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Significance and Impacts of the Tripartite Free Trade Area – a Qualitative Assessment

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Abstract
The Tripartite Free Trade Area (TFTA) has been driven by a need for improved growth in African countries following their respective independence. Since then, member nations have been seeking new initiatives to increase trade and to work cooperatively. The idea of regional integration in this 'Cape-to-Cairo' free trade zone is set to cover just under two-thirds of Africa's population and improve the flow of goods and investment significantly. This paper explores the significance and impacts of the single FTA on various aspects of economic growth, including welfare, trade, price effects, custom tariffs, government revenues, and the labor market.

Keywords
COMESA, EAC, SADC, TFTA, Tripartite Free Trade Area

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1. Introduction

On June 10, 2015 the Tripartite Free Trade Area (TFTA) involving 26 African Countries was signed in Egypt. The agreement is still pending the ratification of each of the member countries' national parliaments, but it was still immediately unveiled at the 25th African Union Summit in South Africa held in mid-June 2015. The TFTA unites three existing trade blocs – the Common Market for Eastern and Southern Africa (COMESA); the Southern African Development Community (SADC); and the East African Community (EAC) – into a single new trade zone.

The TFTA that brings economic integration to the 26 countries involved, covers half the continent's gross domestic product (Zamfir, 2015). The 3 combined regional economic communities (RECs), i.e. the TFTA, will merge 527 million people in 26 countries with a combined GDP of $624 billion. Though 26 countries are involved, the Free Trade Area (FTA) is called tripartite as it merges the 3 existing RECs.

Before the TFTA some member countries have been involved in multiple RECs, and this overlapping membership creates problems at different levels of business and also amongst governments and is disruptive towards regional integration programs. The programs and activities of the different RECs have been contradictory thereby causing inconsistencies in member's regional integration policies as well as creating contradictory obligations and loyalties to the different RECs (Bienen, 2010). For businesses, the overlapping REC membership increased costs as the rules for cross border trade, as depending on the status of the trading partner and which REC the trading partner is a member of, the conditions of trade changed.

Businesses therefore had to have multiple processes if it wanted to trade outside the country in any of the REC member countries. The TFTA is therefore significant as it streamlines processes and improves trading conditions that impacts about half a-billion people in 26 countries.

The three main guiding principles of the TFTA is based on the three main pillars of market integration, infrastructure development and industrial development, which reflected the enormous problems that exists in the region with regards to increasing industrial production and improving transport infrastructure. Hence, the negotiations for this trade deal involved two phases – liberalization of the trade in goods followed by the liberalization of trade in service. In liberalizing the trade of goods, tax and non-tax barriers were removed. On the other hand the liberalizing of trade in services will involve ensuring the free movement of business people between the member countries of the TFTA (Zamfir, 2015). Some countries are expected to benefit greatly from the TFTA economically, fulfilling the agreement's fundamental purpose. Conversely, countries with weaker economies must compete against other strong economies, making it difficult to develop effectively. The TFTA is expected to essentially prevent competition among trade areas because of its unity and equality across the entire TFTA.

2. Viner's Theory as part of the TFTA

Trade, whether it is regional or international, will have direct implications to a country's welfare. The idea of FTAs is to phase out tariffs on imports from member countries; thereby changing demand patterns which in turn leads to adjustments in trade. The FTA is therefore a beneficial trade bloc that improves efficiency and economic welfare amongst member countries (Schiff & Winters, 2003). Economist Jacob Viner formulated a theory that characterizes the welfare effects of a FTA by categorizing them into three fundamental principles - Trade Creation, Trade Diversion, and Revenue Effect – that are also applicable to the TFTA.

Trade creation (TC) is defined as the additional trade generated from a FTA that would not have existed without the FTA's establishment. The less efficient domestic production centers will be priced out by the lower priced import from more efficient production center(s) in the other FTA member nation(s). The removal of the tariffs that protected the less efficient domestic production centers, as a result of the FTA, will essentially displace high-cost domestic production. So the removal of tariffs results in cheaper imports, that drive up demand by consumers in member countries, as imports are more affordable and potentially of a higher quality. The lower prices of goods for consumers are considered to be an improvement of welfare (Viner, 1950).

