The African Continental Free Trade Area: Why is Africa turning to multilateralism?

Marinov, Eduard

New Bulgarian University, Economic Research Institute at BAS

2019

JOURNAL OF FINANCIAL AND MONETARY ECONOMICS

Annual Review

http://jfme.icfm.ro

No.7/2019
ISSN 2537-3269
ISSN-L 2392-9685

From contents

"Victor Slăvescu" Centre for Financial and Monetary Research

ROMANIAN ACADEMY

“COSTIN C.KIRIŢESCU” NATIONAL INSTITUTE FOR ECONOMIC RESEARCH

“VICTOR SLĂVESCU” CENTRE FOR FINANCIAL AND MONETARY RESEARCH

JOURNAL OF FINANCIAL AND MONETARY ECONOMICS

ISSN 2537 – 3269,
ISSN-L 2392-9685
Annual Review

“Victor Slăvescu” Centre for Financial and Monetary Research
13 September no.13, Academy House, building B, 5th floor, 5th District, Bucharest, zip cod 050711,
Phone:+40213182419, FAX +40213182419, e-mail: jfme@icfm.ro

Journal of Financial and Monetary Economics is edited by the "Victor Slăvescu" Centre for Financial and Monetary Research of the Romanian Academy since 2014. It is an annual review that has as main objective the dissemination of theoretical and applied economic research presented annually by the researcher in Romania and abroad in the international scientific conference "Financial and Monetary Economics".

Research published scientific research aimed both economic development and clarification of the current economic phenomena and processes. As a result, conclusions and proposals offered by the authors address both academia - scientists, teachers, students - as well as decision makers. We emphasize the importance of scientific contributions, together with the clarity of concepts, methodologies and conclusions offered.

Contents

THE AFRICAN CONTINENTAL FREE TRADE AREA: WHY IS AFRICA TURNING TO MULTILATERALISM?

Ph.D. Eduard Marinov[70]

Abstract:

The Agreement establishing the African Continental Free Trade Area entered into force on 30 May 2019 and on 9 July all countries on the continent joined it. It marks a significant milestone in the process of African integration which started as soon as the countries on the continent gained their independence. If the massive deal works as hoped, it will connect 1.3 Billion people, create a 3.4 Trillion USD economic bloc, and heat up commerce within the continent itself. The paper aims at tracing the process of economic integration in Africa, discussing the rationale behind Africa's current efforts to achieve multilateral trade liberalization, analyzing the main features and assessing the potential benefits of the implementation of the African Continental Free Trade Agreement.

Keywords: *economic integration theory, developing countries integration, FTA, African economy*

JEL classification: *F15, F55, N77*

Introduction

The leaders of all African nations met on 7 July to make a critical expansion to their continental free trade zone. If the massive deal works, it will connect 1.3 Billion people, create a 3.4 Trillion USD economic bloc, and heat up commerce within the continent itself. This agreement underlines how Africa is moving in a different direction than other regions in the world. The continent's leaders are embracing integration, while some global counterparts have turned away from multilateralism (Shao, 2019).

The Agreement establishing the African Continental Free Trade Area (AfCFTA) entered into force on 30 May 2019. The decision on its creation was adopted at the 18th Ordinary Session of the Assembly of Heads of State and Government of the African Union, held in Addis Ababa, Ethiopia in January 2012. In terms of numbers of participating countries, the AfCFTA will be the world's largest free trade area since the formation of the World Trade Organization. Estimates from the Economic Commission for Africa (UNECA) suggest that the AfCFTA has the potential both to boost intra-African trade by 52.3 percent by eliminating import duties, and to double this trade if non-tariff barriers are also reduced (UNECA, 2019, p. 3). As at 7 July 2019, only Eritrea has yet to sign the consolidated text of the AfCFTA Agreement.

The Agreement marks a significant milestone in the process of African integration which started as soon as the countries on the continent gained their independence. The main objectives of the AfCFTA are to create a single continental market for goods and services, with free movement of business persons and investments, and thus pave the way for accelerating the establishment of the Customs Union. It will also expand intra-African trade through better harmonization and coordination of trade liberalization and facilitation and instruments across the RECs and across Africa in general. The AfCFTA is also expected to enhance competitiveness at the industry and enterprise level through exploitation of opportunities for scale production, continental market access and better reallocation of resources.

