

BRIDGES NETWORK

# BRIDGES AFRICA

Trade and Sustainable Development News and Analysis on Africa

VOLUME 5, ISSUE 4 – MAY 2016



## Harnessing the potential of the services sector in Africa

### SERVICES

The role of the services sector for economic transformation in Africa

### CONTINENTAL FREE TRADE AREA

How to ensure that the CFTA services negotiations produce effective results?

### AID FOR TRADE

Tailoring Aid for Trade initiatives to the services context



International Centre for Trade  
and Sustainable Development

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# Harnessing the potential of the services sector in Africa



*As countries across the African continent are striving to set in motion the structural transformation of their economies, understood as the shift to higher-value added economic activities, the services sector could play a pivotal role. The economic importance of services has significantly increased over the past decades in Africa, with a growing contribution to the continent's growth, employment, and trade. For many African countries, the sector now represents the largest chunk of the economy, while at the continental scale, it accounts for around half of the economic output.*

*Despite this dynamism, Africa still remains a marginal player in global services trade, with an export share of just over 2 percent. African services often entail very little value addition, are mostly non-tradable, and do not generate extensive synergies with other sectors. In particular, the provision of services remains very modest in key subsectors, such as infrastructural services, which could benefit the entire economy and invigorate the development process.*

*In this context, what would be the best strategy to harness the transformative power of the services sector, so that it becomes an engine for economic transformation and sustainable development in Africa? Could the Continental Free Trade Area (CFTA) help realise this important objective? How to ensure that African economic actors, including the smaller ones, are able to seize the opportunities offered by the sector in order to materialise its full potential? Those are some of the questions that this issue seeks to address.*

*In the first article, Bineswaree Bolaky offers insights on the crucial role that the services sector can play to support structural transformation in Africa. Her piece sheds light on the importance of building complementarities between services and the rest of the economy, in particular by promoting the provision of infrastructural services.*

*Another contribution explores the following question: how could the CFTA negotiations help the African services sector to flourish? According to its authors, Viola Sawere and David Ndolo, engaging productively with the private sector and developing pro-competitive regulatory disciplines constitute two important conditions for success.*

*This issue also includes two additional pieces, which look at the services-development nexus from specific angles. While Sonja Grater, Ali Parry and Wilma Viviers seek to identify the conditions that would enable SME service providers to become key drivers of job creation and inclusive growth in Africa, Dan Lui explores avenues to tailor Aid for Trade strategies to the services context.*

*As usual, we welcome your substantive feedback and contributions. Write to us at [bridgesafrica@ictsd.ch](mailto:bridgesafrica@ictsd.ch).*

## SERVICES

# Unlocking the potential of Africa's services for structural transformation

Bineswaree Bolaky

*If Africa is to fully realise the benefits of development, services must play an enhanced role in its structural transformation and economic growth processes. This will require addressing some of the pitfalls underlying the regulation of Africa's infrastructure services sector.*

Services have a vital role to play in the context of Africa's transformational development strategy, whether it is based on the exploitation of its natural resource base or on labour-intensive light industry and manufacturing. For either approach to succeed, however, knowing how to exploit the services potential of Africa will be critical.

The continent is already tapping into some of the opportunities the services sector has to offer. For example, some African economies have been developing their services industries with relative success and are supplying services across Africa. Known examples of emerging regional services are the financial and banking services industries of Mauritius and Nigeria, the commercial and cargo air transport industry in Ethiopia and South Africa, the educational services industries of Uganda and Ghana, the telecommunication services of Egypt and the port services industries of Djibouti and Kenya. Major challenges persist, however, especially as Africa seeks to move away from consumption-based growth to more durable sources of growth through structural transformation.

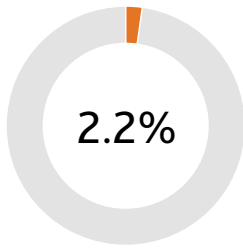
One such challenge lies in enhancing the trade potential of Africa's services sector. In 2012, Africa accounted for only 2.2 percent of the world's total exports of services, compared to 3.6 percent for developing America and 24.3 percent for developing Asia. Africa accounted for 4.0 percent of total world services imports, compared to 5.2 percent for developing America and 27.9 percent for developing Asia. Only 11 African countries have consistently been net services exporters since 2005 (Cabo Verde, Djibouti, Egypt, Eritrea, Kenya, Mauritius, Morocco, Namibia, Seychelles, Tunisia, and Tanzania). With the exception of Djibouti and Kenya, these countries are mainly dependent on exports of travel services. The services sector in Africa remains by and large mostly non-tradable and with limited domestic value-added.

Another challenge lies in informality. Informality is a noticeable feature of the services sector in Africa and of African economies in general. The informal sector in Africa ranges from 50 to 80 percent of GDP and 60 to 80 percent of total employment and accounts for 90 percent of new jobs. Some of the fastest growing services sectors of West African economies (wholesale and retail trade, restaurants and transportation) are dominated by informal firms. African services are predominantly informal and small in scale.

Despite these challenges, the services sector in Africa has of late experienced vibrant growth. During the period 2009–2012, the services sector grew rapidly in real terms in Africa (a rate of 4.6 percent), at more than twice the world average rate. Growth was particularly strong in Eastern and Western Africa. However, the continent needs to shift away from relying on subsistence and non-tradable services to services which generate greater value addition and can act as a catalyst for Africa's structural transformation. Therefore, a key policy question is *how to translate this services-led growth into structural transformation, sustainable employment and inclusive development for Africa.*

## Services as an enabler of structural transformation and sustainable development in Africa

As the most dominant sector in many African economies, services need to support the process of structural transformation, characterised by a shift from low to high-



In 2012, Africa accounted for only 2.2 percent of the world's total exports of services, compared to 3.6 percent for developing America and 24.3 percent for developing Asia.

productivity activities, and a declining share of low value-added agriculture in output and employment, as well as an increasing share of manufacturing and modern services. There are some dynamic emerging subsectors within the services sector with the potential to support structural transformation, which have yet to be tapped. For instance, logistics and distribution could greatly benefit Africa's agriculture (including agribusiness and food trade) and manufacturing sectors. African policymakers thus need to place greater emphasis on how to move towards the provision of more sophisticated services, where there is greater value addition and which offer opportunities for technology transfer and linkage development with other sectors of the economy. Such an approach should be part of an overall strategy intent on fostering the structural transformation of African economies.

So far, progress in that direction has remained limited on the continent. Many African countries have undergone a process of shifting from agriculture to mainly non-tradable services, without undergoing a process of manufacturing development marked by significant productivity improvements, formal job creation, exports of sophisticated goods and the application of technology to the wider economy. During the periods 2001–2004 and 2009–2012, of the 45 countries where the share of services in output rose, 30 experienced a contraction in manufacturing. This suggests that the complementary elements between the two sectors have yet to be fully developed in some countries. Building complementarity, that is, strengthening input–output and demand linkages between services, manufacturing and agriculture, thus remains a necessary continental goal. The services sector has a critical role to play in the industrial and manufacturing development of African countries, as well as in boosting agricultural productivity.

Services are indeed enablers of many production and sales processes. There are important input–output linkages between manufacturing and services. With regard to South Africa, one study estimates that 25.3 percent of the intermediate inputs into manufacturing come from services (of which the bulk comes from trade and finance) and 24.7 percent of the intermediate inputs into services come from manufacturing (Tregenna, 2007). If imported intermediates are excluded, 31.4 percent of all domestically produced intermediates into manufacturing are purchased from the services sector and 18.6 percent of all domestically sourced intermediate inputs into services come from manufacturing. While African countries should aim to develop their manufacturing sectors, increasing the competitiveness of their domestic services sectors should be a concurrent objective.

Some services sectors are considered to be the backbone of economic activity and have a direct bearing on drivers of structural transformation. In particular, infrastructure services – encompassing transport, telecommunications, water, energy and financial services – are of critical importance to economic development through structural transformation. They could contribute to addressing Africa's physical infrastructure deficit and low manufacturing development in order to foster inclusive growth. Infrastructure services also provide and support basic services (i.e. electricity, gas and potable water), which will be critical to the achievement of the sustainable development goals (SDGs) by 2030. Lastly, infrastructure services are essential to the development of other services sectors, including tourism, distribution (wholesale, retail), information and communications technology services and business process outsourcing services. For infrastructure services to contribute successfully to the structural transformation, economic and social development of Africa, the institutional and regulatory environment must be supportive.

This article initially posed the following question: *how to translate this services-led growth into structural transformation, sustainable employment and inclusive development for Africa?* One part of the answer lies in improving the effective provision of infrastructure services in Africa through more effective regulation of the sector. Infrastructure services provision is suboptimal in Africa and entails high costs. Many of the market failures and inefficiencies afflicting the sector may be addressed through regulation and regulatory reform in African countries.

