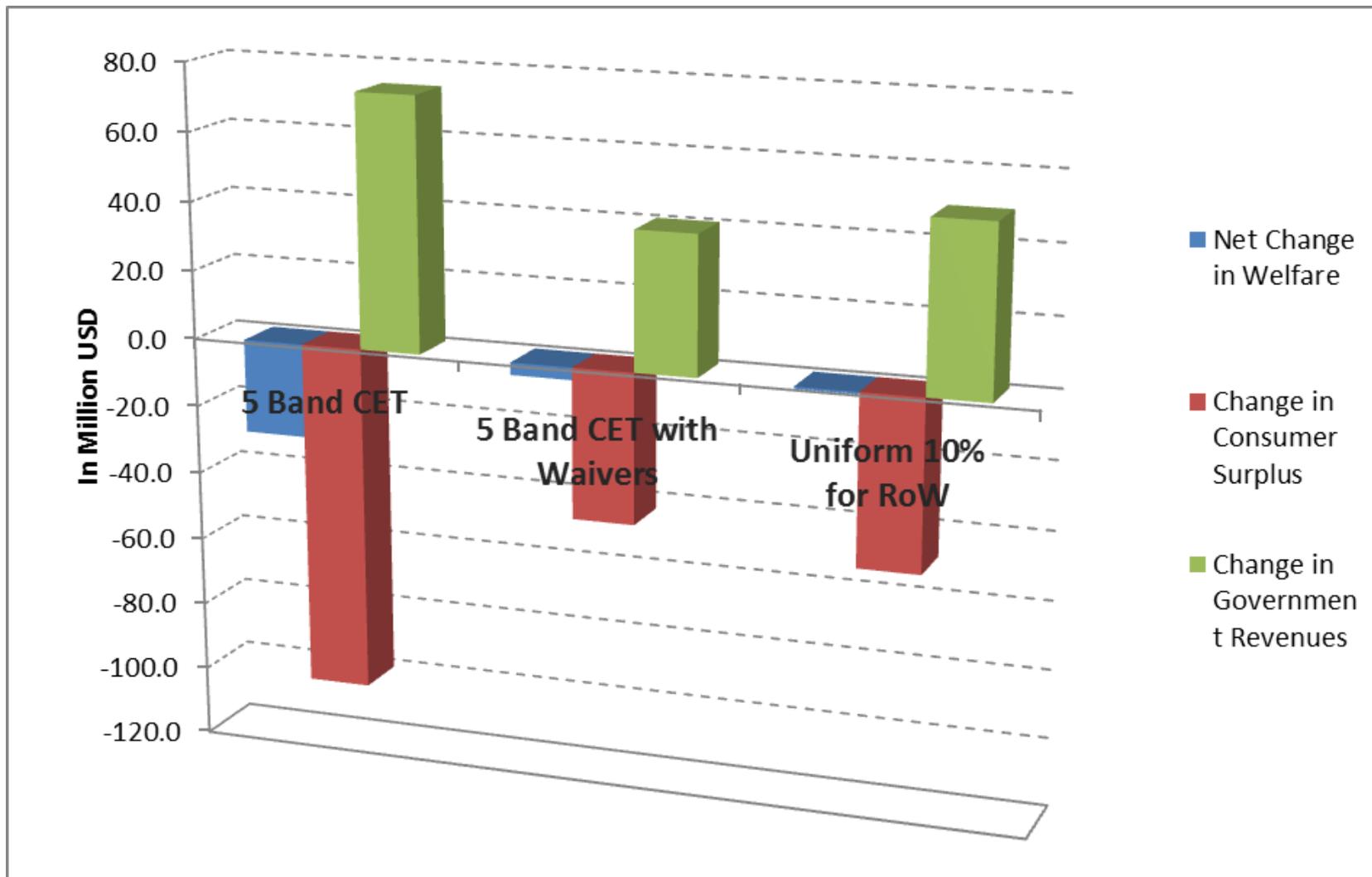
Liberia in ECOWAS (I)

- **Narrow issue:** estimate revenue and poverty effects (from HH surveys) of moving from current tariff structure (with some tariff waivers for essentials (rice), construction materials to the agreed 5-band CET (0(Social)-5(raw materials)-15(intermediates)-25(consumer)-35(exceptions of development interest)).
- **Broader issue:** What trade strategy for Liberia (not yet WTO member). How much of scarce negotiating resources for ECOWAS vs. WTO accession preparation
- Currently, with waivers and exceptions, customs data show an average applied tariff of 5.3% in 2012. Moving to the agreed 5-band CET (with no exceptions) would raise the applied MFN tariff towards non-members to 13.6%

Liberia in ECOWAS—Welfare effects from CET

- Proposed 5-band CET: average tariff up from 5.3% to 11.9% with a reduction in imports of 3.5% while moving to a 10% uniform CET would give average tariff of 8.3%.
- HH welfare of moving to 5-band CET: 3% loss for urban households and 6% for rural households: difference reflecting a higher share of non-traded expenditures (not affected by tariff changes) for urban households. Strong insulation (only 30% pass-through instead of 50%) cuts loss by 1 percentage point
- Put rice, fish, cassava roots, and palm oil) on an exception list at current 0% would cut in half the estimated cost increase.

