

**ESTIMATING THE ECONOMIC EFFECT OF THE AFRICAN CONTINENTAL FREE  
TRADE AREA ON COMESA REGION**

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## Table of Contents

Table of Contents .....	i
List of Tables and Figures.....	ii
ABSTRACT.....	iii
1.0 Introduction.....	1
1.1 Background .....	1
1.2 Overview of Existing trade patterns in Africa .....	2
1.3 Problem statement.....	4
1.4 Objective of the Study.....	5
2.0 Literature review .....	5
2.1 Theoretical literature .....	5
2.2 Empirical literature .....	7
3.0 Methodology .....	8
4.0 Results.....	9
5.0 Conclusions and Policy Implications.....	12
6.0 References.....	14

## List of Tables and Figures

Table 1.1 Intra-regional trade as a share of total trade for African RECs.....	4
Table 4.1 Percentage change in COMESA exports and Imports by sector.....	10
Table 4.2 Average change in import prices.....	11
Table 4.3 Change in tax revenue .....	11
Table 4.4 Welfare decomposition in USD millions.....	12
Figure 1.1 Trends in Africa’s Merchandise trade 2005-2017.....	3
Figure 1.2 Intra-African trade 2008-2017.....	3
Figure 4.1 Percentage change in GDP by region.....	12

## **ABSTRACT**

Despite the marked growth in Africa's total trade over time, intra-Africa trade has reported sluggish growth. To this end, African countries have put up various initiatives to help boost intra-Africa trade. The most outstanding initiative was the decision of the African heads of state to establish an African Continental Free Trade Area (AfCFTA). The AfCFTA agreement initially required member states to eliminate tariffs on 90% of goods and allow free movement of goods, services and people across the continent. COMESA is the largest Regional Economic Community on the continent and therefore stands to be significantly affected by implementation of the AfCFTA agreement. This study sought to establish the economic effect of the implementation of AfCFTA by way of tariff removal on COMESA region. Using CGE based simulation with data from the the Global Trade Analysis Project (GTAP) 7 database, the study found that implementation of the agreement by tariff removal would lead to a rise in COMESA exports and imports, and a fall in import prices within the region. Tariff removal would lead to an overall gain in welfare among the African countries despite the fact that it would marginally lower the welfare of COMESA region. Therefore, the study recommends that the respective governments of COMESA countries should consider elimination of import tariffs on trade with the rest of Africa even as the rest of Africa reciprocates the same as this would boost the regions total trade and intra-Africa trade.

## **1.0 Introduction**

### **1.1 Background**

The 18th Ordinary Session of the Assembly of Heads of State and Government of the African Union held in Addis Ababa, Ethiopia in January 2012, adopted a decision to establish an African Continental Free Trade Area (AfCFTA) by 2017. It was not until March 2018 (in Kigali, Rwanda) that the AfCFTA agreement was brokered by African Union (AU) and signed by 44 of AU's 55 member states. The agreement initially required members to eliminate tariffs on 90% of goods, allowing free access to commodities, goods, and services across the continent. With 44 members signing the agreement, AfCFTA promised to be the largest free trade area in the world in terms of participating countries since the formation of the World Trade Organization (WTO). In May 2019, the agreement establishing AfCFTA came into force with 24 countries having deposited their instruments of ratification. As at the end of 2019, 27 countries had signed and ratified the agreement. Among these countries are; Burkina Faso, Chad, Djibouti, Egypt, Ethiopia, Gabon, Gambia, Ghana, Guinea, Ivory Coast, Kenya, Mali, Mauritania, Namibia, Niger, Republic of the Congo, Rwanda, Senegal, Sierra Leone, South Africa, Eswatini, Togo, Uganda, and Zimbabwe (AfCFTA, 2019). It is hoped that going forward, the remaining African states will ratify the agreement.