### **The important role of infrastructure services in Africa's structural transformation process**

Inadequate infrastructure services remain a major obstacle to achieving full transformative economic growth potential in Africa. The continent needs to raise investment in infrastructure, encompassing a range of services subsectors, in order to achieve its development goals of structural transformation and economic diversification. Addressing Africa's infrastructure gap will require a substantial programme of investment, estimated at \$93 billion per year. Improved infrastructure and the enhanced provision of services, such as financial services, could contribute to growth in the manufacturing sector in Africa, a sector where the competitiveness of African firms is weak. The cost structure of firms, and particularly the difference between the direct and indirect costs of production, have a bearing on the weak competitiveness of African manufacturing. One study shows that the overall level of profitability of African firms, which is much lower than elsewhere, results from high indirect costs (Eifert et al., 2008). Firms in developing regions with a stronger performance have indirect costs amounting to less than 15 percent of total costs, whereas indirect costs in poor African countries account for 20 to 30 percent of total costs, often exceeding labour costs. It may be seen that a considerable share of African firms' indirect costs comprises costs related to infrastructure and public services such as energy, transport, communications, water and security, which constitute significant barriers to the international competitiveness of African manufacturers.

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### *A critical constraint to realising transformative economic growth potential in Africa lies in the state of infrastructure services.*

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A critical constraint to realising transformative economic growth potential in Africa thus lies in the state of infrastructure services. As infrastructure services industries are typically dependent on monopolistic networks (whether public or privately owned, local and/or national), economic regulation of the sector matters and needs to address concerns related to competition (asymmetries of information and abuse of dominance) and consumer interests (universal access, affordability and quality). In addition, with the increasing integration of infrastructure systems across Africa through pan-territorial initiatives (e.g. the Programme for Infrastructure Development in Africa) and common electricity markets, potentially significant benefits from economies of scale and shared resources will require effective regional regulation.

As indicated, infrastructure services regulation is also critical as a guarantor of access, affordability and quality control, which are interconnected. The type of regulation matters; simply regulating inputs or processes rather than outputs or outcomes may reduce a utility or firm's incentive to improve quality, access and efficiency. If a country decides to open up the sector, the sequencing of privatisation and development of regulatory institutions are also important, as establishing an institutional framework conducive to promoting competition and governing access, affordability and quality control before privatising infrastructure services is correlated with improved investment and wider services provision.

There is growing consensus on the key design features of a modern regulatory framework and ancillary agency. The main features of effective regulation of privatised utilities are coherence, independence, accountability, predictability, transparency and capacity, along with accessibility, affordability, ownership and quality control. Coherence implies that the laws underpinning regulation are consistent, with clear divisions of responsibility between municipal and national regulators. Predictability relates to overall decision-making stability in the regulatory framework, as confidence in the decision-making processes of a regulatory body is important for long-term investors in network industries. Capacity relates to the quality of human resources available to the authority and appropriate levels of staffing. Regulatory bodies should be strengthened, allowed to operate independently



and adapted to fit the specific needs of national economies. Minimal state interference in regulatory decisions is also important.

### **Africa ranks low in regulatory independence**

Most African states rank low in regulatory independence across all sectors, and standard international models of infrastructure regulation are not regularly employed on the continent. Most African regulatory bodies are at an early stage of development, have modest budgets (ranging from less than \$300,000 to about \$3,000,000 for electricity) and often lack qualified staff. Staff numbers also vary widely, ranging from one or two to over 30. This reinforces the need for independent regulatory authorities that are autonomous but also have some political backing to fulfil their roles. In some instances, national bodies need to be bolstered through partnerships and collaboration with regional and pan-territorial regulatory bodies, as they emerge. This could help national bodies, as they may use regional regulatory bodies as a counterweight to domestic political pressures on regulatory governance. There may also be a need to separate supervisory functions (e.g. with regard to competition) from regulatory functions (e.g. price and universal service regulation) to ensure that there is no conflict of interest.

To enhance performance, African countries also need to improve the capacity-building efforts of regulatory bodies with regard to human resources, which may be supported regionally through shared training programmes, twinning arrangements and information sharing arrangements to more effectively disseminate best practices and benchmark regulatory performance.

Cross-country regulation, at the regional economic community level or more broadly, is of particular importance. A key issue in such regulation is the harmonisation of national standards and systems, to enable the linking and coordination of national infrastructure networks. This is crucial for international trade in infrastructure services at regional and global levels. Commitments made through regional trade agreements can also facilitate a process of domestic regulatory reform through the following: widening the scope of competition in services markets to include foreign operators, which could lead to higher output and employment across the sector (as in telecommunications); undertaking commitments to open up services, which may enhance the credibility of domestic policy reforms, as regional commitments can indemnify investors against the risk of possible future policy reversals; and allowing countries to tap into the regulatory expertise of their trading partners, thereby bolstering domestic regulatory capacity and harmonisation. Examples of pan-territorial cooperation already in place among regulators include the mechanism for central bankers in Africa, Southern African Development Community (SADC) payment systems, power pools and civil aviation authorities.

### **Policy messages**

In order to fully capitalise on their services sector and turn services as an effective enabler of their transformational development strategy, African countries need to pay greater attention to the state and regulation of their infrastructure services sector. Africa's services provision remains suboptimal and is delivered at a high cost. There are regulatory and policy shortcomings that explain these inefficiencies. Regulatory reforms aimed at increasing the autonomy of national regulatory authorities in the services sector, as well as promoting the adoption of international models of regulation and boosting regional harmonisation of regulatory standards, could benefit the continent's development agenda.

*This article is based on UNCTAD Economic Development in Africa Report (EDAR 2015): "Unlocking the potential of Africa's services trade for growth and development". References are available in the report and can be downloaded at: <http://bit.ly/1TCG0w9>. The report is prepared by the Africa Section of UNCTAD and is headed by Mr. Junior Roy Davis, supported by Ms. Laura Paez and Ms. Bineswaree Bolaky.*



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## CONTINENTAL FREE TRADE AREA

# Approaching the CFTA services negotiations: Which way towards delivery by 2017?

Viola Sawere and David Ndolo

*What are the business challenges that need to be addressed in the CFTA services negotiations and how to engage with the private sector in this process? Is it possible for the agreement to embrace pro-competitive regulatory disciplines? What are the possible options for a successful conclusion by 2017?*

The services sector is becoming a key driver of sustainable economic growth and structural transformation in African economies. The World Bank estimates that the sector accounts for 47 percent of gross domestic product and 37 percent of employment in average in African countries, while statistics from the United Nations Conference on Trade and Development (UNCTAD) indicate a 6.6 percent average growth in total imports and exports for the sector in 2013. Nevertheless, services exports remain low for many countries, averaging 2.6 percent of global African exports over the last three decades. The assessment of Africa's poor trade performance shows that numerous trade bottlenecks lie in the services sector. In 2012, the Africa Union's (AU) Heads of States and Assembly of Heads of State and Government endorsed the Boost Intra-Africa Trade Strategy (BIAT), which outlines the benefits of an open market and the need to develop a competitive services sector. This is to be achieved, among others, through the establishment of the Continental Free Trade Area (CFTA) by 2017.

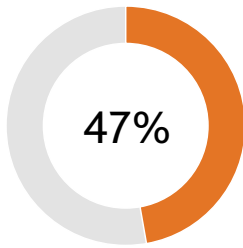
The CFTA negotiations, which were launched in June 2015, will be conducted in two phases. While the first phase covers trade in goods and services, the second phase will focus on investment, intellectual property rights, and competition policy. Since the launch of the negotiations, the AU Commission (AUC) has been undertaking capacity building seminars to enhance the knowledge and negotiating skills on trade in services among policy-makers, negotiators, and private sector representatives. From these seminars, a general consensus seemed to emerge around the idea that market access and national treatment commitments should be complemented by sectoral regulatory disciplines in order to promote trade competition.

## Engaging with the private sector to address business challenges

There have been efforts to raise awareness among the African business sector and coordinate its input in various trade negotiations, but its participation and engagement often remains limited. In a recent policy brief, UNCTAD suggests that in order to foster African integration, a bottom-up approach involving governments, the private sector, civil society, and the international community is necessary. The relation between those stakeholders should be reciprocal so as to nurture an incremental exchange of ideas, information, resources, and trust among them. Systematic engagement of the private sector in identifying business challenges and solutions would help to build a lasting business-oriented collaboration and accelerate the implementation of the agreement once negotiated.

