

Advantages and Drawbacks of Integration of Madagascar in the African Continental Free Trade Area: a literature review

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ABSTRACT

Background and Aim of the research:

The African Continental Free Trade Area is a free trade area. One of the disadvantages of it is the non-tariff barriers (with the gradual elimination of customs duties over a period of 10 years) in the framework of foreign trade, which could overload public expenditure in the country's current context. The objective of the present research is to highlight the main advantages and disadvantages if Madagascar plans to join the African Continental Free Trade Area.

Methods:

The methods include three steps: 1/collect documents related to the African Continental Free Trade Area, 2/extract and evaluate each advantage and disadvantage, 3/elaborate a table of advantages and disadvantages for Madagascar. The collect of documents is guided by the competitive intelligence.

Main findings:

The research has highlighted a table of main advantages and disadvantages for Madagascar. Main advantage is gain even there are dissimilarity of cost ratio between two countries. Export, another main advantage, will increase. Then, global merchandise exchange will grow considerably. However, competitiveness may reprimand as far as 85 percent of trade, of Madagascar, is outside the continent. One main drawback is the progressive elimination of tariffs and non-tariff barriers which impacted strongly the revenue of Madagascar.

Main conclusions:

Joining the African Continental Free Trade Area requires a deep understanding and discussion with the private sector. It involves a strong strategic plan elaborated with participatory and inclusive approach of public and private stakeholders.

Keywords: *African Continental Free Trade Area, Competitive Intelligence, Custom, Tariff*

1. INTRODUCTION

The African Continental Free Trade Area or AfCFTA is a free trade area founded in 2018, with trade commencing as of 1 January 2021 [1]. It was created by the African Continental Free Trade Agreement among 54 of the 55 African Union nations [1]. The AfCFTA aims at accelerating intra-African trade and boosting Africa's trading position in the global market by strengthening Africa's common voice and policy space in global trade negotiations [1]. As at 5 February 2021, 36 countries have deposited their instruments of ratification, 36 countries have ratified the AfCFTA

agreement [1]. Till now, Madagascar has not ratified it.

Madagascar may hesitate due to a need for understanding or a need for advice. Such hesitation could also mean a fear of losing budget revenue, as far as Malagasy budget moderately depends on customs revenue. The research question is, how Madagascar can integrate the AfCFTA?

2. LITERATURE REVIEW

Although many of the world's fastest growing economies are in Africa, there is still much to be done in terms of regional economic integration and

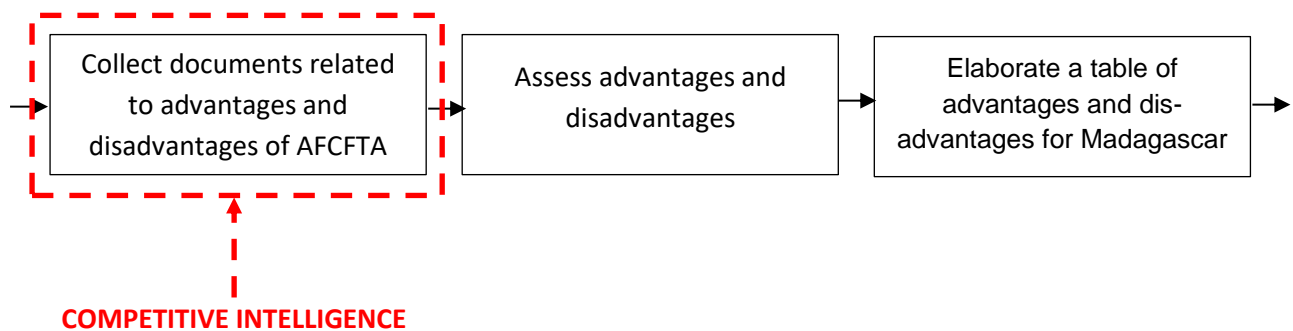
intra-African trade [2]. The African Continental Free Trade Area has the potential to increase employment opportunities and incomes, helping to expand opportunities for all Africans [3]. The AfCFTA is expected to lift around 68 million people out of moderate poverty and make African countries more competitive [3]. But successful implementation will be key, including careful monitoring of impacts on all workers-women and men, skilled and unskilled-across all countries and sectors, ensuring the agreement's full benefit [3].

