



Munich Personal RePEc Archive

Regional Trade Agreements: An African perspective of Challenges for Customs Policies and Future Strategies

Chiumya, Chiza

4 June 2009

Online at <https://mpa.ub.uni-muenchen.de/17838/>
MPRA Paper No. 17838, posted 16 Oct 2009 06:50 UTC

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

By

Chiza Charles N. Chiumya¹

Policy Officer for Customs

Department of Trade and Industry

African Union Commission

E-mail: chiumyac@africa-union.org

chiumya@gmail.com

¹ *The author is indebted to the valuable comments from colleagues at the Customs Cooperation Division of the Commission, however all the views expressed in this paper are not those of the Division or the African Union Commission. All errors of commission and omission are his.*

ABSTRACT

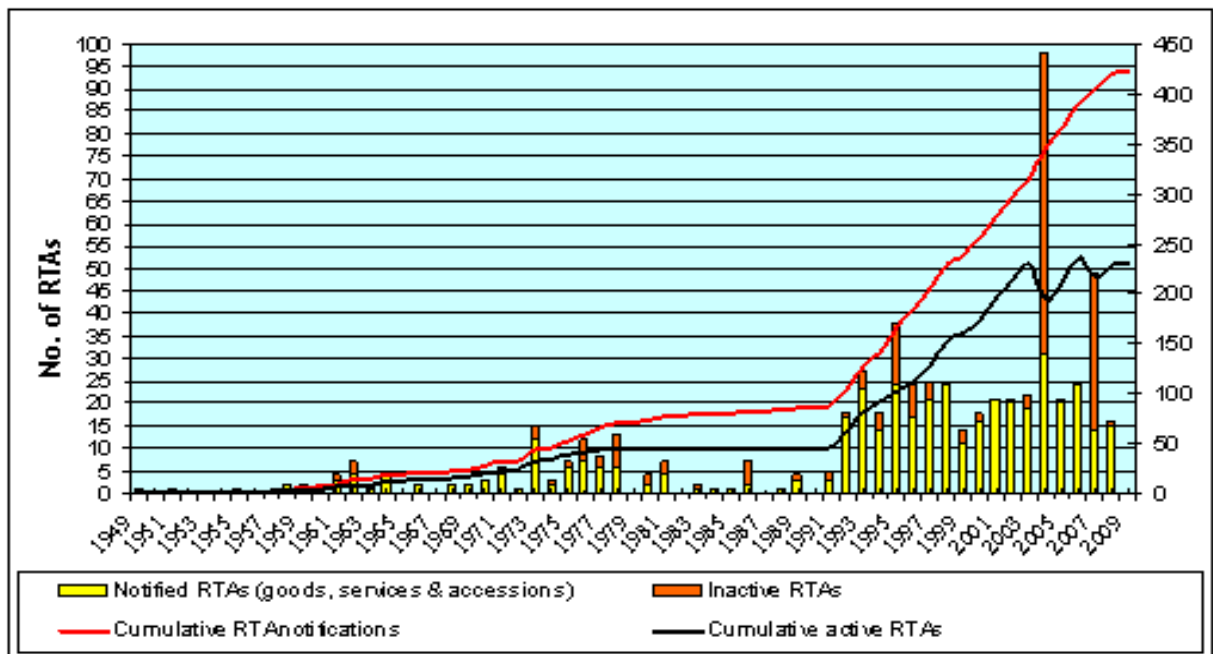
The proliferation of Regional Trade Agreements (RTAs) has not spared the African Continent. The formation of RTAs in Africa is championed by the Regional Integration agenda under the Regional Economic Communities. The challenges that Customs Administrations face when their countries become members of RTAs depend on whether the RTA is Trade Creating or Diverting. A Trade Creating RTA brings more challenges to Customs Administration than a Trade Diverting one. This paper looks at these challenges and areas where future Customs policies and strategies will have to focus in order to address them.