Hence, there is a need to coordinate the participation of the private sector and establish a formal structure for its engagement in the framework of the CFTA negotiations. Insufficient private sector engagement may lead to nonacceptance of the agreement by businesses, as has happened in the case of the Tripartite free trade area (TFTA). So far, the AUC envisages the establishment of an African Business Council (ABC), which would serve as a platform for aggregating and articulating the views of the private sector. The ABC would collect, process, and present the views of the private and business operators from the continent. This issue of how the business sector is organised is of crucial importance, since it will influence the extent to which, and how effectively, the services negotiations will be able to address business challenges.





According to the World Bank, the services sector accounts for 47 percent of GDP and 37 percent of employment in average in African countries.

The underdevelopment of infrastructural and network services is among the business challenges that require regional agreement to coordinate national efforts. The CFTA agreement could be used to promote infrastructure development and secure governments' commitments to invest in infrastructural services. Such a dynamic is important, as it will exert peer pressure among African governments for restructuring regulations in order to promote public-private partnership projects and encourage private sector provision of services. Also, burdensome entry visa procedures have often been cited as a limiting factor to the movement of services providers, traders, and investors in Africa. This constitutes a further opportunity to reduce important trade barriers in the framework of the CFTA.

In addition, insufficient regulation and lack of transparency in the services sector has contributed to corruption as well as hampered the development of trade in services. For example, economic empowerment requirements have in many cases brought in policy reversals and contradictions in the regulations, which frustrates investors. Access to regulations governing the services sector in relation to business registration, licensing procedures, taxation, and profit repatriation policies is key in business decisions and minimises the loopholes for corruption. Additionally, governments need to protect consumer and public interests by ensuring that sound regulations promote fair competition among business operators. At the end of the day, predictable and market-oriented rules in the services sectors would help to promote intra-Africa trade by lowering the cost of doing business. Therefore, the CFTA services agreement could be used to encourage transparency and pro-competitive services regulation on the continent.

#### **What is the current state of play?**

Article 6 of the AU Treaty provides that the CFTA should be built on the achievements of the eight Regional Economic Communities (RECs) – i.e. the Arab Maghreb Union (AMU), the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), the Economic Community of Western African States (ECOWAS), the Economic Community of Central African States (ECCAS), the Inter-Governmental Authority on Development (IGAD), the Community of Sahel-Saharan States (SAN-CED), and the Southern African Development Community (SADC). However, progress in the liberalisation of trade in services in the various RECs has been rather limited.

So far, only COMESA, EAC, and SADC have achieved a comprehensive services agreement with positive list liberalisation schedules. Of the three, only SADC is negotiating some sectoral pro-competitive regulatory disciplines to complement market access and national treatment commitments. The West African Economic and Monetary Union (WAEMU), a sub-region of ECOWAS, has agreements covering market access commitments in dental, medical, accounting, legal, architectural, telecommunication, and transport services. The Central African Economic and Monetary Community (CAEMC), a sub-region of ECCAS, has cooperation agreements focusing on infrastructural development, but they do not include market access issues. Both the WAEMU and CAEMC sectoral agreements do not include pro-competitive regulatory commitments. With regard to the rest of the RECs, they do not have any form of services agreement yet. Additionally, the COMESA-EAC-SADC TFTA signed in 2015 is also envisaged as a stepping stone towards the establishment of the CFTA, but the negotiations on the trade in services component are yet to commence.

Except for Algeria, Comoros, Equatorial Guinea, Ethiopia, Libya, São Tomé and Príncipe, and Sudan, who have not acceded to the WTO yet, all other AU states have schedules of liberalisation under the General Agreement on Trade in Services (GATS). Countries such as Gambia and Lesotho made substantial GATS commitments but to date, they have received only limited investment in the services sector. This points to the fact that liberalisation schedules may not be a sufficient factor to promote trade or attract investment, which raises the following question: what else needs to be part of the equation in order to effectively boost intra-African trade in services? Schedules only address trade rules, and assumes that supportive infrastructure and pro-trade sectoral and regulations exist.

The inclusion of regulatory disciplines in trade in services agreements seems to be the trend, as observed in the most recent free trade agreements (FTAs). For example, the

EU Economic Partnership Agreements (EPAs) with the African, Caribbean, and Pacific (ACP) States and the EU-Korea FTA include a section on sectoral regulatory disciplines covering sectors of interest. Also, some regional FTAs such as the EU Single Market include regulatory disciplines covering broadcasting, financial, professional, telecommunications, and transport services, while the Caribbean Community Single Market settles for regional standards in agreed professions. The rationale behind this approach is to try to deal with regulatory challenges that cannot be addressed through schedules of commitments and to enhance balanced regulatory development and standards in the services sectors. Regulatory disciplines are particularly important for infrastructural and network services (e.g. communication, financial, energy, and transport sectors), where fair competition and access to distribution networks should be managed by independent bodies. However, there has been a slow take-up in the development of pro-competitive regulatory disciplines among African RECs, except for SADC. Therefore, the CFTA negotiations offer an entry point to promote the approach.

#### **CFTA services liberalisation: The approach and possible structure of the agreement**

The existing REC services agreements differ in terms of approach and architecture, which constitutes a challenge for establishing a common denominator as a starting point in the CFTA negotiations. The process of defining such a starting point would require a comprehensive sector audit to assess the state of liberalisation and sectoral regulatory gaps across the AU states. Nevertheless, different starting points could be explored, such as: (1) applying the liberalisation requirements by sector by building on the existing RECs and AU sectoral agreements; (2) building on the achievements of RECs, i.e. EAC, COMESA, SADC, or even TFTA if the process is finalised soon enough to be factored in the CFTA negotiations; (3) starting at the level of GATS commitments; and (4) starting with the

**Table 1: Possible Structure of the AU-CFTA Services Agreement. Sectoral Regulatory Framework**

Sector	Benefits of regulatory reforms	Coverage
Communication	Improved consumer access to affordable mobile telephony services.  New investment in technology to allow faster access to the Internet and mobile banking.	Transparent procedures and converged licenses, anti-competitive practices, independence of regulatory authorities, interconnection, allocation of scarce resources, universal services, confidentiality of information and dispute settlement.
Construction	Vital to the region's needs for infrastructure and industrial development while promoting transparent and non-discriminatory procurement rules.	Covered procurement, mutual recognition, tendering, contractors and related professionals' registration, and local content.
Finance	Improved access to finance, especially for SMEs and MMEs that wish to trade across the region.	Scope and definition, transparent regulation, prudential carve-out, data processing, cross-border insurance, new financial services, microfinance institutions, inter-territorial mobile money transfer, payment systems, exchange control, and dispute settlement.
Tourism	Improved cross-boundary and sustainable tourism trade.	Anti-competitive safeguards, access to tourism infrastructure, sustainable development, standards, education and mutual recognition, involvement of local communities, collective/joint promotion of regional tourism and protection of trans-boundary tourism resources.
Energy	Improved investment climate to help tackle the problem of power generation capacity shortages.	Unbundling of energy services, interconnection and access to networks, anti-competitive practices, independence of regulators, universal services, etc.
Transport	The need to support trade in goods by reducing transport costs, particularly for landlocked countries.	Fees and user charges, anticompetitive practices, promotion of investment, trade facilitation, access to infrastructure, technical standards, etc.

Source: Sawere (2016), Page 15.

current level of autonomous liberalisation in the member states.<sup>①</sup> Learning from the experience of other FTA negotiations, the CFTA process could set up a hybrid scheme to accommodate the different approaches used in the various RECs. The aim should be to increase the degree of services liberalisation achieved by existing RECs and extra-regional FTAs such as the EPAs and other bilateral FTAs.

For the AU, it should be feasible to agree by 2017 on a framework agreement, which would include a transparency list of applicable rules on the typical market access issues. Once this first main part of the CFTA services agreement is concluded, member states could thereafter negotiate pro-competitive sectoral regulatory disciplines to supplement the commitments contained in the transparency list.

The framework agreement would comprise general trade in services rules (i.e. most favoured nation treatment, market access, national treatment, transparency, the right to regulate and competition issues, etc.), other related matters (e.g. promotion of regional value chains, entry visas for services providers, etc.), the institutional framework and the transparency list for liberalisation commitments. The AU states could borrow a leaf from the approach used in the Asian Framework Agreement on Services, whereby specific liberalisation targets are set to be achieved over a given span of time. The CFTA negotiations on the services transparency list could proceed in different rounds, with specific targets for each round. They would aim at agreeing on: (1) clusters of sectors and modes of supply; (2) identified trade restrictive measures, by sector, that will be liberalised and which could be dealt with in a package; and (3) any additional criteria for commitments that would constitute progress in the process.

The sectoral regulatory frameworks should build on existing AU sectoral agreements and focus on trade-related and pro-competitive regulatory disciplines on transparency, anticompetitive practices, independence of regulators, local content and empowerment policies, human resources development, and regulatory cooperation (See table 1 above for illustrative examples in selected sectors).

