STUDY

REGIONAL INTEGRATION AND POVERTY REDUCTION IN THE HORN OF AFRICA:

The AfCFTA Perspective

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The African Continental Free Trade Area (AfCFTA) came into effect in 2019 with the objective of creating a single continental market for goods and services, free movement of persons to deepen the continent's integration. This study attempts to assess the impact of this initiative on the Horn of African countries. It finds that the AfCFTA can boost countries' export, promote intra-regional trade and contribute to the poverty reduction efforts.

When the agreement is fully operational, countries will be obliged to introduce tariff liberalization measures and will have wide ranging implications on their economies. Through its direct impact on trade liberalization, such regional integration initiative could affect countries' citizens through various channels. The overall implications indeed depend on the structure of the economies in terms of informality, labor composition (skilled and unskilled), and population structure (urban and rural).

In that sense it is critical to investigate and identify complementary policies that enhance the effects of tariff reductions, which alone imply small and asymmetric impacts on African countries. Complementary policies are necessary to maximize the gains of the AfCFTA but also to ensure that its benefits are shared broadly to produce a win-win outcome for all countries.

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ACRONYMS

AfCFTA	African Continental Free Trade Agreement
AfDB	African Development Bank
AU	African Union
AUC	African Union Commission
CAADP	Comprehensive Africa Agriculture Development Program
CEPII	Centre d'Etudes Prospectives et d'Informationales Internationales
CFTA	Continental Free Trade Area
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ECOWAS	Economic Commission for West African States
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
HoA	Horn of Africa
IGAD	Intergovernmental Authority on Development
ILO	International Labor Organization
IMF	International Monetary Fund
IPR	Intellectual Property Rights
LAPSSET	Lamu Port-South Sudan-Ethiopia-Transport
NTBs	Non-tariff Barriers
OECD	Organization for Economic Cooperation and Development
RECs	Regional Economic Communities
RTA	Regional Trade Agreement
RVCs	Regional Value Chains
SACU	South African Customs Union
SADC	Southern African Development Community
SSA	Sub-Saharan Africa
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
UNECA	United Nations Economic Commission for Africa
UNOCHA	United Nations Office for the Coordination of Humanitarian Affairs
US	United States
USD	United States Dollar
WDI	World Development Indicator
WTO	Word Trade Organization

1 INTRODUCTION

African governments and their partner multilateral organizations including the World Bank and the African Development Bank recognized the imperative for an integrated and well-connected continent against the changing global landscape to fast-track industrialization and promote inclusive economic growth and development. For Africa, a vast continent of over 1.2 billion people, regional integration has considerable potential not only for enhancing regional trade and promoting robust and equitable economic growth through integrated markets but also for reducing conflict and ensuring peace and security (Matthews, 2003; Alexander et al, 2003). Currently, African governments are showing commitments to a continent-wide free trade area through the African Continental Free Trade Agreement (AfCFTA) which aims at accelerating the continental integration agenda and bringing the continent into the global trading system as a well-connected and integrated continent rather than as individual countries as set out in Agenda 2063 (AUC, 2015). Agenda 2063 clearly states that by 2063, Africa shall be united with world class and integrated infrastructure that crisscrosses the whole continent; and becomes a continent of seamless borders, and manages cross-border resources through dialogue. It plans to promote the low intra-regional trade through coordinated infrastructure investment accompanied by trade facilitation; and calls for action to fast-track the establishment of the Continental Free Trade Area, strengthen the continent's global trade negotiations power.

Regional integration, however, is not an end in and of itself. It is only useful to the extent that it enables African countries to address the development challenges they face, the most serious of which is how to achieve sustained growth and poverty reduction. Regionalism has played a vital role in fostering peace and security in Africa over the past few decades. However, fully exploiting its potential for economic development remains a challenge as evidenced, for example, by the prevalence of weak production and export structures in African countries, the increase in the number of poor people on the continent, and the low shares of regional trade in Africa's total trade.

Recognizing the slow regional integration process and the need to address the fragmentation of the economies, 44 African countries signed a framework agreement to establish a single continental market (i.e., the African Continental Free Trade Area, AfCFTA) for goods and services in 2018, with free movement of capital and business travelers. It entered into force in May 2019 after 24 countries had deposited their instruments of ratifications. Currently, 54 of the 55 AU member states with the exception of Eritrea have signed the agreement and 35 countries of the 54 signatories have ratified the agreement. From the Horn of Africa (HoA) countries, Djibouti, Ethiopia, Kenya and Uganda have already signed and ratified the agreement; while Sudan, South Sudan and Somalia signed but have not yet ratified. Eritrea is yet to sign and ratify the Agreement establishing the AfCFTA. The AfCFTA has been designed as a multi-stage process, meaning that the agreement will continue to evolve over time, and more negotiations are planned. The first phase, covering goods and services trade, took effect this year, though talks to finalize tariff schedules and the rules of origin provisions for Phase 1 remain ongoing. So far, the discussions over the rules of origin cover approximately 81% of tariff lines which means that countries that have ratified the AfCFTA agreement appeared to have agreed on these Rules of Origin. With the start of trading under the AfCFTA on 1st January 2021, Africa is in a position to start trading on over 81% of products on preferential terms. These goods form part of the initial trading, while negotiations on the remaining 20% are ongoing and are expected to be concluded by July 2021. Negotiators will now undertake Phase 2, which involves developing protocols on investment, competition policy, and intellectual property rights (IPR). A third phase will involve the negotiation of an e-commerce protocol.

When the agreement is fully operational, countries will be obliged to introduce tariff liberalization measures and will have wide ranging implications on their economies. Through its direct impact on trade liberalization, such regional integration initiative could affect countries' citizens through various channels. A recent World Bank study estimates that by 2035, AfCFTA will boost the continent's income by $450 billion (equivalent to 7% gain) and promote the continent's exports (especially manufacturing) by around US $560 billion (World Bank, 2020). The overall implications indeed depend on the structure of the economies in terms of informality, labor composition (skilled and unskilled), and population structure (urban and rural). Broadly speaking, regional integration could impact on countries' citizens on the incidence of poverty through allocative or dynamic effects on prices and incomes (ODI, 2005). However, this hinges on putting the right policy reforms and trade facilitation measures in place. Even though regional integration is believed to bring benefits, it may not trickle down to all groups of the society equally. Vulnerable groups such as women, the youth, the poor at large and pastoralists and agro-pastoralist communities in particular can be affected differently. In many cases, vulnerable groups may not have equal access and capacity to benefit from integration. It is, thus, fitting to revisit the nexus between regional integration and poverty reduction and to examine the impact of the AfCFTA in general and the trade liberalizations in particular on poverty reduction and inclusive growth in the context of the Horn of African countries.

The rest of the paper is organized as follows. The second section discusses the methodology and data source. The third section gives an overview of regional integration and poverty in the Horn of Africa followed by discussion on the AfCFTA and what it entails to the countries in the region. The final section summarizes the key findings and offers policy recommendation.

