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POLICY BRIEF

The Director
CSIR- STEPRI
P. O. Box CT 519
Cantonments- Accra
Tel: 0302 773856,
Fax: 0302 773068
Website: www.csir-stepri.org

Potential Impact of the Common External Tariff and Economic Partnership Agreement

CSIR-STEPRI/MOTI/D01

Summary

This policy brief synthesizes the key discussion points emerging from a policy symposium on the Potential Impact of the Common External Tariff (CET) and the Economic Partnership Agreement (EPA) and their implications for policy formulation and implementation in Ghana. The policy symposium aimed at fostering greater awareness of locally available research evidence for informed policy decisions. The CET constitutes sizeable changes to Ghana's tariff structure while the EPA results in the gradual opening of Ghana's market to 75% of tariff lines equivalent to around 65% of the value of imports, from the EU by 2035. Total government revenue was estimated to fall by 1.6% from the CET level, but still remained 1.2% higher than without the CET and EPA scenario. While the average effects of both the CET and EPA are not very large, both trade reforms and especially the CET could lead to substantial adjustment dynamics with both workers and capital likely to eventually move across sectors as well as across firms within sectors.

Introduction

The Economic Partnership Agreement (EPA) is a type of 'preferential trade' agreement in which both sides agree to reduce the taxes (tariffs) on goods coming in (i.e. import duties) and going out (i.e. export taxes) of their countries. The EPA seeks to replace the trade provisions of the Cotonou Agreement that granted non-reciprocal (free) access to the EU market until 2008 with a non-discriminatory trade agreement in order to comply with WTO rules. While the EU hails the agreement as a new form of partnership that will promote economic growth and poverty reduction in ACP countries, ACP countries are skeptical about the impact that EPA will have on their developmental priorities especially, industrialization, smallholder agricultural development, government revenues, unemployment, poverty, and food security.

Following strong opposition to the original EPA by African countries, the EU introduced an interim EPA in 2007. This interim EPA only, a temporary arrangement, allowed countries to continue trading with the EU pending the signing of a regional-wide EPA. In West Africa, Ghana and La Cote d'Ivoire remain the only countries from the ECOWAS to have initialed the interim EPA as of 2012. For some African countries including Ghana, the incentives to opt for the interim EPA include (i) fear of losing EU market access for selected commodities, (ii) lack of options as many of their most important export sectors are dependent on the EU market and (iii) threat by the European Commission (EC) to raise taxes on exports to Europe if Ghana fails to sign on.

This policy brief synthesizes the key discussion points emerging from presentations at a policy symposium organized by CSIR-STEPRI in collaboration with MOTI under the theme "Potential Impact of the Common External Tariff (CET) and the Economic Partnership Agreement (EPA)". It has been realized that careful analysis of trade policy adjustments enables policymakers to make well considered evidence-based decisions. Such analysis facilitates both the judicious evaluation of trade policy adjustments, and the identification of the resultant effects, which can provide direction for accompanying policy measures.

Such analysis should take into consideration the consumption basket and the general income sources of the poor households.

Conclusion and Policy Recommendations

Given that the gains from CET and EPA are relatively marginal, policy makers need to strongly consider potential productivity enhancing policy initiatives that could offset negative effects, support industries to take full advantage of new market opportunities and boost the overall competitiveness of Ghanaian industries particularly, the micro, small and the medium enterprises. The following specific policy directions are proposed:

- Reduce electricity outages and lower transport costs;
- Reduce and simplify tariff and tax exemptions in order to reduce administration and compliance costs as well as the potential for rent-seeking and corruption;
- Ensure a socially equitable adjustment process in the transitional accompanying measures, and prevent those who are affected negatively from dropping out of the labour market;
- Provide measures to reduce cost of production of industries in Ghana to aid competition of Ghanaian products;
- Design and implement strategies for export promotion;
- Create extensive awareness on the impact of CET and EPA particularly, among the manufacturing and other private sector stakeholders on; and
- Provide relevant data for policy related research.

Reference

Jamie MacLeod, Erik von Uexkull and Lulu Shui (2014). Assessing the Economic Impact of the Common External Tariff (CET) and Economic Partnership Agreement (EPA) Tariff Reforms on Ghana. World Bank Report, Ministry of Trade and Industry, Accra.