The paper aims at analyzing the AfCFTA from a historical, theoretical and economic point of view. Therefore the first section traces the process of economic integration in Africa, the second discusses the rationale behind Africa's current efforts to achieve multilateral trade liberalization,

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[70] Senior Assistant Professor, Department "Economics", New Bulgarian University, Sofia, 21 Montevideo Blvd.; Department "International Economics", Economic Research Institute at BAS, Sofia, 3 Aksakov Str. eddie.marinov@gmail.com

while the last two analyze the main features and assess the potential benefits of the implementation of the African Continental Free Trade Area.

A brief summary of African economic integration

Regional integration in Africa is a stated priority goal of both African governments and international donors since the early days of independence. It should address the dynamics of the globalized economy as a means of ensuring competitiveness through the best options available in the field of international trade. In the case of Africa, it is even more important because of the colonial heritage, poor management and numerous conflicts (UNECA, 2010, p. 23). Regionalism is seen as a possible remedy for the political and economic problems of the continent.

Since the late 50s, regional economic integration, even in its lower forms, began to make its way in the Third World. The aim was to achieve political unification, institutionalized in a Union of African States and a Union Government. Besides the political objectives, during this period emerged the idea of economic independence – "the countries to be able to develop their economy based on domestic characteristics and needs and to participate in international economic relations in accordance with the principles of equality and mutual benefit" (Malhasian, 1979, p. 56).

On May 25th 1963 the Organization of African Unity (OAU) was founded in Addis Ababa by 32 participating states. It managed to incorporate the countries aiming at instant unification on and those that believed in a gradual process towards unification. In the period between the first years after its creation until the signing of the Abuja Treaty, the OAU became even less noticeable and insignificant. Its main role was to be a mediator in resolving disputes and domestic and international conflicts. Economic issues remained in the background, hence, Mathews describes the Organization as one being about politics, rather than economics (Mathews, 2008, p. 32). However, during the meetings of state and government leaders the idea of an economic union was conceived and developed, which ultimately led to the signing of the Treaty establishing the African Economic Community (TAEC). Due to the ineffectiveness of the OAU in 1999 a special meeting was held in Sirte, which adopted a declaration for the creation of the African Union (AU) to replace the OAU. The acceleration of the implementation of the TAEC was also among the objectives of the declaration. On July 9th 2002 in Durban the OAU was officially transformed into the African Union (AU).

The Abuja Treaty, which established the African Economic Community (AEC), was signed on June 3rd 1991 and entered into force in 1994. It set the plan for the creation of an African economic and monetary union (with a common currency) to 2028 through the subsequent implementation of six stages. The main motive for the creation of the AEC was the need to reduce the economic dependence of African countries from third countries and to stimulate economic development and economic growth. The AEC was established as a part of the African union. The Treaty defines six stages that should be completed for the gradual creation of the AEC for a period of 34 years (Figure 1).

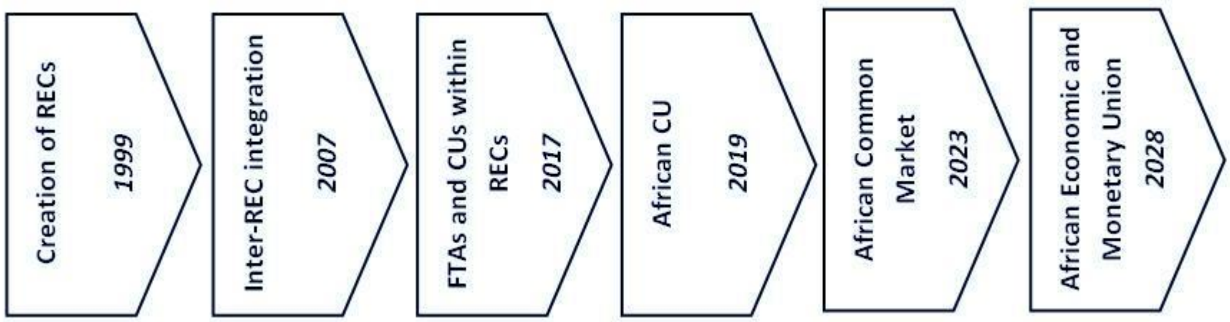

Figure 1. Stages of creation of the AEC

Source: created by the author.

The Treaty adopts an integration approach that to a great extent depends on the success of integration processes within the regional economic communities (Mlenga 2012; p.2). The Treaty explicitly states that the AEC will be established mainly based on coordination and gradual integration of the activities of existing RECs. Thus RECs are defined as the building blocks of the AEC. The idea of this stage approach is that integration should firstly be ensured at a regional level through the creation and strengthening of the regional economic communities which in a certain moment will merge into the AEC.

