

EXECUTIVE SUMMARY

1. PURPOSE OF THE REPORT

A team of economic and legal experts¹ from Imani Development has been engaged to support Rwanda's EAC accession negotiations. The initial phase of fieldwork started on 16th January 2006. Working with MINECOFIN and MINICOM² meetings with key stakeholders were arranged and two brainstorming workshops were held. The Team also visited the EAC Secretariat in Arusha, accompanied by a MINICOM economist. As a result of an urgent request made by the Regional Integration Committee during the initial consultations a note setting out some of the issues emerging during the fieldwork and preliminary work on the impact study was prepared and submitted to the Committee in February together with the Inception Report. Further fieldwork was undertaken in March to consult with the Private Sector, continue with data collection and undertake some training work.

As a result of deliberations on the Inception Report, activities were restructured to reflect the requests of the Regional Integration Committee. In response to the direction given by the Regional Integration Committee, the current study has focussed to a far greater extent on data analysis and quantification of the impact of the EAC. We have also engaged services experts to provide an initial assessment of issues in the context of EAC negotiations on services and movement of people to address specific requests of the Regional Integration Committee.

This has necessitated a somewhat narrower focus in the Impact Report; our assessment is primarily of the tariff provisions of the Custom Union. However, we have maintained the analysis of macro convergence issues and touched on some of the other issues. With regards to the legal analysis, the delay of the EAC Summit meant the Verification Report for Rwanda was not available in time for the preparation of this report.

The programme of support for the EAC Accession Negotiations has the advantage of flexibility in both resource and timing. This has enabled us to provide additional assistance and training as appropriate. It will also hopefully enable us to deal with several issues that have emerged over the course of the study that need to be further addressed, including data issues and trade training for a GOR team of economists, the aforementioned work on services and follow up to the release of the Verification Report on Rwanda's accession.

2. MAIN FINDINGS OF THE REPORT ON EAC CET AND CU

- Fiscal Revenue

Taxes on imports are 42% of total tax revenue or 21% of government revenue if grants are included. For the Government of Rwanda, the most important source of trade taxes is VAT on imports, which accounts for 45% of total government revenue from imports; tariff revenue is the next most important accounting for 35%.

¹ Nick Charalambides (team leader) and Irina Kireeva (trade lawyer) carried out the fieldwork in Rwanda, joined by Richard Hess (regional integration expert) in Arusha and Kigali. Other members of the team are Paolo Vergano (Specialist International Trade Lawyer) and Keith Jefferis (Monetary and Exchange Control Expert). M. Cali and D. te Velde provided expertise on Services and movement of labour.

² Our thanks to John Bosco Kanyanganga, Alloys Mutabingwa, James Foster, Elias Baingana, Prudence SEBAHIZI, Ngabirano Muragira, Denis and other stakeholders who gave so much of their time and shared their insights with the team.

In evaluating the impact of free trade within the EAC, we only examine the impact with regards to Tanzania. This is because trade with Uganda and Kenya is already being liberalised under COMESA. Free trade with Tanzania will lead to a loss of the Frw. 365 million currently collected. There is an additional impact on VAT because it will be calculated on a lower base (currently VAT on imports from Tanzania is calculated on values that include tariffs). This results in a further loss of Frw. 58 million. The total impact on the basis of this static analysis is a loss of FRw. 423 million. There is an additional potential impact as a result of Tanzania displacing imports once its exporters benefit from duty free access to Rwanda's markets - which we estimate to be a maximum of Frw. 83 million. The total potential revenue loss from freeing trade with Tanzania on joining the EAC is therefore a maximum of Frw. 506 million.

With the adoption of the EAC CET, we estimate the fiscal loss to be Frw. 4,874 million representing 24.2% of tariff revenue. VAT will rise as a result of increased imports following tariff reductions and the net impact on total trade taxes is expected to be a fall of 9.1%. However our analysis revealed that CET of 0% on petroleum imports (Rwanda's current rate is 30%) is driving the fiscal impact. Revenue from tariffs on petroleum products was Frw. 4,973 in 2004 accounting for over a quarter of all tariff revenue. Given that no Partner State is a petrol producer the Government of Rwanda is in a position to introduce a non-discriminatory (excise) duty to replace the import tariff. If revenue from petroleum products is maintained, the net fiscal impact of adopting the CET is an increase of an estimated Frw. 99 million.