Acknowledgment

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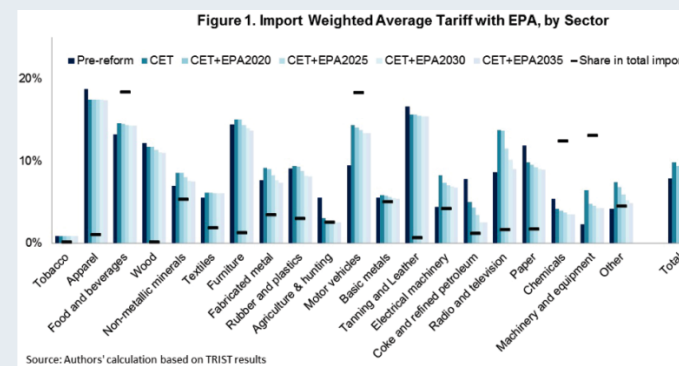
Potential Impact of the Common External Tariff (CET) and the Economic Partnership Agreement (EPA)

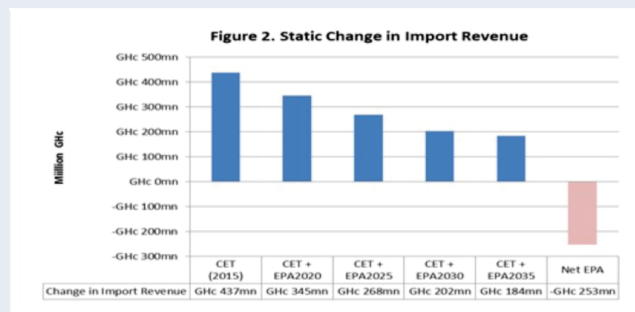
While a reduction in tariffs can be used to support a competitive export-oriented development path, it is important to understand and quantify the revenue implications. The impact on consumers, and in particular on those within the poorest groups, is also of concern. This is particularly important for developing countries such as Ghana lack comprehensive social safety nets. The effect on the competitiveness of firms and jobs is also of significance. A good understanding of these impacts of trade policy reform can help direct accompanying measures to lessen the costs of reform, particularly when these fall heavily on specific groups, and maximize the benefits.

The Economic Partnership Agreement (EPA) between ECOWAS and the EU will result in the gradual opening of Ghana's market to 75% of tariff lines, equivalent to around 65% of the value of imports, from the EU by 2035. This was the outcome of a study conducted at the Ministry of Trade and Industry to assess the potential impact of the CET and EPA (MacLeod et al. 2014). This study adds value to previous studies on both reforms by combining a simple partial equilibrium approach with household and firm level data, thus limiting assumptions but deriving intuitive and policy relevant results.

By raising the average tariffs faced by non-ECOWAS countries, the CET leads to an increase in tariff protection from 7.9% to 9.8% and thus an increase in tariff revenues, as well as lower imports. Total government revenue is estimated to increase by 2.8% while imports fall by 1%. While manufacturing firms are split roughly 50/50 in terms of winners and losers from the CET, winners gain more than losers lose in terms of magnitude of effect and very few manufacturing firms become unprofitable as a result of the CET. However, wins from the CET mainly result from higher protection on outputs. This can produce windfall gains for benefiting firms in the short run, but imposes a burden on consumers and may have a detrimental effect on competitiveness and growth in the future.

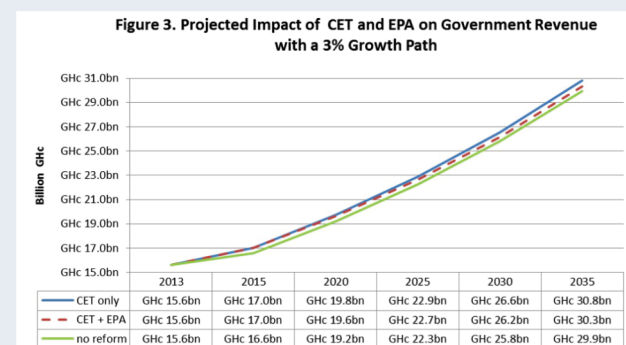
As a result of higher output prices, Ghanaians in the lowest income households are estimated to experience a 1.1% increase in the price of their consumption bundle due to CET. At the same time, the CET may slightly raise the cost of imported capital equipment, while its effect on inputs used by firms in the Ghanaian manufacturing sector is ambiguous. In the short term, losses to manufacturing firms occur mainly in the Food and Beverage, Apparel, Chemical Products and Metal Products sectors (Figure 1).