### Which way forward?

The establishment of the CFTA provides an opportunity for the development of regional rules to boost intra-Africa trade by addressing business challenges in the services sectors. Although the process is yet to fully take off the ground, there is a recognition that engagement between governments and the private sector in the negotiations is necessary and will enhance implementation. There is an urgent need to fast-track the establishment of a private sector consultation mechanism and some form of capacity building for its effective engagement in the CFTA process. Also, since the starting point for the services negotiations is not clear yet, there is a need for taking stock and establishing the state of play both at the national and REC levels.

Since it might be difficult to achieve a comprehensive CFTA agreement on services by 2017, the negotiations could instead be undertaken in several rounds over a period of time. Specific targets could be set for each round. It should be possible to conclude the negotiations on a general framework agreement and an initial transparency list by 2017. The inclusion of pro-competitive sectoral regulations is vital in addressing sectoral challenges and would add value to market access and national treatment commitments. In the case of sectors where there are no AU agreements, sectoral disciplines could be developed on the basis of the illustrative examples shown in table 1. Supplementary or addendum agreements are recommended in areas of existing AU sectoral agreements to bridge any regulatory gaps and manage the inter-relations between agreements in case of disputes.



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<sup>①</sup> Sawere, Viola, (2016), Pro-Competitive Services Sector Regulation: A Possible Direction for The AU CFTA Agreement, Trade Law Centre (Tralac), Cape Town, South Africa.

## SERVICES

## SMEs in the services sector: New drivers of growth in Africa's LDCs?

Sonja Grater, Ali Parry and Wilma Viviers

*How can SME service providers in Africa become key drivers of job creation and inclusive growth, and contribute to their countries' socio-economic transformation?*

Today's rapidly-changing world, fuelled in particular by ongoing advances in technology, is becoming a rich source of new economic opportunities for large and small firms alike. The developed and many developing countries are adapting to the evolving economic climate by producing ever-more innovative and competitive products and services. However, the poorest countries of the world – commonly classified as least developed countries (LDCs) – are finding it difficult to make the necessary transition. Hampered by limited financial, physical and human resources, these countries have not been able to escape the low-development trap and find a path to inclusive economic growth and wellbeing. As a result, there is a noticeable economic divide between the LDCs and the rest of the world.

### The role of SMEs in developing Africa's services sector

Africa has the dubious reputation of being home to 34 of the 48 LDCs, which is a testimony to the continent's staggering development challenges. The African LDCs have highly variable topography, climatic conditions, resources, and economic circumstances, but they are broadly united in their low levels of industrialisation, vulnerability to external shocks, pervasive poverty, and infrastructural shortcomings – especially in the areas of transport, energy, and telecommunications. Unemployment, particularly among the youth, is at alarming levels. One of the factors exacerbating the unemployment problem is that women are often the victims of discrimination in the workplace, which erodes their economic contribution and influence in society.

The rising prominence of services throughout the world could, though, ring the changes for the African LDCs. Already, services account for roughly 50 percent of GDP in these countries. However, with many being heavily dependent on export earnings derived from a slim range of primary commodities, new sources of investment capital and export revenue are sorely needed. There is mounting evidence that the development of the services sector could deliver these, which would help to rejuvenate languid job markets and freshen up different segments of society.

Recent years have seen strong growth in the ICT (information and communication technology) and tourism sectors in several African LDCs, while the creative economy (responsible for outputs such as musical recordings and cultural events) has been identified as an area with significant growth potential for the continent. Yet many services are delivered on a very limited scale and are not of an advanced commercial type. Although African LDCs do export a number of commercial services, they typically run a services trade deficit. Also, the average contribution of services exports to total exports is only about 28 percent, with as much as half this figure attributed to in-bound travel linked to tourism.

As conversations about the importance of services to countries' (and especially poor countries') economies resonate throughout the world, the issue of SMEs (small and medium-sized enterprises) and their contribution to the services sector is often raised. Yet the scope and impact of SME-driven services in LDCs have received scant attention in formal academic literature. Information on SMEs in the services sector in Africa is particularly patchy. However, what is evident from many policy documents, broad

economic analyses, business reports, and opinion pieces is that SMEs in the African LDCs face significant hurdles when attempting to develop and market their service offerings, which can be a source of acute frustration and disillusionment, and make the prospect of business success a distant dream.

The term "SME" defies a precise definition, and varies from country to country, and industry to industry. Generally, though, it is used to describe a business entity that operates with limited resources and produces modest financial returns – at least when compared to large corporates. In this article, an SME is taken to mean a business with up to 100 employees, where a "medium-sized" enterprise would have 50-100 employees and a "small" enterprise would have less than 50 employees. Some people make a further distinction between "small" enterprises (10-49 employees) and "micro" enterprises (less than 10 employees).

A defining feature of African LDCs is that the majority of businesses fall into the "micro" enterprise category and are survivalist in nature, i.e. they generate very low returns and have little growth potential. They are also largely unregistered, operating informally and "under the radar" when it comes to tax and other regulatory compliance issues. In contrast, there is a dearth of medium-sized firms that have a reasonable market following, represent attractive investment prospects, and are well placed to deliver an even stronger economic performance if they were to receive external funding or other forms of support. It is these medium-sized firms (sometimes referred to as the "missing middle") that play a crucial role in creating meaningful jobs and driving long-term, sustainable development in their respective countries.

#### **Performance drivers and constraints**

There are many drivers of SME performance in the services sector. First, there needs to be a strong demand for the services that SMEs offer or aspire to offer. African LDCs tend to have small domestic markets due to low buying power among the population and other demand-limiting factors. However, where a country has natural attractions (e.g. scenic beauty or evidence of a colourful history), SMEs might tap into these obvious tourism-related opportunities and offer tailored or niche services that could compete with more traditional tourist offerings.

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*To flourish, SMEs need to understand the markets they are serving, whether they are local or international, and be able to readily access those markets.*

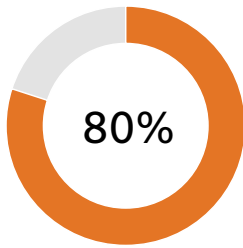
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To flourish, SMEs also need to understand the markets they are serving, whether they are local or international, and be able to readily access those markets. This could be facilitated by, among other things, reliable and affordable transport and telecommunications/ICT, and a regulatory framework that takes SMEs' specific circumstances into account. The rapid spread of mobile banking services in East and Southern Africa is an example of how advances in mobile phone technology have helped to fan entrepreneurial ideas and create new, high-growth industries that have international reach – even in the face of other, persistent market challenges.

Another key performance driver for SME service providers is being continuously exposed to developments in their particular fields – e.g. through formal or informal networking – and acquiring the skills needed to recognise and act on new business opportunities.

Although SMEs with an entrepreneurial leaning like the freedom to experiment with new technologies and business applications, they also need to adhere to effective financial and operational controls. Sound management underpins all successful businesses, but it can be difficult to practise in small enterprises that are trying to survive on a day-to-day basis. In such circumstances, it is all too common for the niceties of developing and motivating





In most African countries, traditional banking has largely failed, leaving about 80 percent of the continent's population "unbanked" in a formal sense.

staff, ensuring financial discipline and accountability, and rewarding good performance to fall by the wayside. Nevertheless, developing human capital is one of the essential building blocks in SME development.

The regulatory environment in which SME service providers in Africa operate can greatly improve their chances of success, but it can also be an instrument in their demise. Understandably, many small businesses are resistant to various types of regulation because compliance can be costly, time-consuming, and energy-sapping. However, well-crafted regulations can help to bring order and certainty to a business sector by prescribing clear entry criteria and performance standards, and by averting market failure induced by excessive competition. Unfortunately, in many of the African LDCs, regulations are opaque, used for protectionist purposes, mired in red tape or motivated by corruption. What is needed is a shift in emphasis from government control/meddling, to government support aimed at building companies' competitiveness.

Another leading constraint to SME service providers' effectiveness in Africa is a general lack of access to finance, both for start-up purposes and for local or international expansion. In most African countries, traditional banking has largely failed, leaving about 80 percent of the continent's population "unbanked" in a formal sense. Personal savings have traditionally been the main funding source for SMEs, although microfinance institutions have made quite strong inroads into a number of markets. More recently, mobile banking services, such as the M-Pesa money transfer system, have gained traction. However, what is really needed is a stronger entrepreneurial culture to take root across the continent, and more venture capitalists and other investors to take risks on new and promising business ideas.

