

REGIONAL TRADE AGREEMENTS: AN AFRICAN PERSPECTIVE OF CHALLENGES FOR CUSTOMS POLICIES AND FUTURE STRATEGIES

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Abstract

The proliferation of Regional Trade Agreements (RTAs) has not spared the African Continent. The formation of RTAs in Africa is championed by the Regional Integration Agenda under the auspices of the Regional Economic Communities. The challenges that customs administrations face when their countries become members of RTAs depend on whether the RTA is trade-creating or trade-diverting. It is the trade-creating RTA that presents the customs administration with the greater challenges. This paper looks at these challenges and the areas where they require customs administrations to concentrate their policies and strategies.

1. Introduction

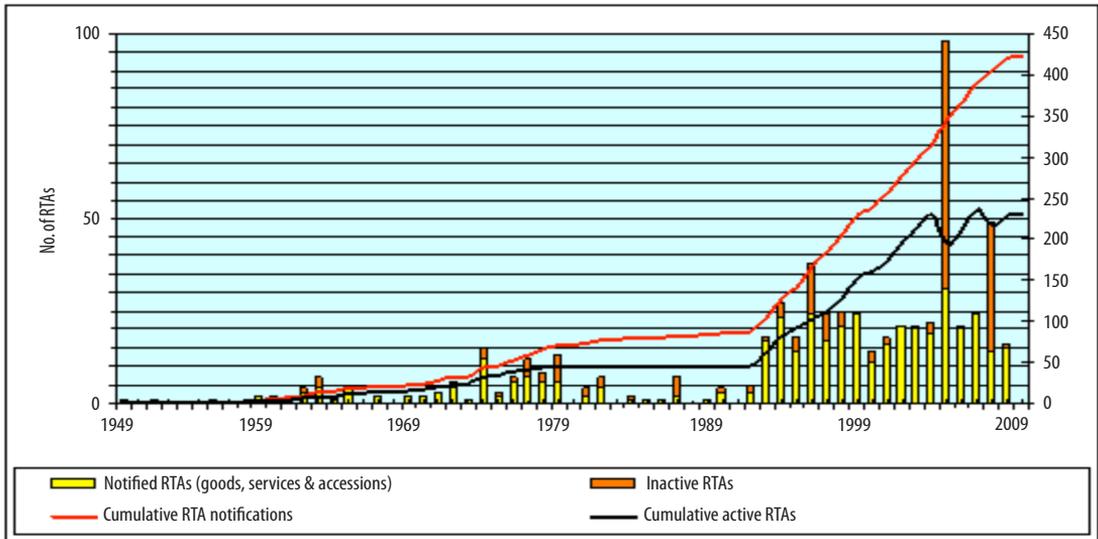
One of the major developments of the last two decades that international trade has experienced (apart from the advent of electronic commerce) has been the dramatic increase in regional trade agreements (RTAs). Between 1948 and 1994 there were only 124 RTA notifications whereas between 1995 and 2008 this figure more than tripled, with an additional 300 notifications (WTO 2009). Figure 1 below charts the global development of RTAs during this period.

The African Continent has not escaped the proliferation of regional trade agreements in the existing global trade regime. The formation of RTAs in Africa has mainly been championed by what are commonly known as Regional Economic Communities (RECs) as the continent moves towards the formation of the African Economic Community (AEC) that was established by the Abuja Treaty of 1991. Despite the fact that there are fourteen RECs in Africa, the Abuja Treaty of the African Union (the major African continental body) recognises only eight of them as Pillars of the AEC. These are the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), the Economic Community of Central African States (ECCAS), the Economic Community of West African States (ECOWAS), Community of Sahel-Saharan States (CEN-SAD), the Arab Maghreb Union (AMU)², and the Inter-Governmental Authority on Development (IGAD).

Almost all the RECs have RTAs in the form of free trade. To date, COMESA has already launched its own customs union and ECOWAS is preparing to do the same. ECCAS and SADC each have their respective free trade areas and both are planning to launch their customs unions in 2010. Although the CEN-SAD is currently at the stage of a free trade zone it has not yet elaborated a distinct road map to strengthen integration amongst its Member States, whilst IGAD is planning to establish a free trade area by 2012. The EAC has also reached the stage of a customs union which was launched in January 2005. It has plans to launch a common market in 2010 with preparatory works well under way for the gradual

establishment of legal and technical instruments in that regard.

Figure 1: Notifications of RTAs to the WTO 1948 to 2008



Source: WTO Regional Trade Agreements: Facts and Figures 2009.

