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POLICY BRIEF

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Did the East Africa Community's Common External Tariff (CET) help Uganda diversify its export products?

Executive Statement

The East African Community (EAC) States are exporters of mainly primary products, concentrated in the agricultural sector. In 2005, the EAC adopted EAC Custom Union and one of the objectives was to increase the variety and quality of EAC manufactures. As part of the customs union, the EAC partners adopted a Common External Tariff (CET) on commodities designated as sensitive items (SI). There are atleast 53 products on the SI list and these attract an import duty of 25% and above. This brief examines whether the adoption of the CET helped Uganda attain structural transformation of its exports—given this was one of the objective of establishing a SI list. The study follows the analysis by Shinyekwa and Katunze (2016)—a study which examined the trade and welfare implications of adopting the CET. The brief applies indices of structural transformation based on "quality upgrading"—to examine the transformation objective of the CET. The results show that, overall, CET had constrained the ability to upgrade the quality of commodities and manufactures. However, Uganda has made advances in upgrading two commodities—maize and rice. This calls for intensification of research and development, increased investment and incentivising labour to participate in both maize and rice as well as other products with a scope for quality improvement such as milk and cream, and sugar.

Introduction

Uganda, and her East African Community (EAC) counterparts, export mainly primary products.[1] Exported products are mainly from the agricultural sector—characterised by use of poor technology and generally low productivity growth. There are calls for diversification of EAC exports to improve export earnings and sustain economic growth. When the CET was adopted, a sensitive list was identified by the EAC partner states to protect certain products that require increase in variety and quality upgrading. In this regard, a duty of 25% and above was imposed on a select number of Sensitive Items (SI). The SI is a list of commodities protected by use of tariffs due to their relative importance to a country's industrial and export strategy and are also deemed strategic for local production and intra-EAC trade. The EAC sensitive items list includes 53 product tariff lines, with 35%, 40%, 50%, 60% and 100% rates; and included finished products such as cigarettes, yoghurt; and inputs such as cement and raw sugar to mention but a few (Shinyekwa and Katunze, 2016). However, the SI has resulted in relatively higher tariff rates for certain consumer products and intermediate inputs. The argument for maintaining the SI is that tariffs do not only raise revenue for government but also can protect infant industries to foster quality upgrading i.e **the process of moving from low value added to both higher value added agricultural products and diversification—through increasing the range of sectors contributing to domestic and export production**.

This brief follows up the analysis by Shinyekwa and Katunze (2016) and employs the methodology by IMF (2014) to examine whether the CET adopted by the EAC in 2005 supported the objective of upgrading the quality of partner states manufactures. The focus is on Uganda but comparisons are made with other EAC counterparts, data permitting.

Methodology and data

We use the 53 products at the 8 digit HS Code tariff line identified in Shinyekwa and Katunze (2016). For compatibility with available data on quality, we aggregate the 8 digit HS Code, at the sectoral level, to the 3-digit SITC level 3 classification. Table 1 shows that the assignment of the 53 products in HS Code to a particular SITC level 3 product results into 9 export sectors. However, we exclude the tariff lines for corks, crown of base metal because there was limited export value data for Uganda. Similarly, matches were also

1 For the EAC, the focus is only on the five countries of Uganda, Kenya, Tanzania, Rwanda and Burundi.

excluded because there is no available quality data for Uganda before CET commencement in 2006. The conversion to SITC level 3 classification is compatible with the classification used by the International Monetary Fund's Quality Index. The quality index is available on the IMF's website and most recent data is up to 2010.[2] For this analysis we utilised quality index for EAC from 2001 to 2010.[3]

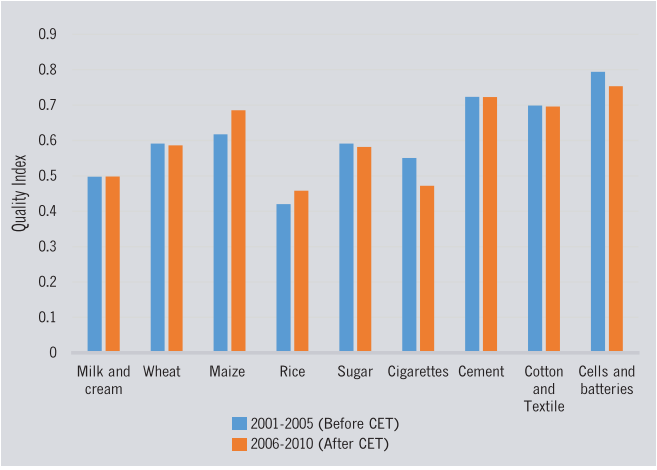
Five-year moving averages for the quality index are estimated to identify differences in quality upgrading over two periods i.e. before and after the CET policy.[4] We also calculated the East African average to construct the quality ladder. The quality ladder is an indicator of the extent of differentiation in quality across different varieties of a given product (IMF 2014). The length of a quality ladder shows the potential for quality upgrading for each SI. Hence, longer quality ladders indicate that there is a scope for quality improvement. To calculate the share of items on the SI list to total exports, we used the latest data, 2018, from Trade Map. The share of exports demonstrate the relative importance of products in the SI list to total exports. We use 2018 to allow time for quality upgrading to have a significant effect on value of exports. A country's position on the ladders may vary according to the individual SI list.

