

ECONOMIC INTEGRATION SCHEMES IN AFRICA: A STUDY OF AFRICAN CONTINENTAL FREE TRADE AGREEMENT

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Abstract: *This paper examined economic integration schemes in Africa with focus on Africa Continental Free Trade Agreement. The paper reviewed some key provisions of the African Continental Free Trade Agreement (AfCFTA) including the Trade Areas and Operational Instruments and as well reviewed the implication of AfCFTA to the development of Africa regional economic integration. The paper concluded that the intents and purposes of AfCFTA are good. However, AfCFTA is a reflection of neo-functionalism as seen in the theoretical review on regional economic integration. This to a large extent will be influenced by the conflicting interplay of the international trade theories member states are amenable to which will help to address transactions protocols in place backed up with the dispute resolution system. Therefore, huge sacrifices will have to be made by member states for the uplifting of Africa, as a whole and not just member states, for AfCFTA to be the success envisaged. It was recommended that companies can go a step further by considering a voluntary disclosure of their Total Tax Contribution (TTC) on their financial statements and websites. This could help companies to demonstrate their commitment and responsibility in supporting Africa to meet its development targets.*

Key Words: AfCFTA, Continental, Economic integration, Schemes, Trade Agreement

1. Introduction Economic integration is the amalgamation of economic policies and programmes between different states through the partial or full elimination of tariff restrictions on trade. The interplay of the various types of integration is crucial to the development of every nation economies. This is because through economic integration, small nations get richer when deeply integrated. The four basic types of integration are; free trade area, custom union, common market and economic union. But of great concern in this study is the African Continental Free Trade Area. Meanwhile, the African Continental Free Trade Area (AfCFTA) entered into force on May 30, 2019, after 24 Member States deposited their Instruments of Ratification following a series of continuous continental engagements spanning since 2012 (African Continental Free Trade Agreement (AfCFTA, 2022). It was launched at the

12th Extraordinary Session of the AU Assembly of Heads of State and Government in Niamey – Niger, in July 2019. The commencement of trading under the AfCFTA was in January 1, 2021. The AfCFTA Secretariat is hosted in Accra, Ghana. As of June 2022, fifty-four (54) AU member states have signed the AfCFTA and forty-three (43) have deposited their instrument of ratification.

The Agreement unites Africa within a trade bloc that will see import duties waived on originating products or those substantially transformed within the continent. There is also an agreement for increased market access on trade in services, amongst others. With the agreement in place, participants have the benefit of accessing a bigger market of 1.3 billion people translating to increased trade in simple terms. For this to happen, member states must cooperate to eliminate barriers, define rules of origin, allow free movement of people and create an efficient dispute settlement system (PwC Nigeria, 2021).

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The African Continental Free Trade Area (AfCFTA) is a major platform for Africa's economic development and is expected to achieve inclusiveness and sustainable development across the continent over the next 50 years (PwC Nigeria, 2021). Similarly, World Bank averred that, it will boost intra-regional trade by 52.3%, raise income by \$450 billion, boost wages (10.5% for women and 9.9% for men) and lift 30 million Africans out of extreme poverty. The results will be attained in phases and depends largely on the functional effectiveness of agencies in state parties (PwC Nigeria, 2021).

Africa as a continent is home to almost 30 regional trade arrangements (RTAs), many of which are part of deeper regional integration schemes. Out of these 30 RTAs, only 8 are recognized by the African Union (AU). This demonstrates that there have been challenges in the implementation of RTAs on the continent. For instance, the Economic Community for West African States (ECOWAS) treaty should ordinarily allow the free movement of goods between Benin and Nigeria. However, affected exporters must obtain country level approvals which prove very difficult and are not guaranteed amidst adequate documentation. The case is somewhat different in the European Union which lends itself as a case study of what good can be had with an effective system. The 27 EU member countries are connected by high-speed rail, there are strong competition policies that are implemented, an EU Trademark (EUTM) provides trademark protection in all 27 member states of the European Union and the European Union Intellectual Property Office in Spain is responsible for managing the EU trademark.

It is obvious that Africa needs to develop fast to make the AfCFTA a success. However, unlocking new industry growth will come with its attendant effect on the environment if sustainable development is not given priority. The Environmental, Social and Governance (ESG) framework is a great framework to ensure we have inclusive growth without harming the environment. For this, the Triple bottom line or 3Ps can be the steer for all state parties to plan for the industrial revolution promised. The 3Ps theory does not rank profit over

environmental and social concerns but sees the impact on the planet, people and prosperity as equal (PwC Nigeria, 2021).