Despite this development, not all Member States of RECs have signed up to these agreements because the principle of ‘variable geometry’ has been widely applied. Whilst this may be a major challenge to the rapid evolution of FTAs to customs unions within the RECs, it grants countries the opportunity to implement the regional integration agenda at their own pace. The RECs in Africa are characterised by a multiplicity of membership (statistics of multiplicity). As a result, there is a cross-membership of RTAs in Africa. However, of late there has been a new development, especially in the Eastern and Southern African region where COMESA, SADC and EAC are in the process of forming a single FTA block. Another important characteristic of RECs in Africa is their multi-prong approach to regional integration. Thus, apart from the trade issues, RECs in Africa are also pursuing other agendas such as socio-economic development, peace and security, agriculture and environmental conservation.

This paper investigates some of the major challenges that customs administrations are likely to face in the near future and seeks to inform future customs policies and strategies on how to deal with these challenges. However, before analysing the challenges, this paper will look at the nature of RTAs because, ultimately, they have a bearing on customs administrations.

2. Nature of regional trade agreements

The impact of any given RTA on Customs will largely depend on whether the RTA is trade-creating or trade-diverting. A given RTA will be trade-creating if some domestic production in an RTA member is replaced by lower cost imports from another member. On the other hand, an RTA will be trade-diverting where lower cost imports from outside the RTA are replaced by higher cost imports from an RTA member as a result of preferential trade treatment.

A trade-creating RTA has both static and dynamic benefits arising from a reduction in administrative costs and an increase in bargaining power, competition, economies of scale and a stimulus to investment through tariff factories amongst other major factors.

A rigorous analysis of whether a particular RTA is trade-creating or trade-diverting is beyond the purview of this paper. However, as a general rule, a given RTA will lead to trade creation if its members maintained high pre-RTA trade barriers, have few trade barriers with the rest of the world, have a dense population and large number of memberships, the economies of its member states are more competitive than complementary, there was significant pre-RTA trade and the members are in close geographical proximity to each other (Salvatore 2004, p. 327).³

A trade-creating RTA has greater bearing on customs than a trade-diverting RTA because it will lead to an increase in both the volume and flow of trade amongst the member countries which, in turn, will lead to greater cross-border transactions with customs. Despite the conventional belief that RTAs in Africa cannot be trade-creating owing to the lack of complementary products and less product differentiation coupled with poor trade-facilitating infrastructure,⁴ there is some evidence to the contrary. For instance, in its annual trade report of 2007 (EAC 2008, p. 20), the East African Community (which has five members) reported an increase in both trade volume and flow following the formation of its customs union in 2005 and, as indicated above, ECOWAS is launching a customs union just like COMESA. Cernat (2001, p. 12) also finds in his study a strong case of trade creation between African RTAs which he attributes to greater trade facilitation amongst members of RTAs. This is a clear indication or a pointer to the fact that RTAs in Africa have good chances of being trade-creating, especially considering the sum of the welfare effects on all RTA members. An increase in both the flow and volume of trade is a very necessary component of economic growth. However, in both respects it has the potential to complicate the traditional customs compliance mission of regulatory enforcement and revenue collection. It is against this background that the challenges of the RTAs on Customs in Africa need to be considered.

3. Challenges of regional trade agreements to customs administrations

Due to the fact that the proliferation of RTAs increases both the flow and volume of trade, the following challenges arise.

3.1 Capacity building

In the face of trade-creating RTAs, the importance of capacity building for African customs administrations cannot be over-emphasised. RTAs have effects on the broad role, purpose, duties, and responsibilities of Customs (Feaver & Wilson 2007, p. 17), hence there is the challenge of coming up with broadly-based capacity building programs that enhance the abilities of both the institutional system and human resources that work with the system to be on a par with the new arrangements. This automatically places greater demands on the scarce resources that Customs works with and, depending on the type of RTA in place, costs may be high and complex as an administration tries to realign itself with the demands of the new trading regimes that will not only have to encompass trade facilitation but also security – amongst other issues.

The immediate areas that would require capacity building are rules of origin and their application. These will require a deeper knowledge of some other non-traditional customs subjects such as the arm's length origin and destination principles, transfer pricing and production processes of multi- and trans-national cooperations, all of which are major determinants of a product's or service's origin.

The implementation of RTAs has led to an increased openness which, in turn, has broadened the role of Customs. Therefore, acquiring expertise in other emerging areas will assume critical importance, for example, it is expected that in the future Customs will have to focus much more on emerging areas such as intellectual property rights.

