AFRICAN CONTINENTAL FREE TRADE AREA AND THE NIGERIAN ECONOMY: Matters Arising

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ABSTRACT

Although the theoretical case for adopting the African Continental Free Trade Agreement (AfCFTA) is firmly established, there are matters arising for Nigeria to participate effectively. This paper considers such matters and posits that there is the need to address the multiple exchange rates regime, hard and soft infrastructure, review the existing trade policies as well as the matter of re-exporting from neighboring countries, among others. In addition, management of the economy must ensure that economic fundamentals such as the rate of inflation, growth of GDP, unemployment and lending rates are moving in the right direction. The need to build a strong domestic economic is important for Nigeria to benefit from the AfCFTA. In the final analysis, what is essential is fair trade among member countries.

JEL classification: F13, F15

1. Introduction

A trade bloc to coordinate trading affairs in Africa has long been an economic issue. Several economic blocs in Africa including the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Economic Community of West African States (ECOWAS), have actively been promoting the narrative of a trade bloc in the continent. Concerted efforts in this direction have led to the creation of the African Continental Free Trade Area (AfCFTA), a trade bloc saddled with the mantle to stimulate competitiveness and productivity, as well as improve the quality of domestic macroeconomic policies and institutions among member states (African Union, 2019). It is also projected that the AfCFTA treaty will lead to the achievement of the Agenda 2063 for sustainable development for all African countries.

Although the entry of Nigeria into this oligopolistic market structure promises to improve the welfare of the economy (Jibrilla, 2018), debates on the achievement of these bold objectives still linger due to shortage of large volumes of internal and inter-regional trade, income disparities, lack of policy coordination, weak domestic economies and other economic misnomers among African countries, especially a large economy like Nigeria. This has prompted the need to examine the viability of the AfCFTA treaty in the Nigerian economy.

Following this introduction, Section 2 discusses the concept of a free trade area (FTA); Section 3 presents the context of the African Continental Free Trade Area (AfCFTA) agreement and the economic potentials the agreement promises; Section 4 builds a micro model of a free trade area and the benefits a country accrues by being a member of a free trade area; Section 5 discusses the feasibility of the Nigerian economy in actualizing the objectives of the AfCFTA agreement; while Section 6 concludes the study. It is expected that the outcomes of this study will stimulate a constructive policy mix in fully utilizing the objectives of the African Continental Free Trade structure in Nigeria.

2. Concept of a Free Trade Area

A free trade area can be defined as a cluster of countries whose members trade without tariffs and non-tariff trade barriers but whose members adopt varying trade policies toward non-members (Kono, 2002). Article XXIV of the General Agreement on Tariffs and Trade 1994 defines a free trade area as "a group of two or more customs territories in which the duties and other restrictive regulations of commerce . . . are eliminated on substantially all the trade between the constituent territories in products originating in such territories" (GATT, 1994).

In other words, a free trade area can be explained as an economic structure in which its members sign an agreement to maintain little or no trade barriers (tariffs and quotas) among themselves. This arrangement is usually undertaken to fully utilize the associated gains of international specialization and division of labour, since the volume of international trade increases among members of the free trade area owing to individual comparative advantages. Examples of free trade areas include the North American Free Trade Area (NAFTA) and the European Free Trade Association (EFTA).

In order for the free trade area arrangement to succeed, there is the need to establish and adhere to rules and regulation on trade operations. If some level of trade restrictions would exist, there is a need to clearly state these and their costs. It will also involve setting rules on resolving trade disputes among members, most especially how property rights would be protected and managed to avoid economic discord.

The advantages of the free trade area have been highlighted in several studies (see Jibrilla, 2018; Saygili, Ralf & Knebel, 2018; Marinov, 2014; Hosny, 2013). These studies opined that among other advantages, free trade areas makes it possible for consumers to access a wide range of quality goods and services at less costs. Although producers might struggle with competition from foreign producers, local markets benefit through expanded structure and operation. The standard of living of individuals residing in member countries is expected to increase. In spite of these advantages, there are certain costs. For instance, some labour may be rendered redundant as production moves to countries with comparative advantages, resulting in loss of value of fixed physical capital and human capital (Ekpo, 2020).