The objectives of the AfCFTA were, among others, to create a single market for goods, services, facilitated by free 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 and to resolve challenges of multiple and overlapping memberships and expedite the regional and continental integration processes. Therefore, the essence of the AfCFTA is to create an integrated continental market. It seeks to go beyond the traditional arguments for static gains through trade creation. According to UNECA & TMEA (2020), implementation of the AfCFTA will catalyze intra-regional trade and investment integration across the continent, bringing new opportunities for employment creation, income generation and poverty reduction. The report estimates that the AfCFTA has the potential to boost intra-African trade by 52.3 percent by eliminating import duties, and to double this trade if non-tariff barriers are also reduced. The AfCFTA can therefore be seen as a timely opportunity for African countries in the wake of globalization. A more integrated Africa is expected to strengthen the competitiveness of its industries, realize economies of scale and accelerate the rate of growth

in trade and income. Saygili et. al., (2018) opined that despite the significant opportunities, the AfCFTA may come with some challenges such as loss of tariff revenue and uneven distribution of costs and benefits in trade and income.

**Box 1: Potential benefits of the AfCFTA to member countries**

The AfCFTA offers enormous advantages for African Countries if it will lead to deeper integration among the member countries. The potential benefits are:

1. Creating bigger and integrated regional market for African products.
2. Permitting producers to benefit from economies of scale and to access cheaper inputs
3. Improving conditions for forming regional value chains and integrating to global value chains (GVCs).
4. Allowing consumers to access cheaper imported products from other African countries.
5. Leading to better allocation of resources and faster economic and trade growth.
6. Catalyzing the structural transformation of the countries from resource and low technology-based economies to more diversified knowledge based economies.
7. Eliminating some challenges associated with multiple and overlapping trade agreements in Africa.
8. Encouraging both intra-African and external direct capital flows to African countries.
9. Stimulating cooperation in other areas such as technology transfer, innovation, investment and continent- wide infrastructure development.

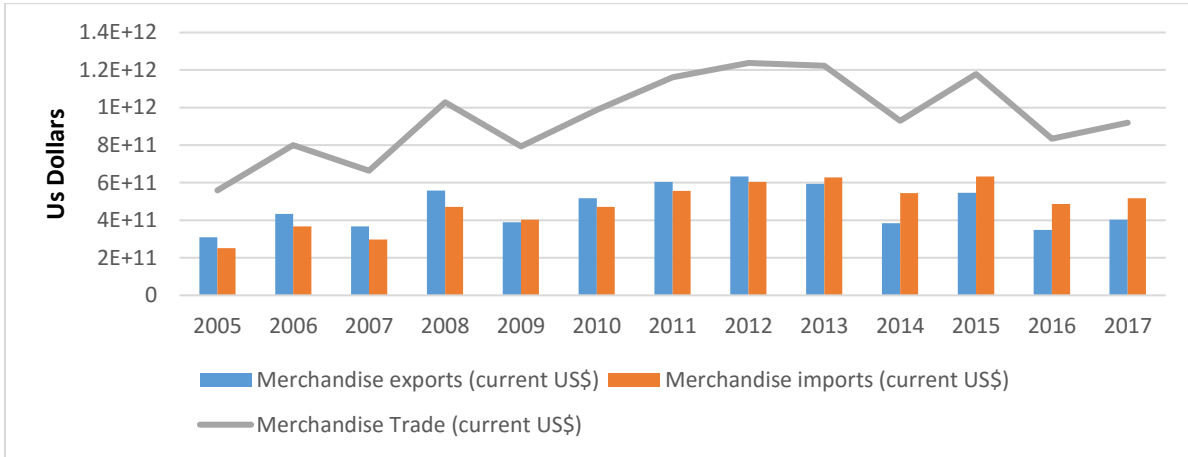
Source: Saygili *et. al.*, (2018)

With a population of 560 million people, the COMESA region accounts for nearly a half of the total population under the AfCFTA. Among the COMESA Member states who have ratified the AfCFTA are Kenya, Egypt, Zimbabwe, Eswatini, Uganda and Democratic Republic of Congo. The effect of the AfCFTA on these countries and the region as a whole is therefore expected to be enormous. Indeed, the AfCFTA can be considered as an opportunity for the region to grow its trade, output and employment levels while deepening regional integration.

