POLICY BRIEF / JANUARY 2021

Regional Integration & Trade Development in the HoA: Progress and Challenges

1. Introduction

Throughout the world, regional integration agenda has been of high priority, as the UN Sustainable Development Goals explicitly stated trade related measures and economic cooperation as instruments to eradicate global poverty (UN General Assembly, 2015). The various goals under SDG call for correcting trade restrictions and distortions in global agricultural markets, increasing aid for trade support for developing countries, especially for low income countries, and strengthening the means of implementation and the global partnership for sustainable development. It stresses the importance of a universal, rules-based, open, non-discriminatory and equitable multilateral trading system under WTO; increasing the exports of developing countries; and realizing the timely implementation of duty-free, quota-free market access on a lasting basis for all LDCs (UN General Assembly, 2015).

At the continental level, the African Union Commission Agenda 2063 articulates regional cooperation and integration as one of the key aspirations of Africa. It states that by 2063, Africa shall be united with world class and integrated infrastructure that crisscrosses the whole continent; and become a continent of seamless borders. The agenda supports Africa's accelerated integration and growth, technological transformation, and trade and development. It plans to promote the low intra-regional trade through coordinated infrastructure investment accompanied by trade facilitation. It also calls for action to fast-track the establishment of the Continental Free Trade Area, and to strengthen the continent's global trade negotiations power[1]. In the HoA region, IGAD has economic cooperation, integration and social development as one of the four pillars of its Regional Strategy (IGAD, 2016).

Yet the region remains less integrated and faces tremendous challenges to ensure successful economic integration globally as well as regionally. Though there has been some progress in reducing tariff barriers, with simple average effective tariff rate falling from 20 per cent in 1996 to below 12 per cent in 2016 in the continent[2], non-tariff barriers remain staggeringly high making trading across borders difficult[3]. According to the World Bank UNESCAP Trade costs database, the bilateral trade costs between countries in the region is considerably high. For example, the ad valorem equivalent trade cost of Ethiopia-Uganda for agricultural trade was 517 per cent in 2015 suggesting that on average, their trade involves additional costs as compared to when the two countries trade within their border.

A similar study shows that trade related costs constitute around 219 percent of the production costs in many developing countries implying that for each dollar it costs to manufacture a product, another US$ 2.19 will be added in the form of trade costs (WTO, 2015). The costs are considerably higher for agricultural commodities which most developing countries heavily rely on for their

[1] The African Continental Free Trade Agreement (AfCFTA) came into force on May 2019 after a majority of AU members (more than 22 countries), ratified it, and was effective on 1 Jan 2021.
[2] Abrego et al, 2019.
[3] In the IGAD sub-region, the simple effective applied tariff was a little higher around 13.5per cent.

exports (Arvis et al, 2013). Intra-regional trade between countries in the sub-region is thus low, not exceeding 15 per cent compared to 36 per cent in ASEAN, 64 per cent in EU (UNCTAD, 2019).

This policy brief draws on HESPI studies that examine HoA countries' progress in implementing the trade facilitation measures, the level of Non-Tariff Barriers (NTBs) and its impact on regional economic integration with focus on trade in the Horn of African economies.

2. Trade in the Horn of Africa

HoA remains to be marginal player in the global and other regional markets, although modest progress has been made in terms of entering into the global supply value chain in the recent years. The HoA countries as a whole like the rest of SSA mainly export a narrow range of primary commodities such as minerals, beverages and tobacco and agricultural products. More than 60 per cent of the region's exports is primary commodities, and few commodities constitute the main exports of each country. For example, three primary commodities (i.e. coffee, vegetables & oil seeds) made two-thirds of its exports in 2017.