3. Context of the African Continental Free Trade Area (AfCFTA) Treaty

The need to establish a free trade area in Africa as a springboard project in achieving Agenda 2063 has also been given considerable attention among policy-makers and economies alike. It is expected that the Agenda 2063 project will result in inclusive and sustainable development in Africa by 2063. Several attempts have been made to achieve sustainable development in Africa through regional and trading blocs such as: Arab Maghreb Union (UMA), Common Market for Eastern and Southern Africa (COMESA), Community of Sahel-Saharan States (CEN-SAD), East African Community (EAC), Economic Community of Central African States (ECCAS), Economic Community of West African States (ECOWAS), Intergovernmental Authority on Development (IGAD), and Southern African Development Community (SADC). However, it is necessary to establish a free trade area whose oversight spans the entire African continent rather than just regions. This will involve the creation of a single, continent-wide structure for trade in Africa, covering all spheres of trade (goods and services), investment, competition policy, as well as property rights.

The African Continental Free Trade Area (AfCFTA) agreement was undertaken to achieve free trade in Africa devoid of barriers and institutional bottlenecks. At its 10th Extraordinary Summit, the African Union on March 21, 2018 signed the African Continental Free Trade Area (AfCFTA) agreement. The agreement gave birth to the world's largest free trade area connecting 55 countries[1] with an estimated gross domestic product of US$3.4 trillion and over 1.3 billion people. It is expected that the AfCFTA will raise the incomes of over 68 million people as well as bring 30 million people out of extreme poverty. It will also facilitate trade by removing red tape and simplifying customs procedures thereby stimulating income gains (IMF, 2020). In other words, the AfCFTA is expected to resolve the challenges of multiple and overlapping trade policies in different African countries.

Specifically, it is expected that there will be scale efficiency in the agricultural and industrial sectors of African countries, through capacity building. Both the formal and informal sectors (especially small- and medium-scale businesses) will be stimulated.

In order to achieve these projections, Article 3 of the AfCFTA identifies the general objectives of the agreement as:

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[1] As at January 2020, 54 (of 55) member countries of the African Union (AU) had signed the AfCFTA agreement. Eritrea is yet to append its signature to the agreement.

> "(a) create a single market for goods, services, facilitated by movement of persons in order to deepen the economic integration of the African continent and in accordance with the Pan African Vision of "An integrated, prosperous and peaceful Africa" enshrined in Agenda 2063;
>
> (b) create a liberalised market for goods and services through successive rounds of negotiations;
>
> (c) contribute to the movement of capital and natural persons and facilitate investments building on the initiatives and developments in the State Parties and RECs;
>
> (d) lay the foundation for the establishment of a Continental Customs Union at a later stage;
>
> (e) promote and attain sustainable and inclusive socio-economic development, gender equality and structural transformation of the State Parties;
>
> (f) enhance the competitiveness of the economies of State Parties within the continent and the global market;
>
> (g) promote industrial development through diversification and regional value chain development, agricultural development and food security; and
>
> (h) resolve the challenges of multiple and overlapping memberships and expedite the regional and continental integration processes." (Africa Union, 2019, p.4).

In order to achieve the set objectives in Article 3, the specific objectives are:

> "(a) progressively eliminate tariffs and non-tariff barriers to trade in goods;
>
> (b) progressively liberalise trade in services;
>
> (c) cooperate on investment, intellectual property rights and competition policy;
>
> (d) cooperate on all trade-related areas;

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

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

(g) establish and maintain an institutional framework for the implementation and administration of the AfCFTA." (African Union p.5).