**1.2 Overview of Existing trade patterns in Africa**

Africa's total merchandise trade gathered momentum; growing by from USD 558.9 billion in 2005 to over USD 1 trillion by 2012. However, by 2017, the continents total merchandise trade in current USD stood at USD 920 billion. The continents merchandise exports generally exceeded merchandise imports in the years before 2011, however from 2013 onwards, merchandise imports surpassed exports (figure 1.1). The growth in African trade was in tandem with the increase in global trade and reflected continued tightening of trade links between nations of the world.

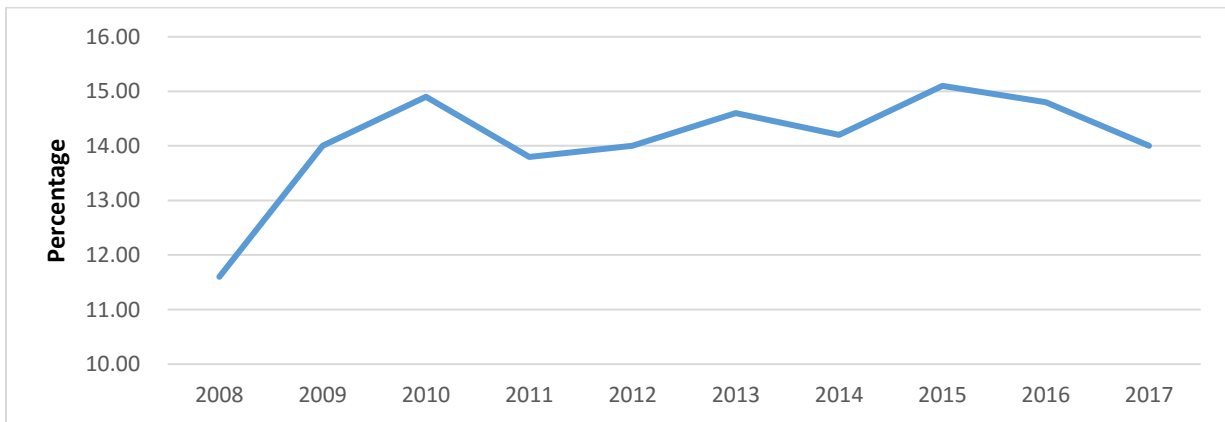
**Figure 1.1 Trends in Africa’s merchandise trade, 2005-2017**



*Source: Compiled from World Bank (2018), World Development Indicators*

Despite the marked growth in the continent’s total trade over time, intra-Africa trade has reported sluggish growth (African Export-Import Bank, 2018). According to the Bank, the importance of intra-africa trade has been demonstrated by the experience of countries such as Kenya, where greater intra-African trade intensity has cushioned the country from exogenous shocks. These experience together with the relatively low level of intra-african trade (as indicated in figure 1.2 below) have lead to a number of initiatives such as the Tripartite Free Trade Area (TFTA) and the current proposed AfCFTA in the continent to promote intra-african trade. The statistics indicate that the share of intra-africa trade in total trade on the continent ranged between 11 percent and 15 percent only from 2008 to 2017.

