

Price Incentives To Rwanda's Exporters: Trade Policy Priorities

Jonathan Argent, July 2011

The current EAC-CET is imposing costs on Rwanda, weighing down export performance and growth, and raising prices for Rwandan consumers. This is in addition to the constraints imposed by Non-Tariff Barriers (NTBs) and transport costs. Rwanda can reduce these costs through negotiations with the EAC, particularly advocating changes in the common external tariff based on its own interests, intensifying EAC work on reducing NTBs, and working collectively with EAC partners on a common transport infrastructure. This note summarizes elements of recent IGC work on Rwanda's trade.

Tariff Protection

Rwanda's shift to the EAC Common External Tariff (CET) in July 2009 represented a large reduction in overall tariffs. Nonetheless, these tariff rates are still high by global standards. The shift also resulted in a number of products experiencing a large increase in tariff rate; particularly those products on the sensitive item (SI) list¹.

High tariff rates have a significant impact on competition and prices within Rwanda. Consider the following simple example. A Rwandan importer of sugar faces the choice of purchasing from within the EAC/COMESA, or importing from countries exterior to these agreements. Exterior producers of sugar face a 60% tariff² and as such, the Rwandan importer will have to pay the border price³ plus 60%. Even if the EAC producers of sugar can produce and sell sugar at the border

price, they can charge up to 160% of this price because of the tariff protection from international competition.

If the sugar sector in the EAC/COMESA were very competitive then the tariff would have less effect. However, few sectors in the EAC/COMESA are so competitive that a high tariff rate would not impact prices.

The effect of the tariff is that Rwandan consumers and producers have to pay substantially more for sugar. Furthermore, to the extent that sugar is obtained from within the EAC/COMESA, rather than imported over a tariff, the Government of Rwanda (GOR) does not benefit in tariff revenue. The CET on sugar has a welfare cost on Rwanda – transferring wealth from Rwandan producers and consumers to sugar producers elsewhere in the EAC/COMESA.

Certain exemptions (e.g. the investment code) allow producers to avoid tariffs on inputs and capital goods. While this reduces the impact of the tariff, it is expensive to administer, creates incentives for corruption and may result in bias towards particular firms or industries. Firms (particularly SMEs) that obtain their inputs from local distributors cannot generally access these exceptions, creating a bias against them.

Sugar imported for direct consumption, does not qualify for an exemption. Rwanda imported RWF 20bn of sugar in 2010, with 90% of it coming from within the EAC/COMESA (57% and 33% respectively). More than three quarters of this was imported for direct consumption. Even if these producers are only charging half of the protection margin, this corresponds

¹ There are 57 HS codes on the current SI list.

² Sugar is on the SI list.

³ The border price refers to the price for which the good can be obtained at the border of the EAC.

to a welfare cost of at least⁴ RWF 4bn, ignoring the impact on sugar-using industries.

High tariffs on consumption goods impact Rwandan living standards through increasing the cost of living. This in turn places upward pressure on wages; and higher wages make Rwandan exports less competitive (though the channels are complex; see Winters, 2004).

Costly Tariffs That Disadvantage Rwanda

While all tariffs prejudice Rwanda's competitiveness and exports, some are particularly pernicious. In general, these include the highest tariffs, those that protect shared monopolies in other countries, and those that affect a large portion of local consumption bundles.

For example, transport buses for more than ten persons carry a tariff of 25%. About 85% of transport bus imports are from Japan, with only about 10% coming from Kenya. The higher prices that transporters face puts upward pressure on prices, even as the GOR has dropped fuel taxes in an effort to slow this inflation. Phasing out this tariff would be a useful means to control transport costs – and compel Kenyan producers to become more cost efficient.

Cigarette imports are dominated by Kenya with a share of 99% and a value exceeding RWF 2bn in 2010. Cigarettes are taxed at 25% under the CET, and this essentially allows Kenyan producers to charge higher prices. Eliminating the tariff and adding excise in equal measure would result in additional excise revenue of at least RWF 700m at present volumes.