2

METHODOLOGY AND DATA SOURCE

i. Methodology

To look into the likely impact of the AfCFTA initiatives on poverty reduction, we used both quantitative and qualitative techniques. The quantitative techniques helped us examine the effect of the regional integration processes on trade to assess whether the integration process has created trade or diverted the trade from the traditional and economically efficient trading partners. In effect, we conducted ex-post analysis employing the widely used augmented gravity model specified in its log linearized form as:

$$LnT_{ijt} = Ln\alpha + \beta_1 LnY_{it} + \beta_2 LnY_{jt} + \beta_3 LnD_{ij} + \beta_4 LnN_{jt} + \beta_6 REC_{ijt} + \beta_7 A_{ij} + \varepsilon_{ijt}$$

Where Y_{it} and Y_{jt} denote GDP of the exporting and importing countries respectively at time period t; D_{ij} is the bilateral physical distance between the trading countries; N_{it} and N_{jt} denotes population of the exporting and the importing country respectively at time period t; REC_{ij} is a dummy indicating common membership in a regional economic community which help us measure the trade creation and trade diversion effects of any Regional Trade Agreement; and A_{ij} represents all other dummy variables which could facilitate or hinder bilateral trade including historical/colonial ties, contiguity, language and other factors. ε_{ijt} is an error term assumed independent of the explanatory variables, and α and β are the parameters to be estimated.

To substantiate the results from the quantitative techniques, we used qualitative techniques (like key informant interviews of relevant ministries from Ethiopia, and the IGAD secretariat, AUC). In addition to that, we conducted extensive document reviews of the national governments in the region.

ii. Data Source

The main data sources for the study were primarily secondary data mostly from the World Bank's World Development Indicators (WDI), IMF's World Economic Outlook and Direction of Trade Statistics, International Trade Centre's Trade Map and CEPII[1]. To substantiate the quantitative analysis, the study employed qualitative techniques including policy documents reviews of national governments and continental (like the AU) and regional bodies (like IGAD, EAC, and COMESA).

[1] All the gravity model is estimated using the cleaned data from CEPII

3

REGIONAL INTEGRATION AND POVERTY IN THE HORN OF AFRICA

3.1. Regional Integration in the Horn

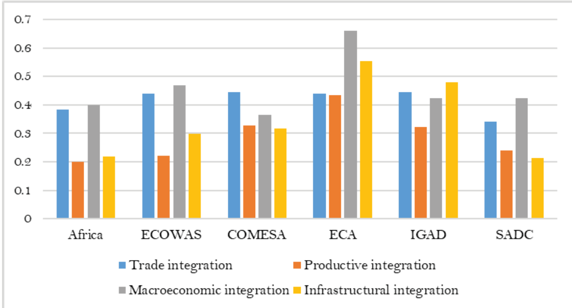
Regional integration in Africa has a long history dating back to 1910 when four Southern African countries namely Botswana, Lesotho, South Africa and Swaziland formed the South African Customs Union (SACU); and in Eastern Africa, Kenya and Uganda formed a Custom Union (the precursor to the East African Community) in 1917 (Edris, 2015)[2]. Currently, there are various regional integration initiatives with overlapping membership including the Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC), Intergovernmental Authority on Development (IGAD) and a recent Horn of African Integration initiative supported by IMF, and World Bank.

COMESA is one of the largest regional integration initiatives. It has already established a free trade area among member states in which each member state enjoys tariff exemptions if the goods they export meet the FTA's rules of origin requirement. However, there are some member states which have not yet joined the FTA. From the Horn of Africa, Djibouti, Kenya, Sudan and Uganda have already joined the FTA while Ethiopia and Eritrea still have only preferential treatments with other COMESA member countries.

The East African Community (EAC) is a relatively successful integration initiative in the region in terms of forging the integration agenda and promoting free movement of goods and people among its members. The Community has now reached Common Market stage where member states grant freedoms of movement for all factors of production and goods and services.

IGAD[3], on the other hand, relatively lags far behind other RECs in the region in terms of promoting economic cooperation and integration among member states despite regional integration and economic cooperation being one of the key pillars of the Secretariat's vision. The latest IGAD Regional Strategy outlines integration and economic cooperation as its fourth pillar. Figure 1 below shows regional integration index by indicators for the various RECs in Africa.

Figure 1: Regional integration index by indicators in 2019



Source: UNECA (2020)

The Horn of Africa region lags far behind other RECs such as COMESA and EAC especially in terms of productive integration and macroeconomic integration. Obviously, the region performs well in infrastructure integration. This could be due to the various cross border infrastructure investments in the region including the LAPSSET and Ethio-Djibouti rail project connecting the countries. Within the region, Kenya, Djibouti and Uganda are integrated in the various dimensions of regional integration particularly in free movements of people. On the other hand, South Sudan, which is also a member of EAC, is the least integrated country from the region, partly attributed to the country's political instability in the last couple of years.

3.2. Poverty and Regional Integration in the Horn of Africa

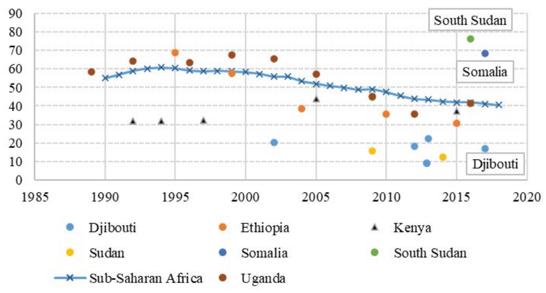
In general, poverty in Africa is one of the highest. However, in the last two decades we observe falling poverty level throughout the continent. In the mid-1990s, poverty head count ratio in Sub-Saharan Africa (SSA) was more than 60% which fell to around 40% by 2018. Performance varies across countries in the continent in terms of poverty reduction. Ethiopia, for example, had the largest proportion of population below the poverty line in the 1990s with 69%. But in 2015, its poverty head count ratio declined significantly to 30.8%.

[2] However, it is worth noting that all these regional economic communities were initiated by colonial powers.

[3] IGAD member states are all the countries in the Horn of Africa (Djibouti, Eritrea, Ethiopia, Kenya, Somalia, South Sudan, Sudan and Uganda)

Similarly, Uganda which had high level of poverty in the 1990s, made remarkable progress over the last two decades or so. Kenya, on the contrary, had seen rising poverty level over the same period from 31.7% in 1994 to 37.1% in 2015. The relatively high-level poverty in these economies demands for well-coordinated measures at the national and regional level to reduce poverty.

Figure 2: Poverty head count ratio in the Horn of Africa- 1989 to 2018



Source: Author's Own computation using World Bank's Development Indicators

3.3. Does Integration through Trade Agreements Have Impact on Trade in the Horn?

To look into the potential impact of integration through regional/multilateral trade agreement on trade and then poverty, we estimate the conventional gravity model for the Horn of African countries against the global trading partners. The results of the gravity model is given in appendix 2. The quantitative empirical analysis from the gravity model shows that Horn of African countries' trade with partner countries is boosted by the various bilateral and multilateral trade agreement initiatives. The elasticity of trade to having a bilateral trade agreement with the partner country is 3.7 implying that having bilateral/regional trade agreement between trading partners boosts trade by 370%. The other traditional trade affecting variables (such as border, distance, supply capacity and demand in the importing country) have the expected sign for both specifications we estimated.

4

WHAT DOES THE AFCFTA ENTAIL FOR THE HORN OF AFRICA?

African economies at large and the economies of the Horn of African countries in particular face notable trade limiting factors. Both tariff and non-tariff barriers hinder the exchanges of goods and services and the social and economic integration and development of communities in the region. Indeed, the relatively poor trade performance of Africa in general and especially its low intra-regional trade as compared to other regions, may partly be explained by such factors as limiting spillovers associated with trade and services flows within the continent. It is in this context that the AfCFTA has been hailed as game changer in terms of its potential to boost the continent's intra-regional trade and promote inclusive economic growth and facilitate industrialization and structural transformation.