Lack of dynamic export sector in most of these economies coupled with growing demand for imported capital and consumption goods has exacerbated the trade balance and contributed to ballooning trade deficits for all the countries, especially since the 2000s. Also, regional trade among these economies is low relative to other comparable regions. Regional trade within the HoA was above 10 per cent before it fell below 8 per cent during the peak of the global financial crisis. Since then it has recovered to close to 15 per cent in 2018. The weak global integration & low intra-regional trade in the region could be attributed to various structural & institutional factors including: (i) weak infrastructure making economies inaccessible and costly for trade; (ii) production structure & lack of trade complementarity[4]; (iii) export specialization on narrow range of agricultural products; (iv) accessing regional markets via PTA/FTA difficult for firms due to the strict rules of origin[5]; and (v) limited availability of local market information for firms in other countries[6].

2.1. Trade policies and trade cost

To promote and facilitate trade among countries and thereby ensure broad based and sustainable economic growth, trade policy choice is critical. Partly due to the economic structure and their historical legacies, countries in the region have somewhat diverse trade policies. Djibouti, Kenya and Uganda (are members of WTO and signed and ratified the AfCFTA) could be characterized to have a relatively open economies. Kenya and Uganda are members of COMESA FTA, EAC[7]; Ethiopia signed and ratified the AfCFTA; and Sudan is a member of COMESA FTA, and signed but not yet ratified the AfCFTA. For Sudan, besides the trade policy choice the US sanctions have contributed to the country's poor trade performance. Eritrea (the only African country which has not yet signed the AfCFTA) has been pursuing a restrictive trade policy imposing import restrictions. The trade policies of Somalia and South Sudan are already affected by political instability and civil unrest, but are inclined towards liberal and open trade policy.

In terms of trade costs associated with moving goods and services across borders (like administrative barriers, tariffs and NTDs, and transaction costs) and doing business environment, the region as a whole is ranked bottom across the various dimensions. In the latest World Bank Doing Business survey, HoA countries are ranked below the global average in most of the indicators including

[4] See Alemayehu and Edris, 2015; Ali and Edris, 2013

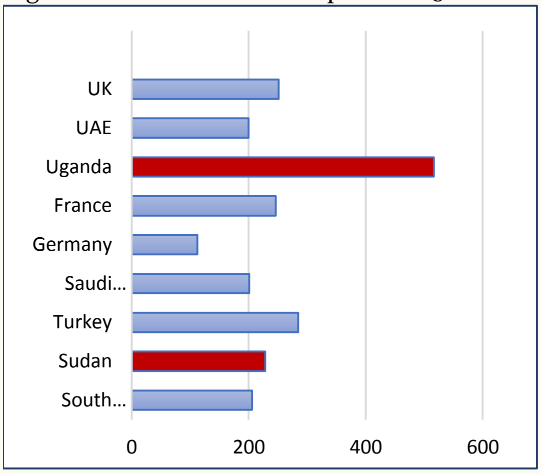
[5] Felbermayr et al, 2019 and key informant interview with private sector representative

[6] This is frequently cited by the representative of the private sector.

[7] As member of the EAC common market, both Kenya and Uganda apply common external tariffs on external goods.

trading across borders[8]. For example, Kenya and Uganda ranked [117th and 121st respectively] in trading across borders, and are the best for the region. Similarly, bilateral trade costs among the HoA countries are substantially higher compared to any other developing region. Ethiopia and Uganda have one of the highest bilateral trade cost despite having a common membership in COMESA and IGAD. On the other hand, Kenya and Uganda have relatively the lowest trade costs attributed to the East African Community common market (see figure below for the bilateral trade cost for Ethiopia with selected countries in 2015 for agricultural goods).

Figure 1: Trade costs of Ethiopia in 2015



Source: UN ESCAP-World Bank Trade Cost Database

The high level of bilateral trade cost between countries in the region despite the close geographic proximity of the countries suggests that the weak infrastructure (both hard and soft) connecting the countries could partly explain the low level of intra-regional trade between countries. The low level of regional trade among these economies could also be attributed to the structure of the economy and the composition of the countries' export. But it is worth noting that, despite all these, these economies have untapped potential for further intra-regional trade (Alemayehu and Edris, 2015).

