The Common External Tariff (CET) after Two Years: An Evaluation from Rwanda's Perspective

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Main points…

On average, applied tariffs were reduced under the CET from an average of 15.8% to 11.5 %, which had a number of effects:

The reduction in tariffs on intermediate inputs increased exports among those exporters that also import.

Employment also increased post CET. While no causal link could be established between the CET changes and employment, the CET definitely did not lower employment. Employment in the formal sector was increasing rapidly after the CET.

But,….the increase in tariffs for items on the Sensitive Items (SI) List is directly increasing poverty in Rwanda, and reducing manufactured exports in agricultural commodities.

The benefits of protection under the EAC-CET are accruing primarily to Kenya and Tanzania (and Uganda), rather than to Rwanda.

East African Community (EAC)

• Regional Trade Area of the East African Community revived with a customs union involving Kenya, Uganda and Tanzania in 2005.

• Rwanda and Burundi joined the customs union on July 1, 2009

• Not the first attempt to create an EAC regional trade area

• The first attempt was in the 1960s. As Venables (2003) analyzes, it fell apart since the agreement was not beneficial to Uganda

• Uganda has extreme comparative advantage in comparison to Kenya. Therefore, the tariff walls of the original CET benefitted the manufacturing firms of Kenya at the expense of the Uganda getting the world low-cost manufactured items in exchange for its agricultural products.

• The trade diversion of Kenyan manufactured imports into Uganda dominated any trade creation effects for Uganda.

Rwanda's Regional Trade Areas

COMESA

EAC

Rwanda’s Trade Context

- Landlocked country

- No railway

- Dependent on road links via Uganda/Kenya to port of Mombasa or via Tanzania to port of Dar es Salaam

- Therefore, first-order trade facilitation issues include maintaining good road infrastructure, and coming to agreements with Kenya and Tanzania on minimizing non-tariff measures (de Melo, Argent, and Collinson, 2011a, 2011b)

- Also suggests that continued development of trade in services may be particularly valuable for Rwanda

The Common External Tariff (CET) – An Evaluation

What was the CET supposed to do?

1) Reduce the tariff rate for imports from Uganda, Kenya and Burundi, which were already low because of joint membership in COMESA (Common Market for Eastern and Southern Africa)

2) Significantly reduce the tariff rate for imports from Tanzania

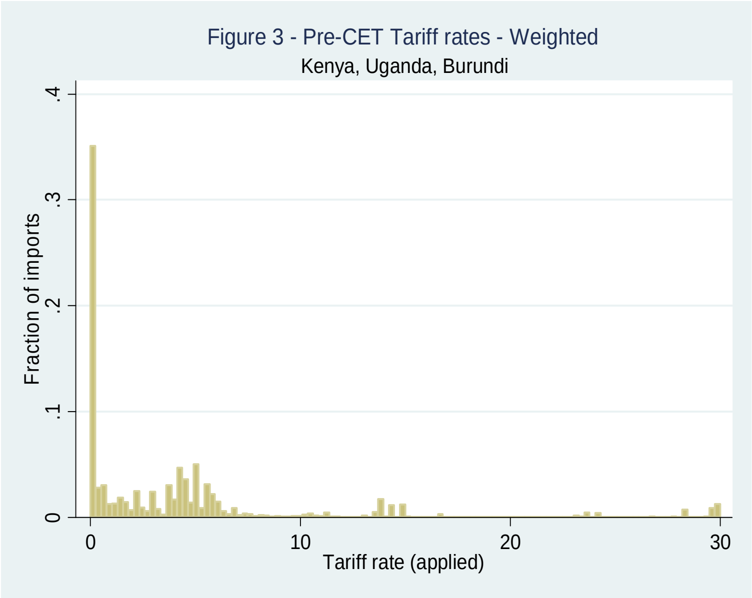
3) Set a common tariff for goods from outside the EAC. Specifically, replace a 0 -5 -15-30 tariff structure (0% tariff for raw materials, 5% for goods with economic importance, 15% for semi-finished goods, and 30% for finished products) with a 0-10-25 normal tariff structure (0% for raw materials, 10% for semi-finished products, and 25% on finished products)