Nigeria, the largest economy, ratified its membership of the African Continental Free Trade Area (AfCFTA) on November 11, 2020, although the country signed the African Continental Free Trade Agreement in 2019. It is expected that Nigeria will benefit from the AfCFTA agreement. Below are some of the potential benefits of the agreement for Nigeria:

- Greater economic activity and job creation. It is expected that businesses, especially SMEs, will benefit from expanded trade and investment.
- Improved policies affecting trade issues such as e-commerce, government procurement, as well as intellectual property protection, which are basically non-tariff barriers (NTB) which stifle trade in Nigeria.
- Nigerian businesses and consumers have the opportunity to access a wider range of new technologies, innovative practices as well as competitively-priced goods and services which will stimulate local production and consumer satisfaction.
- Nigeria will benefit from more economic integration as it shares trade and investment strategies with trading partners in the free trade area.
- Promotion of an in-built agenda that will encourage domestic trade reforms and liberalization.
- Strengthened bilateral relationship with FTA partners.
- Improved trade and investment opportunities that result in economic growth.
- Provision of infrastructural amenities that will improve the welfare of citizens.

The potential benefits of the AfCFTA have prompted the Nigerian government to actively support the agreement. Above all, the agreement has the potential to achieve Agenda 2063.

4. Free Trade Area and Economic Performance: A Micro Model

In order to establish the impact of a free trade area on an economy, a micro model based on Cumberworth (1996) was adopted. The model assumes a world comprising *z* countries, out of which *v* countries decided to form a free trade area (FTA). This implies (*z*-*v*) countries are non-free trade area (NFTA) countries. It is assumed that there was initial common tariff on imports and countries are dominated by two sectors (agriculture and manufacturing sector). The manufacturing sector produces differentiated products. Thus production is subject to internal economies of scale with total manufactured goods being *zK*. The number of firms, *m*, in the manufacturing sector is determined exogenously. The agricultural sector produces homogeneous products subjected to constant returns to scale (CRS).

4.1 Pre-FTA era

Each country comprises a population of firm owners (M), where m =1, 2,... M, and N labourers where l =1, 2…, N. The preferences of firm owners and labourers are expressed as:

$$U^m = C_{Agr}$$

$$U^n = C_{Agr}^{1-\alpha} C_{Manu}^{\alpha}; C_{Manu} = \left[\sum_{i=1}^{zk} c_i{}^{(\beta-1)/\beta}\right]^{\beta/(\beta-1)} \qquad (1)$$

where:

C_{Agr}	=	agricultural goods
C_{Manu}	=	sub utility function of manufactured goods
1-α	=	proportion of income on manufactured goods
α	=	proportion of income on agricultural goods
β	=	elasticity of substitution between manufactured goods

A typical consumer's utility maximization is given as

$$C_{Manu} = \left[\sum_{i=1}^{zK} c_i^{(\beta-1)/\beta}\right]^{\beta/(\beta-1)} \quad subject\ to\ \alpha = \sum_{i=1}^{zK} P_i C_i \tag{2}$$

The above function results in a demand function for manufactured goods, *j* given below.

$$c_j = \left[\frac{P_j}{P}\right]^{-\beta} \alpha$$

where:

$$P = \left[\sum_{i=1}^{zK} (P_i)^{1-\beta}\right]^{-\frac{1}{\beta}} \tag{3}$$

In the expression above, P is the price index and P_j is the price of manufactured goods *j*. The consumer has a maximization problem to choose an expenditure allocation which maximizes overall welfare subject to his budget constraint.

4.2 Effects of Free Trade Area (FTA) on an economy

In order to model the FTA era, we need to introduce trade costs (transportation, tariffs, etc.) between countries into the scenario. Firms are assumed to produce goods under increasing returns to scale in which there are decreasing average costs and a constant marginal cost. Firms incur a fixed cost σ.

The economic decision to join the FTA will exert effects on firms' profits and consumers' welfare in the entrant economy. When a FTA comprising initial members is formed, the population of non-member countries decreases to *z-v*. Consumers in the *v* initial members are faced with a price index P_{tb} comprising products manufactured at home priced at one, imported products from each non-FTA countries priced at τ, and products imported from each of the original *v-1* FTA member countries priced at μ.