The expansion of intra-Africa trade flows and the creation of new trade linkages are likely to open economic and development opportunities in Africa. Regional integration is expected to facilitate labor mobility across borders, enhance incentives to invest in skill developments, and improve the feasibility human capital investments in education and health. However, it will not radically transform the continent in the short run and the potential benefits of the initiative might not trickle down to benefit the most vulnerable sections of the society. Vulnerable groups such as women, the youth, the poor in general; and pastoralist and agro-pastoralist communities in particular, can be affected differently. In many cases, vulnerable groups may not have equal access and capacity to benefit from integration. The HoA region is characterized by low level of export diversification, limited/low industrial base, scarcity of skilled labor, a large group of pastoralist and agro-pastoralist communities and high level of security problem. All these constrain the process of integration and acquisition of benefits accruing from integration. It is thus interesting to analyze what the AfCFTA entails for the region.

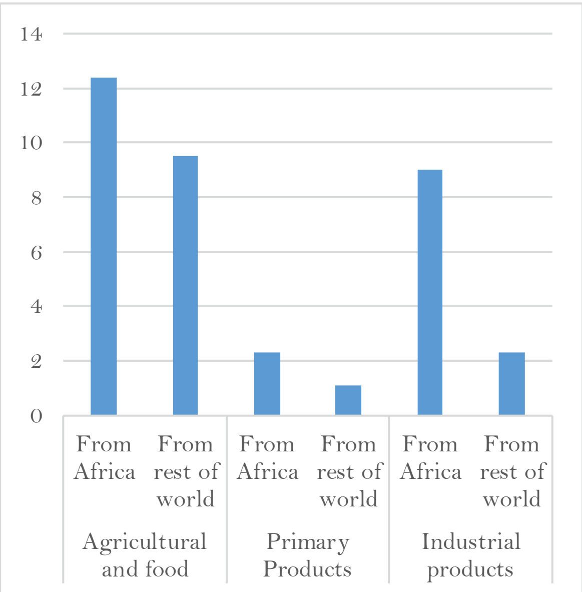
4.1. Trade Related Challenges in Africa

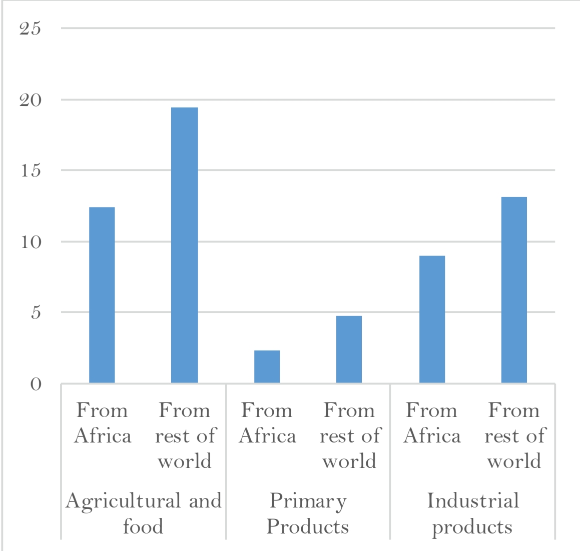
It is imperative to look at what hinders Africa's regional and global trade to understand if the ongoing continental initiatives can facilitate the continent's trade and promote inclusive growth. Here, we present the key challenges that Africa as a whole and the Horn of Africa in particular face when it comes to trade. Narrow range of tradable goods, restrictive trade policy and poor infrastructure and weak institutional arrangements are the three factors affecting the region's trade.

Narrow range of tradable goods: most countries in the region heavily rely on few unprocessed and low addition agricultural raw materials and primary commodities. Such commodities dominate the region's tradable goods. At the global level, Africa has relatively higher market share in fuel, primary commodities and agricultural raw materials making around 9%, 7% and 5% respectively; whereas manufactured goods exports, on the other hand, constitute the smallest global share with less than 1% of the global manufactured goods exports in 2019. This state of affairs indicates that Africa and the Horn of African countries perform better in exporting primary, agricultural and fuel products than they do for processed and manufactured goods. It limits the process of industrialization in Africa. The formation of a continent-wide integration is expected to expedite the process of industrialization in Africa which will be key to achieving economy-wide productivity improvements, job creation and sustained progress in growth and poverty reduction.

Restrictive trade policies of countries: despite recent progress across the continent in terms of relaxing their trade policies (and reducing intra-regional tariffs), it still remains the key factor deterring the region's trade. Currently, intra-regional tariff rates stood at around 9 % in the region which is among the highest, and the applied and most favored nation rates are 13.5% and 16.1% respectively. Since most of the countries in the region are eligible to the various non-reciprocal preferential treatments, the regions' exports face relatively lower level of protections when they export to the rest of the world (less than 3% compared to close to 9% when each country export within the region).

Figure 3: Africa's average protection imposed/faced on their imports/exports



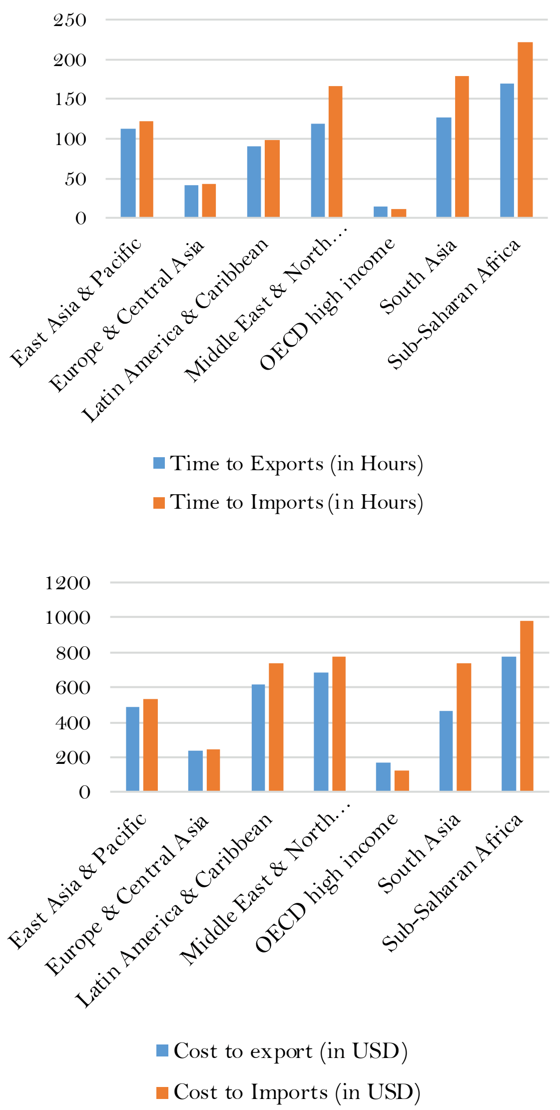


Source: ILO and UNCTAD, 2013

Average tariff rates for primary goods are relatively low while industrial and agricultural and food products face higher tariff rates both when exported to the rest of the world and to Africa. Thus, eliminating tariff in the continental free trade area is expected to boost export of these products in the intra-African trade.

