Preserving Africa's Fiscal Sustainability in the Wake of the African Continental Free Trade Area Agreement

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Concerns are rife that tariff reductions flowing from the African Continental Free Trade Area Agreement (AfCFTA) may occasion fiscal revenue losses and budgetary pressures for African countries (ACs). This piece examines the perceived effects of AfCFTA's associated 'losses' and makes suggestions on how ACs can preserve their fiscal sustainability, in light of dwindling revenue sources.

Following decades of strategic and painstaking negotiations to facilitate intra-African trade, the AfCFTA came into force in May 2019. Enshrined in the AfCFTA are the objectives of eliminating tariffs and non-tariff barriers (NTBs) to trade in goods, whilst progressively liberalising trade in services and fostering cooperation on all trade-related areas. The AfCFTA is expected to increase Africa's market efficiency and reduce business costs through economies of scale, etc.

Whilst intra-African trade holds continental promises, ACs are concerned about decline in fiscal revenues and potential budgetary pressures arising from reducing or eliminating tariffs. Tariffs constitute a crucial portion of government revenue in ACs. Thus, cutting tariffs to facilitate trade may occasion unfavourable socio-economic consequences alongside potentially undermining the continent's sustainable development goals. Accordingly, it is critical to examine AfCFTA's potential effect on the fiscal revenue of ACs alongside AfCFTA's benefits. A cost-benefit approach will underscore whether AfCFTA's benefits outweigh its potential domestic revenue mobilisation reduction-effect.

Data shows that the effect of any revenue loss due to tariff reduction is marginal. The IMF's empirical study premised on fiscal revenue and trade data of ACs suggests that, on average, fiscal revenue losses due to AfCFTA are limited. According to the IMF, ACs' customs revenues are relatively low. Between 2010-2015, customs revenues averaged only about 2.5% of GDP (16% of total tax revenue). Additionally, overall regional imports within Africa's Regional Economic Communities averaged about 17% of total imports. UNCTAD's empirical study coincides with the IMF's figures.

Interestingly, the low averages conceal significant heterogeneity and critical exceptions across ACs. Whilst most countries' customs revenues averaged less than 2% of GDP between 2010-2015, in some countries, they exceeded 5% of GDP. Moreover, in some countries (Cote d'Ivoire, Malawi, Zambia and Zimbabwe), intraregional imports exceed 35% of total imports, suggesting risks of substantial revenue losses.

Notwithstanding, based on the effective average tariff rate to ACs' import data by individual product, the IMF's study finds that if all tariffs on intraregional imports were eliminated (and accounting for VAT losses given smaller tax bases) the average estimated revenue loss is low, at about 0.3% of GDP. However, given existing tariffs and regional trade links, revenue losses in some countries could be large, exceeding 1 to 2 percent of GDP (for example, Democratic Republic of Congo, Sierra Leone, Zimbabwe). These findings indicate that revenue losses would differ across countries. Interestingly, the extent to which a country is affected is dependent on the diversification of its economy. Thus, small countries, more diversified economies and established regional trade/economic communities, who are already open for international competition, are likely to benefit more from AfCFTA than agriculture and natural resources-based economies.

Eliminating all currently taxed intraregional trade flows could increase regional trade by about 16% or welfare gains of US$ 16.1 billion. Whilst the total loss in trade revenue is estimated around US$ 4.1 billion (representing only 9.1% of current tariff revenues). Thus, revenue losses from lower tariffs would be limited, though significant in a few countries with high export tariffs. Tariff loss will affect only intra-African trade and not imports from outside Africa.

Consequently, ACs can preserve their fiscal sustainability by implementing the following three critical recommendations.

Firstly, fiscal authorities in ACs should define clear domestic revenue mobilization policies pre-AfCFTA implementation. AfCFTA recognizes certain necessary adjustments. Article 8 allows ACs to negotiate their Schedule of Tariff Concessions. Such flexibility will circumvent any immediate adverse budgetary pressure arising from fiscal revenue losses. However, it is critical that such measures be phased out within AfCFTA's transition period without undermining AfCFTA's objectives. Effective country and continental policy adjustments would help to free up funds to address AfCFTA adjustment costs. Policies should be combined with structural reforms that would enable each country leverage efficiency in sectors where it has comparative advantage. In addition, efficient tax collection structures will improve the value added to goods, a catalyst for increased income for revenue authorities. Adjustment funds are needed to support poorer countries to address AfCFTA's short-term effects. Coordinated Aid for Trade through financial and technical assistance will further ACs' sustainable development goals and support adjustment policies and funding aimed at improved tax collection. Such measures will meet the dual aim of aiding adjustments and facilitating AfCFTA's objectives.

Secondly, ACs should deliberately seek to eliminate NTBs (including poor infrastructure, trade logistics, quotas, licenses and subsidies) which undermine tariff policies' potential to promote trade and reduce the impact of AfCFTA's agenda. Imperatively, NTBs generally occasion more revenue loss than losses further to tariff revenue elimination. NTBs delay trade and, consequently, reduce the profitability of businesses that could have paid more taxes.

Thirdly, ACs should strive to liberalize trade in services given that the services sector constitutes the largest part of the economy in most ACs. Trade in services can play a pivotal role in ACs' domestic revenue mobilization and development. For instance, intra-continental liberalization of trade in finance and legal services, etc. is critical for revenue mobilization. Tangentially, the UK's legal services market, hugely impacted by EU legal services liberalization, generated £37 billion in revenue in 2019. Luxembourg's financial services, for instance, is the major driver, and represents one-third, of its economy.

In conclusion, it is trite to mention that the benefits and costs from trade expansion may never be evenly distributed across ACs. However, the estimated revenue loss should not be considered as an absolute loss for ACs as the long-term benefits, facilitated by adjustment support remain significant. It will allow comparative advantage to thrive, thereby granting customers and firms access to cheaper products/raw materials in the continent. Revenue loss may also be deconstructed to imply a redistribution of income from governments to customers and producers.

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