Common External Tariff – Application by Origin

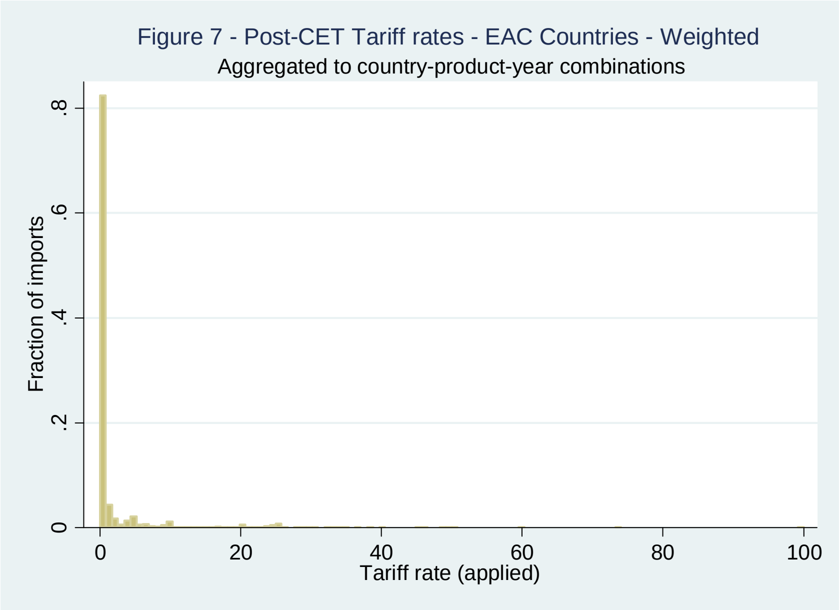
Is this what happened? Yes.

Tariff rates dropped for COMESA partners (Kenya, Uganda, Burundi):

Pre-CET:



Post-CET:

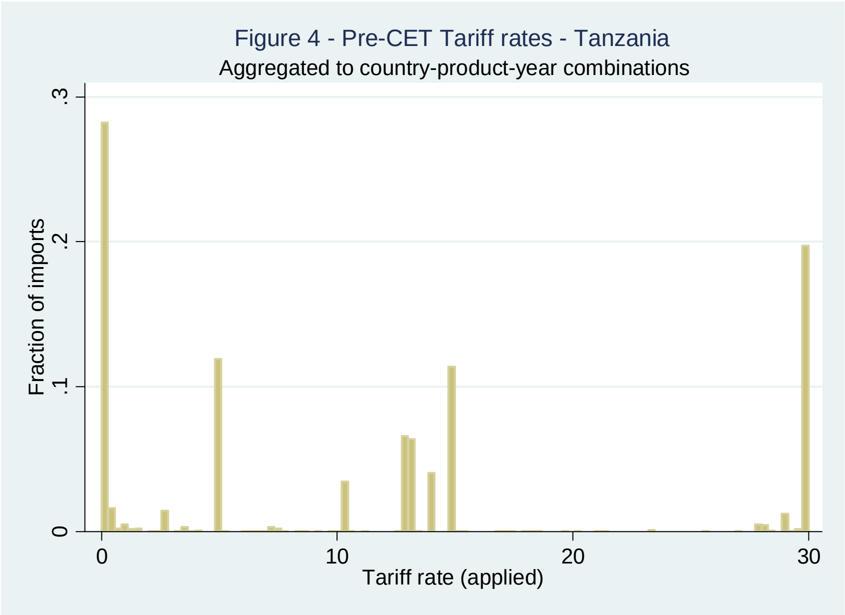


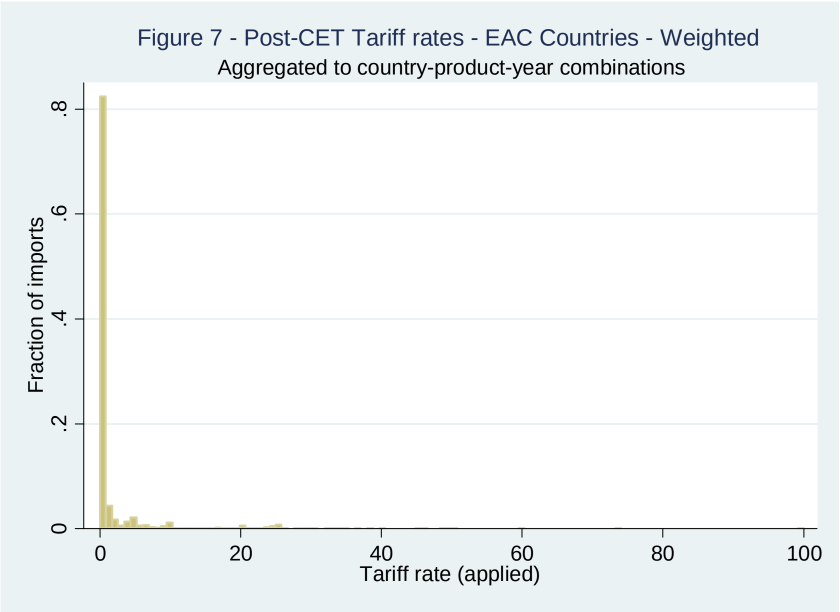
Common External Tariff – Application by Origin

