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Has the Common External Tariff Sensitive list of Products for the EAC Generated Intra-export Trade?

Executive summary

The study, aimed at establishing whether the protection given to the list of sensitive products since 2005: has increased the EAC regional capacity to produce, reduced the importation of the same products from the rest of the world, increased intra-EAC trade, and improved welfare. Results suggest that although intra-EAC trade increased since 2005, the imports of the same products from outside the region even increased more creating a huge negative trade balance. This suggests that there is deficiency in regional capacity to produce these products within the bloc, therefore effective protection was not adequately achieved by the high tariffs imposed on the sensitive list of products.

Introduction

The treaty for the establishment of the East African Community (EAC) in Article 75 provides for the establishment of the EAC Customs Union (CU) which in turn provides for the implementation of the Common External Tariff (CET) among others as measures to develop some sectors of the regional economy. This implementation commenced in 2005 with a CET among the first three partners – Kenya Uganda and Tanzania, and was later joined by Rwanda and Burundi in 2007. The CET is structured in three bands of: zero percent for raw materials, capital goods, agricultural inputs, certain medicines and certain medical equipment. EAC Partner States identified a list of sensitive products with potential for domestic production and cross-border trade. The importation of such products from outside the community could negatively affect domestic production and development of regional capacity to produce. As such, the products were given additional protection over and above the maximum 25 percent duty.

Implementing the sensitive list tariff structure has implications: EAC citizens have to pay more for the same products imported

from without the economy which has welfare implications; and it increases chances for more Intra-EAC trade. However this is partly dependent on the EAC partner states economies addressing supply side constraints and putting in place appropriate mechanism and strategies to expand production to be able to supply. There are chances that the high CET rate on essential consumer and inputs such as cement, clinkers, hard wheat and sugar for industrial use has affected consumer welfare and raised the cost of manufacturing. The main questions are; to what extent has the EAC CET on sensitive products generated effective protection to domestic industries? (ii) has the policy increased the supply capacities to produce most of the products in the CET sensitive list? (iii) what are the trade and welfare implications?

Methods

The study adopts two analytical approaches: Trend analysis using the COMTRADE and TRAINS¹ databases to establish the intra-EAC trade flows for the period 2006 -2013 for Uganda,

¹ COMTRADE is Common format for Transient Data Exchange for power systems and TRAINS is Trade Analysis Information System

Tanzania and Kenya and 2008 -2013 for Rwanda and Burundi. The second part of the analysis uses the World Integrated Trade Solutions (WITS) using the SMART model analytical framework that conducts Partial Equilibrium (PE) analysis to establish the welfare, trade and revenue effects.

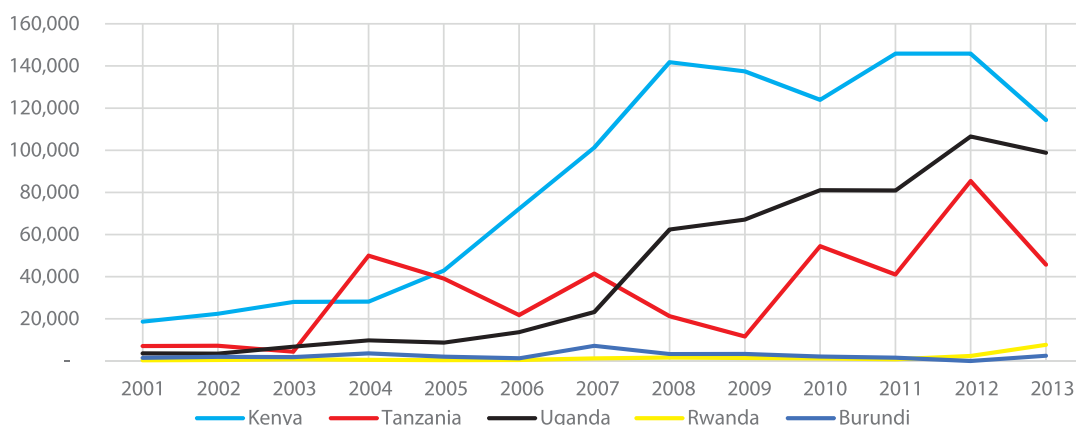
Key findings

The results, indicate that while there is significant intra-EAC export trade demonstrated by increases especially after 2005, it is skewed in nature in favour of Kenya as illustrated in figure 1. In terms of products, Uganda’s main export to the region are cigarettes and tobacco products, followed by sugar, milk products, cement and matches. Kenya on the other hand exports cement, cigarettes and tobacco, corks, crown and base metal products, milk products, wheat, manganese dioxide primary cells and batteries and matches that generate the largest export revenue while Tanzania’s main exports to the region include wheat, cement, rice and maize.

