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POLICY BRIEF

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What are the implications of imposing import tariffs on domestic manufacturing production in Uganda?

Executive Summary

The study examines the effect of tariff increments on the production of selected products in Uganda in the FY 2019/20. The results show continued importation of the selected products even after the tariff increments. This is because manufacturers are constrained and lack the capacity to; produce some of the products, adjust production to meet the local demand, and depend on imported inputs. In addition, there is a loss in consumer welfare in the short term, and the total revenue effect is positive across all tariff lines but not significant. We also note that the expected revenue gains from the tariff increments may not be realized in the short run since most of Uganda's trading partners are within the EAC and COMESA and thus exempted from this tariff increment. We conclude that the government should first identify and address the supply side constraints of producers and their capacity deficiencies and then focus on stimulating domestic production rather than imposing tariffs.

Introduction

Uganda's manufacturing sector is highly constrained; manufacturers cannot produce enough to meet the local demand; the sector is characterized by the use of low-level technology and innovations and highly depends on imported inputs, among other factors. In the FY 2019/20, new tariffs were introduced in the thresholds of 10, 25, 35 and 60 percent on selected products that constitute the country's highest import bill (such as; petroleum and petroleum products, iron and steel, medical and pharmaceutical products, cereals, plastics, vegetable fats and oils, textiles, salt, fertilizer, sugars and sugar preparations; transport; construction; and medical services), to increase their prices, and promote local manufacturing under the Import replacement strategy enshrined in the NDPIII. However, to promote import replacement, it is necessary to address the abovementioned constraints before increasing tariffs to enable local production of the selected products. This brief is based on the EPRC study on Import Substitution: How increased import duties in Uganda affect Trade, Revenue and Welfare (Research series 154). [1]

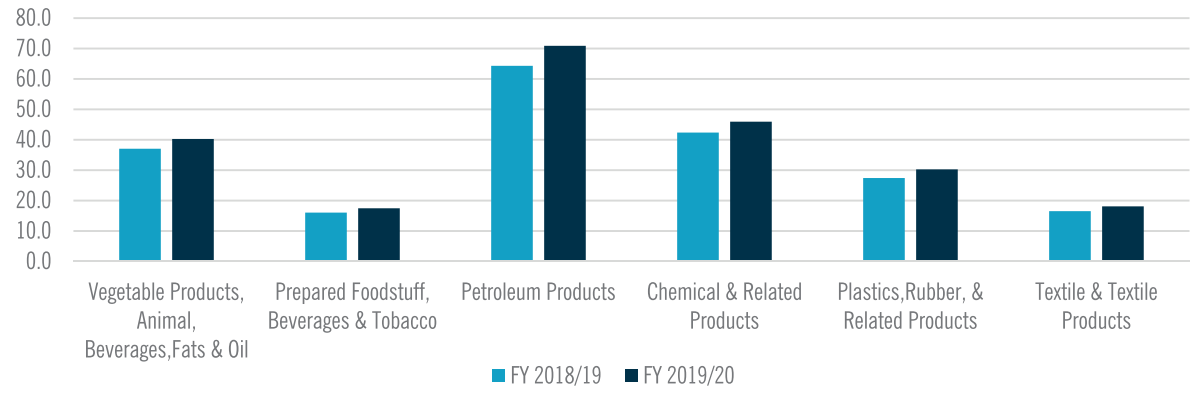
Methodology and data

The study adopted a quantitative approach using the WITS SMART[2] model, based on the work by Laird and Yeats (1986).[3] Equations are derived to estimate various trade policy effects from the tariff changes[4] , particularly trade, welfare, and revenue effects. The study relied on trade data for the 2018 calendar year disaggregated at the Harmonized System (HS) level six. As indicated above, simulations were run for different categories of the varying tariff increments.

Key findings

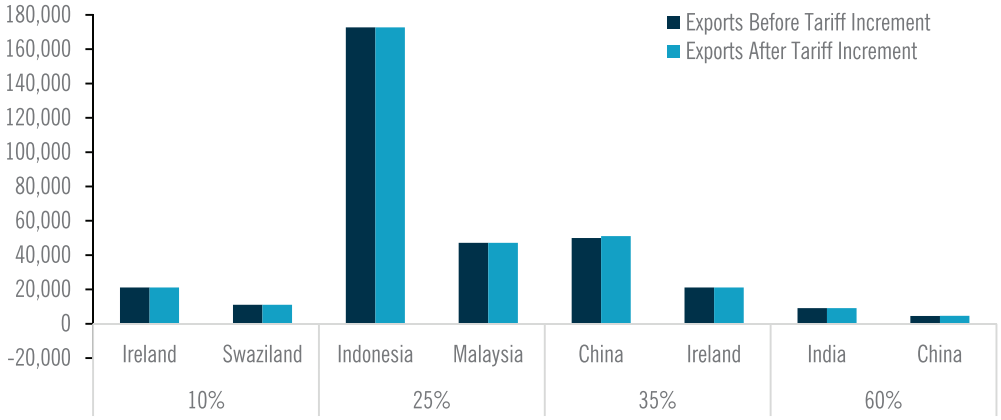
There is a lack of local capacity to produce the selected commodities. The findings indicate continued importation of the selected products even after the tariff increments (Figure 1). The tariff increments were intended to make the selected products expensive and thus discourage importation. However,