3. Regional integration and trade facilitation measures in the HoA

There has been various regional integration initiatives in the region including by IGAD which sets out economic cooperation and integration as one of its pillars through the promotion of trade and investment within the region. Other initiatives include the *COMESA F/PTA*, the *EAC common market* and the recent *Horn of Africa Initiative*. Yet the region remains least integrated across different regional indicators except that of free movement of people (ECA, 2019). Similarly, countries in the region lag in putting policy measures that simplify trade procedures, practices and formalities, which broadly include harmonizing and simplifying document requirements, and automating customs and imports, exports and transit processes. Since these measures require significant investment, their implementation depends on various factors and performances across countries do vary. Based on the progress countries have made, Eritrea, South Sudan, and Somalia haven't made much progress, Ethiopia and Djibouti however have implemented few of the measures, while Kenya, Sudan and Uganda have been making relatively good progress.

Even though governments in the region have given policy focus to trade facilitation, the overall implementation progress of trade facilitation measures is weak throughout the region. To streamline the implementation of trade related measures with much focus on trade facilitation *Djibouti, Ethiopia, Kenya, Sudan* and *Uganda* have established national trade facilitation committees and have a working national committees tasked with following up the implementation of measures and identifying the gaps and best practices for facilitating trade. Similarly, these countries except for Ethiopia, have technical trade facilitation committee mainly at the national level tasked with ensuring the implementation of the Agreement and monitoring and improving the harmonization of the programs and mandated to prepare and formulate national policies priorities and needs for

[8] World Bank (2020)

technical assistance[9]. Such Committees monitor and evaluate the trade implementation processes and provide technical advice in participating in trade facilitation negotiations at all levels. Ethiopia, has a Ministerial and Technical Committee working on the trade facilitation measures and cross-border trade with neighboring countries, while Kenya and Uganda have a Regional Trade Facilitation Sub-Committees to coordinate the implementation of the trade facilitation agreement.

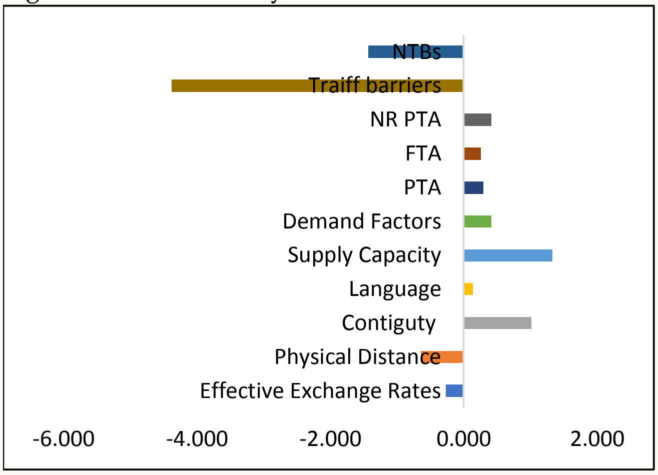
The HoA countries as a whole remain well behind the global average in gender mainstreaming the various trade facilitation measures. In 2019, the UN global survey on trade facilitation measures indicates that most of these economies have not implemented those measures aimed at engaging women in trade facilitation measures. For instance, female participation in the various trade facilitation committees is limited on non-existent and trade facilitation policies/strategies do not incorporate special consideration of female and small and medium traders.

Even though, the implementation of these measures have wide ranging economic and social benefits for economies, many low income countries (including the HoA) have struggled to institute the measures because they entail considerable financial cost and require skilled labor force to ensure successful implementation. Other factors cited in constraining the implementation of such measures are political unrest on conflict inter or intra state maladministration and corruption at customs offices, and instances of sanctions (US on Sudan and the UN Security Council on Eritrea).

4. Empirical Estimates of the Impact of NTBs on Trade in HoA

To substantiate the qualitative results and assess the impact of NTBs on trade in the HoA region, a quantitative analysis was conducted. The qualitative results show that tariffs among countries have fallen in the region partly owing to the proliferation of RECs. However, the quantitative estimate reveals that tariff measures still remain to be one of the key factors constraining regional and global trade countries in the Horn of Africa.