The price index in FTA countries is given as:

$$P_{tb} = \left[M(1 + (z - v)\tau^{1-\sigma} + (v - 1)\mu^{1-\beta})\right]^{-\frac{1}{\beta}} \tag{4}$$

The above is necessitated since, following the establishment of the FTA, a firm in any of the member countries sells in its home market, *z-v* non-FTA market and *v-l* FTA markets. The operating profits of a firm *j*, in a founding member country are:

$$\pi_{tb}^{j}(v) = \left[\frac{1}{P_{tb}}\right]^{-\beta} \alpha N \left(\frac{1}{\beta}\right) + \left[\frac{\tau}{P_{non}}\right]^{-\beta} \alpha N\tau \left(\frac{1}{\beta}\right)(z - v) + \left[\frac{\mu}{P_{tb}}\right]^{-\beta} \alpha N\mu \left(\frac{1}{\beta}\right)(v - 1) \tag{5}$$

The difference in equilibrium operating profits for firm *j* being in the FTA and being in a world without FTA is expressed as:

$$\pi_{tb}^{j}(v) - \pi_{0tb}^{j} = \frac{\alpha N}{\beta}\left[P_{tb}^{\beta} - P_{non}^{\beta}\right] + (v - 1)\frac{\alpha N}{\beta}\left[P_{tb}^{\beta}\mu^{1-\beta} - P_{non}^{\beta}\tau^{1-\beta}\right] \tag{6}$$

There are two effects that arise from joining the FTA, namely *home market effect* and *FTA market effect*. The first term in equation (6) captures the *home market effect*. The effect is negative when P_{non} is greater than P_{tb}. Home market effect has to do with the drop in competitiveness and profit of the new member firm in its home market. This is because following entry into the FTA, firm *j* is less competitive in its home market relative to FTA firms who now leverage on the opportunity to sell at the determined intra-FTA price in firm *j*'s domestic market. In other words, since FTA member countries now sell among economies in the FTA, domestic sales decline leading to a drop in competitiveness.

On the other hand, the second term in equation (6) represents the *FTA market effects*. FTA market effect represents the increase in the competitive and profit level of the new member firm in the markets of FTA member countries. This improves its competitiveness relative to FTA and non-FTA member firms.

The above scenario shows that an economy's entry into the FTA will result in a relative decrease in competitiveness of firms in the home market accompanied by an increase in competitiveness in the other members' markets within the FTA. Entry into the FTA will result in a decrease in competitiveness of the entrants' firms in the domestic market accompanied by an increase in sales within the FTA market. The increase in sales which accrues to the domestic firm of each member within the FTA exceeds the losses incurred locally by competing firms with member states. Due to such symmetry, every member will acquire economic gains by entering the FTA.

Entry into the FTA also holds economic implications for consumers. With the removal of tariffs and other trade impediments among member states in the FTA, consumption pattern changes. Consumers now have varieties of consumption baskets to make choices from. Since the prices of products are relative smaller in member states than non-FTA states, consumers' welfare is better off in economies within the FTA. The model clearly shows that consumers and firms are relatively better off when their host country participates in the FTA.

5. The African Continental Free Trade Area (AfCFTA) and the Nigerian Economy: How Feasible?

In spite of the potential benefits of the AfCFTA Agreement as presented in the micro model, the Nigerian economy may lack the economic and political structure to fully utilize the potentials of the Agreement. Some factors militating against Nigeria's gains from the AfCFTA agreement are exogenously determined while others are determined within the country. In other words, some factors are inherent variables that will limit the country's ability to reap the full potentials of the Agreement, while others are not. Some of these factors are discussed below.

5.1 Multiple exchange rates

Nigeria is an economy that operates the fixed and floating foreign exchange rates at the same time, and both can be used when exchanging currencies. Thus, the foreign exchange market is highly segregated with each segment having its own exchange rate. In Nigeria, there is the official rate – a rate for importers and exporters, and an exchange rate for foreign-exchange bureaus, among others. Although the system of multiple exchange rates has been criticized by the International Monetary Fund (IMF), monetary authorities opined that such multiple exchange rates are needed to control the demand for dollars.