Tariff rates dropped more for Tanzania:

Pre-CET:

Post-CET:

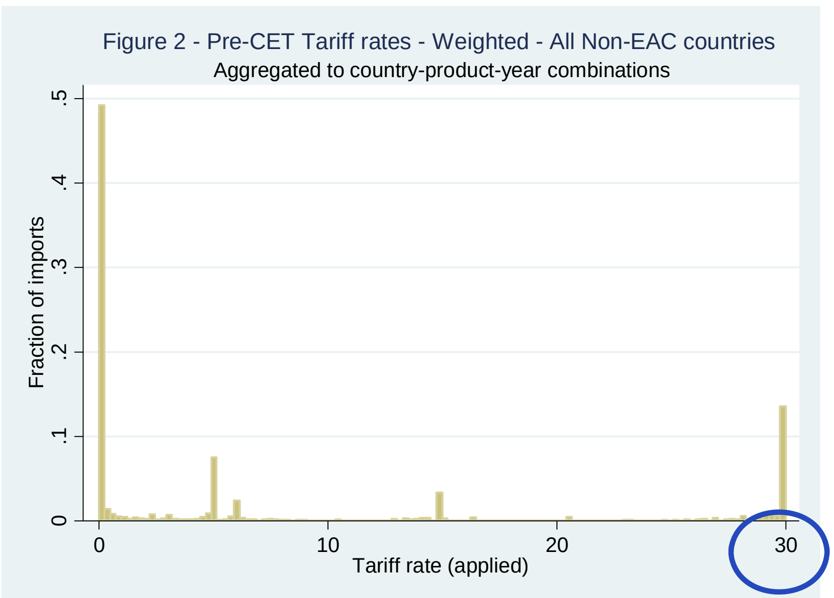




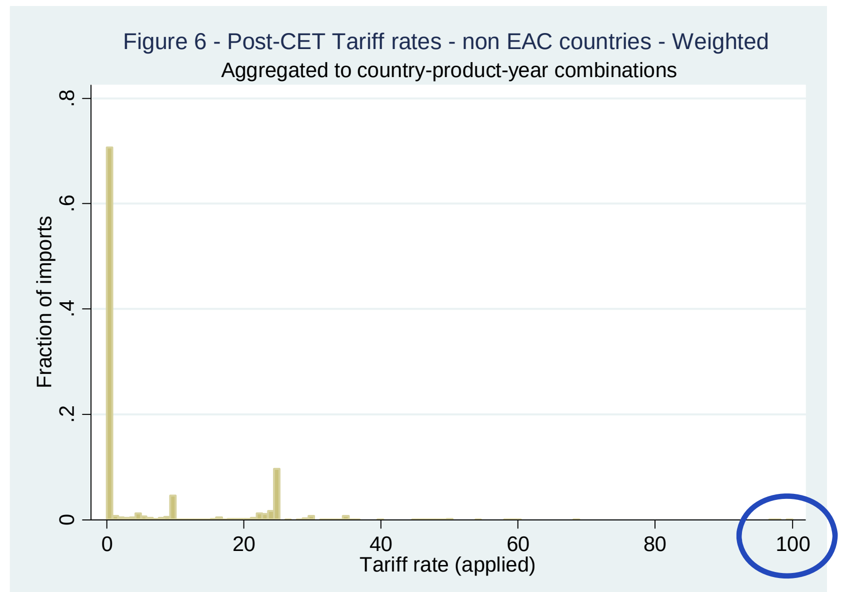
Common External Tariff - Application

Tariff rates also changed for external (non-EAC) countries

Pre-CET (0-5-15-30 structure):