However, the extensive agenda of the AfCFTA integration process among African countries affects several dimensions of economic and socio-ecological development [4]. The eight regional economic communities are the building blocks of the AfCFTA agreement, as every African country participates in one or more of these Regional Economic Communities or REC [4]. However, the

diversity of integration levels and overlapping RECs add complexity to the liberalization process [4]. The ambitious schedule for trade liberalization and regulatory adjustment also requires substantial efforts with respect to the implementation and application of regulations [4]. Since African countries will not have common external tariffs against imports from the Rest of World and the approaches to rules of origin differ in the single RECs [5], AfCFTA rules of origin have to establish the country of origin in order to benefit from preferential access in intra-African trade [6].

3. METHODS

The Centre National de Recherches Industrielle et Technologique researchers of Research Unit "Lean and Industrial System Modelling" have undertaken the work. The research process is the following



The above research process started with a continuous competitive intelligence to collect documents related to advantages and disadvantages of AfCFTA. Six researchers were involved in the competitive intelligence. Then results were reported in Google sheet. Each researcher could insert his inputs in that Google sheet.

Competitive Intelligence or CI is the collection and analysis of information to anticipate competitive activity, see past market disruptions and dispassionately interpret events [7]. It is an essential component to developing a business strategy [7]. CI analysis provides insight into marketplace dynamics and challenges in a structured, disciplined, and ethical manner using published and non-published sources [7].

Taken into account the economic parameters of Madagascar, each advantage and disadvantage were evaluated. Their impacts on the local activities were assessed. Then the last step is to elaborate a table of advantages and disadvantages.

4. FINDINGS

Some documents of the United Nations Conference on Trade and Development were exploited. They point out some key points related to AfCFTA. Then some studies of the World Bank were explored. Those studies show key elements about each African country. The following table shows the advantages and drawbacks if Madagascar integrates the AfCFTA.

Table 1: Advantages and Drawbacks of integrating AfCFTA

ADVANTAGES IF MADAGASCAR JOINS THE AfCFTA	DRAWBACKS IF MADAGASCAR JOINS THE AfCFTA
<p>Gains based on cost ratio Makower and Morton (1953). They noted that if trade creation is going to occur, the gains would be larger; the more dissimilar is the cost ratio in the two countries. In their analysis, economies are competitive if they have similar cost ratio and are complementary when they have dissimilar ratios [8] [9]</p>	<p>Increase of trade only 5% in the next decade The AfCFTA aims at boosting trade within Africa by 25 to 30 percent in the next decade. It also ultimately aims at establishing a continent-wide African Economic Community. As with most regional integration schemes, the underlying economic rationale of the AfCFTA agreement is to provide greater opportunities to reap economies of scale, efficiency through greater competition and specialization, a more attractive internal market for investment (both foreign and domestic), and an acceleration of intraregional trade and stimulate economic growth and lift people out of poverty [10]</p>
<p>Increase of trade The implementation of the AfCFTA is then examined. This is estimated to increase total African exports by US\$ 17.6 billion (2.8 percent increase from the base run) with two FTAs; and to an increase of US\$ 25.3 billion (4.0 percent increase to the baseline) when a single AfCFTA is applied to a single region. [Given intra-Africa trade is 14.6 percent of the total African trade; this translates to an increase of US\$ 2.57 billion in intra-Africa exports in scenario 1 (and about US\$ 3.7 billion in scenario 2)]. If the 2.8 and 4 percent increases are used, instead, this entails an increase in intra-Africa exports of US\$ 2 billion and US\$ 2.9 billion, respectively [11]</p>	<p>Intra-Africa trade is found to be very low Intra-Africa trade is found to be very low because the continent is dependent for about 85 percent of its trade outside the continent, leaving the rest for intra-Africa trade. In addition, even this small intra-Africa trade is dominated by few countries. Few commodities also dominated this intra-Africa trade where primary commodity alone being about 56 percent of this trade - more than half of the latter being fuels. However, the continent is also found to trade more in manufactured goods in its intra-regional trade (about 43 percent) compared to small share of such commodities (about 15 percent) in its trade with the rest of the world. These manufacture exports are also found to be dominated by high and medium-skill intensive products (about 10 percent each) as well as “labor & resource-intensive” and “low skill intensive products” (each having about 6.4 percent share) [12]</p>
<p>Increase of global merchandise trade Over the past decade and half, global merchandise trade has grown substantially, from US\$ 13 trillion in 2000 to reach an all-time peak of US\$ 38 trillion in 2014 (UNCTAD, 2019), before dropping to US\$ 33 and US\$ 32 trillion in 2015 and 2016, respectively. It then increased to US\$ 36 trillion in 2017 (UNCTAD, 2019). [13]</p>	<p>Elimination of tariffs and non-tariff barriers The overarching objectives of the trade in goods protocol are: progressive elimination of tariffs and non-tariff barriers, enhancing the efficiency of customs, trade facilitation and transit, cooperation on technical barriers to trade and sanitary and phytosanitary, development and promotion of regional and continental value chains, socio-economic development, diversification and industrialization across Africa [14]</p>
<p>New markets [15] The AfCFTA will allow African-owned companies to enter new markets. This expands their customer base and leads to new products and services, making investing in innovation viable.</p>	<p>Wide variation that exists in African countries’ levels of development [15] A major potential challenge in harmonizing Africa’s heterogeneous economies under one agreement is the wide variation that exists in their levels of development. For example, over 50% of Africa’s cumulative GDP is contributed by Egypt, Nigeria and South Africa, while Africa’s six sovereign island nations collectively contribute just 1%</p>
<p>Economic growth [15] Manufacturing represents only about 10% of total GDP in Africa, on average. This is well below the figure in other developing regions. A successful continental free trade area</p>	<p>Greatest level of disparity [15] The AfCFTA has the greatest levels of income disparity of any continental free trade agreement, and more than double the levels witnessed in blocs such as ASEAN and CARICOM</p>