With the widening gap between the official and black market rates, the monetary authorities adopted a managed float instead of devaluing the domestic currency. Such imbalances have made businesses whose operations depend on imports more costly, since these businesses cannot access the official foreign exchange rate. They thus resort to high black market exchange rates. These controversies will affect how the country operates within the bounds of the AfCFTA Agreement, unless the country moves towards a convergence of all existing rates.

5.2 Unfavourable balance of payments

In order to fully integrate the AfCFTA agreement into Nigeria, there is the need to critically examine the balance of payments of the country. Table 1 shows an appalling situation, with the BOP/GDP recording negative values between 2009 and 2019 except for 2011 and 2017. Even for these years, the values are negligible. This is in addition to the country's over-reliance on importation of goods and services for local consumption. Until these conditions are addresssed, the Nigerian economy is unprepared for the implementation of the AfCFTA agreement.

Table 1. Balance of payment (% of GDP), 2005-2019

Year	Overall Balance as % of GDP
2005	9.99
2006	9.63
2007	5.46
2008	0.81
2009	-6.31
2010	-2.73

Year	Overall Balance as % of GDP
2011	0.00
2012	-0.25
2013	-1.84
2014	-1.66
2015	-1.21
2016	-0.24
2017	3.29
2018	0.78
2019	-0.94

Source: Central Bank of Nigeria Statistical Bulletin (2019).

5.3 Huge fiscal deficits

Deficits usually arise when expenditure exceeds revenue. Increasing deficits has also been a narrative in the Nigerian economy (see figure 1). For instance, Nigeria's deficit stood at ₦3.90 billion in 1981. This figure rose to ₦161.40 billion in 2005, and further increased to ₦1,557.83 billion in 2015. It stood at ₦4,913.82 billion in 2019. This factor will greatly limit the potential benefits for Nigeria in the AfCFTA agreement and needs to be urgently addressed.

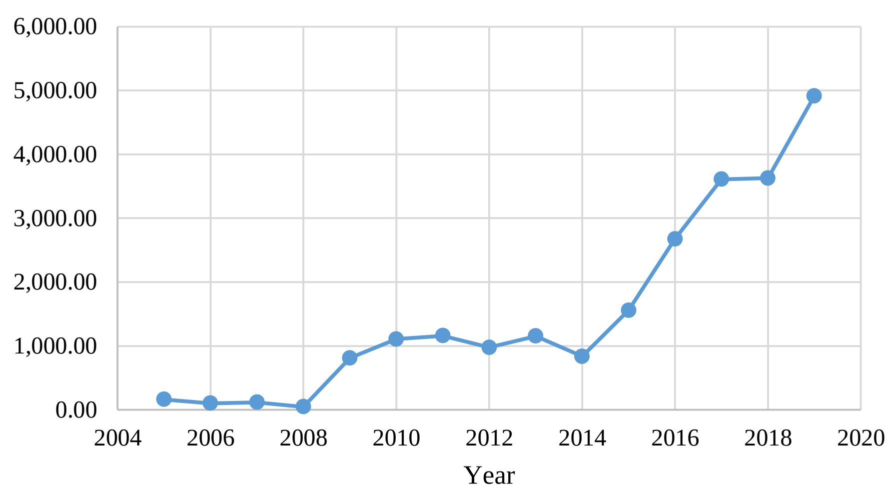

Figure 1. Nigeria's Fiscal Deficit (₦' Billion), 2005-2019.
Source: Central Bank of Nigeria Statistical Bulletin (2019).

