

Summary

Comparative Assessment of the Potential Impact of African Continental Free Trade Area (AfCFTA) and World Trade Organization (WTO) Accession on the Ethiopian Economy

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The global economy's reliance on free trade has grown significantly, offering improved market access to many countries. Consequently, free trade agreements (FTAs) are proliferating worldwide. After World War II, the General Agreement on Tariffs and Trade (GATT) was established to enhance global trade, resulting in significant reductions in trade barriers through multiple negotiation rounds. However, GATT faced challenges, particularly in addressing tariffs on heavily protected sectors like agriculture, and its exclusive focus on goods trade left gaps in resolving disputes. Consequently, in 1995, the World Trade Organization (WTO) was founded, superseding GATT, with a broader mandate and enhanced dispute resolution mechanisms. Despite the WTO's expansive reach, countries have increasingly favored establishing regional free trade agreements (RTAs). Africa ratified the African Continental Free Trade Agreement (AfCFTA) in 2018, which aimed to create a unified and large market size for goods and services across the continent. After abstaining from free trade memberships for a long time, Ethiopia has become one of the signatory members of AfCFTA. Additionally, the country has resumed negotiations to join the WTO, which paused in 2013. Ethiopia became an observer in the WTO in 1997 and commenced the accession process in 2003. These decisions to open up the economy and join free

trade areas are expected to benefit the Ethiopian economy by providing better market access and reducing input costs. However, they also pose a risk to weak or sensitive industries, such as textile and leather. Ethiopia's commitment to join AfCFTA and WTO evokes a mix of hope and apprehension about its economic future.

In assessing the potential impact of these free trade agreement accessions on the Ethiopian economy (trade, output, and welfare), we used trade indicators for our first study, and the CGE model for our second study. In our first study, we identify sectors with potential competitiveness using comparative advantage indicator indexes and with benefits of border barrier protection using the level of protection indicators. Then, we identify sectors that would expand or decline under free trade by combining these two results. The findings from these indicators reveal that fuel oil, light manufacturing, plastic, tobacco and beverage, and energy and extraction would face significant challenges.

For our second study, we used a world trade CGE model to examine the impact of joining AfCFTA and WTO on trade, output, and welfare in Ethiopia. The results of the simulations indicate that membership in both trade agreements would substantially increase Ethiopia's trade and welfare, with WTO accession yielding greater benefits than AfCFTA. The results of a trade simulation indicate that AfCFTA membership would increase imports of energy and extraction, light manufacturing, and processed food. AfCFTA membership would significantly increase Ethiopian imports from AfCFTA regions but would reduce imports from non-AfCFTA. Additionally, AfCFTA membership would substantially enhance exports in all sectors, notably agriculture, energy and extraction, and meat and livestock, leading to increased exports across all AfCFTA regions but minimally affecting exports to non-AfCFTA regions. In contrast to AfCFTA membership, WTO accession would increase imports in the textile, light manufacturing, heavy manufacturing, and processed food sectors, with a significant portion coming from Asia, but decrease imports from East Africa. In terms of exports from Ethiopia, WTO accession would benefit agriculture, transport, and service exports, with increased exports to all regions, particularly Europe, Asia, and the ROW.

The findings on output indicate that AfCFTA would benefit the agriculture, transport, meat and livestock, and machinery sectors, and would negatively affect service, light manufacturing, energy and extraction, and processed food production. WTO accession would increase in output of the agriculture, transport, and meat and livestock sectors but decrease the output of the service,

textile, light manufacturing, and heavy manufacturing sectors considerably. Agriculture, transport, and meat and livestock would benefit from both trade agreements, with larger gains expected from the WTO accession than from AfCFTA. However, service, light manufacturing, processed food, and energy and extraction sectors would consistently suffer under both trade agreements, with the negative impact of the WTO accession expected to be more severe than that of AfCFTA.

Our analysis underscores the benefits Ethiopia stands to gain from joining both AfCFTA and the WTO. However, it is important to acknowledge that alongside the overall gains, there are multiple negative impacts on specific sectors in the economy, such as light manufacturing, textile, and processed food, which are adversely affected by trade liberalization. To maximize the gains from the growing sectors, the Ethiopian government should take strategic measures aimed at facilitating their expansion. These measures may include the establishment of integrated agro-industrial parks, investment in infrastructure to ensure smoother transportation of products and inputs, augmentation of productivity and efficiency, enhancement of value-addition, improvement in product quality, branding of exports, and integration into the global value chain. Additionally, providing financial incentives to these rising sectors and creating a favorable regulatory environment that promotes investment and innovation would also increase Ethiopia's benefits. Investing in workforce development and providing training for workers and managers of small and medium enterprises to acquire essential skills would mitigate losses in the declining sectors and enhance gains in expanding sectors.