**Figure 1.2 Intra-African trade 2008-2017**



*Source: International Monetary Fund, Direction of Trade Statistics database*

In terms of exports, intra-African exports made up only 18 percent of the continent’s total exports, compared to 59 and 69 percent for intra-Asia and intra-Europe exports, respectively as of 2016 (Sow, 2018). Based on these figures, EU is leading in terms of intra-regional exports. This can be demonstrated by considering a few EU countries like Netherlands, Portugal, Slovenia, Belgium who have reported more that 60 percent in share of their exports to EU members (Eurostat, 2018). From a regional point of view, the situation is not any better. Table 1.1 below reveals that as of 2019, the SADC region was leading in total intra-Africa trade with 23.7 percent of its total trade. This was followed by EAC at 21.6 percent and COMESA at 16.3 percent. These indicate the need for the RECs to come up with deliberate efforts to boost intra-Africa trade. Full implementation of the AfCFTA promises to boost the total intra-African trade.

Table 1.1: Intra-regional trade as a share of total trade for African RECs, 2019 (in percent)

Reporting Economy	Intra-REC trade	Rest of Africa Trade	Total Intra-Africa
SADC	21	2.7	23.7
EAC	11.5	10.1	21.6
COMESA	7	9.3	16.3
ECOWAS	10.7	5.6	16.3
IGAD	7.3	8	15.3
ECCAS	2.8	9.5	12.3
CEN-SAD	7.5	4.1	11.6
AMU	3.3	2.5	5.8

Source: UNCTAD (2019).

### 1.3 Problem statement

Africa’s intra-regional trade lies significantly below those of other regions as aforementioned. While Africa has increased its aggregate trade volume, the share of intra-African trade remains stagnant. Furthermore, while international trade agreements such as the African Growth and Opportunity Act (AGOA), the Economic Partnership Agreement between the European Union and Southern Africa among others have positively contributed to the continents total trade, and therefore should be encouraged, Africa is still the world’s least connected continent in terms of trade and mobility of factors of production. According to the Southern Times (2019), the low levels of intra-african trade can be attributed to, among other factors, the lack of sufficient trade agreements to encourage and drive intra-Africa trade. Towards that end, African countries have



come together in an effort to put in place a framework to promote intra-African trade by implementation of the AfCFTA.

The AfCFTA promises to reverse the trend by promoting intra-Africa trade through facilitation, reduction and/or elimination of tariff and non-tariff barriers, harmonization and better coordination of trade and infrastructural development programs across the continent. Implementation of the AfCFTA brings enormous opportunities, and some challenges for Africa. Indeed, empirical studies on trade liberalization generally indicate that long-run gains outweigh the short-run adjustment costs.

Being the single largest REC on the continent, COMESA is expected to be significantly affected by implementation of the AfCFTA. Questions abound on magnitude of the benefits and costs from implementation of the program. Further, the question of how the region should position itself strategically to reap maximum benefits from the continent's integration, while minimizing any associated costs would be best addressed by considering the potential effect of the AfCFTA on the region. As such, there is need to empirically establish the economic effect of implementation of the AfCFTA on the region.

#### **1.4 Objective of the Study**

The objective of this study was to estimate the economic effect of the implementation of AfCFTA by way of tariff removal on COMESA region. The specific objectives were:

- i. To estimate the effect of removal of import tariffs on trade among member states in the AfCFTA on COMESA trade;
- ii. To estimate the effect of removal of import tariffs on trade among AfCFTA members on prices of imports in COMESA;
- iii. To estimate the effect of removal of import tariffs on trade among the AfCFTA members on welfare in COMESA.

## **2.0 Literature review**

### **2.1 Theoretical literature**

Regional integration is considered as a form of selective trade liberalization since it involves liberalization with regional partners but does not necessarily imply any changes in trading relations with third parties (UNECA & TMEA, 2020). It involves removal of tariff and non-tariff barriers

among the participating countries. It is expected that such a move would lead to growth in trade, output, employment levels and welfare.