Poor infrastructure and weak institutional arrangements: Infrastructure and strong institutional arrangements are critical for smooth flow of goods and services across countries. However, the region lacks these critical infrastructures which drive the trade costs and limit the region's trade. Consequently, non-tariff barriers (NTBs) are rampant throughout the continent. For example, in 2019 it takes around 169 hours to process exports (including border and documentary compliance) and 222 hours to import within SSA countries compared to 15 hours for exports and 12 hours for imports among OECD countries. These costs and NTBs are considerably high for agricultural commodities on which African countries depend for exports (see Kee et al., 2009 cited in ILO and UNCTAD, 2013). Since agricultural and food products are perishable and subject to strong sanitary and phytosanitary constraints, any delay in the export/import process is generally more costly than for other categories of products as it can result in the loss of the merchandise.

Figure 4: Cost and time to export and imports for the selected regions including SSA in 2020



Source: World Bank Doing Business

The data analysis illustrates that elimination of tariff barrier, though important, may not have the desired effect if it is not complemented with policy measures to eliminate supply side considerations. In order to move the integration agenda forward and harness associated benefits, elimination of tariff barriers must be accompanied by complementary policies aiming at reducing trade costs (i.e., administrative and customs formalities among others), enhancing mobility of factors within the continent, greater role for the private sector, limited productive capacity or improving financing systems.

4.2. Potential Impact of the AfCFTA

Low trade flows and high trade costs in Africa suggest that there is room for fruitful African integration. The expansion of intra-African trade flows and the creation of new trade linkages are likely to open economic and development opportunities. However, the ultimate effect of a free trade area depends on the particular characteristics of member countries, including the compatibility of their trade profiles, pre-existing tariff structures and geographical proximity. Different empirical studies modeled the impact of the continent-wide free trade area on the economy of African countries. Mevel and Karingi (2013) model the impact of the AfCFTA with the removal of all tariffs on trade between African countries. This analysis is then supplemented with the implied effects of improved trade facilitation between African countries using a database on trade costs. Trade flows would be significantly enhanced with the establishment of vast Free Trade Areas in Africa with trade creation effects more than compensate for trade diversion effects. The creation of AfCFTA would stimulate African exports by 4.0% (or $2.3 billion). Under the AfCFTA reform, intra-African trade is estimated to increase by 52.3% ($34.6 billion), compared with a baseline scenario without a AfCFTA, in 2022. Africa's industrial exports are forecast to enjoy the highest gains, expanding by 53.3% ($27.9 billion). Real wages for all categories of African workers would also be positively affected by the formation of free trade area. Following implementation of a AfCFTA, unskilled workers employed in non-agricultural sectors would obtain the highest real wages increase with +0.80%; their unskilled counterparts engaged in the agricultural sector would see their income raise by +0.74%, on top of the baseline for the year 2022. Real wages for skilled workers are also estimated to increase and there is a small shift in employment expected from agricultural to non-agricultural sectors. Flanking the AfCFTA with trade facilitation measures is found to be important in maximizing the impact of the AfCFTA on Africa's industrialization and ensuring that all countries gain from the AfCFTA.

Chauvin et al. (2016) cited in ILO and UNCTAD (2013) model the cumulative impact of the elimination of tariffs; a 50% reduction in non-tariff measures; and a 30% reduction in transaction costs. They find the short-run impacts in the first years after implementation are generally small but with larger and more positive long-run impacts. By 2027, the AfCFTA is estimated to increase Africa's welfare by 2.64%. Notably, the reduction in non-tariff measures and transaction costs are found to contribute significantly to improving welfare gains. Chauvin et al. (2016) also link the modelled results to household survey data for a selection of African countries to assess the effect of the AfCFTA on subnational economic groups, including female or male-headed households, urban or rural groupings, and different income groups. They find the AfCFTA to have an asymmetric but positive effect on all the subnational groups, with the particular groups that gain most varying by country.

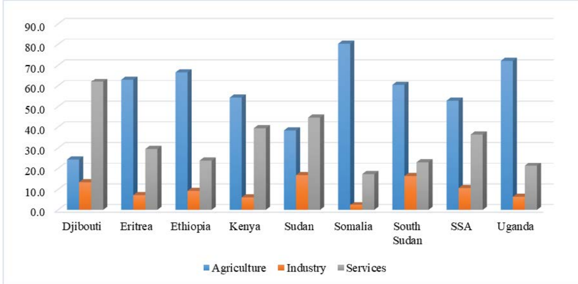
4.2.1. Distributional Impact of AfCFTA

Empirical evidences discussed above and many more are confirming that the continent-wide integration leads to a trade creation effect that more than compensates a trade diversion effect. However, the expansion of trade could benefit different sections of the society differently. It is thus imperative to see the distributional aspects of the benefits of integration. Such a study is addressed through a discussion of integration-induced changes in employment, wages and, more generally, in rewards to factors of production, which further informs the possible impact on distribution and the living and working conditions of the poor.

The impact on poverty: trade and regional integration create opportunities and challenges. The former refers to the ability of the poor to benefit from the liberalization. For example, for consumers this could be lower prices from cheaper imports, increased employment and/or higher wages in expanding sectors; and for producers this could be improved access to export markets, cheaper and/or higher quality intermediates, or increased investment. The challenges are concerned with the ability of the poor to respond/adjust to negative shocks. For producers, this could mean competition from imports leading to reduction in sales/income, for workers the competition from imports could lead to a reduction in employment and/or wages. Reductions in tariff revenue could lead to a decline in expenditure on poverty alleviating measures (health, education, and social security). The impact on poverty, therefore, will depend on the ability of the poor to respond to both the opportunities and the challenges. The impact of regional integration on poverty often is discussed through regional integration's impact on GDP and welfare. To the extent that integration increases GDP and welfare in most individual and groups of African countries, it widens the scope for poverty reduction. However, it is difficult to ascertain a priori to what extent poverty can actually fall. The reduction in poverty that any country can extract from a given increase in the rate of growth depends on many factors, including among others: the initial economic and institutional conditions of the country, the sector composition of growth, its demand for employment, its linkages with the rest of the economy, and the policies that accompany such increase (UNDP, 2011). Using the 1 and 2 dollar a day international poverty lines and applying the elasticity estimates of poverty, UNDP (2011) estimated the poverty impact of the CFTA on different countries in Africa. They found that Africa-wide integration reduces poverty in 10 of the 11 countries examined. Analysis of welfare effects of AfCFTA by Abrego et al. (2019) finds considerable dispersion in welfare gains across countries. In the HoA, Kenya and Uganda will gain more than the median gain for Africa, whereas Ethiopia, Eritrea, Somalia and Sudan gain less than the African median. The report further noted that the largest proportional gains tend to accrue to the countries with the most open economies and countries with strong initial trade ties with other African countries.

The impact on employment: integration affects employment in varied ways depending on the partners involved and the type of integration pursued. Even though integration results in significant gains in welfare and output, the impact on employment is conditioned by the fact that integration affects employment in sectors in opposite directions. African regional integration tends to increase employment in non-agriculture sectors and decrease employment in agriculture. In their simulation results, ILO and UNCTAD (2013) found that employment in the agricultural sector decreases by 0.08%age points in 2022 compared with the baseline scenario but employment in non-agricultural sector increases by 0.02%age points. These changes would be extremely small, however.