could reduce this gap. A bigger manufacturing sector will lead SMEs to create more well-paid jobs, especially for young people, thereby alleviating poverty.	
Foreign Direct Investment [15] With restrictions lifted on foreign investments, investors will flock to the continent. This adds capital to expand local industries and boost domestic businesses. New capital enhances an upward productivity cycle that stimulates the entire economy. An inflow of foreign capital can also stimulate banking systems, leading to more investment and consumer lending.	
Reduction in input costs [15] The AfCFTA will ease the process of importing raw materials from other African countries. It will also enable SMEs to set up assembly firms in other African countries, in order to access cheaper means of production and thereby increase their bottom lines.	
Increased efficiency and sales [15] Global companies have more expertise than domestic companies to develop local resources. That's especially true for businesses in the manufacturing sector. The AfCFTA will allow multinationals to partner with local firms to develop raw materials, training them in best practices and transferring technology in the process.	

The cost ratio is a determinant advantage. It permits to measure and assess how Madagascar can integrate the AfCFTA. Even the cost ratio is different between two countries, there will be trade creation. Besides, there will be competitiveness and complementarity. Above and beyond, the export volume is also an important advantage. It will increase if a country joins the Free Trade Area. Then, the global merchandise will grow considerably while joining the AfCFTA. It is also showed that new markets will appear. In such markets, a successful trade area will enhance manufacturing. That process will be supported by Foreign Direct Investment who will congregate in

the continent. Downstream, input costs will reduce and efficiency and sales will increase.

Disadvantages of integrating AfCFTA are "Increase of trade only 5% in the next decade"; "Intra-Africa trade is found to be very low"; "Elimination of tariffs and non-tariff barriers"; "Wide variation that exists in African countries' levels of development"; and "Greatest level of disparity".

Besides, we found that the World Bank has forecast about what the AfCFTA brings in 2035. For Madagascar, production will be:

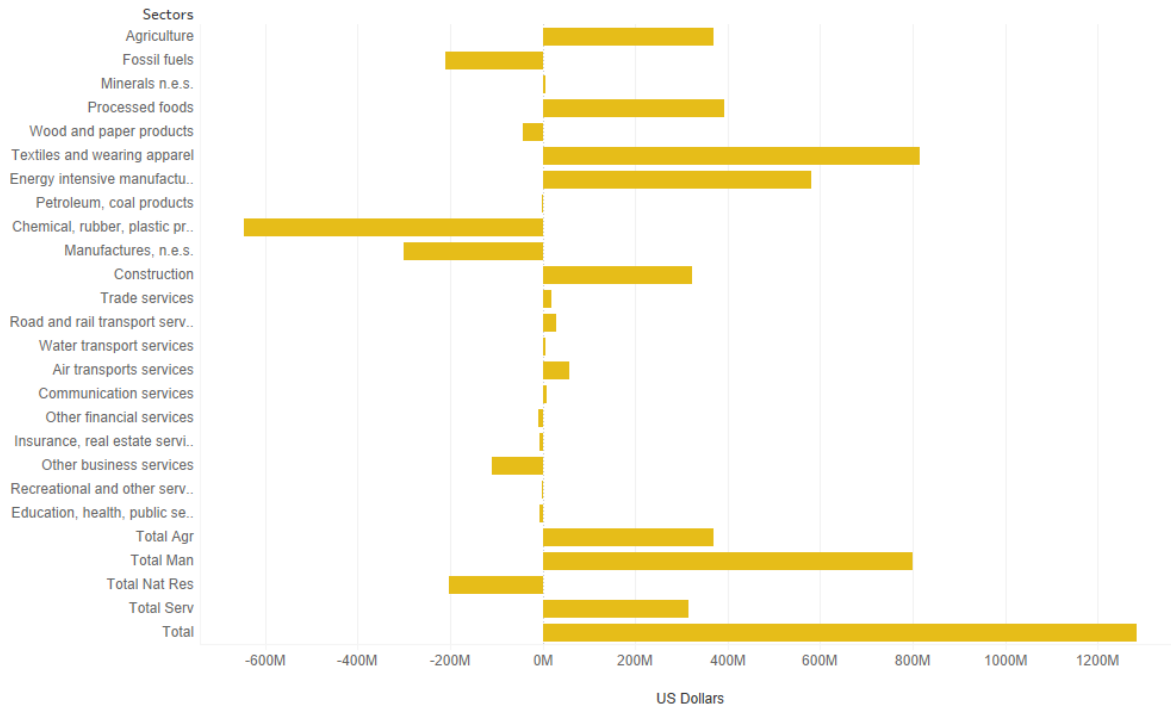
Income	Trade	Production	Employment - Aggregate	Employment - Detailed	Poverty
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Countries
Madagascar

Regions
South Africa

Output changes due to AfCFTA in 2035

by region and economic activity, difference with respect to baseline scenario (USD)



Notes: The graph shows absolute changes with respect to a baseline scenario in 2035. All expressed in billions of real US\$(2014)

Disclaimer: The numbers reflected on these Tables and Dashboards do not represent the official statistics of any country or the World Bank position on these aspects, unless otherwise specified. This visualization was generated exclusively for training purposes.

Source: The World Bank

The growth sectors, in terms of production, are textiles and wearing apparels (US\$800 million) and energy intensive manufacturing (US\$600 million).

They are followed by agriculture, processed foods, construction respectively for US\$375 million, US\$400 million, US\$350 million. Small production is noticed for air transport services (US\$50 million), road and rail transport services (US\$25 million) and trade services (US\$15 million). At mineral, petroleum and coal products, water transport services, and communication services activities only very small production is noticed.

Sector that will lose production is chemical rubber and plastic products (-US\$650 million). It is followed by fossil fuels and manufactures respectively for -US\$200 million, -US\$300 million.