If petroleum tariffs are replaced with non-discriminatory duties the Government of Rwanda will see revenue only fall by an estimated Frw. 407 million from freeing trade with Tanzania and adopting the CET.

The analysis is summarised in Figure 1, which charts total revenue from imports, in Frw million, then the estimated revenue with adoption of the CET, to which the impact of freeing trade with Tanzania is then added (CET & CU). The final column shows estimated revenue from adopting the CET and freeing trade with Tanzania with an excise duty on petrol used to replace the current MFN tariff.

It is important to note that these figures are estimates. The RRA is currently reviewing the data in the light of issues uncovered during the preparation of this impact report and this may result in an upward revision of the fiscal impact.

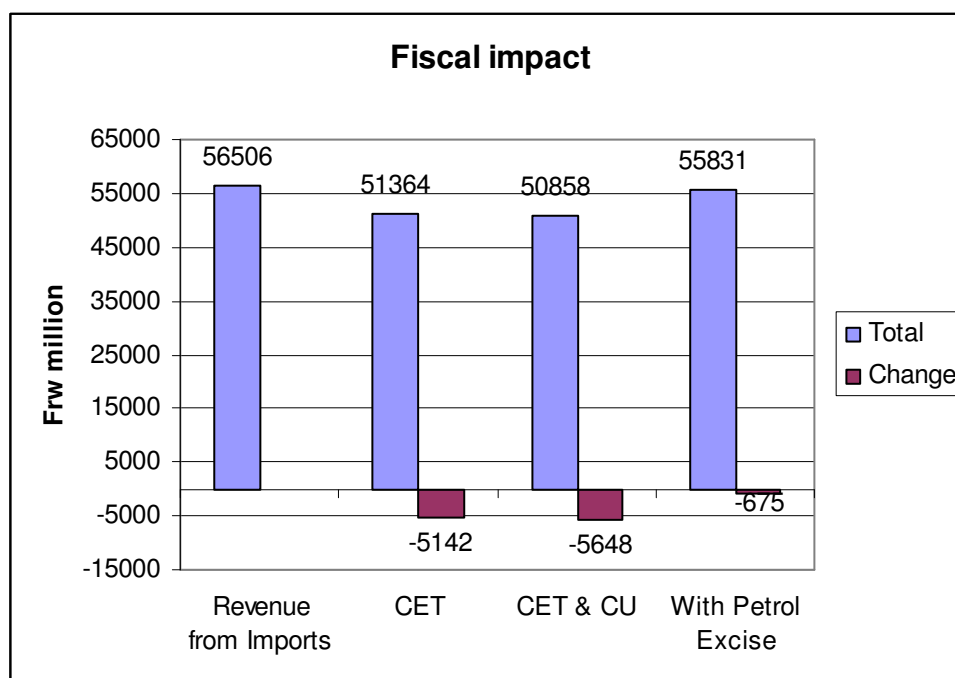


Figure 1

Source: RRA, MINICOM

The provision on “CIF at port of entry” to the customs territory will have a significant impact. We estimate tariff revenue could fall by 10% which in monetary terms is Frw. 1,935 million. Although the EAC has no intention of introducing collection of tariffs at first port of entry in the near future, this is an aspect that Rwanda will have to consider further in a few years’ time when such negotiations get underway.

- Household consumers

We examined household consumption to identify key products for further analysis. In broad terms the most important component of household consumption is food which accounts for 68% of total consumption. However, in rural areas in particular, much of this is produced by the household itself. Food actually purchased accounts for 35% of average total household expenditure. We identified the main food consumption items as sweet potatoes, dried beans, potatoes, cooking bananas and maize. However, with a high and varying level of subsistence, purchases do not follow exactly the same pattern as consumption. The most important household purchases are of dried beans, potatoes, other vegetables, sweet potatoes, sorghum, rice and cassava. Purchases are predominantly of Rwandan produced crops. But imports are a significant source for rice, peas and maize. Though not identified in household surveys, we also include milk and milk products, clothing and sugar as consumption items to further consider.