Increased regional trade cooperation through the removal of intraregional trade restrictions (i.e. tariff and nontariff barriers) is a critical strategy to address the challenges posed by small domestic markets, limited economies of scale and the marginalization of African economies in world trade. The result was the creation of many trade blocs in Africa, aimed at reducing and removing trade barriers, with each country belonging to more than one preferential trade agreement (Kalenga, 2013, p.1). This has led to the problem of overlapping membership in multiple and often conflicting trade regimes that is often regarded as undermining the effective implementation of the respective for each integration scheme trade commitments. The multiplicity of trading arrangements in southern and eastern Africa, ranging from bilateral agreements between individual countries to PTA, FTA and customs unions poses a huge implementation challenge to the business sector, customs administrations and other private and government agencies involved in managing or facilitating trade.

There has been significant progress in the implementation of the stages of the creation of African economic community. Most regional economic communities fulfil their obligations under the AEC Treaty on schedule, in some there is a delay, and some are even ahead of the deadlines. Although the regional communities are making a lot of effort for the realization of the first three stages set in the Treaty by adopting a phased abolition of customs duties in intraregional trade, there are many differences among them – some regional economic communities still cannot create a free trade area, while others already have a working customs union. The pace of progress is not the same and overlapping membership of many countries in two or more regional communities makes it obligatory for strategic decisions to be taken. The recent creation of the African Continental Free Trade Area could be seen as a first step towards a continental customs union, a common market and the ultimate goal – a fully functioning African economic community.

The rationale behind Africa's strive for multilateral integration

This section will discuss the theoretical background for the different motivation of developing and least developed countries to participate in multilateral international economic integration agreements to answer the question why does now Africa push so much efforts towards a continental trade agreement and multilateral liberalization when most of the players in global economy have turned towards bilateral trade agreements and even are imposing measures which speak of pure protectionism.

In most cases, theories of economic integration and its benefits – of dynamic ones, but even more of static ones, are not fully applicable to integration agreements among developing and least developed countries. Even Balassa (Balassa, 1965, p.16) claims that theoretical literature on economic integration issues discusses customs unions only in industrialized countries. Their problems and environment are not related to economic development, but more to relative changes of production and consumption features.

Traditional theory assumes that the larger (in economic terms) the participating countries are, the more substantial the benefits of integration will be. According to Abdel Jaber (Abdel Jaber, 1971, p.262) if the size of the economy is measured by the gross national product, integration benefits for developing countries are negligibly small. Balassa on the other hand claims that integration gains depend not only on the size of the countries participating in the integration arrangement, but also on their rate of economic growth. Thus, as developing economies tend to grow at higher rates than already developed ones, the benefits of integration for them would be even bigger (Balassa, 1961, p.38). Another possible measurement of the size of the integration community is the number of population. Under this criterion, developing countries will surely benefit from integration as they are usually over populated (Hosny, 2013, p.144).

Developing countries in general are specialized in the production of primary products. According to Abdel Jaber (Abdel Jaber, 1971, p.256-257) there is nothing wrong with that as long as the economic surplus gained from this type of production could be reallocated and invested efficiently in other sectors. That however is rarely what happens in reality, thus most developing countries adopt a trade policy of diversification and import substitution to accelerate economic growth. Balanced growth can be achieved by small developing countries by increasing the size of the market, benefiting from economies of scale, and expanding their inter-industry transactions, i.e.

through economic integration. For these effects to be achieved however, a strong commitment is required – both in economic and political terms.

In the past, developing countries have sought motivation for economic integration in the benefits from trade diversion and import-substituting industrialization. Later on, with the introduction of the ideas of the dynamic effects of integration, they began to find arguments for integration in the economies of scale, investment creation, technology transfer, etc. Nowadays, however, the integration initiatives of developing countries far exceed those arguments – most of them pursue policies of trade liberalization and deregulation as part of their overall stabilization programs agreed with international organizations. This approach has the goal to make economic integration policies compatible and complementary to other policies in order to promote international competitiveness. Therefore, according to Hosni, most developing countries regard economic integration as a tool for more competitiveness in a global economy (Hosny, 2013, p. 143).