Results

Quality Upgrading over time

Figure 1 shows that CET, overall, had insignificant effect on Uganda's quality upgrade. Nevertheless, there was minimal quality upgrade in maize and rice after the CET policy. Quality upgrading prospects in maize and rice may typically be associated with CET induced repositioning of the two sectors toward increasing productivity and value addition.

Figure 1 Uganda's Quality upgrading overtime, five year averages



Source: Author's computation using data from IMF's Export Diversification and Quality Databases

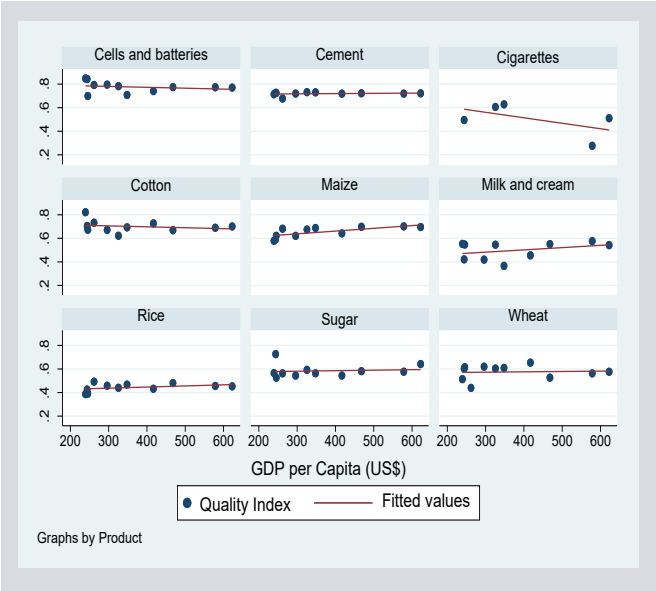
It is surprising that quality upgrading is not strong for manufactures as would be expected. From Figure 1, there is a general decline in the quality of non-food manufactures such as cigarette, and cells and batteries.

Quality and Incomes

Figure 2 shows a weak link between Uganda's GDP per capita growth and manufactures, especially cigarettes and cells and batteries. There is a negative relationship between per capita income and the quality index. This suggests that there is limited scope for quality upgrading for manufactures. This could be because quality upgrading was rapid during period of low per capita income. In this regard, quality of cigarettes and cells and batteries has converged to world's frontier and investments in quality upgrading would be best used elsewhere, especially in agricultural products, where there is still a scope for upgrading.

Figure 2 also shows that there is a positive relationship between maize, milk and cream, rice, sugar, and per capita income. Indeed, as per capita incomes increase, the quality of the aforementioned commodities improves. This suggests that there is scope for quality improvement in those products. Therefore, more public and private investment should be allocated to those sectors. Also, the government should design policies that attract labour and technology to the maize, milk and cream, rice, and sugar SI items. Other SI items such as cement, cotton and textiles, wheat have neutral slopes. This suggests that the 3 aforementioned products are not responsive to increase in income. Therefore, investment in quality upgrade in such SI items will yield limited returns.