It is evident that the list is quiet small for Tanzania. Rwanda’s main exports include rice, wheat, cigarettes and tobacco products and cement while Burundi mainly exports cigarettes and tobacco products. The results suggest that there are products that are produced in almost all the countries and these include cement, sugar, rice, cigarettes and tobacco products, milk and wheat.

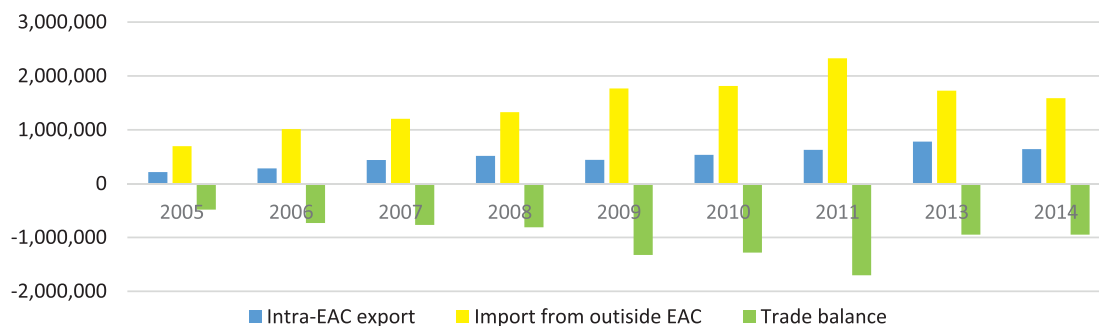
Figure 2 suggests that intra-EAC exports of sensitive products increased from about US\$ 300m in 2005 to US\$ 780m in 2013. Imports from outside the EAC regions increased from US\$ 700m in 2005 to US\$ 2.3bn in 2011 and US\$ 1.7bn in 2013. The Trade Balance (negative) increased from US\$ 482m in 2005 to US\$ 1.7bn in 2011 and declined to US\$ 947m in 2013. The demand exceeds the intra-EAC regional supply and therefore the deficit is met by imports from the rest of the world. This has welfare implications since imports attract high tariffs and artificially increases the local price of the products.

Figure 1. Trends in Intra-EAC export trade of sensitive products (US\$ '000)



Data source: COMTRADE and TRAINS databases.

Figure 2. The Sensitive Products Trade Performance (US\$ '000)



Data source: COMTRADE and TRAINS databases.

The total welfare effect for all EAC is equivalent to US\$ 3.1bn, an amount higher than the total trade effect as depicted in figure 3. The first two years experienced overall negative welfare effects which grew from US\$ 6m to 20m largely borne by Kenya. On the other hand, Uganda and Tanzania started with positive welfare effects and maintained the trend throughout. In 2013 Kenya made the most welfare gains close to 85 %, followed by Uganda (7.7 %), Tanzania (6.3%), Rwanda (1%) and Burundi (0.1 %).

Conclusion

Results suggest that there is significant intra-EAC export trade demonstrated by increases after 2005. However, imports of the same products increased by a larger factor suggesting the objective of building EAC regional supply capacity was not achieved as evidenced from the growth of the negative trade balance. There is still deficiency in capacity to produce within the bloc, notwithstanding the growth in intra-EAC exports of