Figure 5: Distribution of employment by sectors for the Horn of African countries in 2019



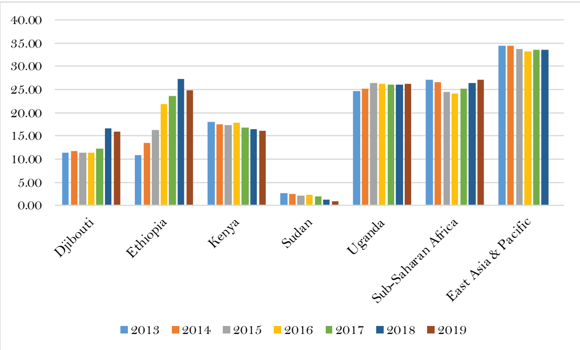
Source: World Bank Development Indicators

Figure 5 shows employment distribution by sectors for the Horn of African countries. Apart from Djibouti, all the economies in the region rely on the agriculture sector for employment. Somalia, Uganda, Ethiopia and Eritrea have higher proportion of labor force working in the agriculture sector with 80.3%, 72.1%, 66.6% and 63.1% respectively. On the other hand, Djibouti's labor force is mainly employed in the service sector. Given the current structure of the region's employment, in the short run, negative impact of regional integration on employment in the agricultural sector (however small it might be) can affect the welfare of the rural people especially the welfare of the agricultural laborers. This calls for some adjustments or policy actions to protect the rural poor.

In the medium and long run, however, the AfCFTA could facilitate the region's transformation by shifting the labor from less productive agriculture sector to the more productive industrial sector which is a welcome effect because wages tend to be higher in non-agriculture activities. Additionally, increases in non-agricultural production encourage migration to urban areas, where job opportunities are more abundant and services can be provided at a lower cost. However, it also implies short-term adjustments with costs that should not be borne by the poor, which also indicates that assistance is needed to undertake the training necessary to obtain the jobs just created in the cities.

The impact on the sector composition of production and factors of production: increasing the role of trade in economic activity has the obvious effect of increasing the share of sectors active in international markets and perhaps decreasing the relative importance of domestic production in sectors where imports might become more important. Africa integration favors manufacturing sectors, light and heavy, which suggests that AfCFTA can potentially build a stronger base for diversification and economic growth. This is mainly reflected in the West, East and North African regions, i.e., including the HoA region (UNDP. 2011). Given the nascent and growing industrial sector for countries (see below the industrial value added as share of GDP for each country in the region), such continental initiative would enable countries to diversify their economies away from agriculture to industrial and service sector.

Figure 6: Industrial value added for the HoA and selected regions-2013 to 2019



Source: World Bank's Development Indicators

Similarly, regional integration and cooperation changes the allocation of factors of production and the market returns to these factors. In general, changes in returns to factors will be friendlier to human development if wages increase more than returns to land, capital and natural resources; market wages of unskilled workers increase more than those of skilled workers; and market returns to low-skilled workers in agriculture increases more than their counterparts in the rest of the economy. In terms of development pathways, the long-term sustainability of Africa's development is arguably better served by changes that increase the return to capital than the return to natural resources, as this could encourage manufacturing activities and movements up the value-added ladder and diversify economies. The link between the change in the relative return of land and capital and human development is less clear, as it depends on the distribution of land in countries, access of the rural poor to land and land quality.

Considering only the tariffs plus transport cost scenarios, simulation results suggest that Africa's integration tends to increase the return to capital relative to land and natural resources (UNDP, 2011). This is an incentive to allocate resources to activities that can help diversify the economy and enhance its competitiveness. In close correspondence with the characteristics of labor abundant countries, integration increases the relative return of labor over capital, an effect that should be noted for its positive impacts on the distribution of income. Rather surprisingly, Africa's integration changes relative wages in favor of high-skill workers and against low-skill workers in the short term. In the long term, increasing the relative wage of skilled workers may create incentives for the acquisition of education, hence reinforcing the long-term development perspectives of African countries. Moreover, the provision of a strong and equitable education endowment for the population requires much more than a change in relative returns in favor of more educated workers. Changes in incentives must be accompanied by a strong education strategy that ensures accessibility, equitability and quality. Finally, the change in wages among low-skilled workers favors those in non-agriculture activities, which is consistent with the overall shift of the economy toward non-agriculture activities that African integration is likely to unleash. Overall, comprehensive regional integration and cooperation opens up opportunities to deepen human development, but tailored policies are required for each country and region to ensure that this happens. The requisite changes, however, include policies on re-skilling and access to tertiary/vocational training as well as social protection mechanisms to safeguard people through the changes brought about by integration.

4.3. Complementary policy reform measures for successful implementation of AfCFTA

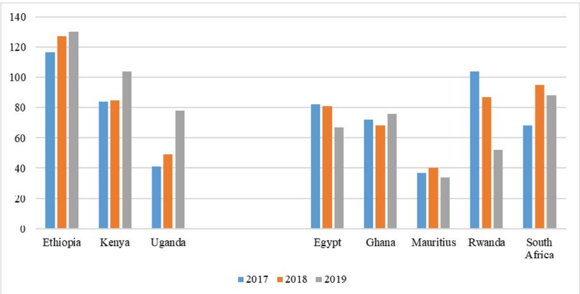
As articulated in ARIA IV (ECA, AU and AfDB, 2010, cited in ECA, AU and AfDB, 2017) liberalizing trade between two or more countries generally has positive welfare effects for those countries and leads to economic growth and poverty reduction. Nevertheless, these gains are not automatic. Flanking policies that are trade facilitating and measures to correct distributional distortions are required. Simulation models are indicating that while results from the analysis focusing on the establishment of larger free trade areas and especially the AfCFTA are rather positive at the global level for Africa, the increase in the share of intra-African trade may not appear sufficient. For example, simulation results by ILO and UNCTAD (2013) projected that intra-Africa trade increases by 52.0% as a result of AfCFTA without supporting trade facilitation measures. This is much lower than the expectations set by the AU Member States; in January 2012, at the 18th African Union Summit of Heads of State and Government, AU Member States expressed the desire to see the share of intra-African trade double within the next ten years (UNDP, 2011).

In that sense it is critical to investigate and identify complementary policies that enhance the effects of tariff reductions, which alone imply small and asymmetric impacts on African countries. Complementary policies are necessary to maximize the gains of the AfCFTA but also to ensure that its benefits are shared broadly to produce a win-win outcome for all countries. Such measures could complement the strict elimination of tariff barriers in goods and potentially augment the relatively small positive effects and counterbalance the minor negative effects associated with the FTA reforms. Accompanying measures to help boost the gains of the AfCFTA include trade facilitation and trade-related infrastructure, i.e., those associated with improved regulatory transparency, harmonization of sanitary and phytosanitary regulations, the accreditation and mutual recognition procedures for technical barriers to trade and improved administrative conditions in customs; policies on re-skilling, access to tertiary/vocational training, as well as social protection mechanisms to safeguard people through the change brought about by integration.

4.3.1. Addressing Non-tariff barriers (NTBs)

NTBs are impediments to trade and are particularly onerous in Africa; they include import bans, unjustified documentation and conditions, excessive border checks, and police stops/check points. The average applied rate of tariff protection in Africa is 8.7%, but other obstacles increase the cost of Africa's trade by an estimated 283% (Sommer and Luke, 2017 cited in ECA, AU and AfDB, 2017). Getting NTBs right in the CFTA will mean including provisions to reduce these barriers. The CFTA is to include provisions on non-tariff measures, such as sanitary and phytosanitary standards and technical barriers to trade that can constitute some of the NTBs for cross-border trade in Africa.

