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CREATION OF THE AfCFTA: TAX LEAKS AND ECONOMIC IMPLICATIONS FOR NIGERIA

Proem

Forty-four (44) member states of the African Union (**"AU"**) signed the Agreement, which established the African Continental Free Trade Area (**"AfCFTA"**) on March 21, 2018, in Kigali, Rwanda.

The main thrust of the Agreement is the improvement of intra-African trade. The Agreement came into force on May 30, 2019 (after attaining the minimum ratification threshold, which is ratification by at least 22 member states of the AU), and thereby created a single market for the free movement of goods, services and persons within the continent. It is envisioned that capital, investments and technology will flow across all AU-recognized Regional Economic Communities (REC) unimpeded.

The Agreement prescribes specific action plans to be undertaken and or given effect to by State Parties to the Agreement. The State Parties are required to;

(i) progressively eliminate tariffs and non-tariff barriers to trade in goods;

(ii) progressively liberalise trade in services;

(iii) cooperate on investment, intellectual property rights and competition policy;

(iv) cooperate on all trade-related areas;

(v) cooperate on customs matters and the implementation of trade facilitation measures;

(vi) establish a mechanism for the settlement of disputes concerning their rights and obligations; and

(vii) establish and maintain an institutional framework for the implementation and administration of the AfCFTA.

Nigeria signed the Agreement on July 7, 2019, though, it is yet to commence the legislative process of domesticating the Agreement by ratifying and codifying it as a local law[1]. Nigeria's delay in signing the Agreement may not be unconnected to concerns raised by relevant stakeholders in the economy in relation to the possible adverse impact it may have on our weak and less-competitive manufacturing and industrial sector, as well as identified potential tax leaks (Value Added Tax/ Import Duty/ Income Tax), which may impact Government revenues.

In this article, we examine possible tax leaks, and the likely economic impact of AfCFTA, and its implications for Nigeria.

Protocols to the Agreement

The Protocols to the Agreement[2], highlighted below, are intended to enhance its efficient implementation:

- Protocol on Trade in Goods;
- Protocol on Trade in Services;
- Protocol on Rules and Procedures on the Settlement of Disputes;
- Protocol on Investment;
- Protocol on Intellectual Property Rights; and
- Protocol on Competition Policy.

The Protocol on Trade in Goods encourages a liberalized single market for the free flow of goods within the African continent; through progressive elimination of tariffs and non-tariff barriers (particularly import duties or charges having equivalent effects) and the enhancement of efficiency in customs and trade facilitation procedures, amongst other things. State Parties to the Agreement are required to accord products imported from other member countries, treatments which are no less favorable than that accorded to similar domestic products after clearing by the customs.[3] Goods are eligible for preferential treatment under this Protocol, if they originate in any of the member countries. The Protocol also allows member countries to apply anti-dumping and countervailing measures when necessary.[4] In this regard, State Parties are authorized to apply safeguard measures to situations, where there is a sudden surge of products imported into their countries under conditions which cause or threaten to cause serious injury to domestic producers of like or directly

[1] Section 12(1) of the Constitution of the Federal Republic of Nigeria 1999 (as amended) provides that no treaty between the Federation and any other country shall have the force of law unless such treaty has been enacted into law by the National Assembly. This constitutional provision is supported by Article 22(2) of the Agreement.

[2] The Protocols on Trade in Goods, Trade in Services, and Procedures on the Settlement of Disputes are annexed to the Agreement whilst the Protocols on Investment, Intellectual Property Rights, and Competition Policy are yet to be concluded.

[3] See Article 5 of the Protocol on Trade in Goods

[4] Ibid, Article 17

competing products.[5] They may also impose measures for protecting infant industries within their territories, where such industries are of strategic value to their national economies.

The Protocol on Trade in Services allows countries to enter into agreements or arrangements for recognition of the education or experience obtained, requirements met, or licenses or certifications granted in other member countries.[6] It also requires them to regulate monopolies within their territories, in order to prevent acts inconsistent with their obligations and commitments under this Protocol. They are further required to eliminate business practices of service suppliers which may restrain competition and thereby restrict trade in services.[7] Subject to the requirements of the Protocol, State Parties to the Agreement are allowed to adopt or maintain restrictions on trade in services, in the event of serious balance of payments and external financial difficulties or threat.[8] This Protocol is primarily designed to achieve progressive liberalization of trade in services on the basis of equity, balance, and mutual benefit through elimination of common barriers.

The Protocol on Rules and Procedures on the Settlement of Disputes creates the mechanism for resolution of disputes arising from implementation of the Agreement. Further to this, the Protocol establishes the Dispute Settlement Body (**"DSB"**) and the Appellate Body (**"AB"**) of the AfCFTA. Whilst the DSB has original jurisdiction to interpret and apply all AfCFTA legal instruments and determine the rights and obligations of State Parties

[5] Ibid, Article 19

[6] See Article 10 of the Protocol on Trade in Services

[7] Ibid, Articles 11 and 12

[8] Ibid, Article 14

under the legal instruments, the AB has appellate jurisdiction over decisions of the DSB but both bodies have powers to issue recommendations and rulings; upon the hearing and determination of a dispute. However, if the recommendations and rulings so issued are not implemented within a reasonable time, the Protocol allows an aggrieved State Party to temporarily suspend concessions granted to the other State Party concerned. This is a form of 'self-help' enforcement mechanism provided in the Agreement.