Figure 1 Imports of selected commodities before and after tariff increments (USD millions)



Source: Authors' construction from ITC/Trade Map, 2019

Figure 2 Top supply markets to Uganda for select commodities, before and after the tariff (US$ 1000)



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most exporting countries' volume of products traded with Uganda remained unchanged (Figure 2). This partly implies the lack of local capacity to produce these commodities; hence, imposing tariffs will only make them expensive, leading to loss of welfare.

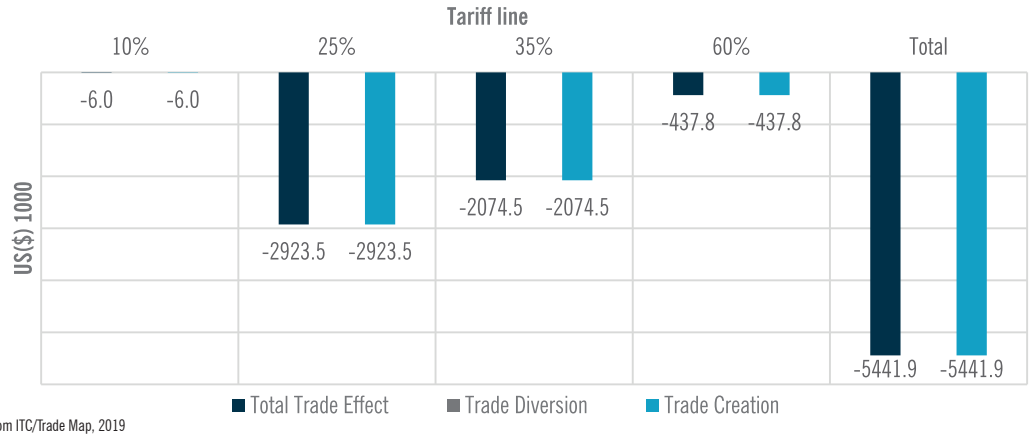
b) **Low levels of technology and innovations**. Technology and innovation are critical features in the growth of the manufacturing sub-sector. However, findings infer those producers may not easily adjust their production in the short term due to the low levels of technology and innovations (especially for SMEs). Most firms in Uganda undertake processing (agro-processing) instead of product innovation[5]. Products such as; flat-rolled iron and steel products, electric accumulators, and television sets are imported (in parts) and assembled within the country.

Therefore, for import replacement to be effective, there is a need to support the national capacity in technology and innovation through funding and commercialization of industrial creations.

c) **Domestic manufacturers highly depend on imported inputs.** For products such as; flat-rolled iron and steel products, essential oils, soap, chocolates and toothpaste, electric accumulators, and television sets, the trade volume did not change even after the tariff increments. Figure 3 shows the trade effect for most products across the 25%, 35% and 60% tariff lines were negative. This indicates high dependence on imported inputs by domestic manufacturers. Therefore, increasing tariffs makes inputs more expensive, discouraging domestic production and reduces welfare.

It is also worth noting that imports from the EAC and COMESA partners were not affected by the tariff increments because they are party to the Common Market agreements. The lag in the market response to the tariff changes and the existing

Figure 3 Total trade effects (US$ 1000)



Source: Authors' construction from ITC/Trade Map, 2019

production constraints may also limit the increase in supply for products, hence continued importation.

Conclusion and Policy recommendations

Increasing import duties may increase revenue in a production and supply-constrained environment but not necessarily create trade. This is because firms cannot adjust their production levels in the short run and supply is limited, local production greatly relies on inputs, and producers may not easily adjust their production due to the levels of technology and innovations. Therefore, whereas increasing tariffs on imports is necessary to build domestic production capacity, it is not sufficient on its own; instead, the government needs to consider easing production and supply constraints of producers as opposed to increasing tariffs.

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Endnotes

1 Nattabi, A. K., Shinyekwa, I. M., & Luwedde, J. (2020). Import substitution: how do increased import duties in Uganda affect trade, revenue and welfare.
2 http://wits.worldbank.org/witsweb/download/docs/Help_Files/Simulation/WITS-SMART
3 Laird S .and Yeats A. (1986) UNCTAD Trade Policy Simulation Model. A note on the methodology, data and uses.
4 In this case, the analysis is for tariff increments.
5 Shinyekwa, I., Kiiza, J., Hisali, E., & Obwona, M. (2016). The evolution of industry in Uganda. Manufacturing Transformation, 191.

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