Figure 7: Global rank in the prevalence of NTBs for selected Horn of African countries compared with other African countries-2017-2019



Source: World Economic Forum Global Competitiveness Index Business

The Horn of African countries are ranked bottom in terms of the prevalence of NTBs and some even have experienced further fall in the global rank. Ethiopia, for example, is the least ranked country (from the HoA countries for which data is available) at 117th in 2017 but in 2019 it was ranked at 130th. Uganda has relatively been ranked high from the region. Therefore, for the successful implementation of the AfCFTA, national governments in collaboration with the regional bodies (like the AU, IGAD and other regional economic communities) should streamline proper implementation of trade facilitation measures into their respective national development agenda to reduce non-tariff barriers. Addressing onerous customs procedures and boosting efficiency could reduce costs and facilitate trade. Accordingly, as suggested by Abrega et al. (2020), to reduce costs and facilitate trade, African countries could take a number of steps such as: making sure that all customs locations have information technology systems that support core processes and are adequately used by traders and officials; enhancing customs control of preferential origin rules to prevent revenue losses and build trust among trading countries; introducing modern risk-analysis techniques and appropriate equipment for nonintrusive inspections and faster turnaround in laboratory sample testing; and deepening modernization efforts, with a focus on reducing costs and delays faced by international traders. Taking all these steps will require pressing forward with modernization processes, intensifying training, and implementing quality-based management.

4.3.2. Social Protection Measures to Vulnerable Groups

The AfCFTA, which is forecast to lead to higher levels of welfare in aggregate and in the long run, is expected to lead to shift of factors of production, including labor and capital, across sectors towards those with expanding exports, and within sectors to more export-oriented firms. It is important to consider the adjustment costs required for this transition in the long run, especially when these costs fall on vulnerable or sensitive groups such as smallholder farmers, women, informal traders and the youth. These groups may be less resilient to even small shocks or lack the resources necessary to reskill and seek new opportunities. Where possible, the AfCFTA and its accompanying measures should include provisions of particular benefit to such groups so that they too can share the gains of the AfCFTA and are protected when necessary.

As part of countries strategy to address chronic food insecurity, governments in the region have introduced safety net programs targeted at reaching out the poorest of the poor. In Ethiopia, for example, the government together with development partners have social safety net program first introduced in the rural areas and now expanded to urban areas. However, these programs are not targeted addressing the adverse impacts of such trade agreements.

i)Smallholder farmers, pastoralists and agro-pastoralists

Pastoralism and agro-pastoralism are one of the dominant economic activities in the Horn of Africa, especially in the arid and semi-arid areas of Djibouti, Ethiopia, Kenya and virtually all parts of Somalia. In the Greater Horn of Africa, the total population of pastoralist and agro pastoralist communities is estimated to be around 30 million . On the other hand, smallholder farming is common particularly in those high land areas of Ethiopia and Kenya with high population growth.

Though export of food and agricultural products rise leading to a rise in wages of unskilled agricultural workers (ILO and UNCTAD, 2013), smallholder farmers, pastoralists and agro-pastoralists may not be directly benefiting from the expansion of trade. This is because these groups are usually connected to export markets through intermediaries who usually retain the benefits rather than passing it on. Moreover, given the very limited market alternatives, pastoralists have few options but to engage in the unpredictable and dangerous cross border trade, in many cases with low-income levels and small profit margins often liable to confiscation (Umar and Baulch, 2007). Indeed, 'legal constraints are stifling trade rather than maximizing the potential of cross-border trade to generate household incomes and government revenue' (UNOCHA, 2006).

It is, therefore, essential to work on ways to integrate these groups into large value gains. The advantages could be obtained through setting simplified rules of origin requirements, trade facilitation measures that help them meet sanitary and photo-sanitary export standards, through assisting these groups with capital and reskilling to focus their production on exports and on those products which they have comparative advantage. Thus, AfCFTA monitoring mechanisms should be particularly sensitive to the effects on smallholder farmers, pastoralists and agro-pastoralists, which may require more time for adjustment to ensure protection or product exclusion.

However, governments in the region have not put any concrete policy towards addressing these challenges in light of the AfCFTA. On the other hand, there are cross border initiatives led by the IGAD secretariat focusing on the pastoralists and agro-pastoralists. To promote cross border trade among these communities in the region (which often live in border areas of the region), the Secretariat, together with the national governments of the region, has to facilitate movement of people and ease the trade formalities for these communities.

ii) Informal cross border traders

Owing partly to the population settlement pattern across the borders, the ecosystem, and the livelihoods of the pastoralist communities, informal cross border trade has been a key economic activity and an integral part of life among these communities. Various estimates show the informal cross border trade in the region to be considerably high and has been key in terms of alleviating poverty and ensure food security (see Berhanu, 2016; Afrika and Ajumbo, 2012). Berhanu (2016) shows that 71% of total value of live animal trade and 78% of consumer goods and productive inputs imported into the Horn of Africa is through informal cross border channel. In some instance, the volume of informal cross border trade among many African countries is estimated to be much larger than the official cross border trade (Golub, 2015). In Uganda, for example, informal exports flowing to its five neighboring countries were estimated to account for USD 231.7 million in 2006, corresponding to around 86% of Uganda's official export flows to these countries. A study conducted by PCI estimates that informal cross border exports from the Northern region of Somalia exceed by a factor of 3.2 to 6.5 the Ethiopian Customs Authority statistics for the number of live animals exported from the whole of Ethiopia (Umar and Baulch, 2007).

Recognizing the huge economic importance of informal cross-border trade, there are many agencies under the IGAD secretariat to streamline informal trade, borderlands and borderland issues in the region. In consultation with the national governments, the IGAD secretariat prepared policy framework to leverage policy shifts on Informal Cross Border Trade and improve cross-border security governance in the IGAD region.

While cross border trade carries huge potential for meeting national, regional and even international demands especially for livestock and contributing to food security in the region, governments in the HoA have often adopted a hostile and punitive attitude towards this specific trade. Cross border activities in the HoA are widely considered informal and illegal and are vulnerable to harassment, violence, confiscation of goods and even imprisonment. With the formation of the AfCFTA and removal of tariffs, informal cross border traders can have the opportunity to trade formally and under the greater protections and security afforded by such formality. However, accompanying measures should go further to benefit this group including removing constraints that they face and to ensure that they are not disadvantaged relative to established formal traders.

iii) Women and Youth

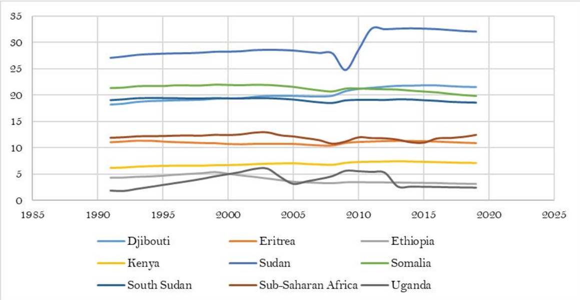
Gender disparity in wage earnings and absence of women from the labor force are costing Africa billions of dollars annually. The UNDP (2016) estimates that unless this trend is reversed, SSA could lose up to 60 billion dollars annually. A joint study by Ethiopia's Ministry of Agriculture and Natural Resources, UN Women, UNDP and UN Environment (2018) shows that the existing gender gap in agricultural productivity in Ethiopia (estimated to be 24% after accounting for plot size and regional variation across the country) could undermine overall agricultural productivity and environmental sustainability.