Lipsey assumes that the lower the share of international trade in GDP of the member states of an integration agreement is, the greater the expected benefits of a customs union on welfare will be (Lipsey, 1960, pp. 508-509). This is very important for developing countries because trade as a percentage of GDP in low-income countries has always been lower than in countries with a high level of income, although in recent years this imbalance is decreasing (Hosny, 2013, pp. 144-145). However, the same does not apply to countries with medium levels of income and least developed countries – their share of trade in GDP is even more significant than that in high-income countries. It can therefore be concluded that this criterion is not applicable to developing countries, because subgroups among them may have a larger or smaller share of trade of GDP compared with high-income countries.

According to Lipsey an integration agreement will bring more benefits in terms of welfare if the share of intraregional trade is growing, while trade with the rest of the world is decreasing (Lipsey, 1960, pp.508-509). Studies show that, trade between developing countries is always much weaker than that between developed countries, suggesting that the benefits of integration regarding welfare will also be smaller.

However, other researchers (Balassa, 1965; Abdel Jaber, 1971) believe that this assumption should not always be taken for granted. They list several factors that restrict trade among developing countries, arguing that if these barriers are removed, trade flows between developing countries engaged in an integration process will likely increase. These factors include: first, the low level of economic development; second, inadequate transport infrastructure and facilities; third, foreign currency control and other restrictions on imports; fourth, inadequate marketing; fifth, the lack of standardization.

It is widely recognized that the best indicator of the success of an integration agreement is the increase of the share of intra- and interregional trade in the total trade flows of member states. Although this is an important aspect of integration Inotai (Inotai, 1991, p.10) believes that it should not be seen as a means to its end. Equally important are the industrial development, the adequate infrastructure, the increase of the technological level, etc. Furthermore, the growth of regional trade may be the result of trade diversion from more efficient and competitive third countries. Therefore it can be regarded as positive only if it is combined with improving global competitiveness as a whole.

A major part of the imports from developed to developing countries consists of capital goods. From the dynamic analysis point of view, integration among developing countries requires substantial investments and since most of them are imported from developed countries in the form of capital goods it is likely that the volume of imports of integrating developing countries will grow. The conclusion of Mikesell is that the long-term goal of integration between developing countries should not be to reduce trade with the outside world, but rather to change in their trade structure (Mikesell, 1965, p.209).

Sakamoto (Sakamoto, 1969, p.293) believes that if the result of integration among developing countries is the trade diversion of consumer goods, this will release more foreign currency for imports of capital goods from third (developed) countries. The volume of trade with the rest of the world may not change or may even increase, but the important thing is it changes its structure.

Another thing that should be noted is that while in developed countries the main rationale for economic integration comes from economic groups of stakeholders, in developing countries integration processes often initially start as a political goal and effort, which in most cases leads to unsatisfactory economic results. Integration processes could be interpreted from the point of view of a combination of economic and political determinants (Haas and Schmitter, 1964, p.713-720).

From the above said, it is obvious that the rationale behind economic integration among developing countries could not be defined and explained just by the static and dynamic effects that determine integration between developed economies. With developing countries some factors have a stronger, while, controversially, others have a weaker impact on their willingness to participate in integration agreements. To assess the integration benefits and costs for developing countries one must take into account their specifics such as stage of economic development, structure of the economy, production characteristics, demand preferences, trade regimes and policies, etc., as well as to have in mind the complexity of the political determinants of economic integration among developing countries.

Although "the benefits of liberalization are important and obvious, but they have already been realized for most of the developed economies" (Ackerman, 2016), the lesser level of economic development, the low volume of intra-African trade and the fast rate of economic growth, as well as the desire to have more market and bargaining power in global economy, makes the creation of a multilateral trade agreement such as the African Continental Free Trade Area beneficial for African countries. "On a pan-African scale, the economic impact of AfCFTA will be significant ... removing tariffs on intra-African trade will boost net income at the continental level by 2.8 Billion USD per annum" (Shao, 2019).

The African Continental Free Trade Area: scope, main features and implementation

The AfCFTA, once complete, will be a continent-wide free trade area for those states which have deposited instruments of ratification. The AfCFTA, along with the free movement of persons and the single air transport market, is a flagship component of the broader Agenda 2063 program – the African Union's framework for structural transformation and development. The African Union's initiatives to Boost Intra-Africa Trade, the Programmes for Infrastructure Development for Africa, and Accelerated Industrial Development for Africa are essential to realize the benefits of the AfCFTA (Tralac, 2018, p. 8). It is called a 'Free Trade Area' but will be more akin to a comprehensive partnership agreement because the disciplines will go beyond trade in goods to over services, investment, competition and intellectual property.

