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AfCFTA in Nigeria

Policies to encourage sustainable growth

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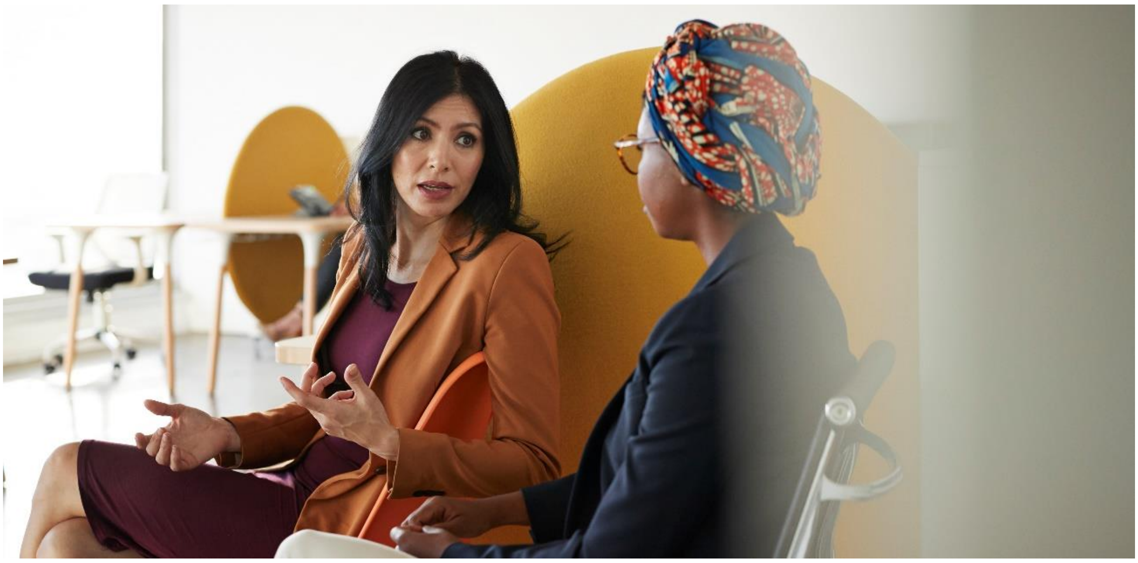
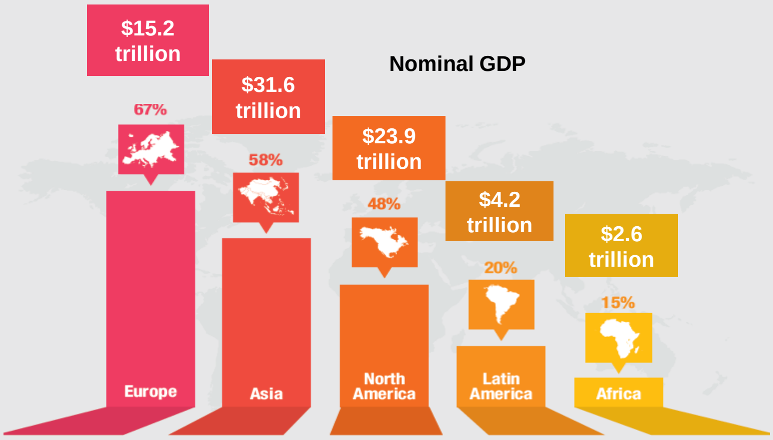


Overview of the AfCFTA

According to Afreximbank – African Trade Report 2018, African countries traded with the rest of the world more than they traded with each other in 2018 with intra-African trade at 15%. In contrast, intra-European trade and intra-Asian trades were about 67% and 58% in 2018, respectively. The Gross Domestic Product (GDP) of these continents reveal the direct correlation between trade and development.

Fig 1: Intra-regional trade in 2018



Source- Afrieximbank – African Trade Report 2018

The African Continental Free Trade Agreement (AfCFTA) was launched on 1 January 2021. 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 (this tells us what qualifies for the duty reduction), allow free movement of people and create an efficient dispute settlement system.