Figure 3. Welfare effects

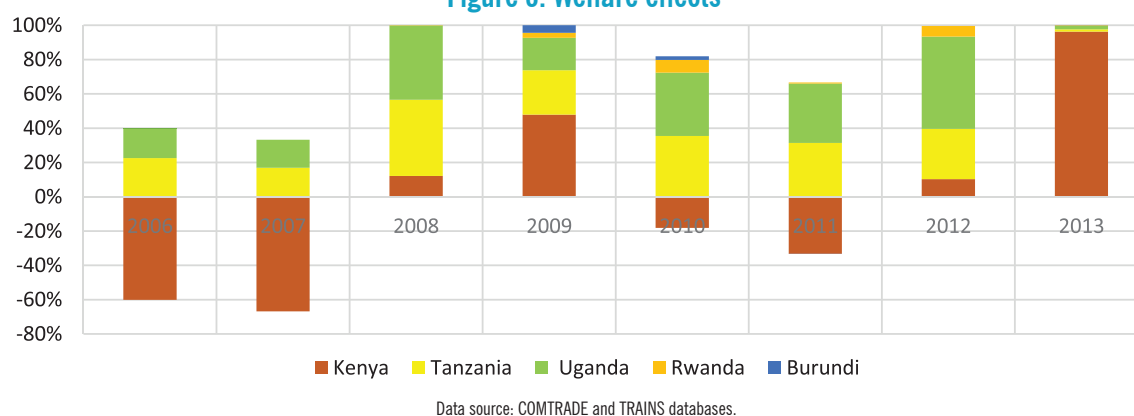
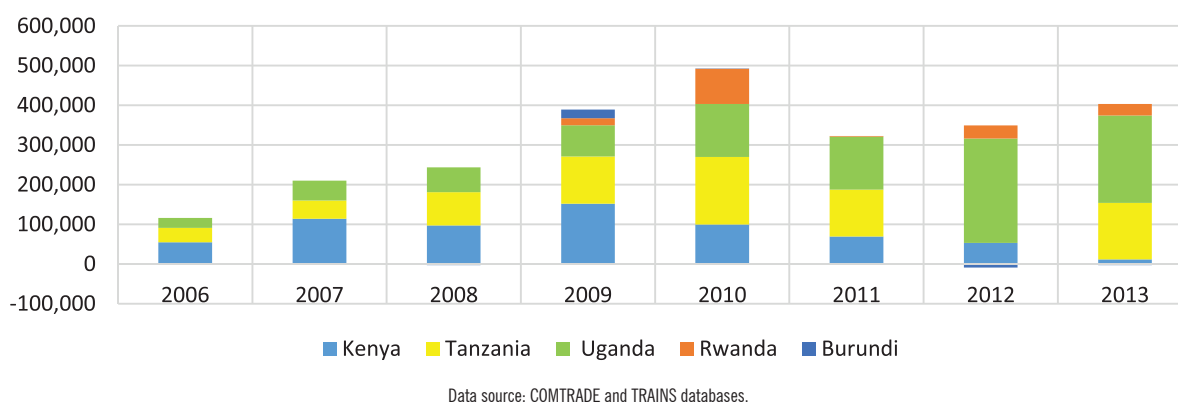


Figure 4. Trade Creation & Trade Diversion (US\$ '000)



The EAC made significant trade creation gains both individually and collectively, amounting to US\$ 2.7bn compared to trade diversion (US\$ 50m) as illustrated in figure 4. At the partner state level, Uganda's trade creation amounted to US\$ 966m, Tanzania's stood at US\$ 866m, while Kenya's amounted to US\$ 651m. Rwanda on the other hand registered a trade creation of US\$ 168m while Burundi's amounted to US\$ 3m. The results support the agreement to maintain the sensitive list of products.

the sensitive list products. Therefore generating a sensitive list was a necessary condition, but not sufficient to build the capacity to produce the same products regionally. We conclude that although the EAC partner states took the first step of generating a sensitive list, they did not adequately put in place the necessary conditions to build sufficient capacity to produce the same products regionally. The EAC citizens pay more for the same products imported from out of the region which has negative welfare implications. Finally, the EAC region made significant trade creation gains collectively to a tune of US\$

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2.7billion compared to trade diversion to a tune of US\$ 50million.

Policy Implications

1. The results identify the sectors where trade has been generated which can be used for strategic investments within each partner state.
2. EAC should review the CET sensitive products list considering the negative effects this is likely to have on manufacturing and consumption welfare in the EAC region. Wheat should be zero rated since the region lacks the capacity as well as the necessary conditions to domestically produce the quantities demanded. Raw sugar being a major input in food processing should have its rate significantly lowered while cement should be zero rated to lower the cost of infrastructure development.
3. Partner states need to design and formulate strategies and plans to support the development of regional supply capacities to enhance the production of the products.
4. There is need to increase competitiveness by lowering the cost of production. This will entail enhancing technologies that increases productivity for instance in cane sugar production.

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