The main objectives of the AfCFTA are to create a single continental market for goods and services, with free movement of business persons and investments, and thus pave the way for accelerating the establishment of a continental customs union. It will also expand intra-African trade through better harmonization and coordination of trade liberalization and facilitation and instruments across the RECs and across Africa in general. The AfCFTA is also expected to enhance competitiveness at the industry and enterprise level through exploitation of opportunities for scale production, continental market access and better allocation of resources.

The overarching aims of the agreement with respect to goods are progressive elimination of tariffs; progressive elimination of 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.

The overarching aims of the agreement with respect to services are: enhance competitiveness of services; promote sustainable development; foster investment; accelerate efforts on industrial development to promote the development of regional value chains; progressively liberalize trade in services.

The AfCFTA Agreement is the umbrella instrument (Tralac, 2018, p. 2). Trade in goods and trade in services are negotiated in Phase I with negotiations on a number of issues (e.g. rules of origin, tariff concessions etc.) still ongoing, while Phase II will cover Intellectual Property Rights, Investment, and Competition policy (Figure 2).

The decision on the AfCFTA sets out an ambitious timeline for further negotiations; however, this may be amended by the Member States. According to the Decision on the AfCFTA, the completed Annexes to the Protocol on Trade in Goods, Annexes to the Protocol on the Rules and Procedures on the Settlement of Disputes, and the List of Priority Sectors on Trade in Services should be submitted to the July 2018 session of the AU assembly for adoption. The 5 agreed priority services sectors are transport, communications, tourism, financial, and business services. Negotiations on rules of origin are still to be finalized. The Decision of the AU Assembly also provides that Schedules of Tariff Concessions and Schedules of Specific Commitments on Trade in Services should be submitted in January 2019. The second phase of negotiations was scheduled to commence in August 2018 to negotiate protocols on Investment, Competition and Intellectual Property. These negotiations have, however, not yet commenced. The AU Assembly decision requires these protocols to be submitted to the January 2020 session for adoption.