Post-CET (0-10-25 structure):



But now there are a number of exceptionally high tariff rates on the Sensitive Items (SI) List

CET – Application by good type

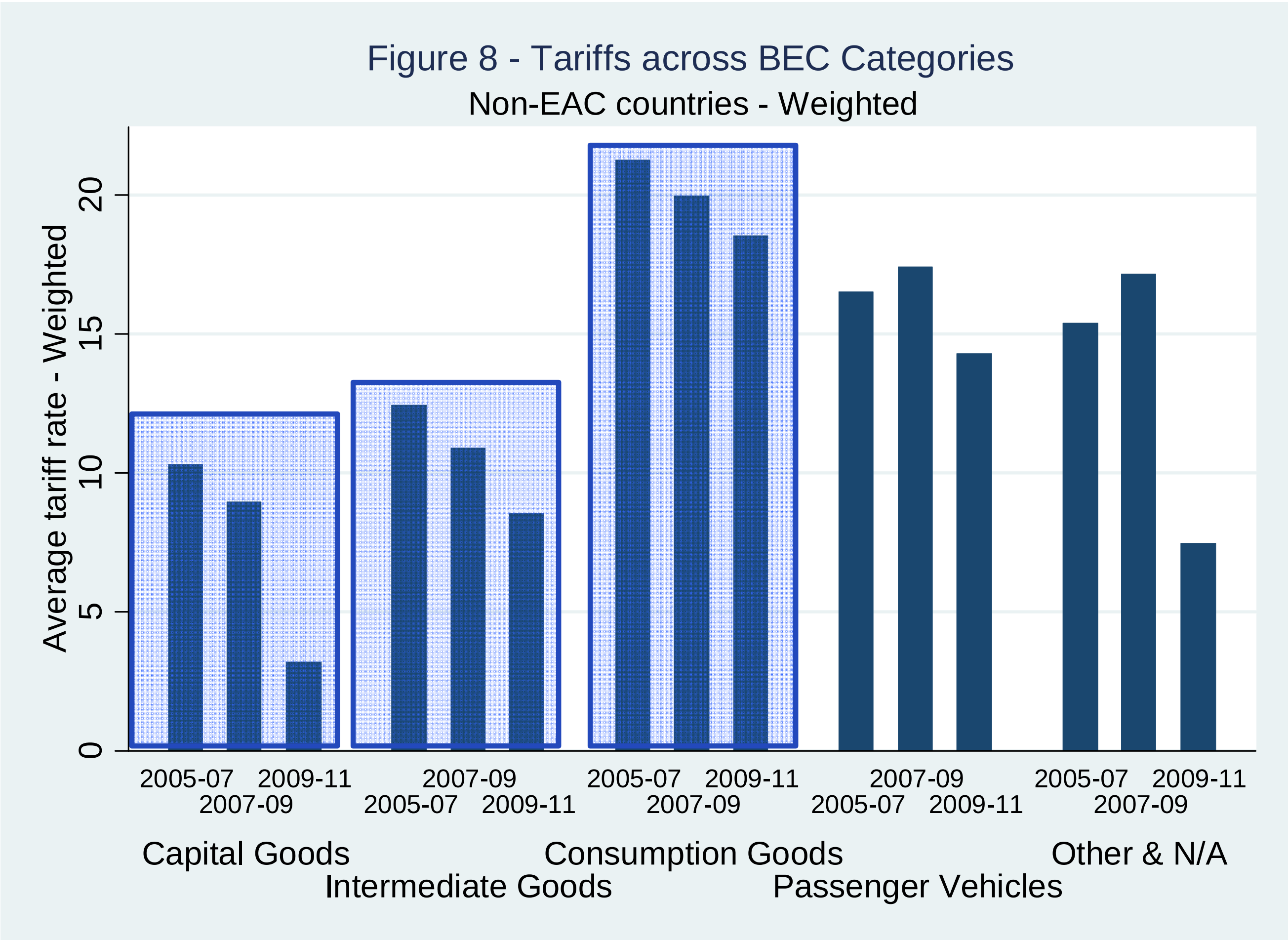
Sensitive items are largely food staples

Milk	60%
Wheat Grain	35%
Wheat Flour	60%
Maize	50%
Sugar	100%
Worn Clothing	50% (or 0.75/kg, the highest)
Kanga, Kikoi and Kitenge	50%

The temporary reprieves that are currently in effect for wheat grain and sugar (and wheat flour, to 35%) are helpful, but temporary.