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

1.0 INTRODUCTION

One of the major developments of the last two decades that international trade has experienced apart from the birth of electronic commerce has been the dramatic increase in Regional Trade Agreements (hereafter referred to as RTAs). According to the World Trade Organization, whilst there were only 124 RTA notifications between 1948 and 1994, this figure has more than tripled with an additional 300 more notifications between 1995 and 2008 (World Trade Organization, Facts and Figures 2009). Figure 1 is a chart mapping the global development of RTAs from 1948 to 2008.

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



Source: WTO Regional Trade Agreements: Facts and Figures

The proliferation of Regional Trade Agreements in the current global trade set up has not spared the African Continent. The formation of RTAs in Africa has mainly been championed by what are commonly known as Regional Economic Communities (hereafter referred to as RECs) as the Continent moves towards the formation of the African Economic Community that was established by the Abuja Treaty of 1991. Whilst there are 14 RECs in Africa, the major African continental body the African Union, through its Abuja Treaty, resolved to recognize only 8, being the Southern African 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 (UMA), and the Inter-Governmental Authority on development.

Almost all the RECs have RTAs in the form of Free Trade. In 2009 COMESA had launched its Customs Union, and ECOWAS was preparing for the launching of its Customs Unions. ECCAS and SADC had their respective Free Trade Areas and were both planning for the launching of Customs Unions in 2010. The CENSAD was at the stage of the free trade zone but it had not yet elaborated a distinct road map to strengthen integration among its Member States, whilst IGAD was planning to establish a Free Trade Area by 2012. The EAC was the only community to have reached the stage of a Customs Union which was launched in January 2005 and it has plans to launch a Common Market in 2010 with preparatory works well underway for the gradual establishment of legal and technical instruments in that regard.

Despite this development, not all the member countries within the RECs have signed up for these agreements as the principle of variable geometry has been widely applied. Whilst this may be a major challenge in the rapid evolution of FTAs to Customs Union within the RECs, it accords the countries the opportunity to progress with the regional integration agenda at their own pace. The RECs in Africa have a characteristic of multiplicity of membership (statistics of multiplicity). This then also means there is cross membership to 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 agenda such as socio-economic development, peace and security, agriculture, and environmental conservation.

This paper seeks to look at some of the major challenges that Customs Administration are likely to face and seeks to inform future customs policies and strategies on how to deal with these challenges. However, before analyzing the challenges, the paper also looks at the nature of RTAs which ultimately has a bearing on Customs Administration.

2.0 NATURE OF REGIONAL TRADE AGREEMENTS

The impact of any given RTA on Customs will largely depend on whether the RTA is Trade Creating or Diverting. A given RTA will be trade creating when some domestic production in a member of the RTA is replaced by lower cost imports from another member, whilst on the other hand, an RTA will be trade diverting when 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 among other major factors.

Whilst a rigorous approach to the analysis of whether a particular RTA is trade creating or diverting is out of the purview of this paper, in general, a given RTA will lead to trade creation if members had high pre RTA trade barriers, lower trade barriers with the rest of the world, has large numbers both in terms of population and membership, the economies of member countries are more competitive than complementary, there was significant pre RTA trade and the members are geographically closer to each other (Salvatore 2004, p. 327). A good treatise of the same can also be found in Feaver and Wilson (2005, p. 4-14).

A trade creating RTA has more bearing on Customs than a trade diverting RTA, as it will lead to an increase in both the volume and flow of trade among the member countries which will also lead to more cross border transactions with Customs. Despite the conventional belief that RTAs in Africa cannot be trade creating due to lack of product complementarities and less product differentiation coupled with low trade supporting infrastructure, (see for example Yang and Gupta 2005, p.38-39) there is some evidence to the contrary. For instance, in its annual trade report of 2007 (p.20), the East African Community which has five members reported an increase in both trade volume and flow after 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 among African RTAs which he attributes to more trade facilitation among members of RTAs. This is a clear indication or pointer to the fact that RTAs in Africa have high chances of being trade creating especially considering the sum of the welfare effects of all the members of the RTAs. Increase in both flow and volume of trade are very necessary components of economic growth, however they both have a potential to complicate traditional customs compliance mission of regulatory, enforcement and revenue collection. It is upon this background that the challenges of the RTAs on Customs in Africa needs to be considered.