Liberia in ECOWAS—Trade Creation and Trade diversion effects from CET



Liberia in ECOWAS (II)

- Pursue regional and multilateral integration (..but at the margin put more resources to multilateral negotiations under greater control than CET...)
- ETLS signed by most members in 1993 – was to remove tariffs and NTBs on trade is still to be implemented (and progress not monitored at ECOWAS level)
- ...in conclusion, need to carry out reforms that will help Liberia enter the 21st century world trading system.
- ...maintain participation in ECOWAS, but go beyond regional decision-making when needed policies are not implemented (or exceptions to announced policies are put in place like the recent Import Adjustment Tax and Supplementary Protection tax adopted on Sept. 30 2013).

South Sudan

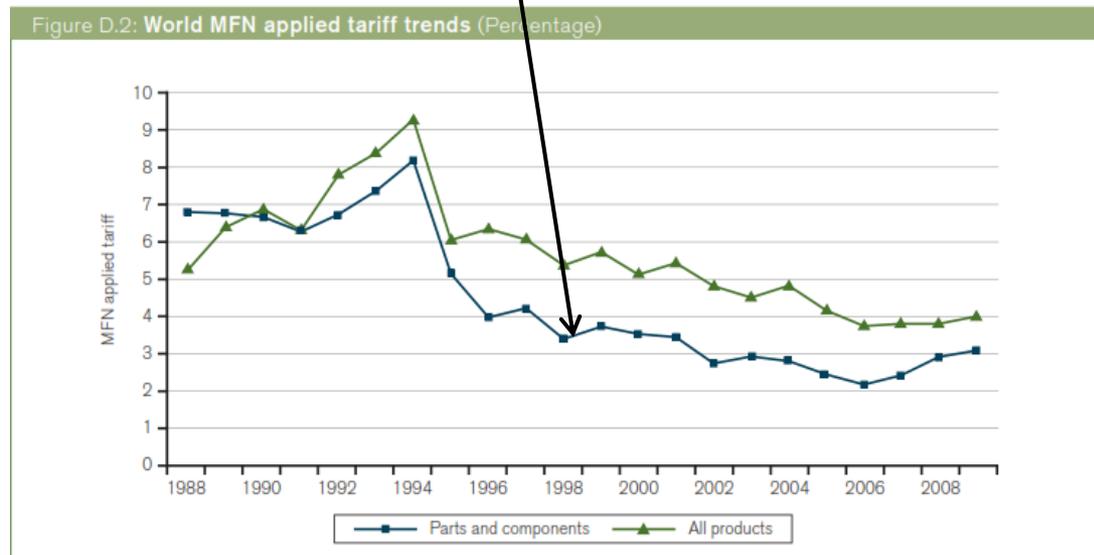
- Discover Trade Opportunities, internal and external...engage international community to support trade capacity building
- 2 prerequisites prior to integrate regional and world markets
 - Stable real exchange rate determined by 'fundamentals'
 - Reduce transport costs within country and with partners
- 3 Pillars
 - Pillar I: Build WTO-compatible Institutions to deliver Public Goods needed for Trade (learn by doing, get data...)
 - Pillar II: Join EAC for economic and political reasons taking heed from Rwanda's successful strategy.
 - Pillar III: Prepare for WTO membership benefits ($\approx 5-10$ yrs.)...Membership could raise growth temporarily (≈ 5 years) resulting in permanent income 20% higher.

African PTAs: How outward-oriented

- To participate in worldwide fragmentation of production, countries have been reducing their tariffs---mostly on parts & intermediates they need to contribute to production chain

- Compared to other regions, applied tariffs still higher in Africa (extra slide)

- Compared to PTAs in other Regions share of imports at Zero tariffs is lower in Africa and it has not progressed as Rapidly. (extra slide)



Summary

- Preferential Tariff Arrangements (PTAs) are good politics
- Deep PTAs address limits imposed by African geography (very unequal distribution of resources, coastal vs. LL, large vs. Small)
- But intra-regional trade has not increased because trade costs have not been reduced (not enough attention to Behind-the-border regulations)
- Cost-reducing common policies were not adopted because of policy differences
- ...and PTAs are still founded on exchange of market access (keeping barriers to non-members too high) rather than opening up to attract needed FDI.