Figure 2 Uganda's Export Quality Upgrading and GDP per Capita, 2000- 2010



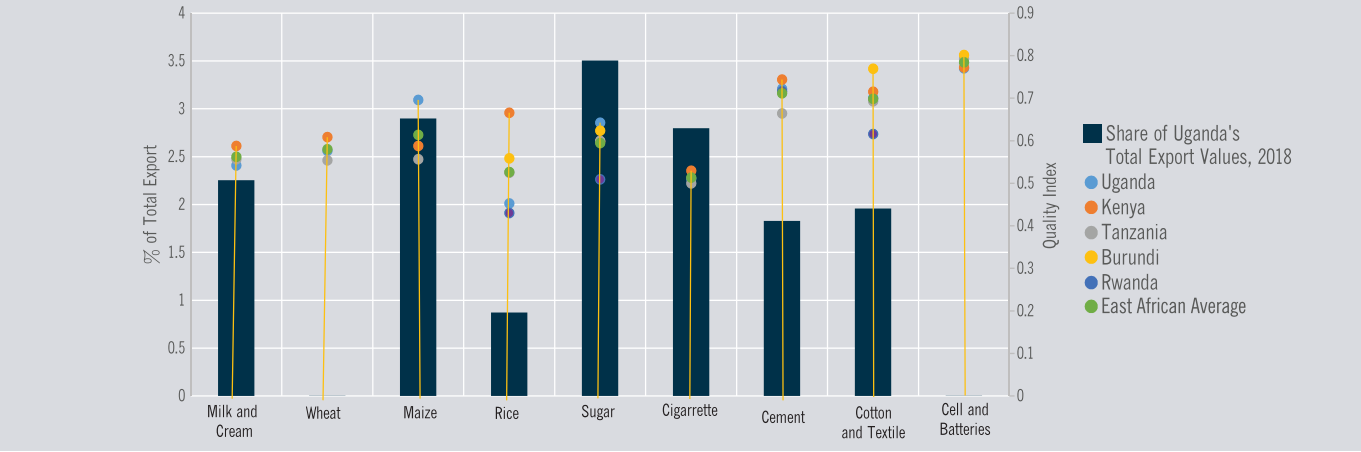
Source: Author's computation using data from IMF's Export Diversification and Quality Databases

2 https://www.imf.org/external/np/res/dfidimf/diversification.htm

3 Future revisions of quality index and other data may necessitate corresponding revisions of this analysis.

4 The first moving average 2001-2005 was before the CET came into force and the second was, 2006 – 2010 after its commencement. We accounted for missing values, by sub-tracting/ adjusting the denominator by the number of missing values, in the calculation of the averages

Figure 3 East Africa's Quality Ladders, 2010



Source: Author's computation using data from IMF's Export Diversification and Quality Databases and Trade Map

Overall, the CET would ideally not be effective for products that display a negative relationship between income and quality index. The reverse would be true for products where there is a positive relationship between income and quality. Therefore, the CET should not be imposed on products which exhibit negative relationships between quality and income, but rather on those that display positive relationships, in addition to encouraging investments and technology transfers to the same. With strategic enforcement of the CET, the EAC can facilitate further quality upgrade.

East Africa's Quality Ladders

Rice, cotton and textile, maize and sugar have the longest quality ladder in EAC's SI list (Figure 3). This suggests that there is scope for quality upgrade in those SI items with longer ladders. The IMF (2014) suggests that at the initial phases of development, it is crucial that a country starts with investments in products with long quality ladders, in order to realise gains from quality upgrading.

At the regional level, Uganda is at the top of the maize quality ladder. This may suggest that there is no scope for quality improvement, for Uganda, in regard to maize. However, all quality estimates are expressed relative to the world quality frontier (IMF 2014). In this case, there is a scope for improvement, for Uganda's maize quality, relative to the world quality frontier. The IMF defines the world quality frontier as "*the 90th percentile of quality in each product-year combination*."

On the other hand, Uganda is at the bottom of the rice quality ladder. This suggest that there is scope to improve relative to the East African Average and the world's quality frontier. On the other hand, the quality ladder for cell and batteries and cement are short but high up on the quality index. This is largely because the gap for quality upgrading has been closed as far as East Africa is concerned. Also, the quality upgrading index ranking, of all EAC members analysed, has converged to the East Africa average. Nevertheless, there could be a scope for quality up grading relative to the world's quality frontier. Similarly, cigarette, milk and cream and wheat have a short quality ladder. Cotton and textile, has a relatively long ladder, but Uganda's quality in this sector has converged with the East African average as well. Likewise, the quality upgrading index ranking, of all EAC members analysed, has converged to the East Africa average.

However, the quality ladders for these SI items are between low and average on the quality index. Considering the SI share of total export values, wheat and cells and batteries contribute a small percentage of Uganda's total exports and there is no space for quality improvement in regard to EA's average. Moreover, Uganda is at the top of the quality ladders for items with a proportionate share of export values such as sugar and maize, and surpassed the EAC quality average of these products but remains below the world quality frontier.

Conclusion and Policy Messages

Uganda exports mainly primary agricultural products, which calls for diversification and transformation of exports to improve earnings and sustain economic growth. The CET supported the increase in variety and quality upgrading. Overall, quality upgrade has stagnated after the CET. However, Uganda made advances with respect to upgrade of maize and rice. Indeed, Uganda is on top of the maize quality ladder relative to East Africa. However, there is a potential for improvement of rice quality since Uganda lies below the East Africa average. This calls for research and development (R&D) in the maize to penetrate the world quality frontier and more investment in rice value chains, especially the rice processing component.