3.0 CHALLENGES OF REGIONAL TRADE AGREEMENTS TO CUSTOMS ADMINISTRATIONS

Increase in both flow and volume of trade due to the proliferation of RTAs comes with it the following challenges:-

3.1 Capacity Building

In the face of trade creating RTAs the importance of Capacity Building for Customs administration in Africa cannot be overemphasized. RTAs have effects on the broad role, purpose, duties, and responsibilities of Customs (Feaver and Wilson 2007, p.17), and hence there is therefore the challenge of coming up with broad based Capacity Building programs that enhance the abilities of both the institutional system and human resources that work with the system to be at par with the new arrangements. This automatically translates to more demand on the scarce resources that Customs works with and depending on the type of RTA in place, the cost may be high and complex as an administration tries to realign

itself to the demands of the new trading regimes that will have to not only encompass Trade facilitation but also security among others.

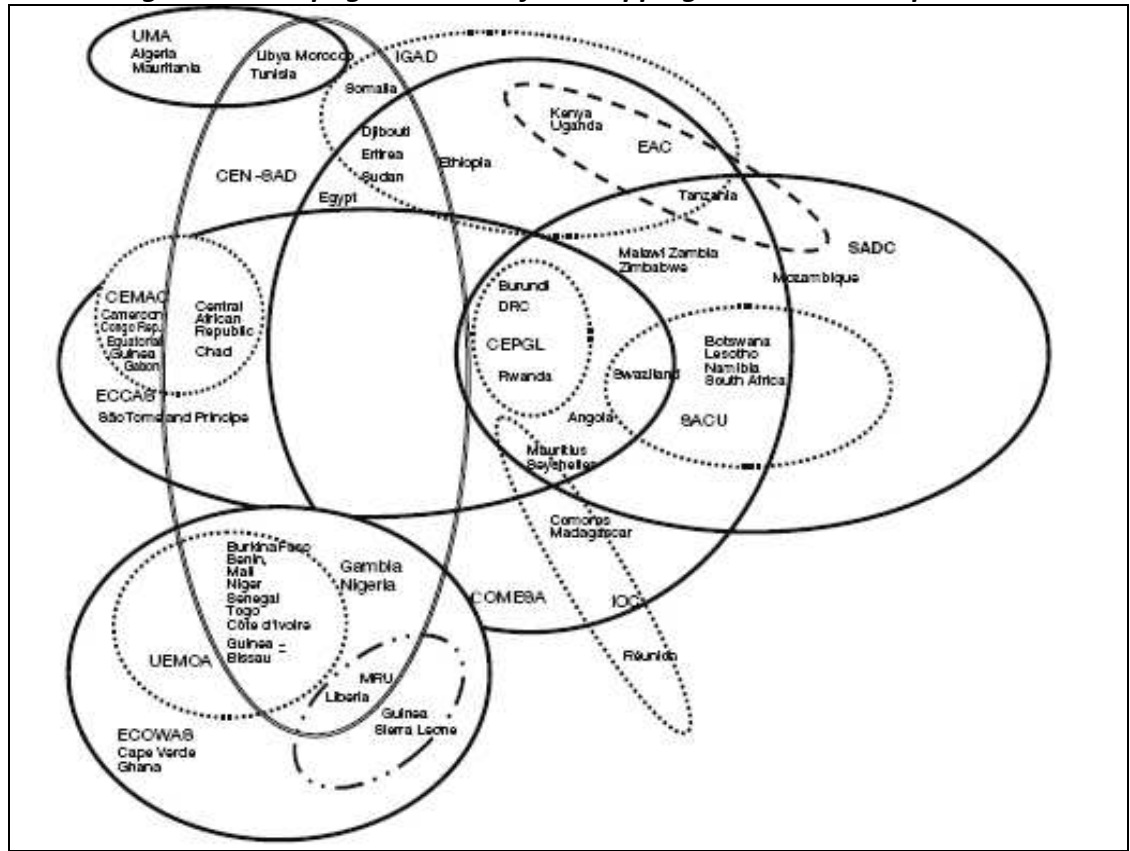
The immediate areas that would require Capacity building are Rules of Origin and their application including a deepening knowledge of some other nontraditional Customs subjects as the Arms length, origin and destination principles, Transfer pricing and production processes of multi and transnational co operations, all of which are major determinants of a product or service origin.