The ideology of Free Trade Agreements can be traced back to the mercantilist era regional when economists believed that Nations drew from a scarce “pot” of resources and that the wealth of a nation depended on favourable terms of trade. However, Smith (1776) in his book stated that the “pot” is not limited and can grow over time as long as there exists free trade between Nations. Smith’s argument is formally referred to as the Absolute Advantage theory of trade. According to the theory, countries should specialise in production of commodities which they possess absolute advantage and export the surplus to facilitate importation of the commodities in which they have absolute disadvantage. The other classical economist to make a significant contribution to the argument of free trade was David Ricardo in his theory of Comparative Advantage. The theory stated that it would be beneficial for a country to specialise in production of the good in which it has a comparative advantage and to trade with the good in which it has a comparative disadvantage (Wood, 1996). These two theories imply that countries should endeavour to remove all tariff and non-tariff barriers in order to promote international trade and development. However, Smith’s and Ricardo’s trade theories do not really address the subject of regional integration despite their strong arguments for free trade among countries.

Viner, (1950) in his theoretical contribution to the discourse on economic integration postulated that the effects of regional integration come in two forms; trade creation and trade diversion. According to him, integration should lead to a net trade creation effect. This implies that the trade created between trading partners within the regional block outweighs the value of the displaced trade with third-party countries. As such, the volume of intra-regional trade should increase as tariffs on intra-regional trade are removed. However, if regional integration favors less efficient producers (members) at the expense of more efficient producers (third-party countries) then there would be trade diversion.

The argument by Viner (1950) suffers a major weakness in the sense that it provides a static view of the effects of regional integration. Cooper and Massell, (1965) posit that for developing countries trade diversion resulting from regional integration could still be considered desirable. From a dynamic perspective, the immediate cost of trade diversion may be a price worth paying in order to spur diversification of the regional economy in the long run.

## 2.2 Empirical literature

In analysing the impact of forming a regional bloc, various methodologies are applied. Specifically, the gravity model is applied for *ex-post* analysis where it is used to assess the trade effects of certain policies, for instance membership of a regional bloc. Partial or general equilibrium approaches is used for *ex-ante* simulation which focuses on assessing the future impact of trade policies. This section, therefore, focuses on previous studies on the impact of regional integration for African economies.

UNECA and TMEA, (2020) applied partial equilibrium analysis, complemented by a Computable General Equilibrium (CGE) model to assess the potential gains of AfCFTA for East Africa. The CGE model was based on GTAP 10.0 database with the data referring to a 2014 baseline. Based on the availability of data, the report conducted simulations for six individual countries in East Africa while clustering other remaining countries as “Rest of East Africa” and aggregated the sectors into 10. Their report established that the implementation of the AfCFTA will result in welfare gains amounting to USD 1.8 billion for the region. On one hand, Partial Equilibrium results indicated that under full implementation of the AfCFTA, East Africa’s intra-African trade would increase by around USD 737 million. On the other hand, the CGE model results indicated that AfCFTA would boost East Africa’s exports to the rest of the continent by 16 percent or USD 1.1 billion. In addition, their findings indicated that the integration would create more than 2 million new jobs, of which majority of the new opportunities emerging in sectors where there is a heavy predominance of female labour, thereby contributing to the economic empowerment of women in the region.

In assessing the potential long-term effects of CFTA on African Union member states, Saygili, *et al.* (2018) used a CGE model. The study distinguished 27 individual countries, 5 sub-regions in Africa and estimated 22 sub-categories of economic activities. The results indicated that there were significant welfare gains, output and employment expansion as well as intra-African trade growth in the long-run. However, gains were not equally distributed among member states. Further, their results showed that countries were likely to bear some tariff revenue losses in the shortrun which may not be distributed uniformly across the continent.

Mold and Mukwaya, (2016), applied the GTAP database and CGE model to measure the static effects of the establishment of the Tripartite Free Trade Area (TFTA) on industrial production,

trade flows and consumption in the TFTA. Their results showed that there was a significant increase in intra-regional exports due to tariff elimination. The manufacturing sectors were found to be the most benefiting sector.