SME service providers, perhaps more than their larger counterparts, are very sensitive to the quality of their countries' national infrastructure as this has a clear impact on efficiency levels and effectiveness. For example, congested and unmaintained roads, and unreliable and expensive electricity and telecommunications services can add significantly to the cost of doing business and dash SMEs' hopes of delivering competitively-priced services at a regional or international level.

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#### **The need for a sound policy environment**

It is of concern that although the SME services sector is playing an increasingly important role in poor countries' economies, it receives little attention at the official policy level. SMEs often appear on the policy agenda, but this rarely translates into concrete and viable initiatives. As a largely neglected group, SME service providers often end up, by default, having to adhere to the same rules and regulations as those applying to larger firms, or they simply opt to remain in the shadows as informal, non-tax-paying entities. In East Africa, countries like Tanzania and Rwanda have been making a concerted effort to streamline regulatory processes so as to fast-track business registration and licensing and facilitate easier access to finance. However, SMEs in these countries still struggle to become competitive in the face of high taxation rates, a plethora of financial reporting requirements and much unnecessary bureaucracy.

In cases where governments do focus on the small business community, financial and other interventions are typically designed for business start-ups. Often overlooked are the more established SMEs, which may be enjoying the economic benefits of operating in "clusters" with other businesses (in, for example, the transport, construction, hospitality/



tourism and education sectors), making inroads into regional or international markets, and creating jobs. Such SMEs are ideal candidates for government grants, subsidised training and business facilitation initiatives because these support measures will build on an existing foundation. The importance of strengthening the micro enterprise sector in Africa should not be downplayed, but the real drivers of growth are the larger SMEs (or at least those with more technological, as opposed to labour-intensive, capacity), since they have greater potential to get involved in exporting and/or act as service links in regional or international value chains.

A policy environment that provides the necessary stimulus for SME development should be the result of an honest and ongoing appraisal of the economic climate in the country, the needs of specific sectors and sub-sectors, and extensive consultation between the government, its social partners and private business concerns.

### **Looking towards a more sustainable future**

If African countries are serious about creating a vibrant SME services sector, one of their anchor strategies should be to adopt a holistic, long-term vision. Sometimes in their eagerness to tackle unemployment, LDC governments focus on boosting economic growth, forgetting that more growth in the absence of supportive and responsible development programmes can erode a country's productive resources and do little to mend the divisions that society and economic circumstances have created between people.

In September 2015, 193 countries adopted the UN Sustainable Development Goals (SDGs), which set out what countries should be doing to reverse the vicious cycle of poverty, inequality, under-development, and environmental degradation that is evident in many parts of the world. Resting on three interlocking pillars – economic development, social development, and environmental protection – the SDGs envisage a future that has been rescued from the current “short-termism” that characterises much political and economic thinking, particularly in Africa. The relationship between SMEs and the SDGs has not been explored in any depth. Nevertheless, the latter have particular relevance for SME service providers in Africa's LDCs as many of the goals have themes that SMEs on the continent can easily relate to, e.g. the need for quality education and healthcare, reliable energy sources, resilient infrastructure, decent employment opportunities, and safe places to live and work.

SMEs in the services sector in Africa have the potential to become the new rising stars across the continent (particularly in the area of tourism, which is brimming with opportunity). However, politicians, businesses and employer groups, sustainable development experts, and many other stakeholders need to find a common language and path if they are to lead the continent into a brighter future.

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## AID FOR TRADE

# Tailoring Aid for Trade to the services economy

Dan Lui

*After ten years of increasing support, how best can the Aid for Trade (AfT) initiative support countries to develop competitive services domestically, and encourage the growth of services exports?*

Since its launch at the WTO's Hong Kong ministerial conference in 2005, the Aid for Trade (AfT) initiative has succeeded in increasing resources available to developing countries to integrate within the global economy. AfT commitments reached more than US\$54 billion in 2013 – around 40 percent of all official development assistance – with over US\$15 billion specifically for least developed countries (LDCs).

Yet the last decade has also seen a changing context for many developing countries, in which economic activity is driven increasingly by services. Services can help reduce poverty, either directly (as in education or health) or through improving efficiency in "embedded" services (such as communication, banking, and transport) supplied to agriculture, mining, and manufacturing. Sectors such as tourism also generate export revenue themselves: services exports have recently been the most dynamic component of global trade growth, and are especially important for many smaller or landlocked LDCs that lack scale or physical connectivity to global product markets.

Despite this, the relationship between AfT and services is complicated, mainly because trade in services differs significantly from trade in goods. The four modes of service supply (cross-border supply, consumption abroad, commercial presence, and temporary movement) each face different kinds of barriers from those for traditional goods. Liberalisation of services often takes place unilaterally, and regulation tends to be dispersed across government institutions. The nature of how services are traded across borders is also still evolving, as new technologies create new opportunities for services trade.

In this context, how can AfT be tailored to better support the development of services sectors? Broadly speaking, improved services depend upon a number of interlinked investments: a robust policy and regulatory environment, strong infrastructure networks, and specific programmes to support key services export sectors. These three potential AfT intervention areas are discussed in turn below.

## Aid for trade and the regulatory environment

The main underlying requirement for developing efficient services is a robust governing framework of policies and regulations. Changes here are often the trigger for a liberalisation or dynamic change within specific sectors. The main challenge is that regulatory systems need to balance amongst competing concerns and objectives: promoting competition, providing a stable business environment, supporting innovation and efficiency, protecting consumers (for example through monitoring price and quality standards), and pursuing social objectives (such as universal access). As such, the development of services can be hindered by unnecessary *overregulation*, including broad "horizontal" measures restricting access to entire markets. Yet services can also be hampered when a *lack* of adequate modern regulations (especially at the sector level) makes it difficult for businesses to make decisions.

Most developing countries have limited experience of putting in place regulatory frameworks and institutions, especially at the sector-specific level. Legislation and institutions dealing with regulation tend to be highly fragmented, which is partly unavoidable given that oversight tends to require specialist technical knowledge. The advent of new technology – most notably the internet which has created new ways of

## US\$54 billion

In 2013, AfT commitments reached more than US\$54 billion – around 40 percent of all official development assistance – with over US\$15 billion specifically for least developed countries (LDCs).

purchasing and providing services – means that regulations also need to keep pace with technological progress. Where regulation does exist, enforcement is made difficult by a lack of capacity or information.

Aid for Trade (AfT) can therefore play an important role in identifying and reforming outdated regulatory frameworks, and plugging capacity gaps. A first set of possible AfT interventions would include investment in policies: to set out strategic goals and priorities for the services economy (including domestic competitiveness and potential exports); diagnose and assess the costs imposed by poor quality services and the potential benefits of market reforms (for example by comparing sector performance with international benchmarks); conduct regulatory audits to map and understand the measures affecting trade in services; and identify and assess alternative regulatory models or degrees of liberalisation. Here in particular, there is much to learn from other countries' experiences of liberalising and developing services sectors and building services exports.

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Secondly, AfT can build capacity by updating legislation and streamline administrative processes (from licensing and approvals, to investigation and enforcement) and helping establish regulatory institutions, such as telecoms regulators or competition authorities. AfT is most needed during transitional phases, when regulatory authorities are still establishing their role, powers, and enforcement capabilities: AfT can build capacity of regulators and other stakeholders including businesses, consumer groups, members of parliament, and the judiciary. Donor support at the institutional level can also provide a signalling effect that increases the credibility of the regulator, safeguarding against the threat of "regulatory capture". Eventually however, the need for independence and sustainability requires that self-financing regulatory models are established.

A further list of possible AfT interventions would include building private sector advocacy around services (ensuring better representation for services sectors vis-à-vis others, including agriculture and manufacturing), improving data on services and trade, and supporting the creation of regional services markets (including harmonised regulations, free movement of capital and labour, national treatment, and mutual recognition of qualifications). Development partners can also help governments pursue innovations in service delivery, for example rolling out systems for electronic payments of taxes, mobile-based information systems, or greater e-learning in schools.

### **The critical role of infrastructure**

Alongside a robust regulatory environment, high quality infrastructure is the crucial enabler for the development of services sectors. The sheer scale of the investments required for establishing network infrastructure means that most AfT will continue to be concentrated here: in Africa alone, the costs of addressing infrastructure needs are estimated at around \$93bn per year.<sup>①</sup>

There are clear linkages between improving services and investment in air, road, and maritime transport facilities, telecommunications networks, and energy infrastructure. A notable recent shift has been towards investments in "corridor" projects, including upgrades to physical transport infrastructure as well as storage capacity at logistics hubs. The latter can facilitate the exchange of goods and multi-modal transport, increasing the level of efficiency in the supply chain, and in many cases making the difference between whether an export industry is viable or not.

