AfCFTA and Trade in Services for development

By: Xaver Keller
July, 2019

Discussion paper
High trade barriers in Africa are an obstacle to trade within the continent and reduce the incentives for foreign investment to Africa (Afreximbank, 2018). African countries have successfully reduced their effectively applied tariffs from over 20 percent in 1997 to 11.8 percent in 2016 (Abrego et al., 2019).

But various non-tariff barriers (NTBs) ranging from poor infrastructure to diverging national regulatory policies and market access restrictions remain a huge obstacle for cross-border trade. This is particularly true for the service sector, which is at the core of most African economies.

Trade in Services (TiS), either through cross-border supply (Mode 1), consumption abroad (Mode 2), setting up a commercial presence abroad (Mode 3) or movement of natural persons (Mode 4)\(^1\), is thus a core element of the African Continental Free Trade Agreement (AfCFTA), which has entered into force on May 30th, 2019. Given the importance of services for African economies, Trade in Services will be key to the success of this historic endeavor.

---

\(^1\) The four Modes of service delivery in cross-border trade are defined by the General Agreement of Trade in Services (GATS) and generally used as categories in TiS policy making. More recently, the term Mode 5 has been used for services which are incorporated as inputs in goods which are traded internationally. However, the international TiS regime does not (yet) cover Mode 5.
The role of services for economic development in Africa

Services have long played but a minor role in discussion about international trade and trade policy. Most people have an idea about trade in goods, with container ships transporting goods across countries being the standard image of international trade. Services, in contrast, are less tangible and are often seen as non-tradeable. In addition, services are an extremely heterogeneous concept, ranging from hairdressers and hotels to teachers, accountants or telecommunication providers.

But they are crucial for economic development, particularly in Africa. Services account for 54% of African Gross Domestic Product (GDP) and for 75% of Greenfield Foreign Direct Investment (FDI) to the continent (Figure 1). The service sector is also an important and growing source of employment. While agriculture remains the major source of employment for Africans, in countries such as Angola, South Africa or Mauritius the service sector employs more than 60% of the working population (Brookings, 2017).

The significance of the service sector for African economic development is even greater than those figures suggest. For starters, services are often not sufficiently included in official statistics, not least because informality is much more widespread in services than in manufacturing. The actual size of the service sector is thus likely to be much bigger.
In addition, services are crucial inputs for other sectors such as agriculture and manufacturing, both of which will remain key to economic development in Africa. As Hoekman (2017) put it, “making progress [in those areas] and enhancing the share of value added created in Africa will require improving the availability of and access to a range of ancillary services, and more generally increasing the productivity of firms supplying services”. This is true for business services such as accounting, financial services, or communication and transport services, which provide the basic infrastructure for cross-border exchange of information and trade in goods.

Furthermore, a properly developed service sector carries great potential from a gender perspective as services are the most important source of employment for women in many countries (UNCTAD, 2017). Services can thus play a crucial role for more inclusive and gender-sensitive economic development, if embedded into the right set of policies (Lipowiecka, 2017).

Technological change increases the importance of services even further. Improvements in digital technologies and ICT makes it easier to trade services across borders. And the advent of Artificial Intelligence, Industry 4.0, or the reshoring of manufacturing to high-income countries reduce the scope for traditional economic development through manufacturing. As Rodrik (2016) puts it, “countries are running out of industrialization opportunities sooner and at much lower levels of income compared to the experience of early industrializers.” The consequence is a growing dependence on the service sector, or what some authors call “premature deindustrialization” (ibid.).
Despite the great economic importance of services for Africa, trade in services (TiS) on the continent remains far below its potential. Services account for only 22% of African trade and African exports remain highly concentrated on agriculture and primary goods (UNCTAD, 2017). Africa accounts for only 2% of global service exports and African service exports are largely dominated by travel (42% of African service exports). In contrast, high income countries rely mostly on high value services such as financial, business, insurance, or intellectual property services (Figure 2).
Yet this might change: In 2018, Africa, together with Asia/Oceania, has had the highest growth rate in services exports worldwide at 9.4% (UNCTAD, 2019). African countries are taking important steps towards strengthening their service sectors and services trade. Five of the eight officially recognized African Regional Economic Communities (RECs) have negotiated regional services agreements or policies (COMESA, EAC, ECCAS, ECOWAS and SADC).

Experience from the EAC shows how new ICT technologies enable companies to increasingly move beyond the domestic towards serving the regional market. According to a World Bank case study, more than half of Kenyan services exporters in 2012 had clients in Tanzania and/or Uganda and one-third have clients in Rwanda (Dihel et al., 2012). Since then, the regional orientation has probably grown even further.