While the Viner theory says that TC will have positive effects on the welfare of member countries in an FTA, the theory also says Trade Diversion (TD) in a FTA has the opposite effect. Taking the case of the TFTA, when pre-existing tariffs are eliminated, African countries are expected to increase trade amongst the countries that are part of the TFTA as opposed to those that are independent or are not members of the TFTA. TD will then occur when goods from more efficient, non-TFTA nations are diverted in favor of TFTA goods that are less efficient. Viner's theory therefore suggests that TD is welfare reducing, as a more efficient and lower cost production center from outside the TFTA is unable to provide a competitive product to the consumers in the TFTA nations. So the TFTA can be a new barrier to improvement of welfare in the member countries. The net effect of TC and TD will therefore determine the overall welfare gain or loss of the TFTA (Viner, 1950).

The net effect of TC and TD is something that can be dictated by the terms of trade. Terms of trade are reflected in the changing prices of exports and imports facing a country (Jensen, Sandrey, & Vink, 2012). A country in the TFTA with improved market access in another member country by way of the FTA, might see an increase in its export price relative to import price. The increased revenue from exports will mean that the country is now able to finance larger quantities of imports than it previously could afford. The terms of trade allows for allocative efficiency amongst member countries, and this affects the distribution of welfare gains across countries (Jensen, Sandrey, & Vink, 2012).

The report by Willenbockel (2013) simulated the balance of TC and TD of the future TFTA. Its results suggested that the establishment of the TFTA is projected to generate an annual welfare gain of 578 million US dollars, roughly 0.1 percent of total TFTA area 2014 baseline absorption. The additional welfare gain that is a direct result of projected tariff elimination among the three RECs is around 250 million US dollars for the entire TFTA union. These are only predictions; they could be influenced or changed significantly based on surrounding circumstances, however they offer a standard to expect from the TFTA. A similar study by Makochekanwa (2014), where the sum of the effects of TC and TD was defined as net trade effect (TE), and the TE was estimated at 1.5 billion US dollars. Preliminary estimates show that the TFTA will be able to help improve the welfare of African nations as a group, though individual nations may have significantly different levels of benefits. And some countries will still not have any gains, as they do not have their own export markets.

If a FTA has a positive effect i.e. the TC > TD, individuals and households will save parts of the extra income, thereby expanding capital stock. The increased employment opportunities and rising incomes will increase demand for produced goods, which drive up factor returns and thus attracting more investments. The countries in the FTA that have positive effect, will be prepared to pay the largest return on capital invested by its citizens, as it gets the most of the new investments. The positive effect of capital gains is another aspect of overall welfare gains (Jensen, Sandrey, & Vink, 2012).

The revenue effect (RE) reflects the loss on the government accounts, as the removal or reduction in customs duties on imported goods results in loss or reduction of customs revenue (Viner, 1950). Loss in customs revenue means the Government will have a smaller budget to provide essential public services, like education, health and sanitation. In the case of the countries in the TFTA, which are essentially developing countries, the provision of these essential services are largely undertaken by the Government. Therefore for the case of the countries in the TFTA, the impact of RE can be insurmountable, unless alternative funds are sought to augment the funds that would have otherwise have come from import tariffs (Makochekanwa, 2014).

3. TFTA's Impacts on the Labor Market

When import tariffs are abolished, members in the TFTA will see resources shift from previously protected industries that are now less competitive to the imports, to sectors that the country has a comparative advantage in. This shift will see a net increase in real GDP and economic welfare for the countries involved. This is defined as gains from allocative efficiency, when reallocation of resources occurs from less to more productive uses (Jensen, Sandrey, & Vink, 2012).

The labor market is one such market that sees the effect of allocative efficiency under the terms of the TFTA. The labor market is comprised of two different types of workers - skilled workers and unskilled workers. The introduction of the TFTA will increase trade, which although will not impact the amount of skilled labor (which will essentially remain fixed), will influence the amount of unskilled labor employed significantly. More-developed countries of the

TFTA will generally benefit from unskilled labor flow assuming that there is not a high unemployment rate. In a country that has a high unemployment rate the changes are hopefully reflected in increased employment. The TFTA is expected to increase employment in all member nations, especially those that are less-developed. In situations where there is increased demand for labor, and in turn the real wages, the employment rate increases while reducing the relative increase in the real wage. This results in the increased competitiveness of the country's industries (Liu, Leeuwen, Vo, Tyers, & Hertel, 1998).