3.3 Customs ethics and integrity

The nascent RTAs in Africa can be translated as an increase in the lines of goods that are attributed zero or low rates of duty. According to the 'rational choice' theory, traders will use all means to ensure they pay the lower rates. Customs will therefore face challenges on two fronts, namely, an increase in commercial (tax) fraud and corruption. As far as the former is concerned, incidences of false documentation (most likely to affect invoices and certificates/proof of origin) may be on the increase as importers try to ensure their goods qualify for the lower rates in the RTAs. On the other hand, since Customs has the final say as to whether or not a given consignment qualifies for preferential treatment, there will be an increase in the combination of power, opportunity and incentive which Customs must also continue to contend with. Whilst the question of corruption has hitherto been regarded as a wholly one-sided affair, with Customs viewed as the sole cause of corruption, a fairer approach would be to recognise the duality of the problem. Corruption, when tolerated becomes a tradeable service with a complete set of consumers and suppliers (and hence a system of supply and demand) for customs and importers respectively.

In the case of lower rates of duties with respect to the RTAs, suppliers (Customs) can induce demand, usually through the utilisation of information asymmetry. Importers may also induce supply by offering better incentives to the suppliers. However, there is more incentive for importers to induce demand for a corruption service due not only to stiff market competition but also to the large markets that open up following the formation of RTAs. The fight against corruption in African customs administrations has thus itself obscured the dual nature of corruption and thereby, masked the reality that it is possible to win the fight convincingly by employing methods that not only stifle trade in the corruption service market but that also target both sides of the market. According to this argument, the real challenge lies in finding an appropriate strategy to fight corruption that takes its dual nature into account.

3.4 Alteration of the resource and incentive structure

In the short term, one effect of a regional trade agreement is the reduction of revenue due to lower rates or even a complete removal of customs duty. This is especially true in least developing countries (thirty-three of which are found in Africa) which lack adequate administrative capacity and an efficient domestic tax system that can compensate for lost revenue (Walkenhof 2006, p. 1). Where there has been significant trade diversion, this loss of revenue may be permanent. However, it also depends on other factors, such as the size of the tariff reduction and resultant growth in economic activity (that is, trade-creation effect).

In Africa, the majority of customs administrations are subsidised by the government and this loss of revenue will be reflected in government expenditure, thereby directly affecting their operations. In such situations, the programs that suffer most are those related to modernisation and capacity-building, two core issues for customs administrations. This scenario is worse in cases where governments have created revenue authorities that obtain a fixed percentage of the revenue that they collect (usually 2 per cent to 5 per cent) for their operations. Thus, a reduction in revenue automatically leads to a reduction in their resources. This applies more to FTAs than customs unions which are equipped with revenue compensation mechanisms. However, even in cases where such revenue compensation mechanisms are in place, there is an absence of clear policies within governments which ensure that customs administrations continue to obtain their fair share of the resource cake. In addition, the revenue loss compensation mechanism is usually marred by a myriad of operational problems and they may be temporary in nature.⁵

Due to the challenging nature of their responsibilities, many customs administrations have used a variety of incentives to motivate their staff. More often than not, these incentives come in the form of bonuses that have been tied to levels of revenue collection among other incentive structures. With the dawn of

RTAs such incentive schemes have become irrelevant as indicators of good performance in Customs. Thus, the current challenge is to base incentive and motivation schemes on performance indicators other than the level of revenue collection, which was tied to the traditional role of Customs and which has now been effectively altered by the RTAs.

3.5 Increase in the cost of customs administration

Regional trade agreements contain various clauses and articles whose implementation more often than not depends squarely on the customs administrations. Some of the major articles or clauses relate to customs and administrative cooperation, legislative procedures, facilitation of transit procedures, valuation, and trade defence instruments such as anti-dumping and countervailing measures, safeguards, and infant industry. These clauses and articles basically hinge on trade facilitation. The crafting of the articles and clauses is usually modelled on the international instruments and standards applicable in customs and trade such as the Revised Kyoto Convention and the GATT Valuation Agreement.

The importance of trade facilitation in a RTA cannot be over-emphasised because it can be a source of major gains in trade (as pointed out in 1. above). However, implementing the necessary trade facilitation and other RTA requirements will incur enormous costs. This subsection attempts to put selected costs into perspective. Some of them are overarching in nature and hence have already been dealt with in other subsections.

