Readiness for the AfCFTA by Member States' Domestic Tax Policies

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The AfCFTA aims to accelerate economic growth for member states. A critical aspect of this is collecting revenue spurred by income tax and value-added tax, supported by improved investment and consumerism. The AfCFTA seeks to eliminate tariffs between member states, which will deplete this source of revenue for member states, most of which are highly dependent on this form of revenue. To curtail the impact of this loss of income, member states need to have the capacity to effectively administer domestic tax policies to take advantage of this anticipated revenue from income tax and value-added tax. Member states' readiness in this area is of concern and must be addressed by providing adequate support to domestic institutions with expertise and knowledge. A strategy to develop, support and invest knowledge and expertise in domestic revenue administrators will place member states in a better position to manage the anticipated revenue and doing so effectively will strengthen the AfCFTA.

1. Introduction

The Africa Continental Free Trade Area Agreement ('AfCFTA') aims to integrate the economies of most African states with the ultimate goal of hastening economic growth on the continent[1]. The AfCFTA aims to do this by, among others, reducing or eliminating tariffs at border posts[2]. The reduction or elimination of tariffs has been a source of concern for developing member states of the AfCFTA because tariffs are an important source of domestic income[3]. Customs tariffs contribute an average of 35% to the total revenue basket in Africa, so the fear of losing this source of revenue is justified.

Although the concern of loss of revenue from tariffs is understandable, the long-term trade-off is said to be the broad-based consumption tax in the form of value-added tax and an expanded tax base emanating from trade creation[4]. These are anticipated to boost domestic tax collections[5]. If the long-term trade-offs materialise, the question is whether tax administrators of member states are prepared to manage revenue collection[6]. In the face of a lack of preparedness, it follows whether the AfCFTA provides institutional support to domestic tax administrators to build capacity and expertise in managing revenue collection[7].

2. Trade Liberalization, Revenue Losses, and the Role of Domestic Tax Policies

Trade liberalisation is achieved by reducing or eliminating tariffs, among other measures[8]. The AfCFTA, for instance, requires member states to liberalise 100% of their tariffs at stage 3 of the integration process[9]. The International Monetary Fund ('IMF') projects that member states of the AfCFTA may lose about 1% to 5% of GDP due to the anticipated tariff reduction or elimination[10]. Liberia, Zimbabwe, Seychelles, Cote d'Ivoire, Ethiopia, Togo, Benin, Cape Verde, Ghana, Democratic Republic of Sao Tome and Principe, and Senegal have between 2% and 6 % of their GDP emanating from customs and other duties[11]. Therefore tariff reduction will inevitably lead to significant revenue reduction for the abovementioned member states[12].

Conventional wisdom would suggest that consumption taxes in value added and income tax should replace the revenue lost by reducing or eliminating tariffs[13]. This suggestion falls short of considering Africa's large informal business sector that is not fully tax compliant[14]. This makes this sector not capable of being taxed[15]. It does not also take into account the low level of taxpayer registration amongst member states of the AfCFTA. For example, registered taxpayers as a percentage of registered voters in the following member states are as follows: 0.2% in Malawi, 1% in Senegal, 11% in Tanzania, 14% in Egypt and 99% in South Africa[16]. Voter data is used because of the lack of data on registered taxpayers in the countries indicated and within member states generally[17].

High levels of informal businesses and low levels of registered taxpayers indicate a lack of tax compliance[18]. Enforcing value-added tax or income tax requires taxpayers to be known to authorities through registration[19]. If there are low levels of registration, the likelihood is very high that there will be low levels of tax collection. Tax authorities often focus on registered taxpayers as far as enforcing compliance is concerned[20].

As indicated above, the low levels of taxpayer registration can be attributed to factors common to member states. The lack of effectiveness of tax administrators[21] features prominently; however, South Africa being the exception, its numbers can be attributed to its tax administrator, the South African Revenue Services ('SARS'). SARS is considered one of Africa's most influential tax administrators[22].

Effective tax administration should accommodate informal businesses and encourage people to be registered as taxpayers in tandem with tax compliance. In Africa, informal businesses account for an average of 27% of the Gross Domestic Product[23]. However, informal businesses are not being taxed effectively because of the high administrative costs associated with enforcing compliance[24]. The low levels of people registered as taxpayers can be attributed to high unemployment in Africa. Still, there is evidence of increased numbers of people being economically active in the informal sector[25]. For example, 22% of the labour force in South Africa is active in the informal sector, and 84% of the labour force are in Zimbabwe as of 2011[26]. It is unclear if AfCFTA member states are adopting and implementing policies that accommodate informal labour and business into the tax grid.

3. Role of the AfCFTA in Developing Robust Domestic Tax Policies

The AfCFTA provides that the secretariat, working with State Parties, RECs, and partners, should coordinate and provide technical assistance and capacity building in trade and trade-related issues for implementing the AfCFTA[27]. There is extensive literature on specific measures that the secretariat can undertake to assist member states with developing tax policies. For example, Attiya Waris suggests that multidisciplinary fiscal teams of experts can be assembled to elaborate policy guidelines and support policy development at subnational, national, regional, and continental levels[28]. While these measures may be successful at designing policy, implementation and enforcement are more important.

This presents a hurdle for the secretariat regarding the legal force of the recommendations it may make in relation to improving the domestic tax policies of member states. Interference in any country's fiscal system potentially borders on violating its sovereignty[29]. Therefore, it is highly unlikely that the secretariat can be in a position to impose and enforce the application of policies that have a bearing on any member state's fiscal system.

Surpassing this hurdle lies in the inevitable exercise of tax harmonisation that the AfCFTA member states will embark on in order to support the successful implementation of the AfCFTA[30]. The secretariat being at the forefront of providing technical assistance and capacity building is most likely to play a key role in developing harmonised taxation rules for member states. This role presents an opportunity to propose enforceable standards of effective tax administrations and programmes that should be undertaken to ensure that domestic tax policies are implemented effectively.

4. Conclusion

The collection of taxes will be an important aspect for member states to realise the benefits of the AfCFTA. A significant part of this objective is to minimise potential losses due to tariff reduction. Although tariff losses are suggested to be offset by consumption and income taxes, most member states are not in a position to take advantage of this transition due to weak domestic tax policies. Therefore, the AfCFTA provides a mechanism in the guise of the secretariat to assist member states in developing desired policies that will effectively take advantage of the shift from tariffs to consumption and income taxes.

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