Another critical area will be the enforcement of expertise in other emerging areas such as Intellectual property rights where Customs will also have to focus on much more due to the broadening of its role as a result of increased openness that comes with implementation of RTAs.

3.2 Multiplicity of membership

As alluded to in the introduction to this paper, there is multiplicity of membership to the RECs by many African countries. A study by the United Nations Economic Commission for Africa and the African Union Commission revealed that by 2006, on average 95% of the members of a given REC belonged to another. Thus Africa has also a spaghetti bowl of its own as shown in figure 2 below. The study also reported that major reasons for multiplicity of membership to the RECs were strategic, political, and economic considerations.

Figure 2: The Spaghetti bowl of overlapping REC membership



Source: UNECA, *Assessing Regional Integration Report II*

Among the major results of this statistic of multiplicity cited in the UNECA and AUC report has been duplication of programs among the RECs, with the most duplication happening in programs in the areas of trade and market integration and trade facilitation which has direct relevance to Customs Administration.

With this scenario, it is therefore very likely to find a given Customs Administration in Africa implementing more than one program in the same area but under two or more RECs. A good example is in the area of Rules of Origin, where Customs officers have to cope and be conversant with more than two sets of Rules of Origin, in accordance with the RTAs which their respective parties are party to this is in addition to each agreement having its own tariff schedule and period of implementation of its programs. Not only does this drain the already scare resources but also may affect the efficiency of trade administration.

3.3 Customs Ethics and Integrity

The advent RTAs in Africa can be translated as an increase in the lines of goods that are zero or lower rated for duty. The rational choice theory therefore dictates as traders will try by all means to pay the lower rates. This may lead to a

dual challenge to Customs which may take the form of an increase in commercial (tax fraud) and corruption. In terms of commercial fraud, incidences of false documentation (the likely customs documents to be affected by this practice are invoices and certificates/proof of origin) may be on the increase as importers try to have their goods qualify for the lower rates in the RTAs.. On the other hand since Customs will have the final say as to whether a given consignment does or does not qualify for preferential treatment, there will be an increase in the combination of power, opportunity and incentive which Customs must continue to contend with. Whilst the question of corruption has been addressed as one sided affair only, with Customs viewed as the sole initiator of corruption, the fair approach would be one that recognizes the duality of the problem. Corruption when tolerated becomes a tradable service, with a complete set of consumers and suppliers and hence a demand and supply side, 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 utilization of information asymmetry and the importers may also induce the supply by offering better incentives to the suppliers. However there is more incentive for the importers to induce demand for a corruption service due to not only the stiff market competition but also the large markets that open up following the formation of RTAs. Thus the fight against Corruption in African Customs Administration itself has in many cases precluded the duality nature of corruption and that therefore the fight can be won convincingly by using methods that not only stifle trade in this corruption service market but by also targeting both sides of the market. The challenge therefore still continues to be is to be finding methods that will tackle Corruption from this angle.

