Rules of Origin as a Key to the AfCFTA's Success: Lessons that can be Drawn from the Regional Experience

By:

Dennis Ndonga

March 15, 2021

The African Continental Free Trade Area (AfCFTA) holds great promise for the continent with the agreement expected to increase intra-African trade and secure socio-economic benefits for member States. Despite trade under the new agreement commencing on 1 January 2020, members are yet to conclude negotiations on the issue of Rules of Origin (RoO). RoO are mechanisms used to determine the economic nationality of a product. Preferential RoO constitute an essential part of preferential trade arrangements, such as Free Trade Agreements (FTAs). Annex 2 of the AfCFTA Protocol on Trade in Goods makes provision for RoO that will provide for a single set of criteria to be applied across the continent. However, discussions on the substantive RoO, which are to be articulated in Appendix IV of Annex 2, are yet to be finalised. In the meantime, member States are expected to apply the preferential RoO covered

by their relevant Regional Economic Communities (RECs) until harmonisation is achieved through the AfCFTA's rules.

The AfCFTA's fifty-five (55) member countries belong to different RECs with varying RoO regimes. For instance, products seeking preferential treatment within Common Market for Eastern and Southern Africa (COMESA) have to comply with one of the five independent criteria outlined in the COMESA Protocol on Rules of Origin. The first targets raw goods by requiring that they be wholly produced in any of its member States. The other four criteria target processed goods and outlines product-specific rules that require such goods to undergo some form of substantial transformation in the member State claiming origin. The second criterion outlines a value addition requirement (ad valorem) by noting that goods produced in a member State using some non-originating materials would receive preferential origin where the value of non-originating material does not exceed 60 per cent of its CIF price (i.e. cost, insurance and freight price). The third criterion outlines a local content rule by conferring preferential treatment where the value added from the process of production in a member State is at least 35 per cent of the ex-factory cost of the product. The fourth criterion confers preferential origin when the non-originating production materials utilised by a member State have undergone processing that has resulted in a Change in Tariff Heading (CTH) in terms of the final product's classification under the Harmonised Commodity Description and Coding Systems (HS). The last criterion recognises a special category of listed goods deemed to be important to the economic development of the member States. Such goods would be granted preferential treatment if their processing within a member State has resulted in a value addition of at least 25 percent.

On the other hand, the Southern African Development Community (SADC) Protocol on Trade applies a wholly obtained criteria for raw goods that is similar to the one applied by COMESA. However, it differs in its criteria for processed goods. Unlike the COMESA RoO which outline an ad valorem percentage that applies uniformly across all products based on CIF price, the SADC RoO stipulates value added percentages based on the ex-works price that are differentiated on a product-by-product basis. The SADC protocol on trade also outlines a general value tolerance (de minimis) of 15 per cent of the ex-works price to all substantial transformation processes i.e. both CTH and specific manufacturing rules. This means that in addition to ensuring that a product has

undergone a CTH (where applicable), producers in the member countries are restricted to using non-originating materials whose value does not exceed 15 per cent of the product's factory selling price, otherwise their product would not receive preferential treatment within the region. SADC RoO have also gone a step further in elaborating specific manufacturing processes and operations that need to occur within a member country to confer origin to specific listed products.

These differing RoO have contributed to the varied intra-regional trade experience. As such, members negotiations on the AfCFTA's RoO need to factor in their experiences with the RoO applied within their RECs. This would be aimed at ensuring that the structural failures in the RECs RoO regime do not replay to frustrate the AfCFTA's objective of enhancing intra-African trade. Recent developments in the RECs RoO implementation seem to suggest that most of the AfCFTA's member countries are leaning in favour of adopting a SADC-style RoO. The Tripartite Free Trade Area (TFTA) Agreement has so far adopted a SADC-style product-specific RoO as articulated in Annex 4 of the agreement. Initial negotiations on the TFTA's RoO had favoured the adoption of a generic COMESA-style harmonised RoO that would stipulate a general percentage across all products for the ad valorem percentage criterion. However, as the negotiations progressed, members opted to adopt a SADC-style approach. Article 5(2) of the TFTA's draft Annex on RoO captures this requirement by outlining that preferential treatment for processed goods would be based on them meeting a list of conditions that would indicate the working or processing which must be carried out on the non-originating materials used in the manufacturing of the various products. However, negotiations on the list of specific manufacturing processes, to be contained in Appendix I, are yet to be finalised.