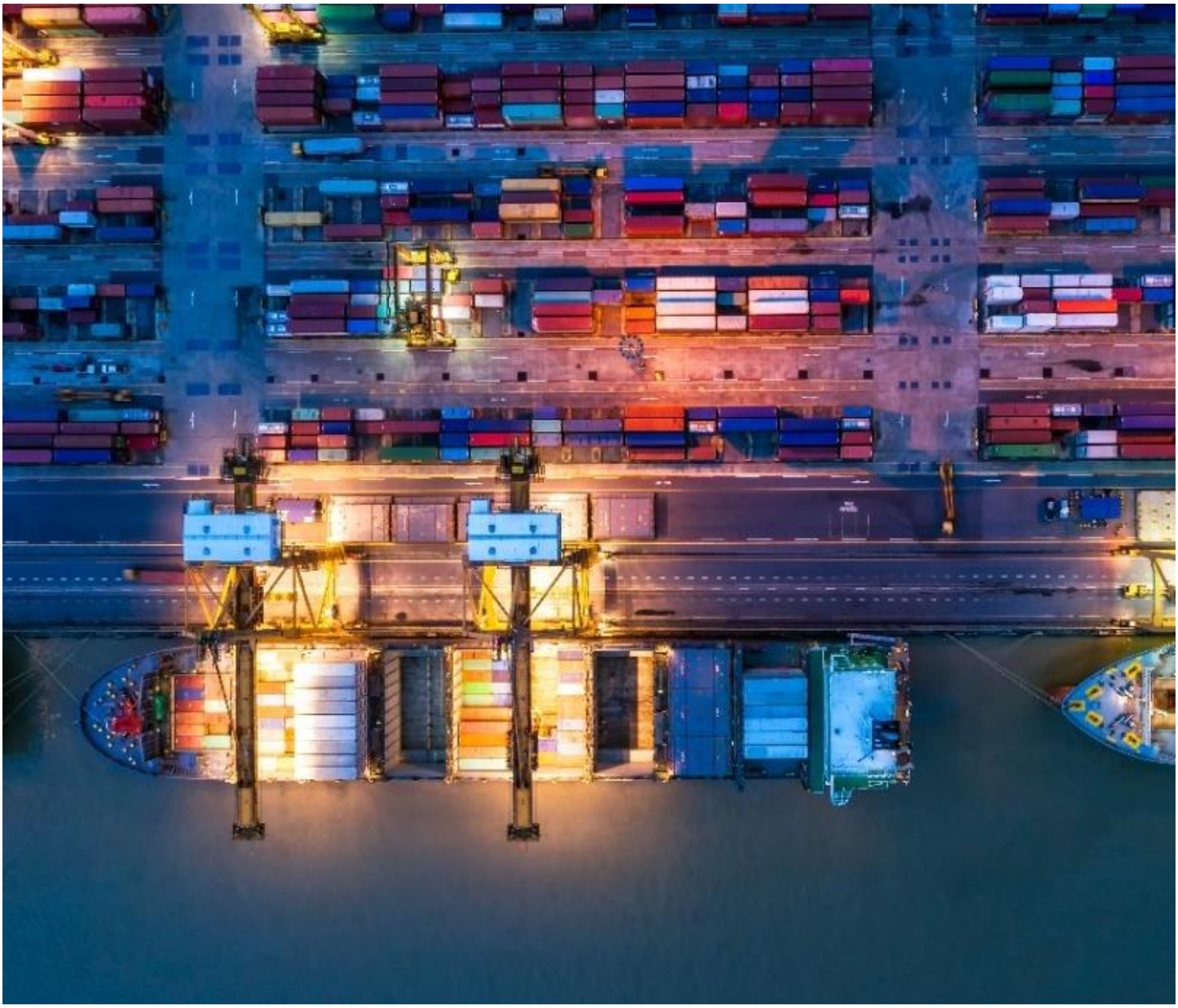
It is a major platform for Africa's economic development and is expected to achieve inclusiveness and sustainable development across the continent over the next 50 years. According to the World Bank, it will boost intra-regional trade by 52.3%, raise income by $450 billion, boost wages (10.5% for women 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.

The AfCFTA is not the first free trade area (FTA) in Africa. The 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 recognised by the African Union (AU). This demonstrates that there have been challenges implementing 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. Unilateral border closures as the one had during the pandemic lock down in Nigeria in response to the rice importation from Benin are ready examples of how FTAs do not work in Africa.

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 (EUIPO) 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. We discuss some perspectives within this framework in this article.



Perspectives on processes and the supply chain

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FTAs usually encourage the traditional business model where manufacturers are located closest to the factors of production and sometimes to the potential target market of their goods.