Looking at the change in tariffs a different way…

We see that the tariff reductions were largest for capital goods, then intermediate goods, and then consumer goods.



So, what did these tariff changes achieve?

1) Exports

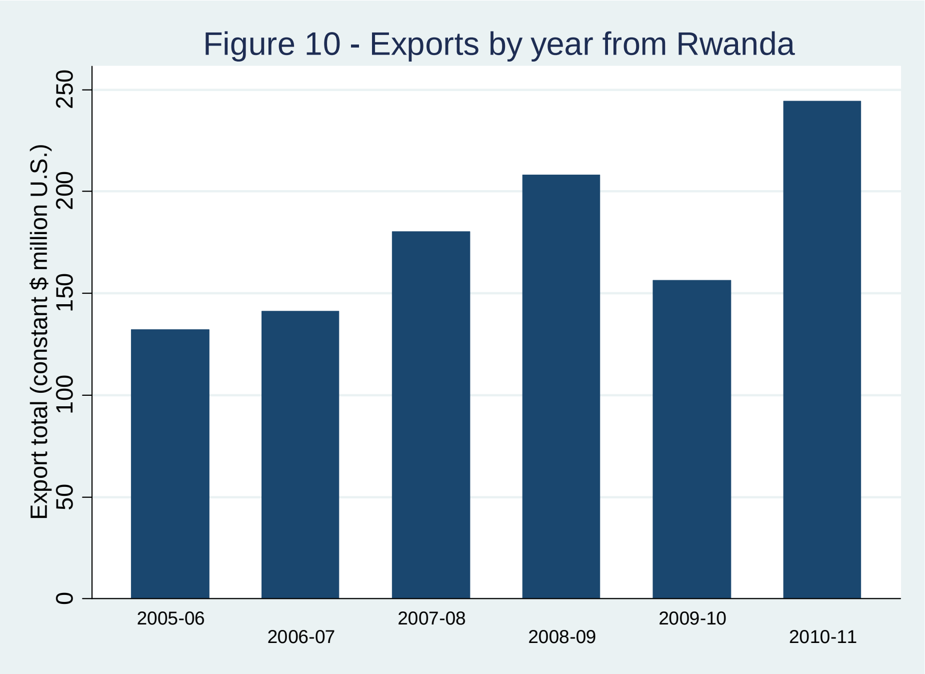
2) Employment

3) Poverty Reduction

We will evaluate the impact of the CET on each of these three areas, as well as on tariff revenue.

First, what happened to exports post-CET?

Exports fell drastically after the CET in comparison to the pre-CET trend, but then picked back up:



Did the CET cause a huge drop in exports? No, this was the year of the global recession.

How does a tariff change affect exporters?

The CET dropped import tariffs <u>on average</u>, but definitely <u>not on everything</u>.

When tariffs drop, some import-competing firms will go out of business, and the resources may end up being used by exporting firms.

But, more directly, many exporting firms also import. So, the reduced prices for imports are advantageous to them. Specifically, Rwandan exporters faced an average tariff rate of 12.0% on their imported inputs prior to the CET, and 7.3% after the CET.

The Impact of Reduced Import Tariffs on Exports

Once we carefully account for the global economic slowdown and expansion, as well as the exporting abilities of individual firms, and trends within export product lines:

…We see that this 5 percentage point reduction in the tariff on imported inputs resulted in an increase in exports of between 5 and 10% for those firms that imported inputs.

…But this should underestimate the effect of these reduced tariffs, because it calculates the direct effect of imported input price decreases on just the exporters that imported them. The lower prices will also benefit other exporters who buy from a “middleman”
.