Beer imports are charged a tariff at 25% under the EAC-CET. Bralirwa currently enjoys a 94% market share within Rwanda, with more than half of the competing imports coming from within the EAC and COMESA. Replacing the tariff with an excise tax could increase competition and raise significant additional tax revenues.

When Rwanda joined the EAC, the CET was already established and it had little influence on its architecture. Future discussions in the EAC on tariffs offer an opportunity to negotiate aggressively for tariff reductions.

Non-Tariff Barriers

Non-tariff barriers (NTBs) are regulatory requirements to trade. Some serve a useful purpose. For example the GOR may specify that all medical products imported into Rwanda must pass certain international standards to ensure their safety for human use. However, most NTBs are simply another means of protection, equivalent to a tariff.

An example of an NTB would be a weighbridge in Kenya that charges a fee on trucks bound for Rwanda. This is equivalent to Kenya levying a tariff on imports to Rwanda. De Melo, Collinson and Argent (2011) estimate that Kenyan, Ugandan and Tanzanian NTBs levied on certain product categories have the same impact as tariffs of up to 60%.

In 2008, the EAC agreed to a time-bound programme for the elimination of 41 NTBs. However, progress has been slow. The MINICOM/PSF 2010 NTB report found that the number of weighbridges along the Northern and Central corridors have not decreased since the 2008 study by the PSF, with the number in the latter having actually increased over the period. In addition, transport through the Northern corridor was found to involve high levels of corruption (essentially an illegal NTB).

The impact of a non-Rwandan NTB on Rwandan firms is roughly the same as the impact of the CET on products produced within the EAC, as explained in the previous section. A Rwandan NTB may provide some gains for the GOR (at cost of Rwandan consumers who ultimately face higher prices), since payment of the NTB may provide income to the GOR and employment to GOR officials. However the danger of Rwanda putting in place NTBs is that her neighbours may retaliate with NTBs of their own.

The agreement by the Partner States in the EAC specifies that (1) countries must monitor and inform the EAC of current NTBs, with a view to removing them; and (2) that no new NTBs should be added. Rwanda should pursue the reduction of NTBs as suggested in this agreement. Success would deliver increased competition within Rwanda, lower input costs and stronger incentives to export.

Transport Costs

Being landlocked, transport costs to export markets are high even in the absence of tariffs, NTBs and illegal NTBs (e.g. corrupt police in foreign countries demanding bribes). For example, transporting a heavy container from the Mombasa port to Kigali costs approximately \$5000 more than shipping to Nairobi (Nathan Associates, 2011). This means that local producers in Rwanda naturally receive protection from geography, since any importer must incur high transport costs to bring goods into the country.

To be sure, Rwanda's has limited instruments to reduce these costs. It is already exploring infrastructure investments that can help (e.g. the current railway project). These will take time, but entail a large pay-off. In the meantime, focusing on tariffs and NTBs in discussion with the EAC can yield immediate results.

⁴ Since at lower prices, we would expect the market to consume more sugar, such a back-of-the-envelope calculation certainly underestimates the true deadweight loss.

The Incentive Framework

These three elements – tariffs, NTBs, and transport costs – affect export incentives. A simple stylized example illustrates how tariffs, NTBs and transport costs combine to create a powerful bias against production for export in Rwanda. The first column of the table below shows how notional levels of tariffs, NTBs (shown in ad valorem equivalent) and transport costs conspire to allow local producers to charge a price 65% above the price at the border. The price calculated in this column is essentially the price that international competition would be able to offer.

Comparing domestic and export incentives

	Local market	Export market
World price	100	100
Tariff (25%)	25	
NTB ave (20%)	20	-20
Transport (20%)	20	-20
Total	165	60

The second column shows the contrasting position of exporters, who receive only 60% of the border price as a result of NTBs and transport costs. This is a generous estimate since it assumes a zero import tariff in the export market. Furthermore the NTB and transport costs used for simplicity here, are far below those that have recently been estimated to hold in reality.

In this conservative example an exporter receives only 36% of the revenue that the producer for the local market does. It is clear that this incentive framework substantially favours production for the domestic market rather than the export market. This is the reason why Rwanda, if it wishes to expand exports, should move assertively in the EAC to revamp policies and shift incentives toward export production.

References and Further Reading

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