With the adoption of the CET, tariffs on all the key consumption items identified will increase by a minimum 20% points. The greatest increases are for “sensitive products” in the EAC CET. The tariff on rice increases by 60% points, on fresh milk by 55% points, on maize and sugar by 45% points, on concentrated milk products by 30% points and wheat by 25% points.

We then considered the extent to which increases in tariffs are likely to pass through into increases in domestic prices. The evidence is not conclusive though there is some suggestion of co-movement between domestic and import prices.

The baseline impact on the cost of household consumption for key food items as a result of the CET is that cost of consumption increases by 22%. However, taking into account the fact that households are also producers and therefore stand to benefit as prices for the output increases means the average household only has to increase expenditure by 8% to maintain their purchases.

The average however hides an important distributional impact. For households based in Kigali and other towns the CET is likely to increase their costs with no offsetting increase in income for food items by 20% – 24%, while rural households' expenditure increases by 8% (see figure 2).

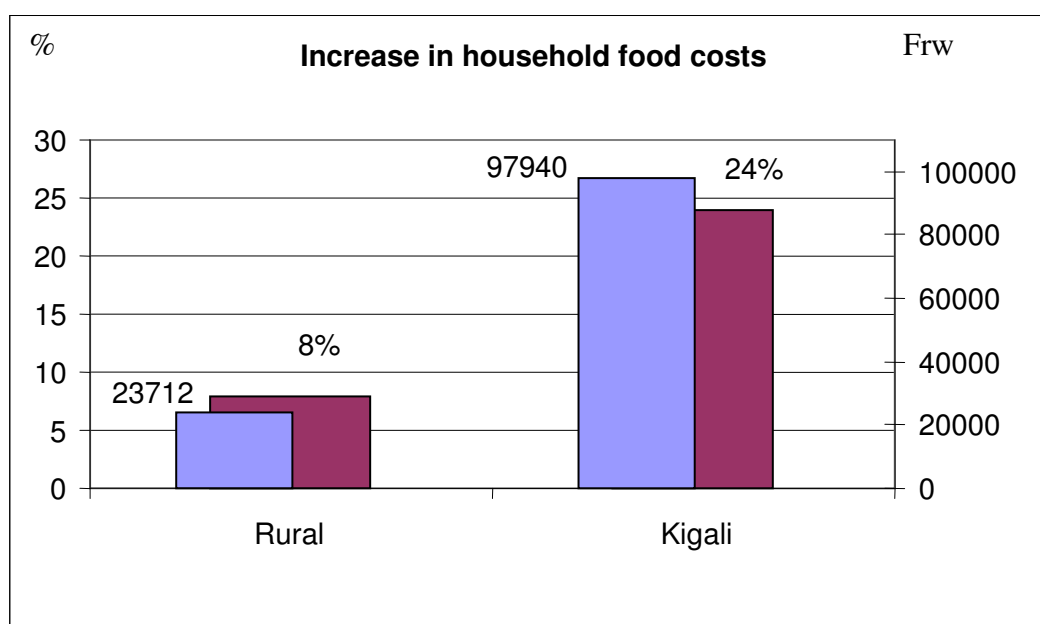


Figure 2

The products that are most affected by tariff changes are rice, maize, sugar, milk products and used clothes.

It should be noted that the estimated impact represents a baseline as is the worst case scenario. Price increases may be mitigated by increased domestic or regional production and/or trade in food crops.