But not all Input Tariffs were Reduced

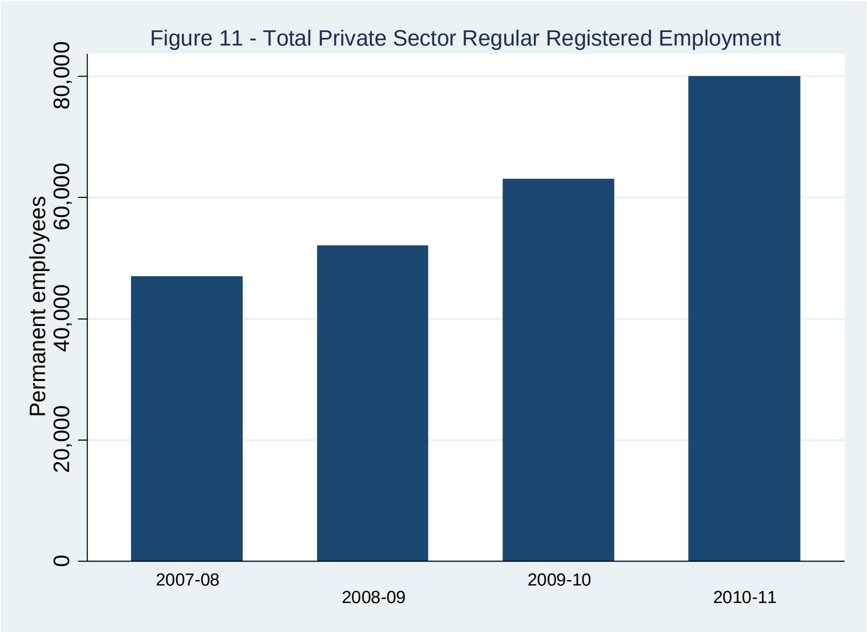
The tariffs in most input categories used by exporters dropped post-CET, but the tariffs on one input increased.

…Sugar. Sugar is on the Sensitive Items List and subject to a tariff rate of 100%. This reduced manufactures, in terms of food processing, as well as the export of these manufactures.

The CET and Employment

What was happening with employment after the CET?

Total (private) registered employment increased:



Did the CET spur the employment increase?

Just as we cannot assume that the CET caused the drop in exports immediately post-CET, we also cannot assume that the rise in employment was caused by the CET.

When we examine whether the drop in tariffs on imports increased employment in the importing firms, we cannot find any direct effect.

There is absolutely no evidence of the CET reducing employment, and employment definitely increased post-CET.

The CET and Poverty

On average, import tariffs dropped under the CET, but there was a lot of heterogeneity, with some tariff rates increasing, particularly for the Sensitive Items (SI) List, which we saw included a lot of staples:

To examine the impact of these tariff changes on the poor, we need to examine what happened to the prices of items included in the household consumption of the poor:

