ECONOMIC POLICY RESEARCH CENTRE

Towards Sustainable Development

POLICY BRIEF

Issue No. 123 August 2020

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Within the EAC, which countries stand to benefit from the implementation of the AfCFTA

Executive Statement

The implementation of the African Continental Free Trade Area (AfCFTA) will affect EAC countries in terms of tax revenues, trade volumes and poverty. Estimates paint a mixed picture among specific EAC economies regarding the increase in demand following the reduction in tariffs, also known as trade effect. Burundi has the most considerable total trade effect of US$ 9.5 million, followed by Kenya with US$ 5.2 million and Uganda with US$ 4.2 million. On the other hand, Tanzania and Rwanda register adverse total trade effects. All the EAC countries incur tariff revenue losses; for instance, Kenya incurs US$ 14.2 million loss followed by Uganda with a US$ 13.5 million loss. Whereas Uganda and Burundi experience positive welfare effects, Kenya, Tanzania and Rwanda experience negative welfare effects. To benefit from the AfCFTA, EAC economies need to (i) increase competitiveness to mitigate the negative impact of trade diversion (ii) pursue policies that promote industrialisation and (iii) compensate for the customs revenue loss by leveraging the envisaged increase in the trade volumes and value for other taxes.

Introduction

The rising importance of regional trade agreements (RTAs) is the trademark of regionalism and policymakers perceive RTAs as channels for economic development, economic growth and employment. So far, 28 African countries have ratified the treaty establishing the African Continental Free Trade Area (AfCFTA), and it came into force in May 2019 after 22 countries had deposited their ratification instruments.

This agreement intends to bring together the 55 African Union member states covering a market of more than 1.2 billion people and a combined gross domestic product (GDP) of more than US$3.4 trillion. The United Nations Economic Commission for Africa suggests that the AfCFTA has the potential both to boost intra-African trade by 52.3 % by 2022 by eliminating import duties (90 %) and to double this trade if non-tariff barriers are also reduced (tralac, 2019)[1]. Furthermore, the AfCFTA has the potential to boost economic growth and promote citizens' prosperity and wellbeing through the four freedoms of movement of goods, services, people and capital. The AfCFTA is also expected to enhance competitiveness at the industry and enterprise level through exploitation of opportunities for scale production, continental market access and better resource reallocation.

Whereas the AfCFTA is expected to boost economic growth, it is likely to be associated with costs and its benefits may not be evenly distributed across and within countries. First, the loss of revenue at the continental level, which is estimated to be close to USD 4.1 billion in the short-run (UNCTAD, 2019)[2]. Second, the increase in international competition with a high likelihood of bigger African economies benefitting more than smaller ones due to relative productive capacities. Furthermore, small and weak companies may be exposed to giant foreign companies due to deregulation or reduced protectionism. Third, the liberalisation of the domestic labour markets will also expose nationals to competition from cheap foreign labour. Fourth, capital mobility being high may also encourage out-sourcing, leading to loss of jobs.

To mitigate some of the likely costs associated with the AfCFTA and to create a conducive trading environment, the countries are undertaking Phase 1 negotiations focusing on the rules of origin and country tariff offers[3]. It is against this background that this brief provides evidence on the likely revenue, trade and welfare effects of the AfCFTA on the EAC economies (except South Sudan) to provide an understanding of what it implies for the EAC to liberalise trade with the rest of Africa. The brief is based on the study titled "African Continental Free Trade Area: The potential revenue, trade and welfare effects for the East African Community"-EPRC Research Series No 153.[4]

Approach and data

This study adopted the analytical framework of the Single Market Partial Equilibrium Simulation Tool (SMART) model following the work of Jammes and Olarreaga (2005)[5]. We use data from the Trade Map database of the International Trade Centre. Following the WITS-SMART analytical framework, the study used the Excel-based simulation proposed by Punt and Sandrey (2016)[6] to determine the revenue, trade and welfare effects to the EAC countries participating in the AfCFTA.