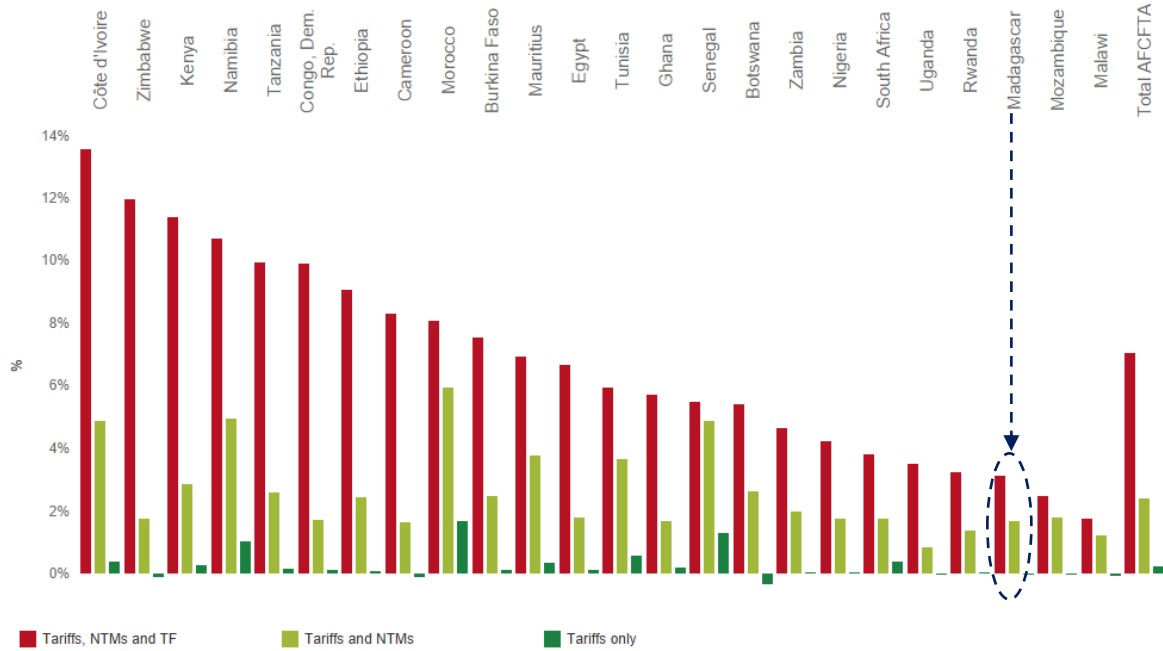
Other business services record a loss of -US\$100 million. There is a loss of production of -US\$50 million for wood and paper products activity.

In all Madagascar will record US\$1300 million, including US\$800 million for manufactures, US\$350 millions for agriculture, US\$300 million for services.

Income	Trade	Production	Employment - Aggregate	Employment - Detailed	Poverty
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Income gains due to AfCFTA in 2035

by country, % change with respect to baseline scenario .



Notes: 1) NTMs stands for Non-tariff measures, and TF stands for trade facilitation. 2) The graph shows % changes with respect to the baseline scenario in 2035. The baseline scenario does not have policy interventions, such as tariffs, NTMs, and trade facilitation measures.

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Source: The World Bank

Madagascar will improve income gains of 3% from “Tariffs, NTMs and TF” and 1.75% from

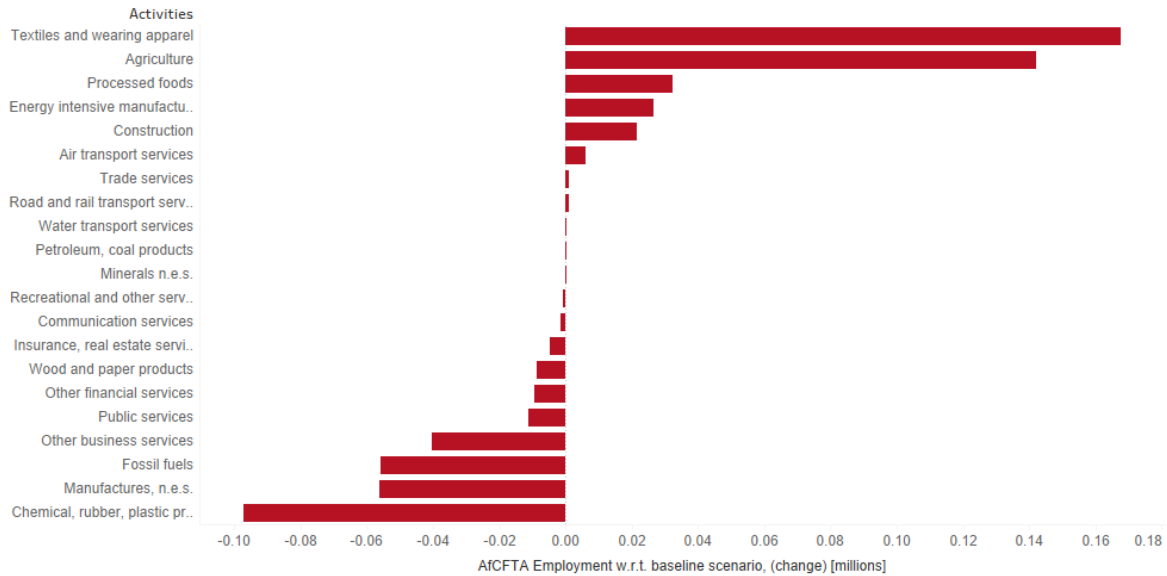
“Tariffs and NTMs” in 2035. Madagascar will be just behind Rwanda

Income	Trade	Production	Employment - Aggregate	Employment - Detailed	Poverty
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Countries
Madagascar

Employment reallocation due to AfCFTA in 2035

by country and economic activity, change with respect to baseline scenarios (millions)



Notes: 1) The graph shows absolute changes with respect to a baseline scenario in 2035. All expressed in millions of people.