Similarly, Walters, Bohlmann and Clace, (2016) employed the CGE model to analyse the effects of TFTA on the South African economy. Their simulation results showed that South Africa's economy would gain following the implementation of the trade agreement with the GDP increasing by more than one percent compared to the baseline. The increased growth was leveraged on a terms of trade increase and a flow in regional trade that allowed for increased exports and imports.

Mukwaya and Mold, (2014) employed the CGE model to measure the static effects of the proposed FTA on welfare, trade flows, prices, consumption and production in the region. The simulation results suggested a net welfare gain of \$10.7 billion. However, the distribution of the gains were found to benefit the consumers in Egypt, South Africa and Zimbabwe mostly. The amplified industrial production as new firms enter the market place across east Africa was expected to increase exports and imports based on their findings.

### **3.0 Methodology**

Studies on regional implementation and effects of trade policy change generally rely on two methodologies; Gravity model analysis and Computable General Equilibrium (CGE) based simulation analysis. The gravity model is used in performing post-implementation of analysis while CGE based simulations are used to perform pre-implementation analysis. This study used CGE based simulation (pre-implementation analysis) since the AfCFTA is yet to be implemented as of date and the member countries look forward to implementing the same.

A CGE model is a system of equations, which describes the economy and the interaction among its different sectors and participants and is derived from economic theory. It includes exogenous and endogenous variables as well as the resource constraints. Endogenous variables are variables which are determined within in the model while exogenous variables are those that are fixed at their initial levels and do not change when the model is solved (Mold & Mukwaya, 2016). The equations are solved simultaneously to obtain an equilibrium of the economy. CGE modelling uses

real world data, taking into account the inter-linkages between various sectors and participants while comparing the effects of a certain change with the baseline. The model adopts a multi-sector and multi-region general equilibrium framework, and is able to capture interactions of different sectors and markets in a given economy and at the international level.

The study data was generated from the Global Trade Analysis Project (GTAP) Version 7 database. The GTAP data is publicly available from the GTAP website and can be aggregated using GTAPagg software. GTAP was established in 1992 to develop a global model and database to enable quantitative analysis in international economics within an economy wide framework. GTAP data is useful for studying issues that cut across regions and diverse sectors. As such, this database is suitable for analysing the potential effect of global trade issues and regional trade agreements.

The GTAP data was aggregated using GTAPagg software to create a three region-three sector (3x3) aggregated data base. The study aggregated the data into three regions namely COMESA, Rest of Africa and Rest of World and three sectors namely Agriculture, Manufacturing and Services. The aggregated database was then uploaded into the RunGTAPv3.7 (GEMPACK) software and a simulation done with the two shocks being; COMESA removing tariffs on imports from the rest of Africa and the rest of Africa removing import tariffs on imports from COMESA, using the standard Closure. The study limited the regional and sector aggregation of the GTAP data to 3x3 because of the limitation in accessing higher versions of the software which could further disaggregate the data into more regions and sectors.

#### **4.0 Results**

Simulation results from the GTAP model provide compelling evidence of positive impact of AfCFTA on COMESA trade.

Implementation of the AfCFTA by way of removal of existing tariffs on all intra-African trade will boost COMESA's aggregate exports by 2.74 percent. Agricultural, manufacturing and service sector exports by COMESA to the rest of Africa would rise by 32.21 percent, 42.73 percent and 0.71 percent respectively as shown in table 4.1 below. Therefore, on average, implementation of the AfCFTA would lead to an increase in COMESA exports to the rest of Africa by 25.22 percent. Additionally, implementation of the AfCFTA would only lead to a marginal decrease in COMESA

exports to the rest of the world implying that the region would not lose out on its trade with the rest of the world due implementation of the AfCFTA.