Unsustainable practices of companies based on the traditional business model include hidden environmental costs not taken into consideration, accelerated depletion of resources, waste generation, pollution and overexploitation accompanied with demographic growth. The AfCFTA's protocol on sustainable development is still in the negotiation phase. It is a good time to incorporate this thinking in the implementation of the Agreement to avoid incremental damage that would only take us further away from attaining net zero by 2050.

The AfCFTA needs to ensure that African businesses satisfy their obligations in relation to the environment by achieving net zero emissions and managing relationships with suppliers, customers, and the communities where they operate. It could ensure that companies are more deliberate about how they source raw materials. For example, in the chocolate industry, programmes that encourage policy reform and put in place concrete measures to end child labour. The AfCFTA negotiations must include campaigns to change social attitudes and promote the ratification and effective implementation of the International Labour Organisation (ILO) child labour conventions. This should adequately address abusive child labour practices in the cocoa-growing areas of West Africa.

To reduce carbon footprints of businesses, use the carrot and stick approach. Environmental taxes and incentives should be introduced across Africa. This would also act as a stop gap measure for products from other continents which are not carbon friendly. There is already a growing list of such taxes in Africa such as the environmental levy on tyres and plastic bags, petroleum pipeline levy and carbon fuel levy in South Africa, plastic fee in Mozambique and timber royalty in Guinea.

On the flip side, environmental incentives such as the VAT Exemption for investment in specified renewable energy equipment in Nigeria, VAT exemption on waste collection in Mozambique and deductions in respect of environmental expenditure in South Africa.

Way forward

Continent wide campaigns must be in full gear to incorporate holistic ESG policies affecting the carbon footprint of expanding organisations or the social welfare of Africans. On 18 November 2021, the President of Nigeria signed the Climate Change bill into law. The Act establishes Nigeria's council on climate change which will seek to make climate change mainstream in Nigeria particularly given the President's pledge for us to attain net zero greenhouse gas emissions by 2060. There must be progressive efforts to change the entire landscape given the timelines and we recommend that the AfCFTA secretariat is fully represented in all the meetings so that the aspiring objectives for industrial growth in the FTA align with our net zero ambitions.

Perspectives on prosperity and profits

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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.

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.

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.

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.

Exposure to transfer pricing rules

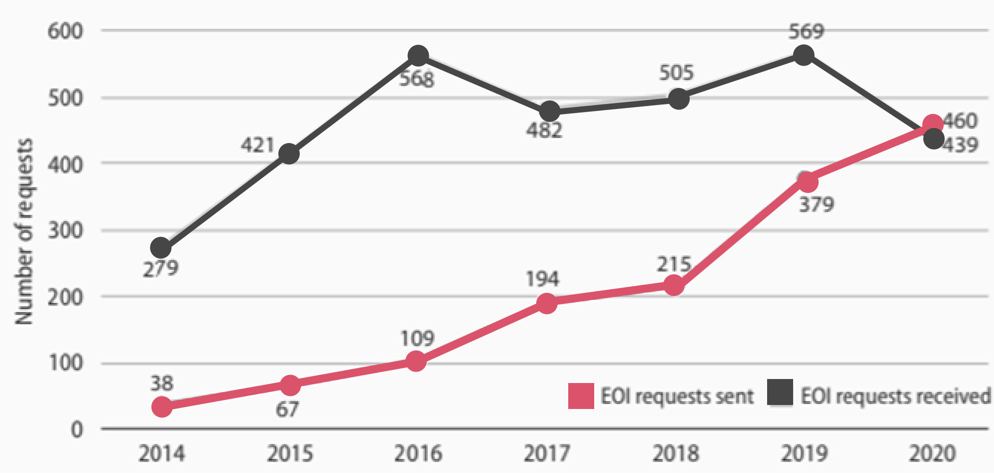
With the implementation of the AfCFTA, it is expected that more businesses will situate their value chains across Africa, through the incorporation of subsidiaries that carry on different functions and activities on the continent. Where this is the case, such multinationals would be exposed to transfer 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).

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.

Fig 2: EOI requests sent and received by African countries since 2014



Source: Tax Transparency in Africa 2021 – Global Forum on Transparency and Exchange of Information for Tax Purposes.