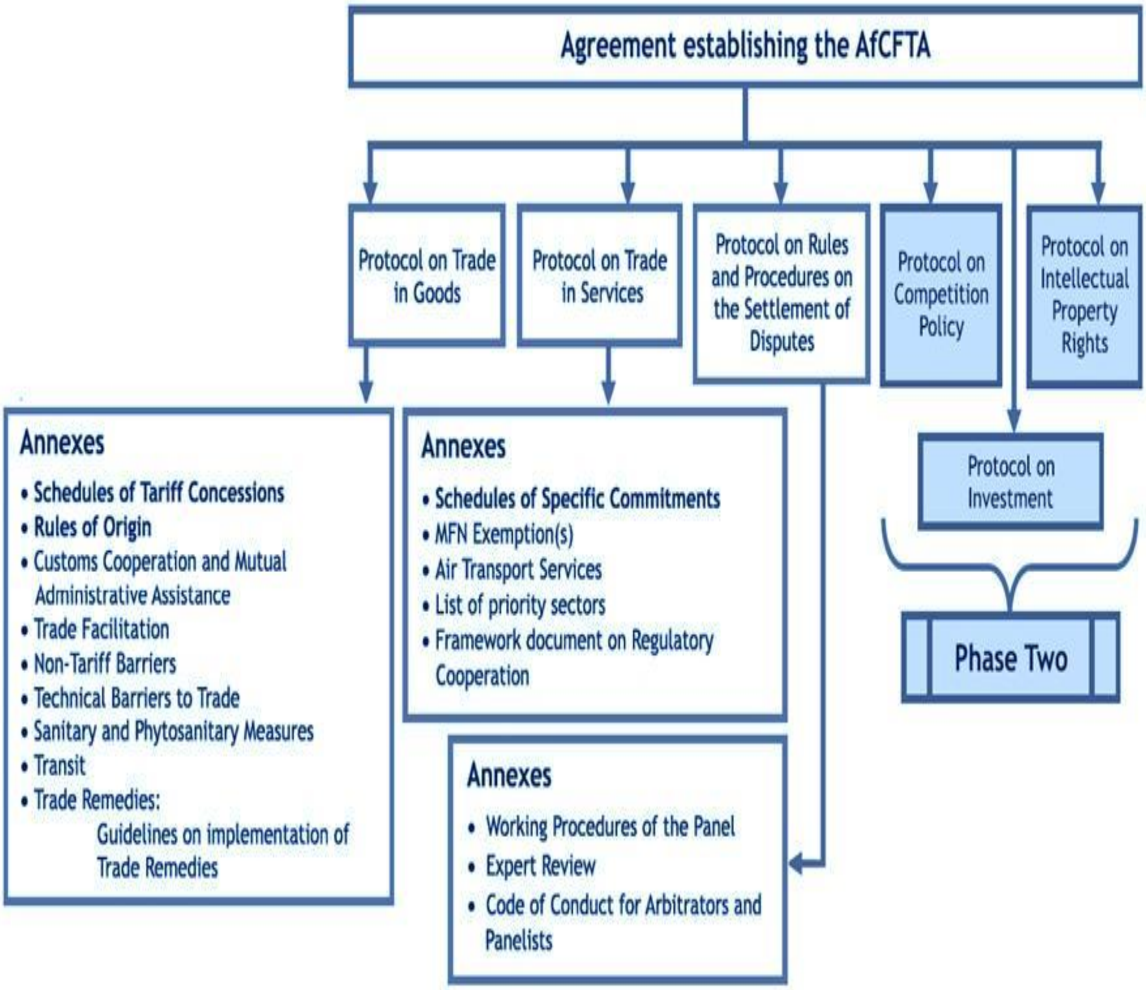

Figure 2. Phases of implementation of AfCFTA

Source: Tralac, 2019, p.5.

The negotiations will aim to progressively reduce and eliminate customs duties and non-tariff barriers on goods. At this stage the goal is for 90% of tariff lines to have a zero duty within 5 years (or 10 years for LDCs). The modalities also provide for members to negotiate on sensitive products, on a request and offer basis, on which tariffs would reduce to zero over a longer period – 10 years for non-LDCs and 13 years for LDCs. The sensitive products and their schedules of tariff reductions may be different in each bilateral relationship.

Trade within RECs will continue according the trading regimes they have in place (customs unions or free trade areas). New tariff liberalization under AfCFTA will only occur among Member States that do not have an existing agreement with one another. For example, SACU Member States do not have any existing preferential trade arrangements with ECOWAS Member States, so tariff concessions need to be determined (Tralac, 2018, p. 6). The AfCFTA does provide for the eventual establishment of a continental customs union, but this is a long way off.

As the nominated leader of the AfCFTA Mahamadou Issoufou, President of the Republic of Niger said “the AfCFTA baby is healthy and growing. We need to ensure that the baby continues to grow. The decisions that we make are very critical in this regard. And when that is achieved, our voice and leverage will also grow. In this way, we would be better placed to negotiate mutually beneficial partnerships with the rest of the world. We should now strive to conclude the negotiations and move to the implementation phase to sustain the growth momentum of the AfCFTA baby…

We have now reached a critical point in the journey of realizing the vision of Creating One African Market. We are about to enter the operational phase of this journey. This will be challenging. However, with the record established so far, I believe we are ready to meet any challenge, no matter how complex it might be. As the popular saying goes: “where there is a will, there is a way”. Our will to continue this journey is strong and unshakable.” (AU, 2019b, pp. 7-8).

Africa facts and figures

Although Africa is the second largest continent on area and population, the economies of the countries there is the least developed in the world. The main reason for this are the properties of national economies of most of those countries which are resource based and oriented mainly towards the development of the primary sector. African countries have a growing role in world politics and economics, especially in terms of the great economic potential and the natural resources they have, as well as of their reorientation towards democratic values and a market economy.

In general Africa is the poorest region in the world – the negative influence of a number of factors inherited from colonialism, slavery, local corruption, socialist economic policies and inter-ethnic conflicts is still felt here. Most of the world's least developed countries (34) are concentrated in this part of Africa, while many countries also face difficulties in tackling hunger, disease, drought and poverty. However, in recent years (since 2011), Africa is one of the fastest growing regions in a global context. According to IMF estimates, six of the world's fastest-growing economies for 2001-2010 are located south of the Sahara (Angola – 11.1% average annual growth, Nigeria – 8.9%, Ethiopia – 8.4%, Chad – 7.9%, Mozambique – 7.9%, Rwanda – 7.6%), while in 2011-2015 the countries with an average annual growth rate of 7-8% are already seven (Ethiopia, Mozambique, Tanzania, Congo, Ghana, Zambia, Nigeria) (IMF, 2018).The main potential for the future development of the region is its population. In 2015, it was over 1 Billion people, with a growth rate of 2.3%, and according to the current projections, in 2050 it will be between 1.5 and 2 Billion people (UN, 2015).