While those initiatives are important stepping stones, the approaches used differ widely and overlapping memberships across RECs remain a serious challenge. Hence the need for an integrated, continental services market.

**Trade in Services within AfCFTA**

To harness the huge potential of their service sectors, AU Member States decided to progressively liberalize services through the AfCFTA. The Agreement establishing the AfCFTA, which entered into force on 30 May 2019 following the necessary number of 22 ratifications, contains a specific Protocol on Trade in Services. However, negotiations for specific commitments in services are still ongoing.

Trade in Services negotiations are very different – and often more difficult – than negotiations in goods trade. Unlike goods, there are no tariffs on services. Liberalizing services is thus not about reducing the duty on a product, say from 10 to 0 percent. Instead, countries negotiate about a broad range of complex policies and underlying public policy concerns regulating governing the market access and regulating service provision.

---

For example, which certificates does a doctor or architect from South Africa need to practice in neighboring Botswana? How – and for how long – can Nigerian accountants get a business visa to temporarily work in a foreign branch of their company? Which conditions does a mobile payment company from Kenya have to meet to offer its services in Ethiopia? Policies governing services trade include very sensitive issues closely linked to the idea of national sovereignty. Hence the difficulty in finding common ground among a large group of very diverse countries.

The countries follow a mixed approach in their negotiations, combining the scheduling of specific commitments as under GATS, on the one hand, with regulatory cooperation, on the other hand. To negotiate market access, countries agreed on a positive list approach to liberalization, i.e. countries liberalize only those sectors they explicitly selected. The first phase of negotiations focuses on five priority sectors: business, communication, financial, transport and tourism services. Negotiations of the remaining seven sectors will follow thereafter. In parallel, countries are negotiating frameworks to foster regulatory cooperation in the services sector.

Members have agreed to submit their offers until end of 2020. According to the AfCFTA roadmap, the schedules of specific commitments shall be finalized and adopted by January 2022. But given numerous remaining open questions, this goal constitutes a huge challenge for many countries.

**What’s next?**

Harnessing the huge potential of AfCFTA in the services sector requires strong commitment by a broad range of stakeholders including Member States, RECs, the AU Commission and its partner institutions including development partners, as well as the private sector. The AU Department of Industry and Trade (DTI) together with its partners is currently developing a six-year Service Sector Development Program (SSDP) aimed at developing a strong and competitive services sector towards the creation of an African services market. The important next steps include, inter alia:

- **Member States** will assess the complex set of policies governing their respective services sectors. In most countries, there is not one single institution overseeing all policies governing services trade, but responsibility is often split among different ministries and agencies. In parallel, States will also identify their offensive and defensive interests in services sectors and decide, which sectors to liberalize and which ones to protect from foreign competition.

- **Member States, RECs, and the AU** are challenged to translate the strong political momentum around the AfCFTA into actual negotiation outcomes on the technical level. More and intensified negotiation rounds as well as technical working group meetings will be necessary to finish the negotiations within the agreed timeframes.

---

3 In contrast, liberalization via a negative approach means that by default, all sectors are liberalized, and states decide which sectors not to liberalize.

4 The categorization of services along 12 sectors follows the so-called W/120 classification used under the GATS. The remaining sectors are: construction, distribution, education, energy, environmental, health and social services.
Relevant stakeholders such as private service providers are crucial to inform the negotiations with practical experience on the ground. In many countries, the manufacturing sector dominates private sector organizations, at the expense of the services sector. The negotiations and policy discussions would benefit from involving services sector representatives when designing policies governing that sector. Depending on the context, that can mean setting up effective stakeholder engagement platforms or even supporting the sector to organize itself in the first place.

International partners will have a chance to continue their support through capacity building and technical cooperation on various levels. Many actors involved have limited technical and financial capacities to finalize the TiS negotiations within the given timelines. Support such as technical trainings on TiS negotiations, fora for stakeholder exchange or background studies on Member States’ services sectors can contribute to a successful finalization of the AfCFTA services negotiations.

Of course, the work does not end with finalizing the negotiations. All stakeholders will have to continue and even increase their efforts during the implementation phase for the negotiation results to come into full effect. For services, this includes designing policies on the national and regional level which go beyond the current focus on actions to facilitate trade and focus more on improving the performance of a variety of services, including transport, logistics, and related services (Hoekman, 2017). Simulations of the economic effects of the AfCFTA show that in the long run, to fully leverage the economic opportunities of the AfCFTA, policy makers would need to adopt supporting policies to encourage structural transformation on the continent (Abrego et al., 2019).

Contact Person:
Xaver Keller
xaver.keller@giz.de


UNCTAD (2017). The role of the services economy and trade in structural transformation and inclusive development.