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Source: The World Bank

Concerning employment reallocation due to AfCFTA, Madagascar will get some tangible results in textiles and wearing apparels, agriculture, respectively 0.17 million, 0.14 million. Medium impacts are appreciable at activities related to processed foods for 0.03 million, energy intensive manufacturing for 0.025 million and construction for 0.02 million. There is a small effect at activity related to air transport services for 0.005 million.

There are very small perceptible impacts at trade services, road and rail transport services. Inconsequential effects on employment reallocation are noticed at water transport services, petroleum and coal services, minerals activities.

There is an important decrease of employment reallocation at chemical, rubber and plastic products for -0.10 million. Intermediate decreases are observable at manufactures and fossil fuels for -0.06 million each, and other business services for -0.04 million. Public services, other financial services, wood and paper products, insurance and real estate services represent a small negative impact of approximately -0.01 million on average. At recreational and other services, communication services, a very small negative impact is noticed.

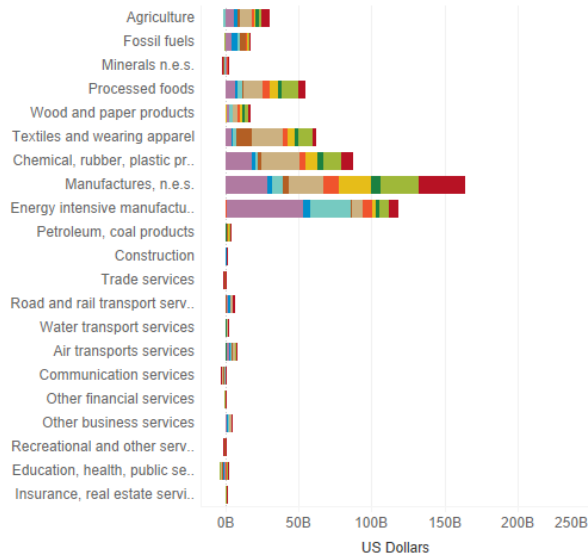
In general, the result of major trends is positive in favor of textiles and wearing apparels and agriculture.

Income	Trade	Production	Employment - Aggregate	Employment - Detailed	Poverty
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Regions
All

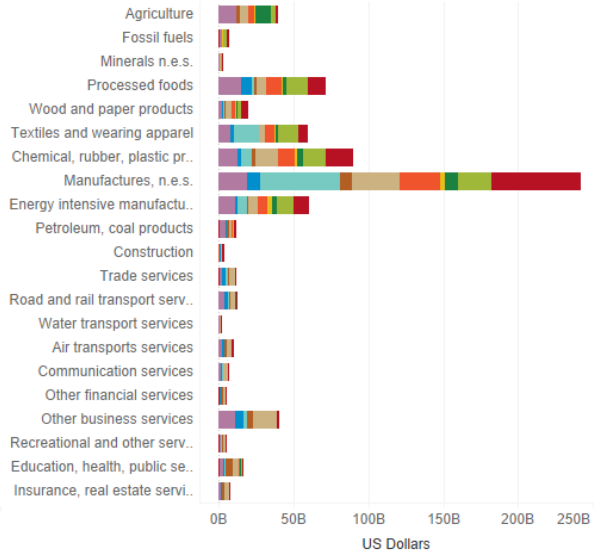
African exports due to AfCFTA in 2035

by destination, change with respect to baseline scenario (USD)



African imports due to AfCFTA in 2035

by origin, change with respect to baseline scenario (USD)



Notes: The graph shows absolute changes with respect to a baseline scenario in 2035. All expressed in billions of real US\$(2014)