3.4 Alteration of the Resource and Incentive structure

In the short run, one of the effects a Regional Trade Agreement is the reduction of Revenue due to lower rates or complete removal of Customs Duty. This is especially true in Least Developing countries, (33 of which are found in Africa) who lack adequate administrative capacity and a well functioning domestic tax system that can compensate the lost revenue (Walkenhost 2006, p.1). Where there has been significant trade diversion, this loss in revenue may become a permanent effect. However this reduction in revenue depends on such factors as the size of the tariff reduction, the growth in economic activity as a result of the tariff cut (trade creations effect). In Africa, the majority of Customs Administrations are government subvented and this loss of revenue directly affects their operations as there has to be some cuts in the government expenditure. In situations like this, the programs that suffer most are those that are related to modernization and capacity building, which usually are at the core of Customs Administrations. This scenario is worse in cases where governments have created Revenue Authorities who get a fixed percentage of the revenue

that they collect (usually 2% to 5%) for their operations. Thus a reduction in revenue is an automatic reduction in their resource basket as well. This is especially true in FTAs than in Customs Unions which are accompanied by Revenue Compensation Mechanisms. However, even in cases where such revenue compensation mechanisms are in place, no clear policies are put in place within governments that would ensure that Customs Administrations continue to get their fair share of the resource cake. In addition, the Revenue Loss Compensation Mechanism is usually marred with a myriad of operational problems and they may usually be temporary in nature. (See for example, Walkenhost, 2006 for a full analysis of Revenue Loss Compensation Arrangements in Africa)

Due to the challenging nature of the Customs job, many Customs Administrations have used a variety of ways to motivate their staff in form of incentives. 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 find other ways and indicators that have to be used in incentive and motivation schemes as opposed to the level of revenue collection which was based on the traditional role of Customs that 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 squarely rest on Customs Administration. Some of the major articles or clauses relate to Customs and Administrative Cooperation, Legislative procedures, facilitation of transit procedures, Valuation, and trade defense instruments such as anti dumping and countervailing measures, safe guards, and infant industry. These clauses and articles basically hinge on Trade Facilitation. The crafting of the articles and clauses are usually modeled on the International Instruments and standards applicable in Customs and Trade such as the Revised Kyoto Convention and the GATT Valuation Agreement among others.

The importance of Trade Facilitation in a RTA cannot be overemphasized, as pointed out in 1.0 above; it can be a source of major gains in trade in an RTA. However implementation of all the necessary Trade Facilitation and other RTA requirements comes at an enormous cost.

This subsection attempts to put into perspective some of these cost, some of which are overarching and hence have been dealt with in the other subsections.

Trade related infrastructure has a big role to play in Trade facilitation. This is a major challenge to Customs who despite not being in direct control of resources that are used for their infrastructure development are supposed to work towards the fulfillment of articles in the RTAs, whose success however depends solely on the availability of the infrastructure. A case in point is communication infrastructure such as installation of a computerized real time communication facility. Exchange of information among Customs administrations let alone in those in a RTA is vital for the smooth operations of Customs. However such infrastructure does not come cheap and yet more often than not, the agreements while containing clauses or articles on customs cooperation do not necessarily provide for such infrastructure. This becomes a major challenge to Customs as it gallops to fill this void. The other aspect of communication deals with inter-agency collaboration and cooperation. Thus since not all trade aspects are done by Customs, but also by other government and non government agencies such as Department of Trade Health, and Chambers of commerce and Industry, there is need that clear channels of communication are established for the smooth and swift flow of trade, which may also require infrastructure and institutional reorganization in order to work flawlessly. Thus there is a clear case for establishment of a Trade Single Window and integrated border management, which have, as already alluded to, enormous cost dimensions.