Even a more-developed nation (e.g. South Africa) would benefit from being a part of the TFTA. According to the study by Jensen et al (2012) the employment and real wage outcomes are both positive for South Africa: employment increases by 0.54 percent and real wages by a greater 1.80 percent. At the same time, the Consumer Price Index (CPI) is projected to increase by 1.08 percent, meaning that unskilled workers would be able to buy more with their wages. All TFTA member nations have initiatives for their growing economies, and so there is evidence that there is confidence amongst the member nations that the TFTA's adoption would make a positive impact on their economies.

4. Trade between TFTA and EU

Negotiations are to be made regarding the EU's trade relations with the countries that are to be members of the TFTA. These negotiations will ultimately lead to Economic Partnership Agreements (EPAs), which will allow tariff-free and quota-free access to the EU's market, given that TFTA member nations will also open theirs gradually to the EU. TFTA member nations would however still be able to place tariffs upon preferential items. The TFTA's inauguration would ensure that there would be an equal trading system amongst the EU and TFTA without any trade imbalance stacked upon the African producers. For this reason, the EU has attempted to support the establishment of the TFTA by funding and organizing infrastructure projects to eventually establish the zone. One of the purposes of EPAs is to encourage regional integration by allowing for the three RECs that comprise the TFTA to cooperate and integrate themselves in the development process. This is a goal of both trade unions, the EU and TFTA, because they both intend to help each other to develop in order to strengthen their bonds for future economic opportunities and co-operations. Although this is an example of a future trade advantage specifically with the EU, trade is not limited to it and the TFTA will certainly have the opportunity to reach out to many more new trade opportunities with countries individually or collectively as economic regions.

5. Challenges Facing the TFTA

Although the plan is largely promising, the introduction of the TFTA has been a prolonged process due to a variety of structural challenges between the future member nations. Many of Africa's nations already import their raw materials, basic commodities and manufactured goods from overseas. In order to allow for a significant increase in intra-African trade, diversification of trade would need to be addressed. Another structural challenge is the inequality that many African countries face. As of now, five countries in the continent dominate intra-African trade: South Africa, Nigeria, Kenya, Egypt and Côte d'Ivoire. These countries account for 62.3 percent of Africa's total exports. Simulations evaluating the impact of TFTA have alleviated concerns that industrial production in the TFTA would concentrate in the countries with the highest productivity levels (Mold & Mukwaya, 2015).

Whilst the TFTA will be a preferential trade area where the member countries eliminate tariffs on almost all trade between members, members will still have the right to determine tariffs on imports from non-members (Letsoalo, 2011). Take for instance a case where one of the member countries makes economic gains from the FTA. The gains from the FTA, this particular country is supposed to re-invest into its own country by improving welfare programs and demand in its local market for products and service from members of FTA. However, if the country choses to exercise its right to impose tariffs and trade with non-members, and channel the gains towards meeting market demands in non-member countries, then the countries in the FTA will not reap the full benefits of the trade pact.

Other challenges include that many nations rely on government revenues from their customs duties to finance their public funded programs and also, that multinational corporations would rule the markets taking advantage of the tariff reliefs. These are all very intricate obstacles that will require close attention and constant review of the terms of the FTA, in order for the TFTA to be a success.

6. Conclusions

FTAs are designed to create opportunities by firstly opening new markets for goods and services. The removal or elimination of custom duties, make trade cheaper, thereby allowing for the allocation of resources amongst member nations from less efficient production processes to more efficient processes. The increased demand that results from the lowered tariffs is expected to improve the welfare of the member nations. The transportability of labor and business people amongst member nations is key towards increasing employment opportunities. The increased employment improves the welfare of the citizens of the member nations. The improved welfare is another factor towards sustaining the growth principle amongst the members of the FTA, as citizens have increased spending ability by way of employment and more economically priced consumer goods and services.

The TFTA agreement is built on the principles of FTA. Upon the ratification of the agreement by the respective countries' parliaments, the member countries have the arduous task of transitioning from the existing 3 RECs to the new TFTA agreement. The transition is not expected to be smooth, but based on studies carried out there is significant opportunities for economic growth in the 26 countries involved as a result of this new agreement. The TFTA is also expected to develop fully the trade pact with the EU, which has been the largest trading partner for the African countries. Beyond EU, the same framework of trade agreement can be adapted for the TFTA to expand to include the rest of the countries in the African continent as well as other trading partners that can bring TFTA economic growth and improve the social well being of its citizens.

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