In energy, the main concern is to increase capacity for power generation and distribution, including developing regional markets for electricity. AfT can also have positive impacts on energy policy and regulation, including deregulation away from monopoly providers to allow new forms of generation and promote renewable energy. In telecoms, AfT has helped fund fibre-optic networks, as well as assisted developing countries in transitioning from state-owned monopolies towards regulated competitive markets.

Beyond these networks, there are also a number of additional services that might be included as "backbone infrastructure" through their essential contribution to broader economic development. These include the financial system – access to banking, credit and insurance services, and efficient payments systems – given its role in providing credit for entrepreneurs to support economic growth. AfT has a role here, in supporting regulation but also for example in improving financial inclusion.

### **Targetting services exports**

Research is only beginning to emerge on where the services export potential lies, even for developed countries. Overall, ICT and communication services are the most dynamic sectors in global services trade, although for LDCs tourism accounts for almost 40 percent of total services exports, which is twice as much as the next biggest sector, transport (which may also include tourism-related travel, alongside freight and shipping services). LDCs themselves have highlighted both of these as priority export sectors, through their recent collective request to the WTO, alongside others such as financial services, IT-related services including business process outsourcing (BPO), and temporary movement of natural persons (Mode 4) across different sectors.

Potential AfT interventions are likely to vary significantly from one individual sector to another, although cross-cutting issues will include:

- Putting in place sector-specific infrastructure;
- Strengthening sector-level policy, institutional capacity, and coordination;
- Maximising linkages with other sectors;
- Providing assistance with marketing, establishing reputation, and attracting investment;
- Establishing and improving industry standards;
- Strengthening information and data;
- Negotiating on market access barriers where these exist;
- Building supply capacity and skills.

Applying this framework to tourism, for example, demonstrates the significant role that AfT could play in developing services exports. Compared with goods, a key advantage of tourism is the lack of administrative barriers – tariffs, customs and quarantine procedures, subsidies for domestic producers – that usually hinder trade: for tourism, an "export market" of overseas consumers comes to you. Furthermore, tourism depends on natural and cultural endowments that are in limited global supply or often unique: it can therefore be exploited by smaller countries with labour and land constraints. It is notable that tourism is important both to small islands and to landlocked LDCs such as Lao, Nepal, Uganda, and Zambia.

Beyond financing for network infrastructure (such as airports), AfT can also play a role in developing the sector, with key interventions including:

- *Strengthening tourism policy* with integrated and coherent strategies that incorporate regulatory issues (such as visas, investment rules, consumer protection, licensing laws, security issues), taxation regimes, broader issues such as language, cultural, land, and environmental policies, SME support, and helping spread tourism to outlying areas. This also includes maximising the potential for spill-overs to other sectors, such as agriculture.

- *Strengthening marketing strategies* that target geographical markets and types of tourists sought, based on factors such as competition, capacity, and product offering. Operators may also need training with understanding and accessing different markets. "Export diversification" beyond one particular market can include developing new offerings (activities or different types of tourism) or attracting visitors from new countries. AfT can also help improve data for policy and marketing, for example on tourist expenditures.
- *Improving standards* related to hospitality, but also in areas such as safety (given the damaging effect of accidents) and food quality, or environmental standards.
- *Supporting the development and protection of tourism assets* with development assistance directed towards specific cultural and environmental resources (for example through UNESCO) or on general projects (for example in water, sanitation, and waste management).
- *Supporting skills development*: tourism depends heavily on skills and experience, and development assistance can facilitate education, training, and skills exchange. Language skills in particular are essential for attracting new markets.

Despite this, direct AfT support for tourism development is extremely low, especially compared with other productive sectors. Between 2010 and 2014, almost US\$14 billion was disbursed in AfT just to LDCs for agriculture projects, roughly eighty times more than the US\$175 million committed specifically to tourism projects in LDCs over the same period (table 1).

**Table 1: Aid for Trade disbursements to LDCs and other LICs, 2002-14 (constant 2013 US\$ million)**

		2002-5 (avg)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Infrastructure Networks	Transport & Storage	1884	2084	2282	2791	2986	3520	3721	3604	4070	3889
	Communications	126	127	112	107	127	110	161	184	207	209
	Energy	715	641	928	1418	1409	1592	1689	2412	2989	2772
	Financial Services	455	202	295	331	812	442	407	425	615	514
	Business Services, etc	183	640	774	539	426	540	613	455	538	509
Productive Capacity	Agriculture	1107	1322	1563	1827	2522	2797	2729	2586	2882	2976
	Forestry	98	96	80	72	93	156	126	105	126	107
	Fishing	82	91	77	100	97	68	91	94	91	98
	Industry	298	263	209	284	314	313	391	338	354	358
	Mining	197	93	80	116	93	69	189	126	153	106
	Tourism	14	12	11	13	14	49	39	33	28	26
	Trade Policy & Regn's	35	67	180	165	164	197	199	247	340	244
	Total	5196	5636	6590	7764	9058	9852	10354	10610	12392	11807

Source: OECD Creditor Reporting System

Beyond tourism, other potential services exports will face challenges that are similar and different. For example, in ICT-related services both network infrastructure (high-quality telecoms, reliable inexpensive electricity) and the regulatory environment will again be important. But governments can also put in place proactive policies to encourage uptake and innovation while improving the provision of public and private services in sectors from education and health to professional services and commerce. Developing countries have already become involved in business processing outsourcing (BPO) with high levels of job

creation; it is likely that other not-yet-foreseen ICT-related opportunities will emerge as technology progresses.

Finally, Mode 4 is an area where there is enormous potential for developing countries to benefit, yet where most significant barriers to services exports still exist. Thus far, many developing countries have yet to put in place any kind of "export strategy" for Mode 4 that looks in detail at market access barriers, potential opportunities, and supply conditions, for specifically identified target sectors (such as construction, plumbing, electricians, welding, mechanics, services incidental to mining and agriculture, health and education professionals, and tourism). Taking an "export development" or "supply chain" approach to Mode 4 would be a first step towards building more coherent approaches in this neglected area.

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*After ten years of increasing support, the AfT initiative and donors still have much to do to tailor their approach to the services context.*

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### Conclusion

In summary, services are the main economic activity in developing countries, and increasing trade in services has enormous potential to improve overall economic efficiency and provide direct export opportunities. AfT can help countries address challenges in building services-based economies, through establishing high-quality infrastructure and strong regulatory frameworks to foster competition. AfT can also support new policy approaches to services exports, and targeted investments in areas such as marketing or ICT innovation.

Yet services issues have received little specific attention so far under the AfT initiative, especially compared to the dedicated support programmes available for specific export products (such as sugar), or issues such as trade facilitation. By contrast, instruments for providing direct support to tourism or BPO, or tackling barriers in Mode 4, are rare and small in size. After ten years of increasing support, the AfT initiative and donors still have much to do to tailor their approach to the services context.

*This article is an adaptation of a forthcoming conceptual paper to be published by ICTSD.*

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- ① Foster, Vivien and Cecilia Briceño-Garmendia (2010), *African Infrastructure: A Time for Change*, World Bank, Washington DC.



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## REGIONAL TRADE AGREEMENTS (RTAS)

# Mega-regional agreements and global trade governance: Ensuring openness and inclusiveness in an increasingly complex system

Fabian Bohnenberger

*Mega-regional trade agreements erode WTO centrality and carry significant risks for countries excluded from the negotiations. The international community must identify ways to minimise these risks and find ways to ensure these trade deals can instead be a source of new opportunities, even for countries outside these deals.*

The key challenge for policymakers in international trade over the coming years will be to ensure that mega-regional and plurilateral agreements complement rather than undermine the multilateral trading system. The rise in selective associations between WTO members, aimed at a deeper integration of their economies, has fundamentally changed the dynamics of trade negotiations at the global level. The 10th WTO Ministerial Conference, held in Nairobi in December 2015, yielded only limited results. While the United States and the European Union called for the conclusion of the Doha Round, developing and emerging countries expressed a desire to keep the agenda alive. Expectations now are that global trade policy will be increasingly negotiated in smaller groups.

As the new “main loci of global trade governance for beyond-WTO issues,”<sup>1</sup> mega-regionals have caused widespread concerns. The Transatlantic Trade and Investment Partnership (TTIP), the Trans-Pacific Partnership (TPP), and the plurilateral Trade in Services Agreement (TiSA), have been subject to intense debate. These accords have proven much more legitimacy-sensitive than past agreements because they increasingly aim at harmonising risk management, instead of focusing exclusively on eliminating traditional protectionist policies. While their implications for participating economies have been widely and publicly discussed, the effects on excluded countries have received far less attention. The risks these agreements carry for those left out can, however, be significant and potentially contrary to global multilateral trade objectives.