Results

Tariff revenue effects

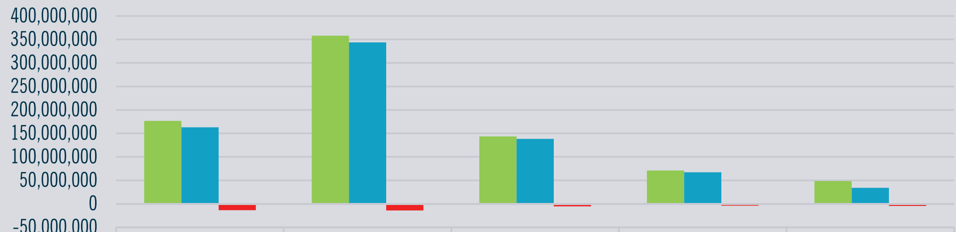
In the event that the tariff reduction is substantive, the significant loss arises from the Rest of Africa (RoA) given that tariff revenue from existing trade is reduced. Tariff revenue is also lost from other trading partners outside Africa due to trade diversion. Figure 1 provides a summary of the tariff revenue effect for each of the EAC economies. It is observed that overall, each country experiences a loss with varying levels and proportions depending on the quantities involved. In absolute amounts, Kenya incurs the largest tariff revenue loss of US$ 14.2 million, followed by Uganda with US$ 13.5 million, Tanzania US$ 5.3 million, Burundi US$ 4.3 million and finally Rwanda US$ 3.9 million.

Trade effects

Figure 2 gives a summary of trade effects in the short run. Regarding trade creation, Kenya will create a total of US$4.3 million and Burundi up to a tune of US$8.3 million. On the hand Uganda, Tanzania and Rwanda will not create trade.

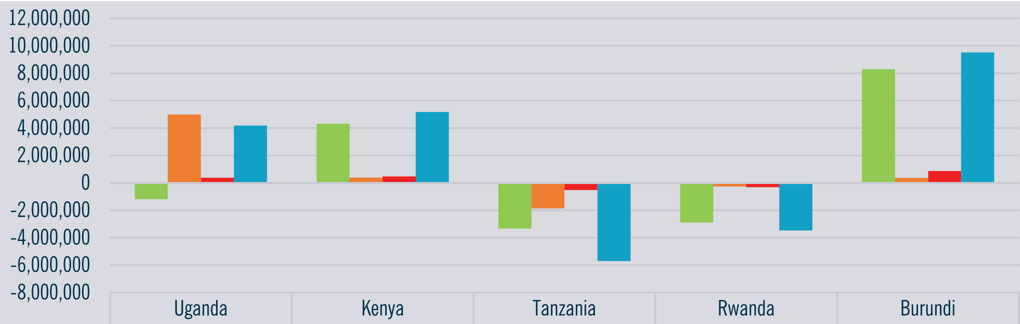
For Uganda, this will be accompanied by a significant trade diversion of a value of US$4.9 million, which further disadvantages the country because this will come at the cost of more expensive imports. Kenya will experience a minimal trade

Figure 1 **Tariff revenue effects**



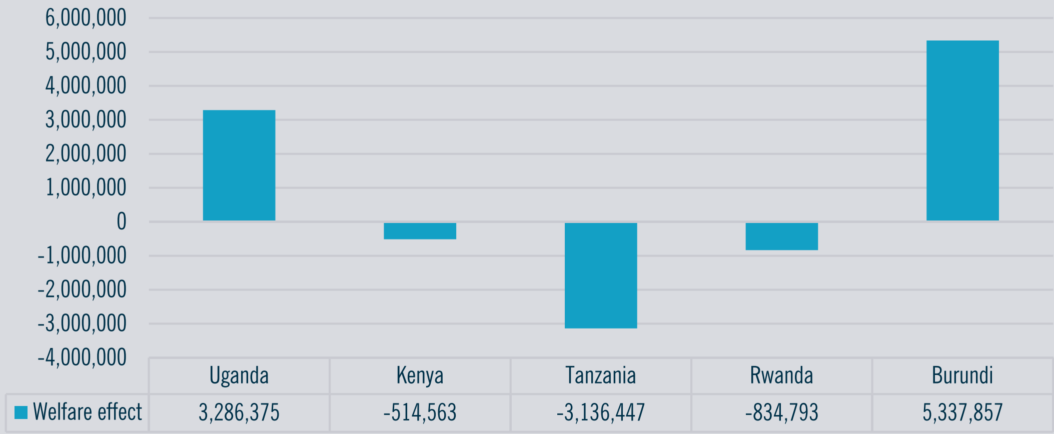
	Uganda	Kenya	Tanzania	Rwanda	Burundi
Original tariff revenue	176,475,650	357,887,700	143,607,700	71,012,600	48,573,400
New tariff revenue	162,983,388	343,701,652	138,269,006	67,074,146	34,193,128
Tariff revenue effect	-13,492,262	-14,186,048	-5,338,694	-3,938,454	-4,380,272

Figure 2 **Trade effects**



	Uganda	Kenya	Tanzania	Rwanda	Burundi
Trade Creation	-1,189,208	4,311,514	-3,328,730	-2,898,855	8,290,288
Trade Diversion	4,987,878	389,597	-1,860,063	-257,351	361,265
Price effect	379,867	470,111	-518,879	-315,621	865,155
Total Trade Effect	4,178,537	5,171,223	-5,707,672	-3,471,827	9,516,709

Figure 3 **Welfare effects**



diversion of about US$0.4 million, which can be internalised by the high value of trade created. Rwanda and Tanzania, on the other are likely to experience a negative trade diversion.