The Agreement is subject to five-year periodic review and a State Party can withdraw from it, at any time after five (5) years from its effective date, by giving written notification to other State Parties to the Agreement.

Commentary

The AfCFTA is expected to be one of the world's largest single markets, accounting for $4 trillion in spending and investment across the continent, with multi-trillion dollar opportunities for the 54 African countries. It is believed that effective operation of the AfCFTA would deepen Africa's economic integration and support the realization of the continental "Agenda 2063" – an integrated, prosperous and peaceful Africa. In a similar vein, the Agreement has been projected by most African leaders and global analysts as a framework for driving economic progress and heralding a new phase of industrial boom for Africa. Ordinarily, AfCFTA is a course expected to be supported and championed by Nigeria, as the continent's largest economy and most populous nation.

However, as earlier indicated, the AfCFTA, in spite of its promises, may not benefit Nigeria in the areas of revenue generation and general economic growth; except immediate and drastic measures are taken to reposition the economy by addressing the fundamental challenges facing the manufacturing and industrial sectors.

Whilst the envisaged single market and integrated economy would likely attract more foreign investments to the African continent, as production in one African country effectively allows for free access to the entire continental market; the likely undue concentration of economic activities in few African countries with low production cost levels, may lead to huge economic imbalance among the member countries of the AfCFTA. The reason for this is that investors (foreign or African) might be more willing to produce in African countries with lower production cost levels and thereafter export finished products to other African countries with higher production cost levels.

Nigeria belongs to the latter group of countries, given its wide infrastructure gap, bureaucratic regulatory regime, high trade-related costs, inadequate power supply and dearth of sufficient incentives to foster the growth of infant industries. A country's competitiveness or ability to produce goods at lower costs, compared to its peers, determines the extent to which it can take full benefit of the continental market established under the Agreement.

Rising aggregate cost of production continues to impact the manufacturing sector, with Nigeria's non-oil exports performing below full potential. The implication of this is that, businesses engaged in the production and export of non-oil goods in Nigeria are likely to suffer severe revenue downturn; as cheaper goods imported from other African countries with lower production cost levels will displace locally produced goods and significantly reduce the sales volumes of local businesses engaged in the production and sale of the goods. This will likely result in significant VAT and income tax leaks for the country, as local manufacturing businesses will have a low tax base (due to reduced sales volumes) while transnational manufacturing businesses will be entitled to claim tax breaks under the progressive tariff elimination provisions of the Agreement.

In any event, the progressive tariff elimination provisions of the AfCFTA may be incompatible with the fiscal policies of Nigeria on international trade. Nigeria generally operates a fiscal policy designed to encourage exports and discourage imports. This is currently achieved by granting tax incentives to exports while denying such benefits to imports. Implementation of the progressive tariff elimination provisions of the Agreement are likely to reverse this trend and effectively hike the rate of importation of goods and services in Nigeria – to the detriment of locally-manufactured goods and services.

A recent study conducted by the Nigerian Economic Summit Group (NESG), on the economic implications of the AfCFTA on Nigerian industrial sectors, expressed concern that the industrial sectors in Nigeria will lose out in all segments; if the government eliminates tariffs completely and at the same time attempts to cushion the economy by increasing expenditure. The only palliative to this potential economic crisis on the country's industrial sector is for the government to augment the complete elimination of tariffs with an increase in government investment, rather than expenditure. Even if government were to adopt this measure, the industrial sector will generally not derive any special benefits therefrom. This is because the revenue losses to the government, resulting from the reduction in tariff, may not be compensated for by the expected level of expansion in local industrial activities.

Hence, the general assumption that the progressive elimination of tariff barriers will automatically spur expansion in African economic activities may be fallacious. The assumption may not prove true for economies like Nigeria, where there are long-standing non-tariff barriers that represent a critical obstacle to the competitiveness of the Nigerian industries. It goes without saying that the benefits of the AfCFTA will likely accrue unevenly among all participating countries. It is also apparent that the larger portion of any such benefits, will be captured by few countries with stronger export capacities and economic competitiveness. As already shown, Nigeria may not fare well in this regard.

Although there may be scope for further increases in the share of trade for countries that strengthen their value-added contents at all levels, the Nigerian industrial sectors are currently not operating at the capacity (in terms of technical and volume indexes) where they could leverage on the potential benefits of the AfCFTA, to create more wealth for the economy. Implementation of the progressive tariff elimination provisions of the Agreement will thus effectively erode the tax base of Nigeria, through a significant reduction or outright elimination of the country's customs duty revenue base. Customs revenue generally constitutes a significant portion of Nigeria's annual tax revenue influx. Nigeria therefore needs to put measures in place to plug the tax leaks, that may result from implementation of the Agreement in the country.

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