Since participation of most women in the region is often concentrated in lower-value subsistence crops rather than cash crops for exports, this narrows their opportunities to benefit from export trade expansion due to the AfCFTA. Moreover, women account for roughly 70% of informal cross-border traders (ECA, AU and AfDB, 2017), which makes them vulnerable and benefit less from the AfCFTA.

To help women benefit from the AfCFTA, the task is to make women's participation in agriculture more productive and to connect female agricultural workers to export food markets, enabling them to garner higher incomes (UNCTAD, 2014 cited in ECA, AU and AfDB, 2017). Moreover, trade facilitation measures that focus to help informal cross border traders also need to have deliberate emphasis on women.

Another important feature of the continent is its youthful population; whereby 60% of Africa's population are aged 24 or younger and are about to enter the workforce (ECA, AU and AfDB, 2017). Despite the growing percentages of youth population in the region, unemployment among these group is relatively high, especially in some countries like Sudan, Djibouti, Somalia and South Sudan (as can be seen from figure 10). In Sudan, for example, the latest estimates show that more than 32% of youth are unemployed; in Djibouti, Somalia and South Sudan youth unemployment in 2019 was 21.6%, 19.8% and 18.6% respectively.

Figure 8: Unemployment, youth total (% of total labor force ages 15-24)



Source: World Bank's Development Indicators

A shortage of opportunities for Africa's youth contributes to high youth unemployment and working poverty rates approaching 70% (ILO, 2016). Structural transformation is required to produce new jobs for young people and to absorb these new entrants into the labor force. What will be important for Africa is restructuring economies away from capital-intensive commodities towards labor intensive sectors, such as manufacturing, information and communications technology, and agriculture and agro-industries, to produce the jobs that can pull Africa's youth into the workforce (ECA, AU and AfDB, 2017).

Supporting Africa's youth requires a development strategy that goes beyond trade policy. Policies in education and skills development, such as the Continental Strategy for Technical Vocation Education and Training and the Science, Technology and Innovation Strategy for Africa (2014–24) are important, as are others in health and well-being and in youth empowerment. The AfCFTA can be an additional component. Most important, the AfCFTA, supported by complementary policies, can contribute to the kinds of export diversification and structural transformation that promote labor-intensive industry and help to "pull" Africa's youth into productive activities.

4.3.3. Human Capital Development

The most important gains from the AfCFTA will be realized over the long run as the agreement contributes to the economic restructuring of African sectors towards more productive industrialized and export sectors, and improved investments. The AfCFTA can create industrial sector opportunities to help less-industrialized countries increase their manufacturing footprint. This is a welcome effect for the long-term perspectives of African economies because wages tend to be higher in non-agriculture activities. However, the countries may require additional support to realize these opportunities, which may include improving their productive capacities through increased FDI and intra-African investment as well as implementing the program for the Accelerated Industrial Development of Africa. To help firms—predominantly the small and medium sized—engage in intra-African trade, investments must be made in trade information and the facilitation of access to trade finance. Factor market integration, including the improved movement of persons and cross-border investments, can be especially valuable in fostering RVCs. Additionally, increases in non-agricultural production encourage migration to those urban areas with relatively good job opportunities. However, tailored policies are required for each country and region to ensure that this happens. The support includes policies on re-skilling and access to tertiary/vocational training which requires domestic investments in education and training to ensure the necessary skills. Important initiatives include the Continental Strategy for Technical Vocation Education and Training and the Science, Technology and Innovation Strategy for Africa (2014–24).

5 CONCLUSION

Over the years, African governments and various organizations including continental institutions such as the AU, AfDB and UNECA have made significant efforts in promoting regional integration at the continental level. There have been strong commitments taken lately aiming at accelerating the integration of African economies. In that respect, the African Continental Free Trade Area (AfCFTA) agreement to establish a single continental market is a notable one which provides opportunity for economies to boost intra-regional trade and promote inclusive growth. The agreement came into effect in May 2019 after 22 countries ratified the agreement.

Regional integration, however, is not an end by itself. It is only useful to the extent that it enables African countries to address the development challenges they face, the most serious of which is how to achieve sustained growth and poverty reduction. Results from previous empirical analyses indicate that deep regional integration in Africa through establishment of such large continental FTA would benefit the continent. In our analysis, we find significant positive impacts of the various regional/bilateral trade agreements including membership to WTO in terms of promoting the region's trade. Such reforms (aimed at removing tariff and non-tariff barriers) would increase exports, real income as well as real wages for all categories of workers for Africa as a whole. Moreover, the analysis suggests that the larger the reform the greater the associated gains.

However, the mere removal (reduction) of tariff barriers on goods within the African continent would not be sufficient to generate benefits for every African economy. In addition to tariff barriers, reducing non-tariff barriers which are rampant in the continent, inhibiting intra-African trade, are key. The NTBs take multiple forms, such as lengthy customs procedures, sanitary and phytosanitary measures, product standards, anti-dumping measures, countervailing duties, and licensing. Moreover, poor infrastructure, weak institutions, human capacity, insecurity and political instability, and the lack of private sector development are strong obstacles to integration. Therefore, it is paramount that additional measures aiming at easing trade inhibiting factors across borders accompany FTA reforms. For example, studies show modernizing customs procedures at borders to reduce the time that merchandises are held at ports would lead to positive exports and real income increases in all African countries.

Reducing NTBs together with proper implementation of the AfCFTA could boost the continent's intra-regional trade and increase real incomes. Real income gains from full implementation of AfCFTA could increase by 7% by 2035, or nearly 450 billion dollars (in 2014 prices). Similarly, it increases volume of total exports by almost 29% by 2035 relative to the baseline (World Bank, 2020). Moreover, introducing trade facilitation measures would expand the exchanges of industrial products thereby increasing the sophistication of intra-African trade. In percentage terms, the increase of Africa's industrial exports would surpass that of Africa's agricultural and food exports, leading to higher wage increase for skilled and unskilled workers employed in non-agricultural activities than for their counterparts in agriculture.

6
POLICY RECOMMENDATIONS

Analysis of the impact of AfCFTA suggests that African integration holds strong potential for enhancing sustainable growth and poverty reduction in Africa including in the countries in the Horn. However, the realization of this potential depends on critical policy choices made by national governments and regional bodies like IGAD secretariat and the African Union Commission. The following are actionable policy recommendations for the national governments and the regional bodies that could enable countries maximize the benefits of regional integration.