References

Melo, Jaime de and Laura Collinson (2011) «Getting the Best t of Regional Integration: Some Thoughts for Rwanda»

<http://www.theigc.org/publications/working-paper/getting-best-out-regional-integration-some-thoughts-rwanda>

Melo, Jaime de «Pillars for a Trade Strategy for South Sudan» (2013)
mimeo, IGC

Melo, Jaime de and Armela Mancellari (2013) «Regional and Global Trade Strategies for Liberia» <http://www.theigc.org/publications/working-paper/regional-and-global-trade-strategies-liberia>

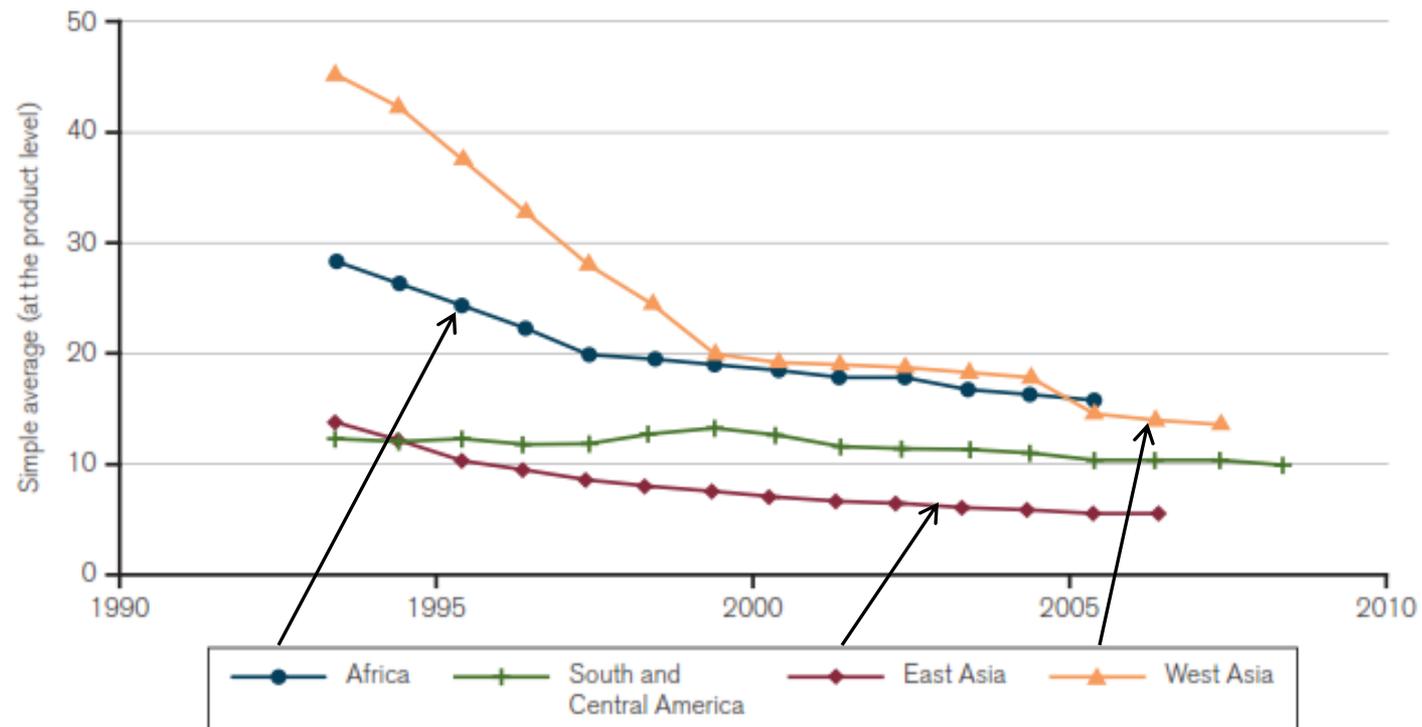
Melo, Jaime and Yvonne Tsikata (2013) «Regional Integration in Africa: Challenges and Prospects», mimeo

Extra Slides

Africa is catching up but still lags most regions

...Tariffs are falling across all regions, so are adjusted preferential margins now estimated at only 1 percentage point for Africa

Figure D.1: MFN tariff trends in developing countries by region (Percentage)



African PTAs have low import shares at zero tariffs

Some progress in EAC but not ECOWAS: Import Shares with zero tariffs by decreasing order: ASEAN(53%), EAC (44%), COMESA(37%), (ECOWAS)(15%)

ECOWAS 5-band
CET

Average tariff is
13.6%
(before negotiations
on exclusion lists)

Liberia's current
average tariff is
5.3%

High economic costs
for a small economy?

Figure 6 Share of imports with MFN zero tariffs, various RTAs, 1995 to 2008..