The TFTA is intended to serve as a precursor to the AfCFTA and its influence on the latter's structure cannot be understated. The TFTA, which covers 27 member States that are part of the three RECs in Eastern and Southern Africa and just over half of Africa's total population, is set to be the second largest FTA in the continent. Since the AfCFTA's RoO will be created through consolidation of the TFTA and other FTAs, it is expected that the TFTA's final RoO will be crucial in determining how the AfCFTA's rules will be modelled.

The main problem with the SADC-styled RoO is that they are complex and restrictive in comparison to the COMESA rules. In fact, countries like Malawi, Swaziland and Zambia that are members of both SADC and COMESA have in most cases preferred to use the COMESA RoO owing to the fact that they are more straightforward to meet. This is in spite of the fact that tariff rates are, on average, much lower under SADC preferences. Part of SADC's choice of product-specific rules was dictated by an overarching need to inscribe rules that would act as a safeguard to weak border management systems in most African countries. In pushing for the adoption of the SADC RoO South Africa had raised concerns about the possibility of low cost Asian products infiltrating the regional market through the porous borders of weak member States, and thereafter gain preferential treatment, which could disrupt the competitiveness of genuine regional products. However, there is no evidence to suggest that restrictive rules do offer a solution to the border administration challenges. Moreover, it remains doubtful whether member States who are challenged by weak border administration would be better placed to enforce such complex requirements.

What can be ascertained is that the restrictive RoO have had a negative effect on intra-SADC trade for most of the region's smaller economies. For instance, between 1990 – 1998 Malawi's textile sector had managed to benefit from a bilateral FTA with South Africa. The Agreement's RoO outlined a uniform product-specific criterion that defined goods produced in Malawi to cover goods where materials produced and labour performed in Malawi represented at least 25 per cent of the production cost, and where the last process of production occurred in Malawi. The bilateral trade agreement saw to the expansion of Malawi's clothing and textile industries. Several South African garment producers also shifted their production to Malawi owing to the country's comparative advantage in labour-intensive industries. Between 1996 and 1999 South Africa as a market destination accounted for over 60 per cent of Malawi's textile exports. The termination of the bilateral arrangement by South Africa in 1999 also coincided with the amendments to the SADC's RoO in 2000. The SADC RoO have elaborated a double-transformation production rule for clothing and textile products, which requires manufacturers to source both the fabric (textile) and the garment from within SADC in order to qualify for preferential treatment. The restrictive RoO requirements contributed to a decline of

Malawi's clothing and textile industry.

Other restrictive RoO provisions contained in the SADC Trade Protocol like the much-increased value added requirements and much-decreased import content (de minimis) threshold have been seen as an attempt by South Africa to protect its labour-intensive, relatively high-wage industries. Despite the challenges, South Africa has managed to thrive and dominate intra-SADC trade at the expense of its partners. For instance, in 2017 intra-SADC imports accounted for only 7 per cent of South Africa's total imports which was in stark contrast to the significant role that the SADC market plays for South Africa's exports, accounting for 23 per cent of the country's total exports. The restrictive RoO have partly prevented other member countries from taking advantage of their comparative advantage in competing with South Africa, as was the case with Malawi's textile sector.

Hence, in negotiating the AfCFTA's RoO, members should be weary of the experience gained from their RECs RoO, in particular the SADC RoO. The AfCFTA's RoO should be appropriately structured to support its vision of promoting intra-African trade and creating regional value chains within the continent. Emphasis should be placed on implementing RoO that are restricted to serving their primary purpose, which is stimulating economic integration and preventing trade deflection by authenticating that goods claiming preference do in fact originate from the participating member States. As such member countries should ensure that the AfCFTA RoO are simple and clear and to avoid using them for protection and other non-related functions. The RoO should be easy to understand and minimise compliance costs for firms as well as avoid being administratively burdensome. The implementation of restrictive list-based approach that apply varying product-specific rules has not served well to promote the flow of trade within SADC and adopting a similar structure for the AfCFTA would only serve to limit its broader objectives.

View online: Rules of Origin as a Key to the AfCFTA's Success: Lessons that can be Drawn from the Regional Experience

Provided by Afronomicslaw