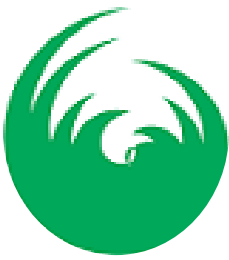
Nigeria has signed and deposited the Instrument of Ratification of the Agreement Establishing the AfCFTA with the African Union legal depository on December 5, 2020. The broad aim of this paper is to review some key provisions of AfCFTA and, in particular, share perspectives on prosperity and profit germane to AfCFTA and the likely implications to African regional economic integration. It is hoped that this will trigger quantitative research on the consequences of continental import penetration on manufacturing and government revenue, at country levels, among others.

2. Concept and Theory of Economic Integration

2.1 Meaning of economic integration

The CFI Team (2022), wrote that economic integration involves agreements between countries that usually include the elimination of trade barriers and aligning monetary and fiscal policies, leading to a more interconnected global economy. Economic integration is consistent with the economic theory, which argues that the global economy is better off when markets can function in unison with minimal government intervention. Economic integration, like the name implies, involves the integration of countries' economies. Another term to describe it is globalization, which simply refers to the inter-connectedness of businesses and trading among countries.

An economy is defined as a set of inter-related activities that determine how limited resources are allocated. In the modern economy, all economies feature a form of a market system. A market-based economy utilizes the economic forces of demand and supply in order to distribute these limited resources. Traditionally, economies were thought of as separate for each region or country, with each country managing its own separate economy and largely unrelated to other countries. However, globalization allows the movement of goods, services, capital between countries and blurred the distinctions between economies.



Today, there is no economy that functions completely isolated from other economies. There is a simple reason for such an occurrence – trade benefits all economies in most cases. It allows for specializations of economies with comparative advantages and can trade with other economies that possess alternative comparative advantages. For example, consider a country that happens to possess an abundance of oil sands located within its borders. The country can extract the oil and trade it for other resources that it lacks, perhaps food such as corn or wheat. Another country may enjoy optimal weather for growing such crops and therefore can specialize in growing corn or wheat and trade it for oil to provide energy for their society. It illustrates how trade can benefit all economies by taking advantage of specialization and comparative advantages.

Economic integration is expected to improve the outcomes for all economies by many economists and policymakers. Within economics, there are seven stages that lead to complete economic integration: Preferential Trading Area; Free Trade Area; Customs Union; Common Market; Economic Union; Economic and Monetary Union; and Economic Integration. Many countries move in and out of these stages with other partner countries. The best example of complete economic integration is with the European Union (EU). AfCFTA, the case in study, by its name appear to dwell more at the Free Trade Area stage.

2.2 Theories of regional integration: The Neofunctionalism

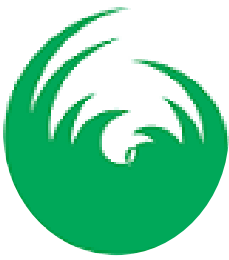
According to Marinov (2014), economic integration theory goes through two development stages each of which addresses the relevant for its time political and economic context. The first stage is regarded as static analysis and includes the traditional theories of economic integration that explain the possible benefits of integration. The second stage includes the new economic integration theories that are often referred to as dynamic analysis of economic arrangements. Among these theories is the Neo-functionalism.

Neofunctionalism was developed by Ernst B. Haas in 1958 in his research on the European Coal and Steel Community as the first European integration theory. This theory of integration downplays globalisation and reintroduces territory into its governance. Neofunctionalism seeks to explain the European integration process and why states accept to become a part of supranational organization. The theory explains the process of regional integration with reference to how three causal factors interact: Growing economic interdependence between nations; organizational capacity to resolve disputes and build international legal regimes; and supranational market rules that replace national regulatory regimes.

The early neo-functional theory assumed a decline in importance of nationalism and the nation-state; it predicted that, gradually, elected officials, interest groups, and large commercial interests within states would see it in their interests to pursue welfarist objectives best satisfied by the political and market integration at a higher, supranational level. The theory emphasized three mechanisms that would drive the integration forward, these are; positive spillover; the transfer of domestic allegiances; and technocratic automaticity.