Developing countries are especially likely to be negatively affected by the increasing regionalisation of trade relations and ever broader market liberalisation outside the WTO. With member states divided over the future of the Doha Round and negotiators still struggling to find their bearings in the post-Nairobi negotiating landscape, countries should prioritise discussing and identifying ways to minimise the risks of these agreements for third countries as much as possible. Reducing negative effects on third parties is absolutely crucial to alleviate fears of marginalisation and forestall the creation of competing trade blocs by excluded parties. It will also be critical to ensure the compatibility of mega-regionals with the multilateral trade system.

To respond to this challenge, the international community must discuss new strategies and trade models. By outlining ways to open mega-regionals and reduce risks for developing countries, this article hopes to contribute to a more fruitful debate in upcoming trade talks.

## The risks for developing countries

The creation of mega-regionals implies that countries will be treated less equally in the future. The effects depend on the degree of product and export market diversification, as well as the ability of these countries to enter the competition for regional trade partnerships with their own initiatives. Poor developing countries excluded from mega-regionals are likely to suffer losses in trade and competitiveness, not least because of

## TTIP

The Transatlantic Trade and Investment Partnership (TTIP) is a proposed trade agreement under negotiation between the European Union and the United States. The two partners together account for around half of global GDP and more than 40 percent of global trade.

preference erosion. Should mega-regionals redirect trade flows, these countries could also have a harder time accessing capital and technology.

Moreover, mega-regional initiatives outside the WTO could further reduce the influence of developing countries in trade negotiations. In the past, developing countries joined forces in the WTO to pursue market liberalisation that corresponded to their national development levels. Negotiations in sub-groups limit this kind of coalition-building, which allows advanced economies to play competing trade partners off against one another. The result is similar to what developing countries experienced at the time preceding the rise of emerging powers, when they were not able to defend their interests in a multilateral trade forum against the major economies.

Developing countries that do not want to be left behind their export competitors feel increasing pressure to agree to liberalisation in more and more areas covered in mega-regional agreements. TPP confronts developing countries with issues that, so far, do not figure prominently at the multilateral level. This includes commitments on intellectual property rights, state-owned enterprises, and e-commerce. For example, some of the developing countries affected by Vietnam's improved market access to the US, such as Pakistan or Bangladesh, could decide to join the TPP to protect their export competitive industries, despite not really being ready to adopt many of the agreement's provisions and having had no opportunity to help shape it.

Risks are lower for emerging trade powers like Brazil, India, and China. Because of their economic and political clout, these countries can enter the competition for regional trade partnerships. China is already pursuing a mega-regional in the Pacific, the Regional Comprehensive Economic Partnership (RCEP). In this situation, it is important that TTIP and TPP are not perceived as an attempt to counterbalance the increasing influence of emerging economies. Heightened competition for political and economic spheres of influence which results in an ever more complex system of trade rules and regulatory standards would not only hurt developing countries but also raise the costs for EU and US exporters.

### Ways to alleviate the risks

Actions to create open, benign mega-regionals can be divided into three categories. First, those changes that can be implemented unilaterally by the negotiating parties to ensure openness. Second, provisions that allow for full or partial accession by third countries. Third, actions at the multilateral level that reaffirm the centrality of the WTO.

#### *Signatories' choices*

The responsibility to craft mega-regionals while bearing in mind the broader implications for the international trade system lies primarily with the negotiating parties. Scope and design of the trade agreements will be crucial in determining their effects on third countries and the international system. This includes open rules of origin (RoO), the liberalisation of market access on a most-favoured nation (MFN) basis, and the extension of regulatory cooperation to third parties.

Mega-regionals provide a basis for harmonising the RoO frameworks between trade partners. TTIP's potential to shape the EU and US approaches to rules of origin has been repeatedly recognised. Producers everywhere would benefit from a simplification and standardisation based on a liberal definition of RoO. In order to ensure that developing countries can maintain or enhance their position in value chains, the threshold at which inputs are considered of domestic origin should be set as low as possible. Options for cumulation could also protect existing production networks and supply chains.

Liberalisation of market access on a MFN basis should be considered in services trade and public procurement. While full integration of markets might require a deeper convergence of regulatory regimes feasible only among a subset of countries, the literature suggests that countries could reap more benefits if agreements are not exclusive, but rather open to all parties able to satisfy the regulatory requirements within the integrating area. For

procurement regimes that already benefit from considerable foreign competition, such as in Europe, the benefits of preferential reform may also be ambiguous and even adverse because of the traditional concerns about trade creation and diversion.

Regulatory cooperation will account for most of the benefits in mega-regional agreements like TTIP and is of particular concern for third parties. The extension of mutual recognition of norms and technical standards to non-member country producers should therefore be discussed as a strategy for alleviating potential negative effects: this would occur if companies from third countries were allowed to sell throughout the mega-regional provided they meet the standard of any one of the members in the agreement. This type of regulatory cooperation can already provide one step towards accession.

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#### *Accession options*

Negotiating parties will also need to determine accession rules for future participants. South Korea and the Philippines have, for example, already expressed their interest in joining TPP. Negotiating separate agreements with all participants of the mega-regional, or, alternatively, upgrading existing agreements to the mega-regional's standard might not be feasible for outsiders. While the planned upgrade of the EU-Mexico trade relationship could align their bilateral agreement with TTIP, the same might be more difficult with regard to TPP, where countries would need to negotiate or update multiple agreements. This strategy would also represent an isolated response that does not decrease the risks for developing countries in an asymmetric bargaining position. Apart from full accession, membership requirements for developing countries could vary depending on their levels of development.

An explicit accession clause would be the most comprehensive way to open mega-regionals to interested parties and to acknowledge their stake in preferential access to the involved markets. Accession, however, comes at a price: candidates would have relatively little influence on the agreement's substantive provisions. Comparable to WTO access, the scope of renegotiations will be limited mainly to market access issues – an offer that is unattractive to many countries, especially those with political or economic clout. For developing countries benefiting from unilateral preference schemes, the demands for liberalisation would simply be too high. The role of “rule-taker” would only be acceptable to a small group of countries that have already negotiated their own bilateral trade agreements with one or all parties in the mega-regional and remain deeply interdependent with these markets – for example, countries of the European periphery to TTIP. In this regard, accession is clearly inferior to multilateral negotiations.

Developing countries which consider one or more of the mega-regional's members an important trade partner may, however, be interested in partial accession. Similar to the WTO and North-South agreements, asymmetric liberalisation should mean that fewer and less demanding obligations would apply to developing countries in areas like services, competition, and investment. This could also include regulatory cooperation, which would increase transparency and allow third country producers to participate in the standard-setting process. In the case of TTIP, for example, third parties could negotiate an accord that is confined to the implementation of a narrower set of rules and regulations – comparable to multilateral sector-specific agreements negotiated in the 1990s. Below this threshold, some authors suggest that third parties might also react unilaterally by adopting regulatory standards equivalent to those in TTIP.<sup>2</sup> This could represent a first step to prepare their economy for a mutual recognition agreement with the EU and the US.

## TPP

The Trans-Pacific Partnership (TPP) is a trade agreement among twelve Pacific Rim countries, i.e. Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam. It was concluded in October 2015. Those countries together account for 40 percent of global GDP and 20 percent of global trade.

Because it would only pertain to “some” and not all rules in the agreement, this strategy would allow third parties to secure a core area for autonomous decision-making.<sup>⑤</sup> Again, this process will only be attractive to countries satisfied with rule-taking.

### Responses on the multilateral level

In the absence of options for active participation, excluded parties – heeding the not-so-subtle announcements of policymakers on both sides of the Atlantic, who argue that TTIP and TPP should set rules for global commerce – will be incentivised to pursue their own liberalisation projects. This can happen both within and outside the WTO; rather than creating competing mega-regionals, third countries could embrace a variable geometry approach in the WTO.

Plurilaterals would be especially desirable relative to mega-regionals as long as they are MFN-based and smaller developing countries, including least developed countries, also benefit from the agreements. However, in the absence of commitments to openness and inclusiveness by present-day mega-regionals, restraint by third parties seems unlikely. The members of TiSA remain unwilling to open up their agreement as long as there is no critical mass of countries backing the agreement. Including China in these negotiations, which has recently been supported by the European Parliament, would certainly bring the agreement closer towards multilateralisation and would probably incentivise more countries to join the negotiations.

In light of the “persistent and fundamental divisions on our negotiating agenda”<sup>④</sup> after the Nairobi ministerial, member states increasingly aim at delivering on parts of the Doha agenda in a piecemeal fashion based on a “critical-mass subset of countries willing to move faster and farther.”<sup>⑤</sup> This implies that the WTO’s consensus rule would be broken and members would thereby forego any potential compromise on the most contentious issues that hold up the negotiating process. On the other hand, there are good reasons to assume that the areas in which members would be able to bridge their differences would be the same with or without Doha. In fact, the increasing interest of developed countries to discuss new issues such as investment and digital trade at the WTO level suggests that it might not be possible to sustain the multilateral system the way it currently is. Given the reluctance of poorer countries to shift the focus away from development, selective agreements between interested members with or without MFN become increasingly likely.