5.4 Debt burdens

One factor which will greatly affect the preparedness of the country for adoption of the AfCFTA agreement is its huge debt burden. Both domestic and external debts have been on the increase over the years (see figure 2). For instance, in spite of government's concerted efforts, domestic debt outstanding as at 2019 was ₦14,272.64 billion (Central Bank of Nigeria, 2019), while external debt outstanding rose from ₦2.33 billion in 1981 to ₦3,097.28 billion in 2000. As at 2019, it stood at ₦9,022.42 billion. Nigeria's total public debt portfolio stood at ₦31.01 trillion (₦11.36 trillion external debt; ₦19.65 trillion domestic debt) in the second quarter of 2020 due to the increase in multilateral loans and FGN bonds (Central Bank of Nigeria, 2020).

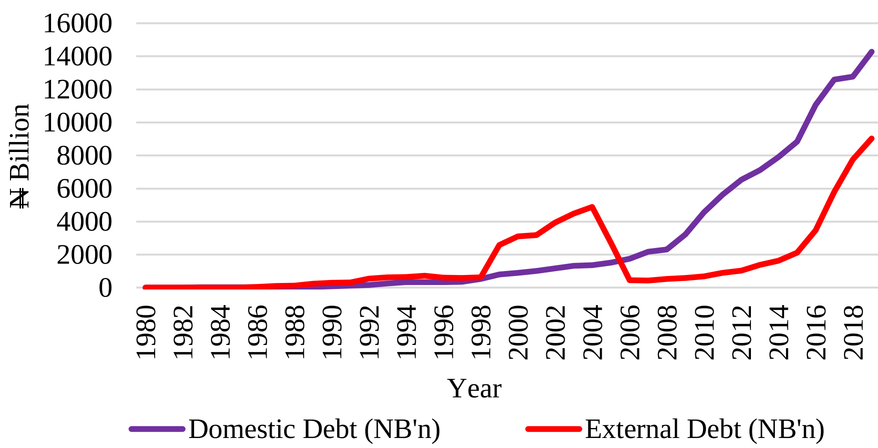

Figure 2. Nigeria's Debt Stock.

In addition to the above internal factors, the Nigerian economy has to grapple with the impact of rising inflation and unemployment rates, as well as security challenges which adversely impact trade and regional integration. The issues of large infrastructure gaps and significant trade-related transaction costs are yet to be addressed. For instance, for so many years, the quality of roads, ports, air transportation, and other measures of infrastructure efficiency have been low in Nigeria. If these issues are left unaddressed by the Nigerian government, the objectives of the AfCFTA Treaty will be more of an illusion.

5.5 Huge income disparities

The African continent is characterized by huge income disparities, with 27 countries categorized as low-income; 18 countries as lower middle-income; 8 countries as upper middle-income; and 1 country as high income (see table 2).

Table 2. Africa: Distribution of Income and Population

S/N	Categorization	Countries	Proportion of Continent's population (%)
1.	High Income	Seychelles	0.01
2.	Upper Middle	South Africa, Algeria, Botswana, Libya, Gabon, Equatorial Guinea, Namibia, Mauritius	9.5
3.	Lower Middle	Egypt, Nigeria, Morocco, Angola, Sudan, Kenya, Tunisia, Ghana, Côte d'Ivoire, Cameroon, Zambia, Republic of Congo, Mauritania, Eswatini, Lesotho, Cabo Verde, Djibouti, Sao Tome and Principe	45.9
4.	Low	Ethiopia, Tanzania, Uganda, Congo (DR), Senegal, Mali, Madagascar, Mozambique, Burkina Faso, Zimbabwe, Chad, Guinea, Benin, Rwanda, Malawi, South Sudan, Niger, Somalia, Togo, Sierra Leone, Eritrea, Burundi, Liberia, Gambia, Central African Republic, Guinea-Bissau, Comoros	44.6

Source: IMF (2020).

The heterogeneity in income distribution will allow certain countries to benefit more from the free trade area arrangement than others. For instance, countries in the low-income category will benefit more than those in the higher categories. In other words, the presence of income disparities among African countries may have a negative effect on the operation of the AfCFTA. Unless policies to synchronize these differences are established, Nigeria stands to benefit less from the AfCFTA Treaty since dumping will be highly encouraged. Such dumping of goods in the country may hurt the already fragile domestic businesses, especially infant industries.