Figure 2: Trade Elasticity for the Horn of African Countries



Source: Own Computation Based on the Estimation of Gravity Model

We found a trade elasticity of 0.1 suggesting that a 1 per cent decrease in tariffs on tradable goods could lead to around 3.7 to 4.3 per cent increase in IGAD economies exports. Likewise, NTBs have a statistically significant negative impact on the countries' trade showing that both tariff and non-tariff barriers are critical factors affecting the HoA countries' trade in general. This might signify that trade facilitation and logistics related costs have significant adverse effects on countries' trade. The supply capacity of the exporting countries and the demand factors are also found to constrain export potential. Membership in the various integration arrangements particularly non-reciprocal preferential trade agreement such as the AGOA and EBA have increased countries' bilateral trade. Bilateral distance remains one of the factors determining the bilateral

[9] In addition to the National Committees, there is also bilateral working Ministerial Committees on Trade related issues between the countries in the region. For example, Ethiopia has such committees with Sudan, Djibouti and Kenya meet quarterly to discuss bilateral cross-border trade and customs issues.

trade of countries suggesting that, despite the notion that the relative impact of distance on trade is falling owing to expansion of information technology, in the HoA region distance remains to be a key trade inhibiting factor.

5. Key findings

Much progress has not been achieved in integrating the HoA countries, owing to prevalent political instability, inadequate economic infrastructure connectivity, and restrictive trade policies pursued by some countries and the slow progress in implementation of the various trade facilitating measures. Countries in the region have restrictive trade policies limiting the trade flow as well as labor movement across borders.

Despite the decline in recent years, tariff among HoA economies stands around 9 per cent which is high (compared to 5 per cent in COMESA, 4 per cent in SADC, and 0 per cent in EAC). Non-tariff related costs also remained staggeringly high hindering trade across countries. Owing to the high trade cost (attributed to the poor logistic and physical infrastructure coupled with the slow progress in implementation of trade facilitation measures).

Progress has been made across the region in terms of putting trade facilitation measures in place. Nonetheless, there exists significant variation among the economies in implementing these measures. Kenya and Uganda have taken aggressive and bold measures to facilitate trade across borders. The economies affected by prevalent conflict and political instability lag far behind in putting the reforms and measures. The factors constraining the ability to introduce trade facilitation measures include inadequate finance and technology, limited manpower, and poor governance and customs administration.

The empirical results show tariff and non-tariff trade costs to have a huge effect on these economies' global trade. A one percent fall in tariff could lead to a 4 percent increase in trade of the countries. Similarly, a 1 percent fall in non-tariff costs (which are directly linked to trade facilitation measures) could boost countries' trade by 1 percent.

High trade costs, limited supply capacity of countries (measured by GDP of the exporting country), geographic distance from the global markets, and restrictive trade policies of countries are the key factors affecting the region's integration and intra-regional trade. The various regional and bilateral trade agreements (especially those non-reciprocal trade agreements like AGOA and EBA) have created substantial market potential and have positively promoted the region's exports.

6. Policy recommendations

The following are some specific policy recommendations to effectively integrate the countries into the regional and global markets:

- Initiating cross-border investment projects aimed at improving the region's infrastructure connectivity. This will enable countries to conduct a well-organized impact assessment and joint execution of these cross-border infrastructure investments;
- Harmonizing the trade and investment policies of each economies; and mainstreaming clearly defined private sector development strategies into each countries national development frameworks (like national development plans and poverty reduction strategies (PRS)) and initiating a regional level private sector development strategies well aligned with each countries' strategies through IGAD or AU. ;
- National governments in each country could work closely with the regional bodies like the AU and IGAD to mobilize international support for the implementation of trade facilitation measures.;

- Integrating trade facilitation reforms process into countries' national development strategies, the building of productive capacities and donor relations
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- Expediting the EAC-IGAD merger to reduce overlapping membership and accelerating A Northern-Eastern Africa trade bloc in line with the AfCFTA;
- Initiating a comprehensive regional level trade and investment agreements with the Gulf countries; and
- Facilitating inter-governmental cross border cooperation among these economies to ensure the region's socio-political and economic stability.