There is a limited scope for investment to improve manufacture of products such as cell and batteries and cigarettes. Indeed, cell and batteries, cigarette and cement display short quality ladders. Evidence from other low income countries shows that diversifying into products with longer quality ladders as an initial step to building capacity for quality improvement (IMF, 2014). This calls for a review of the 2005 SI list to concentrate more on improvement of quality of agricultural products such as maize, rice, and sugar.

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There is a weak link between Uganda's GDP per capita growth and manufactures, especially cigarettes and cells and batteries. This suggests quality of cigarettes and cells and batteries has converged to world's frontier. Indeed, the quality ladders of these items are short and have converged to the East African average. This calls for reallocation of labour, investment and technology from traditional manufactures toward increasing productivity of agriculture sector and agro- industrialization.

References

Shinyekwa, Isaac & Katunze, Miriam (2016), 'Assessment of the Effect of the EAC Common External Tariff Sensitive Products List on the Performance of Domestic Industries, Welfare, Trade and Revenue', EPRC Research Series # 129, Economic Policy Research Centre (EPRC).

IMF (2014), 'Sustaining Long-Run Growth and Macroeconomic Stability in Low-Income Countries—The Role of Structural Transformation and Diversification', International Monetary Fund (IMF).

Appendix

Table 1 Aggregation of commodities using SITC Code 3

Description	Sitc 3 Code	Hs Code	And Product Description
Milk and cream	22	4011000	Milk not concentrated and unsweetened not exceeding 1% fat
		4012000	Milk not concentrated & unsweetened exceeding 1% not exceeding 6%
		4013000	fat Milk and cream not concentrated and unsweetened exceeding 6% fat
		4021000	Milk powder not exceeding 1.5% fat
		4022110	Milk and cream powder unsweetened exceeding 1.5% fat
		4022190	Others
		4029110	Milk and cream unsweetened, nes
		4029190	Others
		4039000	Butter milk,curdled milk & cream,kephir & ferm or acid milk & cream nes
		4031000	Yogurt concentratd or not,sweetend or not,flavourd o contg fruit o cocoa
Rice	42	10061000	Rice in the husk (paddy or rough)
		10062000	Rice, husked (brown)
		10063000	Rice, semi-milled or wholly milled, whether or not polished or glazed
		10064000	Rice, broken
Wheat	41,46	10019090	Wheat nes and meslin
		11010000	Wheat or meslin flour
Maize	44	10059000	Maize (corn) nes
		10061000	Rice in the husk (paddy or rough)
		10062000	Rice, husked (brown)
		10063000	Rice, semi-milled or wholly milled, whether or not polished or glazed
		10064000	Rice, broken
Sugar	61	17011110	Juggery
		17011190	Raw sugar, cane
		17011290	Raw sugar, beet
		17019100	Refined sugar, in solid form, containg added flavourg or colourg matter
		17019910	Refined cane or beet sugar, solid, without flavouring or colouring matter
		17011210	Juggery
		17019990	Others
Cigarettes	122	24022010	Cigarettes containing tobacco
		24022090	Others
		24031000	Smokg tobacco,whether or not cntg tobacco substitutes in any proportion
Cement	661	25232900	Portland cement nes
Cotton and Textile	651, 652, 653, 654, 655, 656, 263	52085110	Plain weave cotton fabrics,>/=85%, not more than 100 g/m2, printed
		52085210	Plain weave cotton fabric,>/=85%, >100 g/m2 to 200 g/m2, printed
		52095110	Plain weave cotton fabrics,>/=85%, more than 200 g/m2, printed
		52115110	Plain weave cotton fab,<85% mixd w m-m fib,more than 200 g/m2,printd
		52122510	Woven fabrics of cotton, weighing more than 200 g/m2, printed, nes
		55134110	Plain weave polyester stapl fib fab,<85%,mixd w/cot,<=170g/m2,printd
		55144110	Plain weave polyester staple fibre fab,<85%,mixd w/cot,>170g/m2,printd
		63022100	Bed linen, of cotton, printed, not knitted
		63023100	Table linen, of cotton, not knitted
		63025100	Bed linen, of cotton, nes
		63029100	Toilet and kitchen linen, of cotton, nes
		63051000	Sacks&bags,for packg of goods,of jute or of other textile bast fibres
		63090000	Worn clothing and other worn articles
Cells and batteries	729	85061000	Manganese dioxide primary cells and batteries
		85063000	Mercuric oxide primary cells and batteries
		85064000	Silver oxide primary cells and batteries
		85065000	Lithium primary cells and batteries
		85066000	Air-zinc primary cells and batteries
		85068000	Primary cells & primary batteries nes

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