5.6 Trade exploitation through re-exports

The United Nations (1998) defines re-exports as “foreign goods exported in the same state as previously imported, from the free circulation area, premises for inward processing or industrial free zones, directly to the rest of the world and from premises for customs warehousing or commercial free zones, to the rest of the world”. In a free trade area, Nigeria will face the hurdle of restraining businesses from engaging in re-export racketeering. In other words, members of the FTA may deliberately charge lower tariffs to non-FTA nations in order to win trade, and then re-export the same product with no modification or alteration to a FTA partner, thus gaining a trade advantage over other FTA partners.

5.7 Measure of trade value

Another pressing issue that may put Nigeria in peril in the AfCFTA agreement is the unit of measuring trade value. In other words, what currency should be adopted in international transactions within the FTA boundary? Although a common currency across Africa will generally ease transaction costs, it will however strip the Nigerian economy of the ability to utilize monetary policies in responding to asymmetric shocks, which have often been encountered, especially in recent times.

Africa’s experience with the CFA franc zone and the Common Monetary Area (CMA) which hinges on the South African rand emphasizes the need to re-evaluate the AfCFTA agreement. These common currencies in these zones did not deliver on low inflation or a stable exchange rate. Thus, the establishment of a common currency that takes into account the country-specific monetary and fiscal challenges of all member countries will highly boost trade in Africa.

5.8 Monetary authorities synchronization

Even the proposal to create a common central bank in Africa may not guarantee that Nigeria will gain from the AfCFTA agreement. This is because the Central Bank of Nigeria is not generally independent and the economy has experienced periods of hyperinflation because the Central Bank of

Nigeria was coerced to finance deficits or certain white elephant projects. Without improved fiscal discipline, Nigeria's trade gains from the AfCFTA agreement will be under threat.

5.9 Unhealthy external competition

Nigeria faces yet another challenge that questions the economy's preparedness. This involves external competition emanating from outside the FTA, that is, developed countries. The competition as regards product research, invention and quality poses a threat to the Nigerian economy which is largely a mono-product economy, with its industries struggling to achieve local relevance. This one-sided trade battle may affect the gains of Nigeria from the AfCFTA agreement.

6. Conclusion

As plausible as the African Continental Free Trade Area (AfCFTA) agreement appears to be, the Nigerian economy seems to be at a comparative disadvantaged position given the country's economic parameters. Unstable trade policies, multiple exchange rates, huge debts, and lack of infrastructural facilities are among the challenges that emphasize the unpreparedness of the Nigerian economy to reap the full potential benefits of the AfCFTA agreement. In order to create an enabling environment to fully utilize the provisions of the AfCFTA agreement, we suggest the following:

- *Review of trade policies*. There is urgent need to review all existing trade policies with a primary goal of harmonizing all such policies. This may include the trade legal structure, consumer protection legislation, copyright protection laws, customs procedural policies, competition policy, among others.
- *Convergence of all existing exchange rates into a single rate*. This involves adopting a viable exchange rate policy that incorporates all existing economic indicators, instead of operating a system of multiple exchange rates which some economic *dramatis personae* are biased against.

- *Improvement of infrastructural amenities*. There is a need to improve on both hard and soft infrastructure in the country with emphasis on electricity and transportation. This will directly reduce the cost of regional trading between Nigeria and her trading partners in the free trade area. It is also important to build capacity in trade matters.
- *Building institutional capacity*. There is also the need to build the institutional capacity of the country. Such action will help eliminate bottlenecks in the production process. Transparency in business operations is highly needed for the country to benefit from the AfCFTA treaty.
- *Attention to non-tariff barriers.* Although the AfCFTA treaty focuses on tariff barriers, there is need for the Nigerian economy to pay close attention to non-tariff barriers to trade. This includes policies relating to banking, fiscal deficits, debts, labour market, transportation, government procurement, among others. After all, what is important is fair trade among members.

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