Ideas on the WTO’s role in managing the rise of mega-regionals remain modest. The Nairobi Ministerial Declaration instructs the WTO’s Committee on Regional Trade Agreements to discuss the systemic implications of RTAs for the multilateral trading system. With regard to the WTO’s nature as a member-driven organisation, reform proposals are often limited to traditional conceptions of international organisations as forums for the collection and dissemination of information to member states. The goal of transforming the current provisional transparency mechanism for regional trade agreements into a permanent mechanism, reaffirmed in paragraph 28 of the Nairobi Declaration, can be seen as a step in this direction. A similar idea is the creation of a “Transparency Exchange Mechanism”, a database where trade liberalisation efforts at various levels will be stored which Mavroidis suggests as part of his vision of a WTO 2.0.<sup>⑥</sup> Previous work by other authors also supports the formation of an “RTA Exchange” – an annual forum and interactive website where information and research on trade agreements is pooled and accessible.

Few proposals go further and, for example, suggest a mechanism that supports third parties in voicing their interests and concerns. Mortensen proposes a “reform [of] the current mechanism of overseeing, scrutinising and permitting the formation and continued operation of FTAs.”<sup>⑦</sup> He acknowledges, however, that given the sensitivity regarding sovereignty among the WTO membership, “it is unlikely that the WTO will ever be equipped with an effective and autonomous capacity to conduct self-initiated reviews of the notified FTAs.” In this regard, the unilateral actions by negotiating parties outlined above become even more critical.

## Conclusion

The future of the WTO hinges on its ability to come to terms with recent developments. Richard Baldwin recently issued this warning:

"Without reform that brings existing RTA disciplines under the WTO's aegis [...], the trend towards eroding WTO centrality will continue and possibly take it beyond the tipping point where nations ignore WTO rules since everyone else does. There is the risk of drifting back towards a 19th century 'Great Powers' world."<sup>8</sup>

Policymakers engaging in the next phase of international trade talks should heed this warning. If mega-regionals' risks for third countries are not addressed in time, perceptions of competing bilateralism could spread further and the creation of rivalling trade blocs accelerates, Baldwin's "tipping point" will be looming rather sooner than later.

At present, the WTO and individual members certainly cannot stop the frontrunners that strive for deeper integration with selected trade partners. However, what we need to do in a multi-speed system is to bridge and enlarge the clusters of deep integration with the slower-moving members. Most importantly, this involves minimising the risks for developing countries ensuing from mega-regional agreements.

*This article was selected as part of the TDS Bridges Writing Competition. For more information please see the following link: <http://bit.ly/1OIuPWm>*

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# The newsroom

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## EU trade chief calls for building on Nairobi momentum

The results from last December's WTO ministerial conference went well beyond expectations, EU Trade Commissioner Cecilia Malmström said in Geneva on 2 May, reiterating recent calls for the organisation's members to draw on this momentum and begin charting a clearer path toward the next ministerial and beyond.

Speaking to a packed room of academics, ambassadors, and other trade watchers, the EU official highlighted the opportunities that may now be available in the wake of last year's ministerial meet, while explaining that the EU is still considering its own position on many areas.

One week before, the EU trade chief also outlined in a speech to civil society a series of areas that, in her view, could be fruitful areas for WTO members to begin their post-Nairobi discussions. While stressing that the EU's preference is for multilateral deals whenever possible, she also indicated that a next-best option would be plurilateral pacts on a most-favoured nation basis.

## Trade takes centre stage at ACP Council of ministers

Trade issues took centre stage during the 103rd session of the Council of Ministers of the African, Caribbean and Pacific (ACP) Group of States, which was held on 25-29 April in Dakar, Senegal.

Ministers discussed prospects regarding the Economic partnership agreements (EPAs) still under negotiation with the EU, as well as issues related to trade in various commodities, such as fishing products and sugar.

In their resolution on EPAs, ACP ministers renewed their call for flexibility on the part of the EU, "so that outstanding negotiations can be concluded for mutual benefit", states a press release by the ACP Group. They also asked for the EU to resume the stalled negotiations with Central Africa, Eastern and Southern Africa (ESA) and the Pacific at the ministerial level, further indicates the communiqué.

## Discussions on implementation of decision on preferential RoO

WTO members should prepare for the implementation of the decision on preferential rules of origin for least developed countries (LDCs), said the Danish ambassador Christian Wegener, chairman of the WTO's committee on rules of origin, during a meeting held on 22 April. The meeting marked the first discussions on this issue since the adoption of the decision in Nairobi, last December, at the tenth ministerial conference of the organisation.

Developed countries have an obligation to submit a notification on the efforts they have undertaken to implement the decision by the end of 2016, reminded Wegener. Developing countries, for their part, are allowed to wait until they have declared themselves in a position to implement the decision's provisions.

Rules of origin are often pointed out as being too restrictive, thus preventing LDCs from taking full advantage of the preferential market access they are granted by various countries.

## Climate change adaptation to cost more than expected

Adaptation to the consequences of climate change could cost as much as US\$500 billion per year worldwide by 2050, according to a new report released by the United Nations Environment Program (UNEP).

The main message of the report is clear: failing to significantly reduce greenhouse gases emissions by the half of this century would dramatically increase the costs of adapting to the changes in climatic patterns around the world.

Previous figures released in a 2010 World Bank study suggested that climate change adaptation could cost between US\$70 and US\$100 billion per year for the 2010-2050 period. The new estimates published by UNEP are four to five times higher, indicating that those costs could range from US\$280 billion and US\$500 billion by 2050.

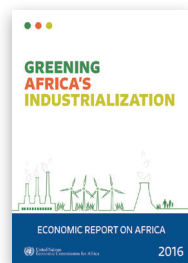


# Publications and resources



## **A Proposed G20 Initiative for the International Trade and Investment Regimes on Sustainable Development and Climate Change – E15 Initiative – April 2016**

As a critical forum for global economic governance, the G20 (with strong leadership from China as the host nation for the 2016 G20 Summit) could provide important direction to various organisations and stakeholders on the importance of conducting their activities in a manner that reinforces the SDGs and the 2015 Paris Climate Change Agreement. This paper offers an array of ideas on how to weave the concept of sustainability into the fabric of international cooperation on trade, investment, and development – including the institutions of global economic governance. <http://bit.ly/1W0g8QX>



## **Economic Report on Africa 2016: Greening Africa's industrialization – UNECA – April 2016**

Structural transformation in Africa's economies remains the highest priority, and industrialization is the top strategy for achieving it in practice. This report underlines that as a latecomer, Africa must seize the opportunity to adopt alternative economic pathways to industrialization. It also notes that dispelling the myths currently surrounding green growth will promote the re-shaping of Africa's economic growth in favour of sustainable development. <http://bit.ly/1smAqHG>



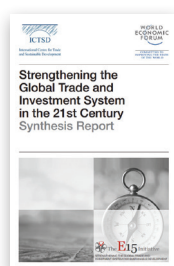
## **Competition Policy and the Trade System: Challenges and Opportunities – E15 Initiative – April 2016**

This paper examines the importance of competition policy in promoting free trade and allowing countries to specialise in those sectors where they have comparative advantage. It calls for better coordination among competition authorities and puts forward several proposals for discussion, including the use of already existing mechanisms to achieve convergence in competition law regimes. <http://bit.ly/1PQS2zi>



## **Assessing Regional Integration in Africa (ARIA) VII – UNECA – April 2016**

The 2016 edition of UNECA's Assessing Regional Integration in Africa report examines how the three elements of regional integration, innovation and competitiveness are interlinked. It explores the prospects for harnessing them within the framework of Africa's normative regional integration development model oriented to foster structural change. The report aims to shed light on innovation and competitiveness in the broader context of development policy and strategy in Africa. <http://bit.ly/1WBLLpj>



## **Strengthening the Global Trade and Investment System in the 21st Century – E15 Initiative – January 2015**

At the beginning of the year, the E15 Initiative delivered a comprehensive set of policy options for improved governance of the global trade and investment system in the 21st century. This Synthesis Report and interprets the significance of the policy options for progress on many of the international community's most important shared imperatives. Synthesis report: <http://bit.ly/1XiRk5L>. Executive summary: <http://bit.ly/1XiRASd>. Interactive tool to explore all E15 publications: <http://bit.ly/1VvdQRe>

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