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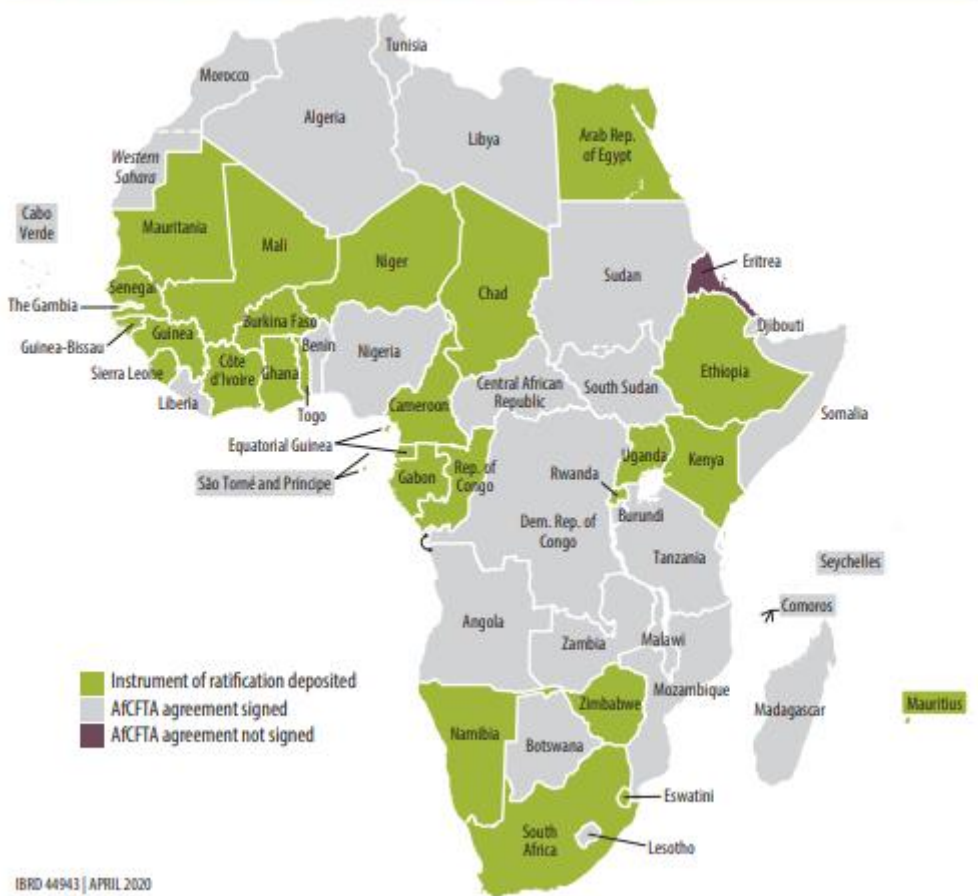
The figure shows that African imports are superior than African exports. Africa continues to import agriculture, processed foods and manufactured products.

5. DISCUSSION

The AfCFTA encounters many problems of misunderstanding. Although many publications, seminars and documents, integration requires caution. Decision should be non-repetitive and hardly reversible. According to Freund [16], the implementation of AfCFTA would be a huge step forward for Africa, demonstrating to the world that it is emerging as a leader on the global trade agenda. The AfCFTA is expected to lift around 68 million people out of moderate poverty and make African countries more competitive [17].

The welfare effects of preferential trade arrangements are theoretically ambiguous [18]; [19]. This is confirmed by Abrego and others [20] who find very small welfare gains from import tariff elimination. Those authors also approved that the AfCFTA would have a strong impact on intra-African trade volumes, but its effects on overall trade would be limited. Studies on the impact of the AfCFTA on inequality are inconclusive; using a traditional Computable General Equilibrium model and a sample of six African countries, Chauvin, Ramos, and Porto [21] find large heterogeneity across countries.

The following map shows the status of ratification. Madagascar is concerned through analysis of advantages and disadvantages.



6. CONCLUSION

The present research points out that advantages and disadvantages exist if Madagascar plans to join the African Continental Free Trade Area. The advantages are on commercial exchange of merchandises. That gain is not up to cost of ratio. Which is benefit due to JIRAMA problems that may impact local industries.

The future research concerns “what are strategies to develop to tackle the challenges?”.

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7. ACKNOWLEDGEMENTS

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