Proper monitoring of the RTAs requires detailed trade data collection, analysis and presentation. While collection of Trade Statistics data is one of the traditional functions of any Customs Administration, the proliferation of RTAs has placed an extra demand on the same, which may call for additional resource costs both human (in terms of relocation or hiring of officers with know how just to handle this new aspect) and material (in terms of data processing equipment such as computers and servers). This again is a major challenge to Customs in Africa that cannot be overlooked as such resources are very pricey. As pointed out in subsection 3.1, RTAs demand retooling and hence retraining of Customs Officers due to the radical change in their traditional responsibility whose emphasis had been revenue collection. This too can translate to major adjustment costs

4.0 REGIONAL TRADE AGREEMENTS AND CUSTOMS FUTURE POLICIES AND STRATEGIES

A whole body of challenges exists for Customs as a result of the proliferation of RTAs just as illustrated in section 3 above. However, this can be a good opportunity for Customs Administrations to make a critical analysis of their operations with respect to the new challenges and the community that it serves. It is a good opportunity for customs to do a gap analysis so as to continue staying relevant, efficient and effective. This process of re-invention will require pragmatic policies that have to be well backed by effective strategies to counteract and or reduce the impact of the challenges that lay before the Customs administrations. The World Customs Organization's

“Customs in the 21st Century” document (widely known as the C21 document) forms a good starting point as it portrays a good direction that Customs Administration should take.

In this regard future Customs Policies and Strategies in Africa will not only need to put much emphasis on adoption of international standards but also to adapt them. The adaptation strategy is necessary as it will enable the policies to work well within the already existing Customs framework. This approach helps to reduce reform related implementation hiccups and bottlenecks and helps the system to stay relevant to the goals that it was meant to achieve. Specifically there is a need for the formulation of policies and strategies that will focus on:

- (i) Capacity Building for Customs to have full control of the local and regional supply chains. Feaver and Wilson (2005, p.12) 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 effect”.
- (ii) Addressing resource constraints, through use of cheaper IT but efficient technologies and adoption of a risk based operations.
- (iii) Legal based reforms that will allow use of modern advances in technology, cross border cooperation and procedures that are in line with the RTAs
- (iv) The enhancement of inter agency cooperation between Customs and other border and cross border actors.
- (v) Issues of integrity that, if not adequately addressed, have the potential of causing significant trade related economic losses 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.
- (vi) Customs trade related infrastructure development that can undermine institutional reforms no matter how well designed.

5.0 CONCLUSION

This paper has attempted to illustrate the challenges that RTAs have brought on the operations of Customs operations in Africa and the possible policy and strategic options that would help to minimize their impacts. The proliferation of RTAs has also brought to light the need for Customs in Africa to continue (where this is not the case, to lobby) to be part and parcel of RTAs negotiating teams in their countries as this will help to anticipate the challenges which they are likely to face when the RTAs are implemented. There is also the need for Customs in

Africa to understand and follow closely and analyze trade developments at the national, regional, and global level.

6.0 BIBLIOGRAPHY

African Union Commission 2009, *The Minimum Integration Program*, AUC, Addis Ababa.

Cernat, L 2001, *Assessing Regional trade Arrangements: Are South to South RTAs More Trade Diverting?* Policy Issues in International Trade and Commodities. Study series Number 16. UNCTAD Geneva Switzerland

East African Community, 2008, *Trade Report 2007*, EAC, Arusha.

Feaver, D & Wilson, K 2005, *Preferential Trade Agreements and their Implications for Customs Services*. Working Paper Number 05-03, Zayed University, Dubai.

Glenday, G 2000, *Trade Liberalization and Customs Revenue: Does Trade Liberalization Lead to Lower Customs Revenues? The case of Kenya*, African Economic Policy, Discussion Paper Number 44, John F. Kennedy School of Government, Harvard University.

Salvatore, D 2004, *International Economics*, John Wiley and Sons.

United Nations Economic Commission for Africa, & African Union Commission 2006, *Assessing Regional Integration In Africa II, Rationalizing Regional Economic Communities*, UNECA, Addis Ababa.

Walkenhost, P 2006, *Compensating Lost Revenue in Regional Trade Agreements*, International Trade Department, Trade Note Number 28, World Bank, Washington.

World Customs Organization, 2008, *Customs in the 21st Century*, WCO, Brussels.

Yang, Y & Gupta, S 2005, *Regional Trade Arrangements in Africa: Past Performance and the Way Forward*, Africa Department, WP/05/36, International Monetary Fund, Washington.