The positive spillover effect is the notion that integration between states in one economic sector will create strong incentives for integration in further sectors, in order to fully capture the perks of integration in the sector in which it started. Increased number of transactions and intensity of negotiations then takes place hand in hand with increasing regional integration. This leads to a creation of institutions that work without reference to "local" governments.

Meanwhile, the mechanism of a transfer in domestic allegiances can be best understood by first noting that an important assumption within neofunctionalist thinking is of a pluralistic society within the relevant nation states. Neofunctionalists claim that as the process of integration gathers pace, interest groups and associations will transfer their allegiances away from national institutions towards the supranational European institutions. They



will do this because they will, in theory come to realise that these newly formed institutions are a better conduit through which to pursue their material interests. Greater regulatory complexity is then needed and other institutions on regional level are usually called for. This causes integration to be transferred to higher levels of decision-making processes.

On the other hand, technocratic automaticity described the way in which, as integration proceeds, the supranational institutions set up to oversee that integration process will themselves take the lead in sponsoring further integration as they become more powerful and more autonomous of the member states.

3. African Continental Free Trade Agreement (AfCFTA)

AfCFTA (2022), states that the African Continental Free Trade Area (AfCFTA) is the world's largest free trade area bringing together the 55 countries of the African Union (AU) and eight (8) Regional Economic Communities (RECs). The overall mandate of the AfCFTA is to create a single continental market with a population of about 1.3 billion people and a combined GDP of approximately US\$ 3.4 trillion. The AfCFTA is one of the flagship projects of Agenda 2063: The Africa We Want, the African Union's long-term development strategy for transforming the continent into a global powerhouse.

As part of its mandate, the AfCFTA is to eliminate trade barriers and boost intra-Africa trade. In particular, it is to advance trade in value-added production across all service sectors of the African Economy. The AfCFTA will contribute to establishing regional value chains in Africa, enabling investment and job creation. The practical implementation of the AfCFTA has the potential to foster industrialisation, job creation, and investment, thus enhancing the competitiveness of Africa in the medium to long term.

The trading under the AfCFTA examined the following;

3.1 Trade areas

The AfCFTA will be negotiated in two phases (AfCFTA, 2022). Phase one covers Trade in Goods; Trade in Services; Dispute Settlement Mechanism; and Customs

and Trade Facilitation. Phase two covers Intellectual Property Rights; Investment, Competition Policy; Digital Trade; and Women and Youth in Trade.

Each of the areas covered in phase one has a directorate at the AfCFTA Secretariate that will implement the protocols, facilitate negotiations, provide technical advice and formulate the rules, principles and procedures. Areas covered in phase two already have committees working or are still being developed.

3.2 Operational instruments

The operational instruments include the AfCFTA E-Tariff Book; The Non-Tariff Barriers (NTBs); The Pan-African Payments & Settlement System; The AfCFTA Adjustment Fund; and The Automotive Fund.

3.3 Perspectives on prosperity and profits

A key aspiration of the AU, as articulated in Agenda 2063 and in the objectives of AfCFTA, is to develop a continent that is self-reliant and that looks beyond aid to achieve sustainable socio-economic development (PwC Nigeria, 2021).

To attain sustainable socio-economic development and prosperity within the continent, companies, and multinationals (including those multinationals that will emerge because of the AfCFTA inspired integration) must begin to think beyond profit maximisation, cost minimisation and begin to proactively plan to act responsibly by paying the right amount of tax in countries where they have derived value. This is crucial because, based on the Organisation for Economic Co-operation and Development (OECD) Revenue Statistics in Africa 2020 report, the average tax-to-GDP ratio of African countries in 2018 was 16.5%, compared to an average of 23.1% in Latin America and Caribbean, and 34.3% in the OECD during the same period. Apart from the relatively low tax-to-GDP ratio, Africa is also hamstrung by illicit financial flows (IFFs) which is estimated to reduce the continent's annual revenues by at least \$80billion per annum (PwC Nigeria, 2021).

Although specific tax provisions are yet to be agreed (negotiations will commence after phase 1 has been completed after 31 December 2021), companies and multinationals with a footprint in Africa, must begin to



consider their cross-border tax obligations, exposure to transfer pricing rules, and the impact of tax cooperation and exchange of information on their operations, based on existing tax rules and trends (PwC Nigeria, 2021).