- Enterprises, output and exports

Although the EAC CET lowers the average rate of tariff protection – which reduces the anti export bias of tariffs – it is broadly similar to the current Rwanda tariff provisions. Changes in specific tariffs do, however, significantly change the profitability of certain sectors. In broad terms the manufacturing sector is most affected. If resources were allowed and enabled to reallocate according to changes in profitability, manufacturing output would stand to increase by as much as 8% and total output by 0.7%. These figures should be treated with extreme caution however because of the often poor quality and scarcity of data, the sometimes severe assumptions that have to be made to derive a quantitative result and – more importantly – because the results assume a functioning capital and labour market. However, the results

illustrate the potential benefits from a reallocation of resources to more productive activities in Rwanda, a process in which trade policy can play a fundamental role.

It is also noted that for this reallocation of resources to take place it is possible that up to 3,368 jobs and output of Frw 6,144 million would be at risk during transition.

With regards to exports, our data analysis suggests very little impact on intra-EAC trade, with the possible exception of increases in exports of worn clothing, metal kitchenware, cane furniture and mattresses.

However, this analysis is backward looking. The main message of the analysis is that trade policy needs to be used as part of a strategy to achieve structural change in the private sector and the economy as a whole.

To get a perspective on future developments we undertook consultations with a number of companies. The interviews strongly suggest that a dynamic outward looking private sector is emerging that is seeking to take advantage of market opportunities and respond to the challenges of greater competition. In terms of future exports, companies are investing in the production of fruit juice and concentrates and yoghurts for the regional as well as international market. Cigarettes and beer are also seen as having a potential market in the EAC and COMESA regions. The increasingly proactive nature of the private sector is evidenced by the efforts of juice and juice concentrate manufacturers to work with the Rwanda Bureau of Standards to develop standards for their products to enable exports.

Several companies, in particular those manufacturing metal products, soaps, edible oils and paper products, noted an increase in competition on domestic markets primarily with producers from Uganda. Competition with Kenyan producers appears less pronounced than expected because of higher transport costs from Kenya relative to Uganda. Of the companies interviewed only one, a producer of paper products, expressed an interest in increasing protection on the Rwandan market. It will come as no surprise that all companies considered key challenges for competitiveness to be transport and power costs. Standards development to facilitate exports was also noted as a constraint. One company also highlighted the need for a "level playing field" with regards to the even application of regulations and standards, e.g. packaging regulation, for imported and domestically produced goods.

All companies interviewed had responded to greater competition by reinvesting in capital equipment and/or diversifying their product range. To illustrate: one metal products manufacturer now offers corrugated sheet metal in various colours, as tiles and also made-to-measure. This innovation, initially in response to greater competition, seems also to have enhanced profitability: the price per square metre of the new products is on average Frw 500, compared to Frw 300 for basic corrugated sheeting.

Not one company reported they had retrenched staff as a result of greater competition. However, as already noted it was not feasible to undertake a full survey of the private sector and therefore results from the interviews can be taken as indicative only.

3. MOVING FORWARD

Key areas to be considered in the next phase of preparations for negotiations include:

- Private sector consultations of the impact of the loss of exemptions under various legal instruments including Customs and REIPA.
- The possibilities for tariff arrangements amongst EAC Partner States
- The Verification Report and the implications for the legal road map
- An analysis of Rwanda's offensive and defensive interests in EAC negotiations on services and movement of people.

This report includes a preliminary overview of issues relating to services and movement of people and details a way forward. Key areas for concern relate primarily to the absence of data on the mobility of labour, confirmed by the Bureau of Statistics.

4. APPROACH AND STRUCTURE OF THE STUDY

Part 1 of this report addresses the economic impact of the EAC Customs Union. The key tariff provisions are set out in section 1. Fiscal impact is analysed in section 2. The potential cost to the household consumer is examined in section 3. The impact of the CET and CU on protection in the economy is examined in section 4 and the potential impact of the change in incentives for enterprise is traced through to the output, employment and exports.

Part 2 goes beyond tariff issues. Section 5 provides a preliminary assessment of services and movement of persons. Section 6 addresses Macroeconomic convergence issues. Rwanda's negotiations on accession to the EAC need to be based on the key drivers for what Rwanda requires from regional integration. Concerns obviously include tariff negotiations, but tariff issues are only one component. Section 7 provides a very preliminary indication of key drivers for regional integration and the potential implications for EAC Accession.