The CET and Poverty

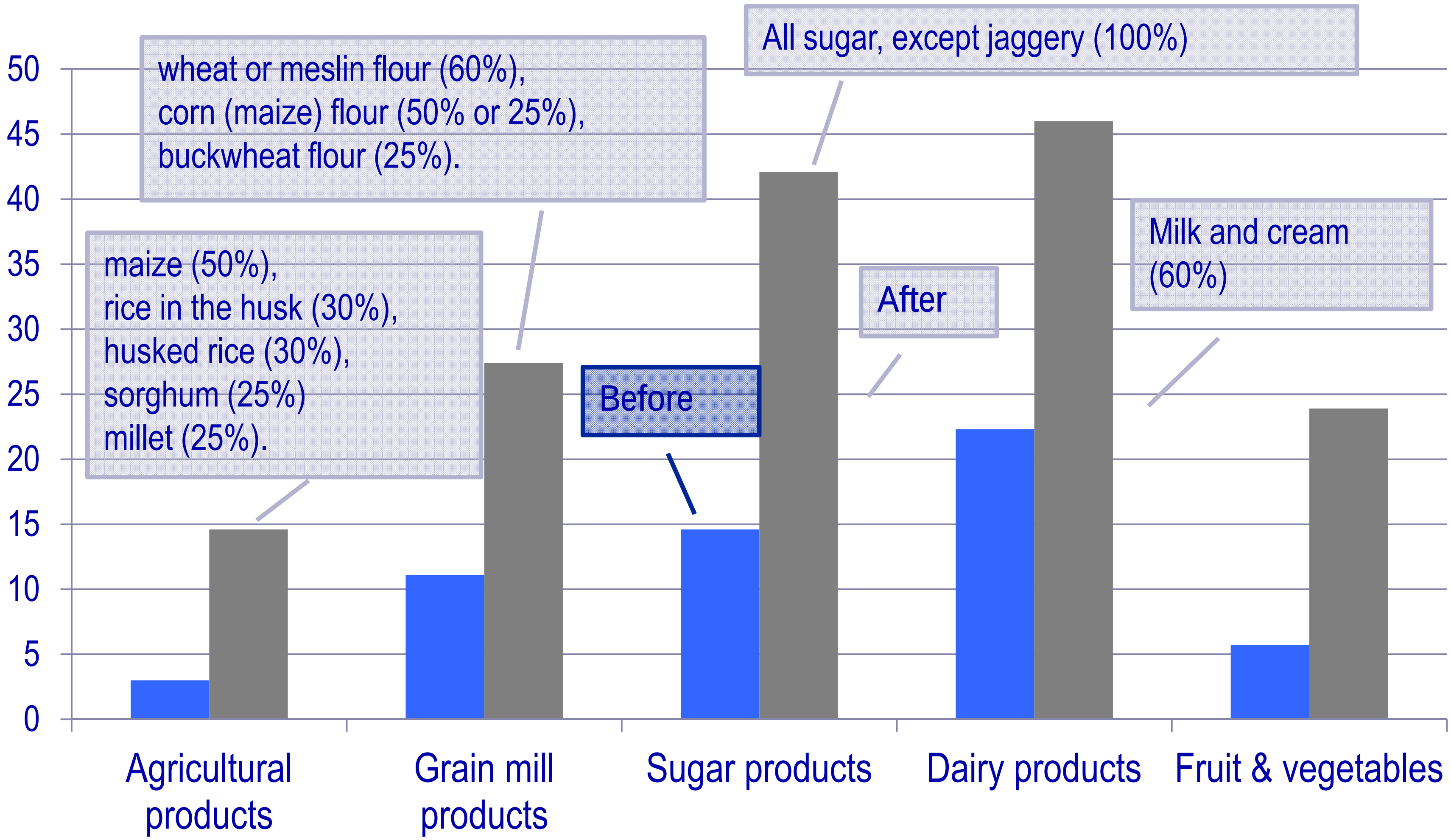
Sector	Expenditure Share
Agricultural products	10
Meat products	9
Grain mill products	9
Soap products	8
Bakery products	6
Sugar products	5
Other food products	4
Wearing apparel	3
Petroleum products	3
Dairy products	3
Beverages & tobacco	3
Oils & fats products	2
Footwear	2
Other manufacturing	2
Other paper products	1
Fish products	1
Fruit & vegetables	1

The brown-coloured categories did not change their tariff rates under the CET more than 25%.

The petroleum product category was the only category where the tariff rate dropped more than 25%. (Even here, it was replaced by an excise tax.)

In each of the blue categories, the tariff rate increased by more than 100%. In the agricultural products category the tariff rate increased by 380%.

CET – Tariffs on staples



What was the overall effect of the CET on poverty in Rwanda?

If we take into account all of the price changes induced by the tariff changes (both tariff increases and decreases, but overwhelmingly increases), we find that the CET directly reduced the income of low-income people in Rwanda by as much as 4%.

Why? Products on the SI List.

The CET and Tariff Revenue

As noted, lowering tariffs can boost the economy in a variety of ways, but at the same time, it does lower the tariff revenue collected by the government, except when the increased quantity of imports overwhelms the reduced tariff applied per unit of quantity.