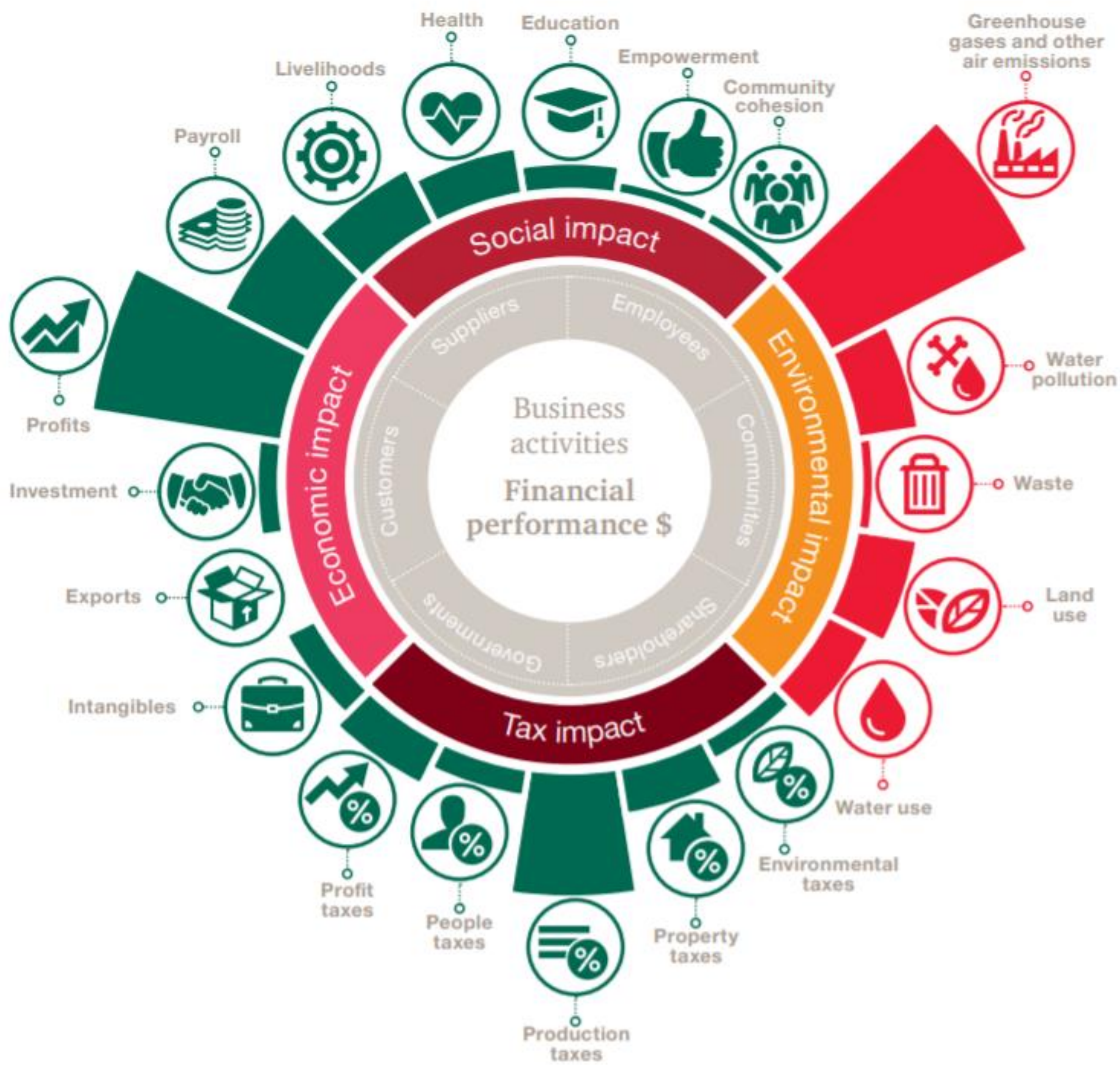
From a tax cooperation perspective, African countries are also relying on tax and transfer pricing expertise from ATAF, Tax Inspectors Without Borders (TIWB) and other multilateral institutions. This support generally takes the form of tax risk assessment and case selection, experience sharing, review 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.

Way Forward

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'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.

Fig 3: Total Impact Measurement and Management



Perspectives for people

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Organisations are run by people who are the greatest assets driving the change needed. For trade to be effective, people should be able to move freely among member countries. The AfCFTA took effect on 1 January 2021 without the ratification of the Continental Free Movement Protocol by most member countries. The implication of this is that member countries would have to rely on their local legislations to address labour, immigration, and other related employment matters. Individuals seeking to work in a territory other than their home county would have to obtain the relevant work permits based on the nature of their activities and their duration of stay in that territory.