**Table 4.1 Percentage change in COMESA exports and Imports by sector**

Sector	Rest of Africa	Rest of World	Comesa
<b>Exports</b>			
<b>Agri (Agriculture)</b>	32.21	-1.07	-1.29
<b>Mnfc (Manufacturing)</b>	42.73	0.7	-6.31
<b>Services</b>	0.71	-0.21	-0.14
<b>Imports</b>			
<b>Agri</b>	27.99	-0.17	-1.29
<b>Mnfc</b>	96.47	-6.92	-6.31
<b>Services</b>	-0.16	0.08	-0.14

*Source: GTAP simulation results*

Similarly, aggregate COMESA imports would increase by 2.25 percent. The region's imports from the rest of Africa are expected to grow by an average of 41.43 percent. Manufacturing sector imports would rise by 96.47 percent while agricultural imports would grow by 27.99 percent. This indicates that the firms within the region engaged in manufacturing are likely to benefit by significantly exporting to other African countries. Imports of services are expected to decline marginally at 0.16 percent.

While the AfCFTA will promote intra-regional trade, it may not have a significant effect on the overall trade balance given that increased intra-regional exports imply increased intra-regional imports. However, the implementation of AfCFTA is expected to boost competition and firm efficiency across the region as it opens to the rest of Africa.

The improved trade and efficiency within the region would ultimately benefit consumers. Removal of trade tariffs would not only lower product prices but also provide a wider range of commodities to consumers. The lower product prices can be attributed to a decline in prices of imported goods and services as indicated in table 4.2 below. This finding is consistent with the results by UNECA and TMEA (2020). It is worth noting that the benefit to consumers that arises from this price changes should be balanced with the decline in imports from the rest of the world who might be more efficient to avoid the problem of trade diversion.

**Table 4.2: Average change in import prices**

Pfm [ <b>**Comesa</b> ]	Agri	Mnfc	Services
<b>Agri</b>	-0.221	-0.221	-0.221
<b>Mnfc</b>	-1.27	-1.27	-1.27
<b>Services</b>	-0.004	-0.004	-0.004

*Source: GTAP simulation results*

Full implementation of the AfCFTA is expected to lead to significant loss in revenue from import duty among the COMESA member states. This remains a serious challenge for the successful implementation of the agreement since the tariff revenues constitute an important source of revenue to some governments. The study findings presented in table 4.3 indicate that on average, COMESA would lose 3.97 percent in tax revenue due to removal of tariff barriers within the AfCFTA. This result compares with the findings in Mold and Mukwaya (2016) as well as UNECA and TMEA (2020).

**Table 4.3 Change in tax revenue**

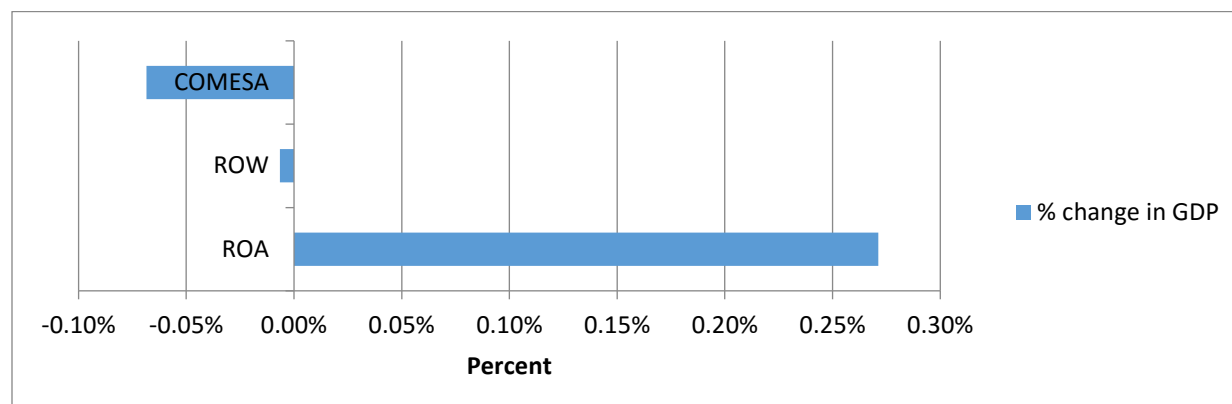
	PRE	POST	% CHANGE
<b>Rest of Africa</b>	175476	175773	0.17%
<b>Rest of World</b>	16138546	16137474	-0.01%
<b>COMESA</b>	24032	23077	-3.97%