Trade-related infrastructure has an important role to play in trade facilitation. This is a major challenge to customs authorities which, despite not being in direct control of resources that are used for their infrastructure development, are nevertheless obliged to work towards the implementation of articles in RTAs. However, success in this endeavour will depend solely on the availability of the necessary infrastructure. A case in point is communication infrastructure, such as the installation of a computerised, real-time communication facility. The exchange of information between customs administrations is vital for the smooth operations of Customs in general, and this applies even more to those in an RTA. It goes without saying that such infrastructure comes at a high price and yet the relevant agreements do not always contain the necessary provisions for it, despite containing clauses or articles on customs cooperation. This becomes a major challenge to Customs as it gallops to fill this void. The other aspect of communication relates to inter-agency collaboration and cooperation because not all aspects of trade are dealt with by Customs but also by other governmental and non-governmental agencies such as Departments of Trade and Health, and Chambers of Commerce and Industry. As a result, there is a need to establish clear channels of communication for the smooth and swift flow of trade which may also require infrastructure and institutional reorganisation in order to function flawlessly. Overall, there is a clear case for establishing a single window for trade and integrated border management, which has enormous cost dimensions.

The proper monitoring of RTAs requires detailed trade data collection, analysis and presentation. While the collection of trade statistics is one of the traditional functions of any customs administration, the proliferation of RTAs has placed extra demands on those administrations, which may call for additional human and material resources (that is, in terms of the relocation or hiring of officers with the requisite knowledge on this subject or data processing equipment such as computers and servers). Again, this constitutes a major challenge to Customs in Africa that cannot be overlooked as such resources entail great expense. As pointed out in subsection 3.1, RTAs demand the re-tooling and hence re-training of customs officers owing to the radical change in their tasks which had been traditionally weighted towards revenue collection. This too can translate into major adjustment costs.

4. Regional trade agreements and future customs policy strategies

A whole body of challenges exists for Customs as a result of the proliferation of RTAs (as illustrated in section 3. above). On the other hand, this can also be seen as presenting customs administrations with a good opportunity to critically evaluate their operations in the light of new challenges and the community that they serve. In this respect, customs administrations could carry out a gap analysis to ensure that their tasks are relevant and are performed efficiently and effectively. This process of re-invention requires pragmatic policies that will have to be backed up by effective strategies to counteract and reduce the impact of the challenges for customs administrations that lie ahead. The World Customs Organization's 'Customs in the 21st century' document (widely known as the C21 document) provides a good starting point by recommending the future direction that customs administrations should take.

In this regard, future customs policies and strategies in Africa will have to emphasize both the adoption and adaptation of international standards. An adaptation strategy is particularly necessary as it will enable the chosen policies to work well within the existing customs framework. This approach will help to reduce reform-related implementation hiccups and bottlenecks and help the system to continue to work towards the goals it was originally intended to achieve. Specifically, there is a need to formulate policies and strategies that will focus on:

- Capacity building for Customs in order to ensure that it has full control of the local and regional supply chains. Feaver and Wilson contend that 'well designed and targeted capacity building (initiatives that are closely linked to PTA initiatives and objectives) can deliver additional efficiency benefits that may also have trade increasing effects' (Feaver & Wilson 2005, p. 12).
- Addressing resource constraints, through use of cheaper IT but efficient technologies and adoption of risk-based operations.
- Legal-based reforms that will allow the use of modern advances in technology, cross border cooperation and procedures, in line with the policies of RTAs.
- Enhancement of inter-agency cooperation between Customs and other border and cross-border actors.
- Issues of integrity that, if not adequately addressed, have the potential to cause significant trade-related economic loss by increasing the cost of doing business, marring the investment climate of a country or region and thereby grossly undermining the country's or region's competitiveness in the global trading system.
- Customs trade-related infrastructure development that can undermine institutional reforms no matter how well designed.

5. Conclusions

This paper has attempted to illustrate the challenges that RTAs present to the operations of customs operations in Africa and the possible policy and strategic options that would help minimise their impacts. The proliferation of RTAs has also brought to light the need for Customs in Africa to continue (or, if necessary, to lobby) to be part and parcel of RTAs negotiating teams in their countries because this will help to anticipate the challenges which they are likely to face when the RTAs are implemented. There is also a need for Customs in Africa to understand, follow closely and analyse trade developments at a national, regional, and global level.

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Endnotes

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- 2 Union du Maghreb Arabe (UMA).
- 3 A good treatise of the same can also be found in Feaver & Wilson 2005, pp. 4-14.
- 4 See, for example, Yang & Gupta 2005, pp.38-39.
- 5 See, for example, Walkenhurst (2006) for a full analysis of revenue loss compensation arrangements in Africa.

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