The density of the population is 42 people per square kilometer (compared to 170 in the Western Europe, and 140 in Asia). The average age in most African countries is under 20 (compared to over 30 in Asia and Latin America, 36 in the United States, and over 40 in Europe and Japan).

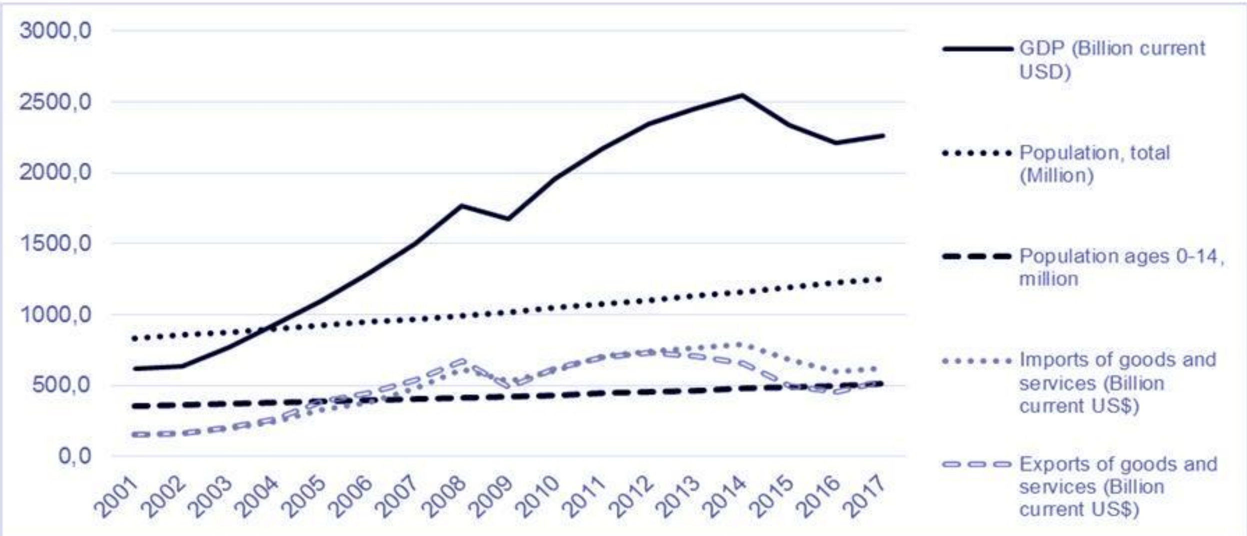

Figure 3. Main economic and demographic indicators for Africa

Source: World Development Indicators.

Africa's trade flows have been growing steadily since the beginning of the century, with a growth rate almost twice higher than the global increase, and with exports increasing faster than imports (Figure 4).

However, most of the goods traded by African countries have low value added and include mainly raw materials (mostly fuels and agricultural produce). The main export commodities of the continent are fuels and minerals - they account for over half of the exports, of which about 75% are fuels. From a global perspective Africa is the largest exporter of gold, uranium, chromium, vanadium, antimony, coltan, bauxite, iron ore, copper and manganese.

Africa is highly dependent on manufactures import which represents nearly 2/3 of the total export value and almost half of it is import of machinery and transport equipment. Manufactures and especially machinery and equipment remain with high shares in imports and although this is positive as these goods are investment assets, it reflects two main weaknesses in Africa's economies structure. The first is the continuous strong dependency on import of producer goods which shows that although necessary African countries still have not managed to undergo through a technological transformation. The second is the failure of the manufacturing sector to take its rightful place in consumer goods import which, as stated by Ali-Dinar, proportionally remains at the same levels as in the beginning of the 1970-ies (Ali-Dinar, 1995, p.30).

African countries' main trade flows are highly dependent on their historical ties with the rest of the world and especially with Europe. Over 80% of all African exports are directed towards markets outside the continent. Similar is the share of imports coming from external sources (Figure 4).

The majority of African counties' trade flows, consisting of over 80% of the total volume of trade since the beginning of the century are directed towards the EU (33% in 2018), PR China (16%), intra-continental trade (15%), the USA (8%), India (6%), Japan (3%) and Russia (1%).

The main trends observed are the shift of trade flows from the EU and the U.S. to China and India, although in almost all communities the EU maintains its leading position as trade partner. Moreover, a closer look at the data for the past 15 years shows that trade fluctuations in Africa are primarily due to movements in the same direction of trade namely with China and India. African countries trade less with each other, but they have the potential to increase trade in terms of geographical proximity, cultural heritage and size of the economies. Since 2000 interregional trade is growing at a faster pace than the total volume but its share and volume still remain low.