Source: Author's Compilation

The effect of the EPA is much smaller than that of the CET (Figure 2). This is because it applies to imports originating from the EU only, and around 35% of the value of EU imports is excluded from liberalization. Effects also occur gradually over the 20-year EPA implementation period. The EPA causes a moderate decline (from the CET level) in tariff protection to 8.7% and thus a fall in tariff revenue, and an increase in imports and trade diversion towards the EU. By full implementation in 2035, total government revenue is estimated to fall by 1.6% from the CET level, but still remain 1.2% higher than in a scenario in which both the CET and EPA were not implemented as shown in Figure 3.



Source: Author's Compilation

Ghanaians in the lowest income households are estimated to benefit from a 0.4% reduction in the price of their consumption bundle due to the EPA. Over three-quarters of manufacturing firms, and an even higher share of manufacturing workers, can be expected to experience a small net benefit from the EPA in the short run. Benefits occur mainly through lower prices and easier access to imported inputs and capital equipment, and thus there is no harm for consumers and potential for a longer term boost to productivity and growth. This is consistent with the focus of the EPA being to target tariff reductions on inputs and intermediate products. Profit losses for manufacturing firms are concentrated on the Mineral Products and Furniture sectors, yet very few manufacturing firms become unprofitable as a result. While the effect of the EPA on Ghana exporters to ECOWAS markets is ambiguous, continued duty-free access to the EU market

particularly benefits many of the priority sectors in Ghana's export diversification strategy. This includes processed cocoa products, fruit and vegetable products, and fish. The impact of both the CET and EPA is relatively small compared to even a minor acceleration in productivity growth. Examples for potential productivity enhancing policy reforms, which could form possible targets for EPA Development Programme (EPADP) support, and that could offset negative effects and boost overall competitiveness include reducing electricity outages and lowering transport costs. Policies to reduce the revenue loss impact of the EPA include the reduction and simplification of tariff and tax exemptions, which are pervasive in Ghana's customs structure. Doing so would also reduce administration and compliance costs as well as the potential for rent-seeking and corruption.

It is important to note that while the average effects of both the CET and EPA are not very large, both trade reforms and especially the CET may lead to substantial adjustment dynamics with both workers and capital likely to eventually move across sectors as well as across firms within given sectors. This creates a policy challenge to ensure that such adjustment, on one hand, can take place freely so that the Ghanaian economy can take full advantage of new market opportunities. On the other hand, it will be equally important to ensure that adequate policy measures are in place to accompany the transition, ensure a socially equitable adjustment process, and prevent those who are affected negatively from dropping out of the labour market.

Emerging Issues

Capacities of local industries must be improved in order to trade competitively in the global market. Impliedly, the accompanying measures with EPA for the next 10 years need to be productivity enhancing in order to build competitiveness. Ghana needs harmonized strategies to take advantage of trade opportunities. Most importantly, Ghana's export base must be diversified. Policies should be geared towards reduction in transportation cost, improve power supply for industrial growth and policy-makers should have a re-look at tax exemptions and check exploitative possibilities by corrupt individuals.

Non-tariff barriers such as quality standards should be implemented to prevent flooding of cheap imports on the Ghanaian market. However, meeting quality standards is a huge challenge and needs trade negotiations. Work done by Ghana Standards Board on standard conformity programs is important for the enhancement of domestic products quality. Generally, stakeholders agreed that building local capacity to use evidenced based research policy decisions is critical but data must be made available to facilitate research.

Additional research evidence will be required on (i) long-term impact analysis incorporating unforeseeable factors influencing CET and EPA (ii) changes in the consumption patterns due to CET and EPA, (iii) impact analysis of the implications of CET and EPA on micro and small scale firms which constitute significant proportion of trade and services sector in Ghana, and (iv) impact analysis with respect to trade diversion possibilities such as having the local market flooded with goods and services from countries other than the EU such as China and the US.