The overall trade effect is positive for Uganda primarily arising from trade diversion to a tune of US$4.2 million. Burundi significantly benefits from trade liberalisation given that its total trade effect is US$9.7 million, which is mostly accounted for by trade creation than trade diversion, followed by Kenya with US$5.2 million. Therefore, the consumers in Burundi and Kenya do not experience significant welfare losses given that trade creation is far larger than trade diversion. Tanzania has the largest negative trade effect of US$5.7 million, suggesting that it loses more than the other EAC Partner States following trade liberalisation with the RoA. This is followed by Rwanda with a trade effect loss of US$3.5 million.

Welfare effects

The welfare change for the EAC economies arises from the additional revenue as a result of the increase in imports and the additional consumer surplus as a result of the increase in imports. Results in Figure 3 suggest that whereas Uganda and Burundi experience a positive welfare effect, Kenya, Tanzania, and Rwanda experience adverse welfare effects. Specifically, Burundi's positive effect is US$5.3 million, and Uganda's is US$3.3 million. Tanzania has the most massive welfare loss of US$3.1 million, followed by Rwanda with US$ 0.83 million and Kenya with US 0.51 million.

Conclusions and policy implications

The brief provides evidence on the likely trade, welfare and revenue effects of the AfCFTA on the EAC economies. Generally, all the EAC countries incur tariff revenue losses. Kenya incurs the most extensive tariff revenue loss followed by Uganda, Tanzania, Burundi and finally Rwanda. Whereas Burundi and Kenya are likely to experience positive trade effects primarily arising from trade creation, Tanzania and Rwanda will experience adverse trade effects. Regarding the welfare effect, whereas Uganda and Burundi experience positive welfare effects, Kenya, Tanzania, and Rwanda experience negative welfare effects. The consumers in Uganda and Burundi are more likely to relatively experience positive welfare effect compared to the others.

Recommendations

To benefit from the AFCFTA, the EAC economies need:

- To mitigate the adverse effects of trade diversion, that is, the resultant high cost of imports from third party countries which leads to a welfare loss. This can partly be achieved by increasing the competitiveness of products produced within Africa, through actions that significantly lower the unit cost of production. Besides, these countries should strengthen or put in place policy and regulatory frameworks that support competition.
- To pursue policies and investments that support industrialisation for value addition and product diversification for both the domestic and external markets. These include sustaining investments in infrastructure (energy, communications and transport) and human capital (health, education and training), developing

standards and promotion of research and development. Also, investments in industrialisation should focus on developing the entire value chain and not a particular segment.

- To leverage the envisaged increase in the volumes and value of trade for other broad-based taxes such as the value-added tax to compensate for customs revenue loss due to lowering the tariffs on goods from the RoA. The onus is upon the governments of the respective EAC countries to strengthen institutional quality in tax revenue administration to minimise revenue losses.

Endnotes

1 tralac. (2019). The African Continental Free Trade Area: A tralac guide. 6th ed. Jamestown, Western Cape.
2 UNCTAD. (2019). African Continental Free Trade Area: Challenges and opportunities of Tariff Reductions. UNCTAD Research Series, Paper No. 15.
3 Due to the outbreak of the COVID-19, the official month for the launch of trading under the AfCFTA was moved from July 2020 to January 2021.
4 Shinyekwa I.M.B., Bulime E.N.W., Nattabi, K.A. (2020). African Continental Free Trade Area: The potential revenue, trade and welfare effects for the East African Community. Economic Policy Research Centre. Research Series 153
5 Jammes, O., & Olarreaga, M. (2005). Explaining smart and GSIM. The World Bank.
6 Punt, C., & Sandrey, R. (2016). Trade diversion and trade creation effects of economic integration: Illustration of an Excel based tariff simulation of Zambia entering a hypothetical Free Trade Agreement (FTA) with South Africa. tralac Working Paper, No. S16WP03/2016

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