The flagship projects of Agenda 2063 of the African Union is aimed at the African Passport and the Protocol on Free Movement of People. The target date for this was 2018. However this is yet to be actualised as only 32 member countries have signed the agreement.

The implementation of AfCFTA portends a general rise in income levels as expanding businesses seek to attract employees for a larger market base. What are the tax considerations for mobile employees within Africa or those working from their home countries for companies headquartered in other member states?

Tax Implications for Cross border employees

Individuals can create tax footprints because of their status of residence, source of income or even nationality. Furthermore, an individual may be liable to double taxation based on the different tax rules in the individual's home and host countries. The DTAs will however help to mitigate the impact of double taxation.

Currently Nigeria has 13 DTAs with other countries including South Africa as the only African country.

The case is no different with most other African countries with South Africa and Mauritius having the highest number of DTAs with other countries in Africa. This implies that individuals are largely exposed to double taxation when they embark on cross border arrangements in Africa. Furthermore, in cases where DTAs exist and employees are able to claim tax credits, such individuals need to provide adequate documentation that taxes have been paid to claim such credits.

A similar scenario plays out in other FTAs across the world where liberalization is mostly on trade and not on movement of people. A single market area such as the European Union (EU) however have some level of oversight over tax rules across member countries to make sure they are consistent and to avoid discrimination of workers or businesses.

Way Forward

Without a doubt, AfCFTA portends great benefit in regional and economic integration across member countries. There is an urgent need for African leaders to ratify the Continental Free Movement Protocol as free movement of goods and services can only be enhanced by free movement of people.

Furthermore, member countries need to review and amend their existing employment, tax, social security, and immigration laws to bring them in tandem with the objectives of the AfCFTA to create a truly secure market that guarantees free trade. The existence of tax treaties, though not topmost, is a criterion considered by investors for assessing the risks and rewards for business. Member states in Africa should start considering a multilateral tax instrument to foster trade and situate incentives for players within the continent.Visa-free travel in Africa should also be pursued using a common identifier on National passports pending when we have AU passports.

Perspectives for MSMEs

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Micro, small and medium sized enterprises (MSMEs) are regarded as the backbone of any economy and are estimated to account for 96% of businesses in Nigeria. According to 2017 statistics jointly conducted by both the National Bureau of Statistics (NBS) and the Small & Medium Enterprises Development Agency of Nigeria (SMEDAN), MSMEs have been estimated to record a 50 percent contribution to the nominal gross domestic product and 7.6 percent to total exports in that year. Common hurdles faced by MSMEs which must be overcome to take advantage of the AfCFTA include access to finance, competitiveness, inimical governmental policies and multiple taxes.

According to the World Bank, access to finance is the second most cited obstacle facing SMEs in emerging developing countries. In an interview with a representative of the Manufacturers Association of Nigeria, finance was regarded as the number one challenge encountered by MSMEs in Nigeria. In PwC's 2020 MSME survey, obtaining finance was cited as the most pressing problem for Nigerian MSMEs.
Most companies simply are not able to expand their business given the high cost of finance in the country.

One of the concerns that Nigerian businesses had prior to signing the AfCFTA agreement was centred around the competitiveness of Nigerian products compared to the products of other African countries especially countries where cost of production is lower. Nigeria hasn't performed well in terms of competitiveness, specifically in matters such as quality of infrastructure, access to foreign exchange, trade logistics or security.

In 2011, a Project Assessment Committee established by the Federal Government identified that Nigeria recorded about 11,866 abandoned projects. The country is estimated to need an amount of $100 billion annually in order to address its infrastructural deficit. The lack of improved infrastructure has impacted on the cost of MSMEs in the country.

Incentives available to MSMEs: (A case study of Nigeria)

The Nigerian government has put in place some incentives to support MSMEs. One of such is the Federal Government of Nigeria (FGN) Special Intervention Fund which offers an all-inclusive single-digit rate of 9% to MSMEs in the agriculture and manufacturing sectors both of which are critical to the industrialisation of the nation.

Another incentive available to incorporated MSMEs with a turnover of N25 million and below is the exemption from paying Companies Income Tax, Minimum Tax and Tertiary Education Tax. The Companies and Allied Matters Act 2020 also allows a small business with a turnover of not more than N120 million to incorporate a company as a single shareholder, to decide whether to hold or not hold an Annual General Meeting (AGM), and to decide whether to appoint an auditor and legal practitioner etc.