1. Cross border tax obligations

From an international tax perspective, when companies operate in several jurisdictions, countries, including African countries, generally rely on local laws or double taxation agreements (DTAs) -where they exist- to determine which jurisdiction has taxing rights over certain types of income. Right to tax is usually determined based on source and residence rules. Broadly, the source country exercises taxing rights over business income, while the country of residence has the right to tax passive income. Therefore, as companies begin to expand across Africa, they need to consider the implication of source and residence rules on the different types of income which they earn. Companies also need to consider if they have crossed permanent establishment (PE) thresholds in different countries to determine if they have paid the appropriate amount of tax in the different countries where they operate. Another consideration for companies is the proposed revisions to DTAs (by the multilateral instrument which several African countries have signed up to/committed to sign up to) to include specific base erosion and profit shifting (BEPS) measures, such as measures to eliminate treaty shopping, revision of PE rules, introduction of limitation of benefit rules etc (PwC Nigeria, 2021).

2. Exposure to transfer pricing rules

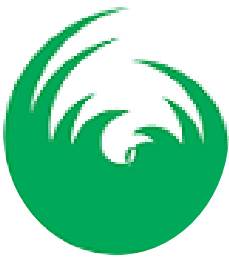
With the implementation of the AfCFTA, it is expected that more businesses will situate their value chains across Africa, through the incorporation of subsidiaries that carry on different functions and activities on the continent. Where this is the case, such multinationals would be exposed to transfer pricing rules that require intercompany transactions (e.g., import and export of products and services, intra-group financing, transfer and use of intellectual property etc.) between members of such multinational groups to be priced at arm's length. Therefore, affected businesses need to put in place appropriate transfer pricing policies that meet the arm's

length standard and demonstrate that profits have been allocated appropriately within the value chain. Although several African countries follow the arm's length principle and administer it in accordance with the OECD's guidelines, a few countries have nuances which companies need to consider (such as specific rules for intangible transactions, commodity transaction, services etc.) if they are to demonstrate that they have complied in the different countries where they operate. We also note that several African countries are beginning to align their transfer pricing regulations because of the support and recommendations that they are receiving from the African Tax Administration Forum (ATAF) (PwC Nigeria, 2021).

3. Exchange of information and tax cooperation

In the past decade, there has been a renewed focus on tax transparency and tax cooperation in a bid to reduce tax evasion and IFFs. From a tax transparency standpoint for instance, the Global Forum and other multilateral institutions, set up the Africa Initiative to equip African countries with the tools required to fight tax evasion and to improve domestic revenue mobilisation, in line with Agenda 2063 and the Sustainable Development Goals. Specifically, the Africa Initiative encourages African countries to invest in infrastructure and human capacity to facilitate the exchange of information (such as accounting records, financial records, and legal and beneficial ownership information about taxpayers) between one another to identify additional tax revenues from targeted tax audits and investigations. It is estimated that between 2009 and 2020, African countries identified over €1.2 billion in additional tax revenues because of exchange of information. It is also estimated that African countries sent 21% more requests for information in 2020 than in 2019 to carry out audits. This signals the important role that exchange of information is playing in improving prosperity in Africa (PwC Nigeria, 2021).

From a tax cooperation perspective, African countries are also relying on tax and transfer pricing expertise from ATAF, Tax Inspectors without Borders (TIWB) and other multilateral institutions. This support generally



takes the form of tax risk assessment and case selection, experience sharing, review of audit files, and periodic capacity building. It is estimated that joint programmes by ATAF, TIWB, OECD and the World Bank Group have resulted in \$989million in additional tax revenues and \$2.7billion in tax assessments. We expect that this trend will be sustained and will increase under AfCFTA. Therefore, companies and multinationals must be deliberate about complying with their relevant obligations as integration under AfCFTA will likely expose tax authorities to more information required to carry out audits and investigations (PwC Nigeria, 2021).

4. Implications of AfCFTA to African Regional Economic Integration

In the triple bottom line or 3Ps theory coined by John Elkington, one of the Ps stand for profit. Profit in the theory connotes the positive and negative impact an organization has on the local, national and international economy. This includes creating employment, generating innovation, paying taxes, wealth creation and any other economic impact an organization has. Profit here is not in the traditional sense of the financial profit made by a company as this interpretation is too limited and wrong for two reasons. First, it focuses on the financial aspect only without the economic impact. Second, it focuses on profit for the organization only neglecting the social impact (societal profit). So, the question on the positive and negative impact of AfCFTA on the national and regional economies from the profit perspective as described above begs for answers.