- **Fast-tracking the implementation of trade facilitation measures:** different simulation results suggest that benefits of AfCFTA can be harnessed only if tariff removal is accompanied by elimination of non-tariff barriers. In countries in the Horn of Africa, like the rest of the countries in the continent, NTBs increase trade costs considerably compared with tariff barriers limiting intra-African trade. Therefore, national governments in collaboration with regional bodies like the AU, IGAD and other regional economic communities should streamline proper implementation of trade facilitation measures into their respective national development agenda to reduce non-tariff barriers.
- **Expanding social protection programs:** economic integration is expected to lead to shift of factors of production which in turn can result in distributional impacts within countries. Since not all impacts will be positive, it is important to consider adjustment costs required for this transition in the long-run. In this context, appropriate social protection policies can help maximize and sustain benefits of integration across all sections of the society. Social protection mechanisms (which include broadening and strengthening of social safety nets for the provision of targeted assistance to those adversely affected by trade liberalization and targeted training programs to ease worker mobility across industries and promote employment, along with other active labor market programs) are particularly important for more vulnerable groups (like small holder farmers, pastoralists and agro-pastoralists, informal traders, women and young people). The regional bodies could play active role in expanding such programs by mobilizing the required resource.
- **Diversifying domestic resource mobilization base from trade taxes to domestic ones:** trade liberalization could have ramifications for national governments in terms of revenue for it significantly reduce tariff and tax bases (for imported goods). Therefore, national governments should diversify their resource base by broadening domestic tax bases. This expansion will help governments manage the potential adverse fiscal revenue impact of AfCFTA. The fiscal space to cover these needs could come from revenue mobilization strategies or re-prioritization of expenditures. Revenue mobilization should be guided by country specific reform strategies. However, measures could include expanding the tax base through initiatives to reach sectors that are difficult to tax, developing (or leveraging) existing platforms to combine domestic revenue and customs operations and to simplify customs clearance operations and adopting automated systems across tax and customs administration, and other modes of financing, such as user fees or public-private partnerships.
- **Promoting skill development:** regional integration allows for expansion of industrial sector opportunities to help less industrialized countries, such as those in the Horn, increase their manufacturing footprint. However, tailored policies with a focus on human development are required for each country and region to ensure that this happens. Such an intervention includes policies on re-skilling and access to higher level of training, specific measures to address distortions in labor costs and easing restrictions on labor reallocation across sectors, firms, occupations, and regions. It also requires domestic investment in education and training to ensure the necessary skills and cross border mobility of labor.
- **Harmonization of trade policies:** differentiated regulatory schemes and trade standards represent a drag on regional economic activity. Much can be gained by harmonizing frameworks and making all economic agents aware of their parameters. This is true for labor markets (and cross-border mobility) as well as markets for goods and services. The regional bodies will have active role in harmonizing the national trade policies across the region.

- **Expanding well-functioning financial markets.** among other things, financial markets would ease the process to secure loans based on credit histories. In this way, credit markets could help facilitate a more flexible labor market. In addition, better-functioning credit markets will improve firms' access to long-term competitive financing to expand production and facilitate more extensive trade. More generally, improvements in credit markets that provide expanded access to financial services to the wider population will increase efficiency and enhance gains from trade.
- **Promoting and implementing well-target transformational strategy:** such transformational strategies help countries to promote growth and enable firms to move up the global value chain through greater innovation and investment (both foreign and domestic). This would increase firms' ability to seize new opportunities made available by trade liberalization under the AfCFTA and help expand employment opportunities. Efficient implementation of this strategy could be supported by ratification of the freedom of movement protocol of the AfCFTA and improvements in development and trade financing.

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APPENDICES

Appendix 1: Description and definition variables used in the quantitative analysis

VARIABLES	Definition of variables
Importer cost of business startup (% of GDP)	This is cost of business startup in the importer market (expressed as % of GDP)
Exporter cost of business startup (% of GDP)	Cost of business startup on the exporter country (as % of GDP)
Area of the Importer	Land area of the importer in Sq Km
Area of the Exporter	Land area of the exporter in Sq Km
Exporter GDP	Exporter GDP as a measure of supply capacity
Importer GDP	Importer GDP as a measure of demand in the importing country
Landlocked Exporter	One if the exporter is landlocked, and zero otherwise
Landlocked Importer	This takes a value one if the importer is landlocked, and zero otherwise
Bilateral Distance	Bilateral distance between the trading partners as indicator for transport costs
Exporter GDPPC	Exporter GDP per capita
Importer GDPPC	Importer GDP per capita
Common Border	This is common border indicators for the trading partners. It is equal to one if they share common border, and zero otherwise
Common Official Language	This takes a value one of both trading partners have common official language, and zero otherwise
Common Colonizer	This takes a value one if the both trading partners had common colonizer
RTA	An indicator whether the exporter and the importers have common RTA. So, it takes one if both these economies have common RTA, and zero otherwise
Exporter WTO	This is an indicator whether the exporter is member of WTO. So, it takes one if the exporter is member of WTO and zero otherwise
Importer WTO	An indicator for the importer regarding membership to WTO. It takes one if the importer is member of WTO, and zero otherwise

Source: CEPII

Appendix 2: Estimation Result of the Gravity Model for the Horn of African Countries-1990-2019

VARIABLES	Random Effects	Frontier Analysis
Importer cost of business startup (% of GDP)	-0.0492	-0.0485
	(0.0601)	(0.0382)
Exporter cost of business startup (% of GDP)	0.0545	0.0109
	(0.0577)	(0.0465)
Area of the Importer	-0.22	-1.746
	(1.273)	(1.296)
Area of the Exporter	0.118	0.0827
	(0.648)	(0.473)
Exporter GDP	1.519**	1.056**
	(0.709)	(0.477)
Importer GDP	0.398	0.593***
	(0.408)	(0.228)
Landlocked Exporter	-1.500***	-1.314***
	(0.432)	(0.347)
Landlocked Importer	-2.751***	-1.736**
	(1.031)	(0.864)
Bilateral Distance	-1.864***	-2.733***
	(0.362)	(0.323)
Exporter GDPPC	-1.541**	-1.134**
	(0.658)	(0.442)
Importer GDPPC	-0.133	-0.277
	(0.425)	(0.239)
Common Border	2.197***	1.683***
	(0.481)	(0.477)
Common Official Language	0.421**	0.232
	(0.202)	(0.183)
Common Colonizer	-0.0576	-0.0192
	(0.219)	(0.204)
RTA	1.543***	1.373***
	(0.426)	(0.413)
Exporter WTO	2.387**	2.596***
	(1.05)	(0.74)
Importer WTO	0.138	0.00221
	(0.226)	(0.148)
Constant	-11.36	27.15
	(19)	(18.7)
Observations	7,888	7,888
Year FE	YES	YES
Country FE	YES	YES

Robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1

Note: All continuous variables are in log meaning that the coefficients for these variables can be interpreted as trade elasticity with respect to that particular variable.

The definition of each variable can be found in the appendix

Source: Authors' computation based on the CEPII Gravity Database

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Regional Integration and Poverty Reduction in the Horn of Africa: The AfCFTA Perspective

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In 2019, the AfCFTA came into effect after 24 African countries ratified the agreement. Such initiatives have wider economic implications for countries in the region depending on the structure of these economies, the composition of the countries' trade and labor force. Therefore, in the light of this, this study assess the implication of the AfCFTA on trade, poverty reduction and inclusive growth with much focus on the Horn of African countries. Consistent with previous empirical works, the study finds regional integration which removes tariff barriers boost countries' exports and promote intra-regional trade, increases the real wage workers earn especially for those in the export sectors. However, structural factors such as countries' restrictive trade policies, poor inter-country connectivity, narrow range of tradable items remain the key factors which hinder the regional trade.

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The AfCFTA could also facilitate the transformation of the region by promoting structural change in the medium to long run. It could speed up the rural-urban migration and shifting of labor force from the less productive agricultural sector to the more productive industrial sector. Nevertheless, this readjustment might imply short term economic costs for certain sectors, groups or economic activity. Certain vulnerable groups such as smallholder farmers, women, informal traders and the youth are less resilient to shocks and lack the required financial resource necessary to acquire new skills and seek new opportunities. Thus, to ensure the inclusivity of the growth, national governments should provide assistance to the affected groups, sectors or economic activity by providing skill training to make them employable in the urban industrial sectors.

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