IGC International Growth Centre

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Revenue and Welfare Implications for Rwanda finalizing an Economic Partnership Agreement with the EU

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- Revenue losses and welfare gains are likely to be very limited and spread over a long time span.
- Dynamic effects of the EPA are likely to be more important, inducing competition and productivity growth in the region.

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At the end of the Cotonou Partnership Agreement, its members agreed to put in place a WTO-compatible regime, forming a free trade area. WTO-compatibility implies that 90 per cent of the bilateral trade between the European Union (EU) and the Africa-Caribbean-Pacific countries would have to be duty free and quota free within a reasonable (unspecified) amount of time. The East African Community (EAC) negotiating group is in the process of finalizing its Economic Partnership Agreement (EPA) with the EU. The EU accounts for around 15 per cent of Rwanda's imports, and the share of the EU in tariff revenue is 14 per cent.

WHAT ARE THE FORESEEABLE STATIC EFFECTS OF THE EPAS FOR THE EAC IN TERMS OF REVENUE AND WELFARE? AND WHAT WILL THE DYNAMIC EFFECTS BE?

The revenue effect is likely to be minimal

Under the EPA, revenues on import from the EU will decrease. A simple estimation (assuming that import patterns will not change after the entry into force of the EPA) forecasts a total revenue loss of around 37 per cent of initial revenues from the EU for Rwanda during Phase 2 and 3 of tariff elimination, totaling USD 7,358,000. A more realistic analysis (simulating changes in import patterns derived by changes in tariffs)

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suggests that under the EPA Rwanda's imports would increase by 0.1 per cent because of the small reduction (3.3 per cent) in the average applied tariffs on all imports. Tariff revenue would decrease by 3.2 per cent.

Under both scenarios, the impact of the EPA on tariff revenues seems low given that the tariff revenues from the EU are not large. Moreover, the losses are spread over many years and they are unlikely to be noticeable in terms of total government revenue.

Revenue estimates of the full EPA

	EPA with official EAC exclusion list	EPA with no exclusion list – 100% liberalized
% change in imports	0.1%	0.5%
% change in tariff revenue	-3.2%	-13.2%
% change in Total Border levies revenue	-0.8%	-3.3%
% change in collected applied tariff rate	-3.3%	-13.6%

Source: Authors' simulations from TRIST on 2012 data.

Gains to consumers and producers are likely to be limited

Lower prices due to the elimination of tariffs will be beneficial to consumers and producers in Rwanda. However, as the effect on imports and collected tariffs of the negotiated EPA is low on Rwanda, the increase in consumer surplus is also low accounting for only 0.1 per cent of initial (total) import expenditures. These gains will partially compensate the tariff revenue loss. As a net result, the EPA could have slightly negative effects on the total welfare of the Rwandan economy. In case of a "full liberalization" (that is, if all tariff lines were included in the liberalization schedule), gains for the consumers would be higher, but so would be the revenue loss, resulting in slightly higher welfare losses.

The EPA will promote import of intermediate and semi-processed goods

Among the sectors most affected by the EPA (by a drop in prices and an increase imports) there are mostly intermediate or semi-processed goods. A fall in the price of these goods will raise the value-added price, and hence the profitability, of downstream sectors. Other affected sectors are mainly high and middle technology manufactures.

Dynamic effects will promote increases in productivity in the region

Although the static effects of the EPAs might be almost neutral, the gains deriving from liberalization will become evident in the long run, with the creation of dynamic effects. A large number of studies has shown that trade liberalization has beneficial effects in terms of increasing productivity. In the case of the EAC increased competition to local industry (primarily in Kenya) will promote productivity and growth. The dynamic gains are likely to more than offset the short-term, limited static welfare losses.

POLICY IMPLICATIONS

The beneficial impacts of the EPA agreements will become evident in the longer term. The effects are likely to be stronger in case of a "full liberalization".

A few points on the future of the negotiations can be summarized as follows:

- The long and complex EU-EAC protocol on Rules of Origin (RoO) should be simplified to avoid product-specific rules of origin (present in the ongoing EAC-EPA negotiations). In general, RoO should be made more compatible with the multilateral trading system.
- EPA negotiations focus on goods and ignore the services sector. However, a services sector that is open to the world market (and well regulated) could attract the investments needed to compete in goods markets. Literature focussing on East African countries has shown that gains from successful opening of the services sector are larger than potential gains from removing remaining tariffs in the EPA.
- In these final stages, the EPA negotiations should focus on providing the necessary aid-for-trade resources to support the creation of an appropriate supportive regulatory framework in the EAC. The CARIFORUM EPA is a good example of how to pursue a cooperative approach to remove the constraints in the services sectors.
- The phasing of tariff elimination under the EPAs is extremely long. The EAC does not start reducing tariffs on EU imports before 2014, with tariff reductions ending in 2033. In general tariff-reduction negotiations (NAFTA, MERCOSUR) are spread over less than 10 years. In view of the very small changes in revenue and welfare estimates, the EAC should consider moving the removal of tariffs to a closer date, perhaps to 2020.

ABOUT THE IGC

The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research. Based at the London School of Economics and in partnership with Oxford University, the IGC is initiated and funded by the UK Department for International Development.

The country team for Rwanda includes Linda Calabrese and Radhika Goyal, In-Country Economists; Aaron Weisbrod, Hub Economist; Andrew Zeitlin, Lead Academic; and Richard Newfarmer, Country Director.

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