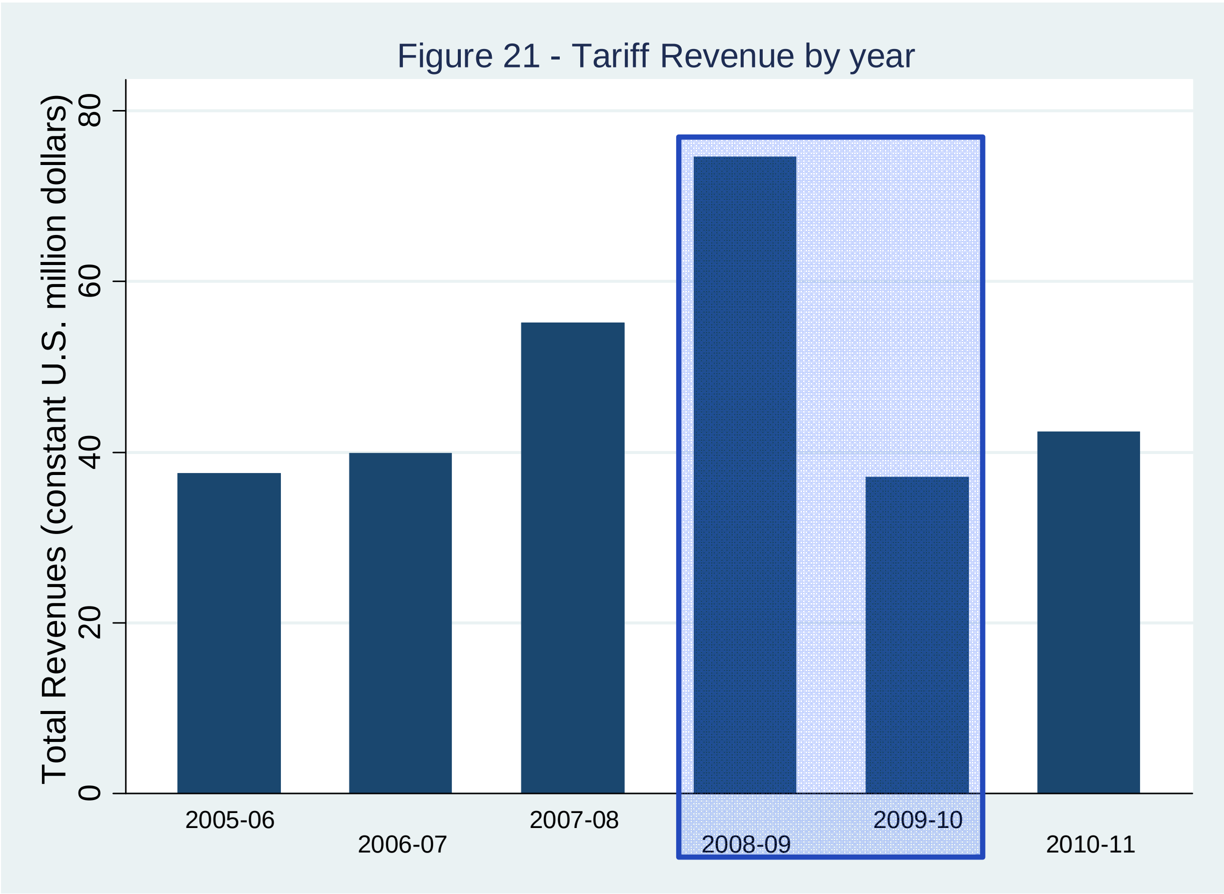
In Rwanda, the external tariff (for non-EAC countries) was lowered with the CET.

Also, for EAC countries, the tariffs were largely removed.

These two combined effects definitely lowered tariff revenues.

However, the largest category of lost tariff revenue was petroleum, and this was replaced by a petroleum excise tax.

CET – Impact on revenue



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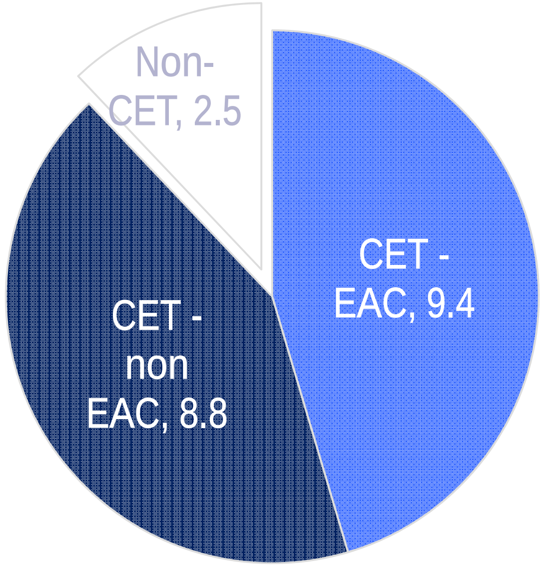

Conclusion

The increase in tariffs for items on the SI List is increasing poverty and reducing manufactured exports in the food processing sector.

The reduction in tariffs on intermediates reduced costs of local production and as a result increased exports.

Employment increased post-CET. This could have been related to the GOR's many policy initiatives, including the CET.

The benefits of protection under the EAC-CET are accruing more to Kenya and Tanzania (and Uganda) than to Rwanda.