*Source: GTAP simulation results*

However, the revenue loss may be considered as a necessary sacrifice for the added efficiency to the regional and continental economy. Tariff revenue loss by governments in the region would mean lower taxes paid by consumers and producers across the continent. Therefore, the tariff loss could imply redistribution of income from governments to producers and consumers. Additionally, the member states can undertake measures towards greater reliance on non-tariff revenue.

In regard to GDP, the study found that implementation of the AfCFTA is likely to cause a decrease of 0.07 percent in GDP of COMESA region as shown in figure 4.1 below. This marginal decrease could be attributed to the slightly higher increase in imports as compared to the increase in the region's exports. This result compares with part of the findings in Mukwaya and Mold (2014). However, it is worth noting that this result could change in a dynamic model where imports act as intermediate inputs that are used to produce final goods which are subsequently traded.

**Figure 4.1 Percentage change in GDP by region**



*Source: GTAP simulation results*

On net welfare, the study findings indicate that consumers within the AfCFTA will gain a net of USD 699 million. However, this welfare gain will be skewed in favour of the rest of Africa. Consequently, the consumers within COMESA region would suffer a welfare loss of USD 58 million as summarised in table 4.4. This can be attributed to the fact that the region suffers a loss in allocate efficiency and terms of trade.

**Table 4.4: Welfare decomposition in USD millions**

	Allocate Efficiency	Endowment Effect	Terms of Trade Effect	Investment Savings	Total Welfare
<b>Comesa</b>	-19	0	-26	-13	-58
<b>Rest of Africa</b>	197	0	593	-33	757
<b>Rest of World</b>	-109	-1	-567	47	-630

*Source: GTAP simulation results*

## 5.0 Conclusions and Policy Implications

The AfCFTA is a vital step towards integrating African economies and boosting intra-African trade. Its agenda is not only ambitious but also far-reaching as it intends to hasten Africa's industrialisation and exploit the enormous opportunities in the various sectors through removal of existing tariff and non-tariff barriers to trade, among others. This is expected to improve development prospects for COMESA and allow firms within the region to tap into the fast-growing



markets throughout the continent. The AfCFTA can therefore be seen as a timely opportunity for COMESA countries, and indeed African countries in the wake of globalization.

Being the single largest REC within Africa, the COMESA region is expected to be affected by implementation of the AfCFTA. This study undertook to establish the effect of implementation of AfCFTA by way of tariff reduction on the COMESA region. To achieve the objective, the study employed the CGE model and GTAP data base to simulate the effect of elimination of import tariff by the rest of Africa on imports from COMESA and Vice-Versa.

The study established that removal of import tariffs as proposed by AfCFTA will lead to a rise in COMESA exports and imports, and a fall in import prices within the region and the AfCFTA at large. Tariff removal would lead to an overall gain in welfare among the African countries despite the fact that it would marginally lower the welfare of COMESA region. Additionally, the study found that implementation of the AfCFTA would lead to a marginal fall in COMESA's GDP which can be attributed to the significant rise in the region's imports.

The findings of this study provide empirical evidence on the economic effect of the implementation of the AfCFTA on the COMESA region. The study recommends that the respective governments of COMESA countries should consider elimination of import tariffs on trade with the rest of Africa even as the rest of Africa reciprocates the same as this would boost the regions total trade. Furthermore, it would lead to an increase in trade between COMESA and the rest of Africa which will increase intra-Africa trade. However, COMESA countries should be ready to absorb the marginal loss in tax revenue due to elimination of import tariffs. This can be achieved through other measures that would expand their tax base.

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