To promote and support the activities of the MSME, the government created an MSME Clinic which offer the following facilities:

01 One stop shop: Offices created across seven cities in the country with representative officers from the Bank of Agriculture, Bank of Industry, Small and Medium Enterprises Development Agency of Nigeria for the purpose of providing support and assistance to MSMEs.

02 MSME Survival Fund: A fund established by the Economic Sustainability Committee, following the emergence of COVID-19 pandemic, and designed to support MSMEs struggling to meet their payroll obligations. Based on the National MSME Clinic website, about 949,511 beneficiaries have benefited from the fund from which a total amount of N56.8 billion has been disbursed as at September 2021.

03 MSME Shared Facilities: A project which provides affordable amenities such as power, high quality operating equipment, broadband connectivity etc. and is expected to benefit an estimated 1,500 MSMEs.

Lessons from other economic integrations

The EU, which is the most popular common market in the world, adopted a scheme referred to as the Competitiveness of Small and Medium-sized Enterprise scheme (COSME). The COSME scheme ran from 2014 to 2020 on an estimated budget of €2.3 billion and was aimed at supporting SMEs by providing access to finance, promotion internationalisation and access to markets, creating a competitive business environment and encouraging an entrepreneurial culture.

The EU, through the initiative, acted as guarantee and counter guarantees to enable financial institutions to provide loans to the MSMEs. It also supported equity fund investments by providing seed capital aimed at promoting small businesses at both the growth and expansion stages.

The COSME initiative also funds the Enterprise Europe Network, which is a network of 600 offices across the EU, established to assist member countries understand policies and regulations, and locate technology and business partners across the EU. In addition, COSME actively supports entrepreneurship through the promotion of internationalism aimed at assisting SMEs who want to develop their business outside Europe. The monetary union also supports SME helpdesks within other regional economic communities that offer advice and facilitate exchange of experience with European SMEs.

Other relevant policies and programmes put in place by the EU are the “Think First Small” and the “Erasmus for Young Entrepreneurs”. The “Think First Small” addresses roadblocks and bureaucracy in government policies by encouraging governments to enact laws which simplify business processes and reduce cost. The “Erasmus for Young Entrepreneurs”, on the other hand, focuses on cross-exchange programmes which allows young entrepreneurs to gain knowledge, experience, and exposure by working with experienced entrepreneurs in other countries for a period of one to six months.

Way Forward

Most African nations, Nigeria inclusive, appear to not be prepared for the AfCFTA. There is a need to aggressively promote awareness among MSMEs on the workings of and the benefits that can be obtained from the AfCFTA.

The difficulties and bottlenecks commonly encountered by small businesses in accessing government funds, need to be addressed and made transparent. A lot of MSME bodies have voiced out the frustration of only a few of their members being able to access these facilities. It is expected that the Government will pay more attention to making funds easily accessible to MSMEs specifically for those that will be willing to expand and take advantage of the AfCFTA.

There is a need for a quality review and development strategies aimed at ensuring the products exported to other countries are of high standard. With regards to competition, businesses have lamented the cost of doing business in Nigeria. Although the SME Clinic has been designed to address these challenges, there is still a lot of work that needs to be done as information from the website of the National MSME Clinic shows that there are only about 5 of these shared facilities in the country today. It is important to spread more of these facilities to remote areas where a lot of small businesses are located.

There will be a need for learning initiatives to be put in place for MSMEs. Learning of other African languages can help facilitate cross-border interactions. Government could introduce initiatives aimed at facilitating exchange programmes that would give small business owners and young entrepreneurs the opportunity to obtain practical experiences from businesses in other countries.

Conclusion

The AfCFTA is expected to have an overall positive impact on the African continent. To give life to the AfCFTA and reap its promising benefits, there is a need for all countries in the continent to ratify the agreement. In ratifying the AfCFTA, it is important for member countries to approach its implementation from an ESG perspective which is focused on improving the welfare of people, enhancing prosperity of businesses, maximising shareholder wealth and at the same time preserving the natural environment.

Political leaders across the continent will be expected to show a strong commitment to following the rules contained within the agreement with focus on the collective good of the continent. Given the prospects that could stem from the successful implementation of this agreement, Africa has a promising future to look forward to.

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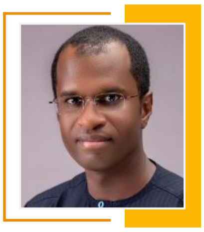

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