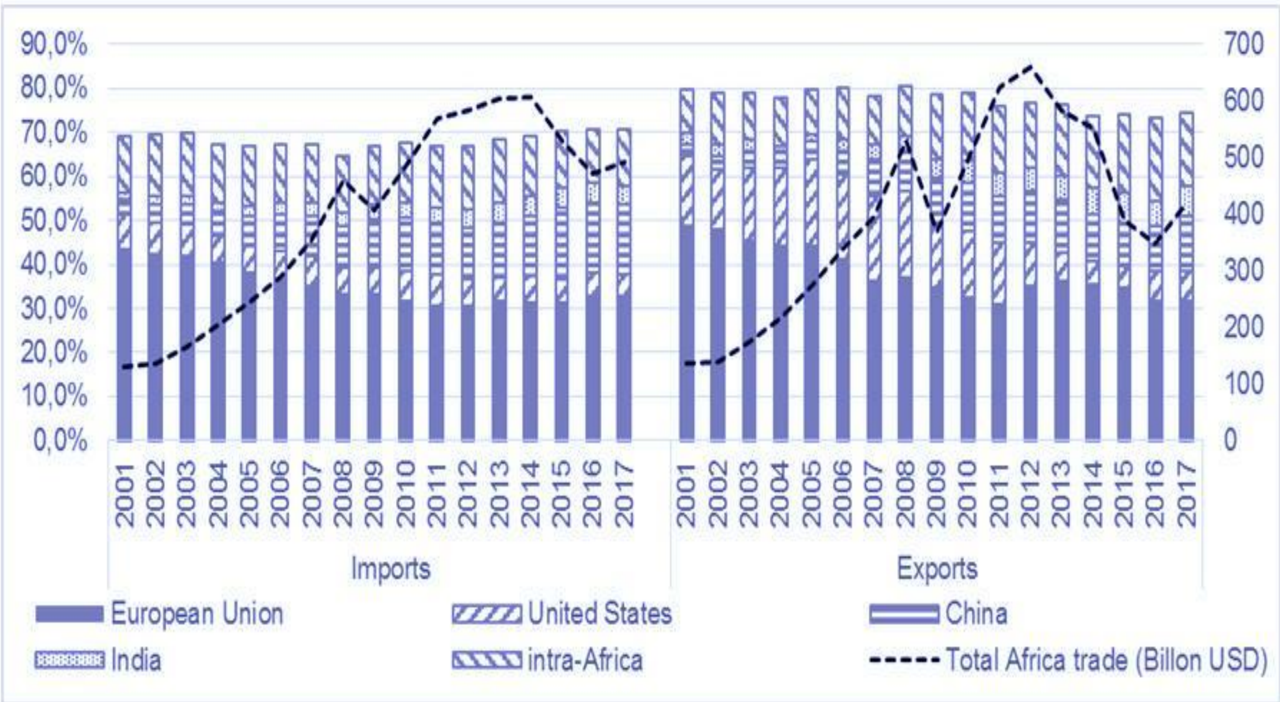

Figure 4. Africa international trade

Source: ITC.

It is not a coincidence that over the past few years many of the leaders of the world's largest economies have made visits to Africa – even to places that none of their predecessors have ever visited. Along with the huge wealth in resources and the increasingly open markets, Africa, though currently producing less than 3% of global GDP, concentrates in it over a quarter (26.2%) of the world's population under 15 – the future workers and consumers.

Conclusion

The development potential of Africa is undoubtedly enormous. Undoubtedly, there has been a serious rearrangement of key external players in recent years, and some of the countries in the region have been seriously involved in both regional and global international economic relations. The recent start of the African Continental Free Trade Area could make Africa a serious player in global economy.

If implemented, the African Continental Free Trade Area could unite 1.3 Billion people, create a 3.4 Trillion USD economic bloc and boost trade within the continent itself. It would also bring benefits for both African and international investors, as it will make it easier for businesses to expand operations across the region, thus fostering net income at the continental level, economic growth and welfare.

As the current chairman of the union, Egyptian President Abdel Fattah al-Sisi said at the July 2019 African Union Summit "The eyes of the world are turned towards Africa. The success of the AfCFTA will be the real test to achieve the economic growth that will turn our people's dream of welfare and quality of life into a reality" (AU, 2019a).

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