As seen earlier in paragraph 2.2.3 on perspectives on prosperity and profits, PwC Nigeria (2021) began to share on the cross-border tax obligations, exposure to transfer pricing rules and exchange of information and tax cooperation corollary to AfCFTA. These perspectives shared are examined and further perspectives shared below:

- i. PwC Nigeria (2021) rightly stated that the right to tax is usually determined based on source and residence rules when determining cross-border tax obligations. Therefore, member countries within the

AfCFTA trade bloc with higher proportions of source and residence for taxable incomes will enjoy more taxes than others. Some countries will be so affected by reason of the comparative advantage and factor endowment theories in trade. The implication is that some governments will lose tax revenue while others will gain more revenue which constitutes a major source of revenue to governments. It is hoped that the AfCFTA Adjustment Fund will also address tax revenue losses in addition to trade tariff revenue losses and the others it is billed to address.

- ii. As PwC Nigeria (2021) noted, member companies of multinational corporations operating within the AfCFTA trade bloc will be exposed to transfer pricing rules that require intercompany transactions to be at arm's length. Therefore, the responsible directorates of AfCFTA have a lot of work to do in ensuring that the responsible agencies of member states also ensure that affected businesses put in place appropriate transfer pricing policies that will ensure fair profit allocation within the value chain across the member companies. The directorates will also need to ensure that the nuances that may exist with some countries are properly dealt with to ensure compliance with the transfer pricing rules. Anything short of these will see profit base erosion leading to tax revenue losses and other attendant problems.
- iii. The exchange of information and tax cooperation is a welcome development as noted by PwC Nigeria (2021) with the attendant tax audits and investigations that are already yielding huge tax revenue recoveries. However, investment in infrastructure and human capacity to facilitate the exchange of information may



be too huge for some member states. Again, tax cooperation with multilateral institutions may also be capital intensive depending on how these operations are funded. It is again hoped that the AfCFTA Adjustment Fund is billed to cover these needs when they arise in order not to become a cog in the wheel of progress.

- iv. Access to a bigger market of 1.3 billion people within the AfCFTA trade bloc translates to increased trade in simple terms which means more demand and supply resulting in job creation. It also means wages will be boosted which according to the World Bank will be by 10.5% for women and 9.9% for men in years to come. This is expected to impact positively on the human development index (HDI) for Africa.
- v. AfCFTA will boost intra-regional trade by 52.3% and raise income by \$450 billion according to the World Bank over the years ahead leading to greater tax revenues to governments for development.
- vi. The resultant wealth creation of AfCFTA is also anticipated to lift 30 million Africans out of extreme poverty according to the World Bank review.

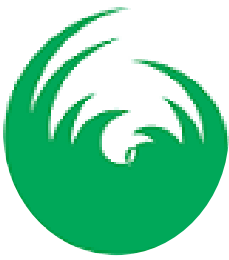
4.0 Concluding Remarks

The intents and purposes of AfCFTA are good. However, AfCFTA portends a reflection of neofunctionalism as seen in our theoretical review on regional economic integration. Only time will tell how it will play out, especially, since the success does not depend largely on the functional effectiveness of agencies in state parties to AfCFTA. This will largely be influenced by the conflicting interplay of the international trade theories member states are amenable to which we hope will be addressed by the duo of transactions protocols in place backed up with the dispute resolution system, where effective. Therefore, huge sacrifices will have to be made by member states

for the uplifting of Africa, as a whole and not just member states, for AfCFTA to be the success envisaged. In addition to considering some of the above, companies can go a step further by considering a voluntary disclosure of their Total Tax Contribution (TTC) on their financial statements and websites. This could help companies to demonstrate their commitment and responsibility in supporting Africa to meet its development targets. PwC Nigeria's method for assessing a company's impact on society is the Total Impact Measurement and Management (TIMM). TIMM brings together measures of a business impact in 4 areas: social impact, environmental impact, economic impact and tax impact. The latter is measured through a TTC approach which focuses not only taxes borne, but also those collected by an organisation as these contribute to public finance (PwC Nigeria, 2021).

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