

Module 2: Deep Dive into Tariff Systems and Related Concepts

Learning Objectives

By the end of this module, participants will be able to:

- Explain what customs tariffs are and differentiate between bound and applied tariffs
 - Distinguish between MFN, preferential, and non-MFN tariffs
 - Recognize different tariff formats and calculate their impact on product prices
 - Apply analytical concepts: tariff escalation, preferential margin, and tariff advantage
 - Use Market Access Map to analyze and compare tariffs across markets and competitors
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2.1 Understanding Customs Tariffs

What is a Customs Tariff?

A **customs tariff** is a tax imposed on goods when they cross a national border, typically on imports.

Tariffs serve multiple purposes:

- **Generate government revenue**
- **Protect domestic industries** from foreign competition
- **Influence consumer behavior** by affecting final prices
- **Serve as negotiating tools** in trade agreements

Example: Uganda Refrigerator Imports

If Uganda imports a refrigerator valued at USD 500 with a 20% tariff:

- **Tariff amount:** $\text{USD } 500 \times 20\% = \text{USD } 100$
- **Landed cost:** $\text{USD } 500 + \text{USD } 100 = \text{USD } 600$
- **Impact:** Makes imported refrigerators more expensive than locally produced ones

Key Question for Consideration

Why would countries impose tariffs even when consumers pay higher prices?

Potential reasons:

- Protect domestic employment in competing industries
- Develop infant industries that need time to become competitive
- Generate revenue for government programs
- Respond to unfair trade practices by other countries

2.2 Bound vs. Applied Tariffs

Bound Tariffs

Bound tariffs represent the maximum tariff levels that WTO members commit not to exceed:

- **Legally binding** commitments under WTO agreements
- **Cannot be raised** without offering compensation to affected trading partners
- **Provide predictability** for exporters in planning investments
- **Often higher** than actually applied rates

Applied Tariffs

Applied tariffs are the actual tariff rates charged at the border:

- **Can be lower** than bound rates
- **Include MFN, preferential, and non-MFN** tariffs
- **Changed more frequently** based on economic conditions
- **Determine actual** cost of importing

Illustration: Uganda Sugar Tariffs

- **Bound tariff:** 40% (WTO commitment ceiling)
- **Applied MFN tariff:** 25% (actual rate for WTO members)
- **Applied preferential tariff:** 0% (under COMESA agreement)

This structure provides flexibility while ensuring predictability for trading partners.

2.3 MFN, Non-MFN, and Preferential Tariffs

Most Favored Nation (MFN) Tariffs

MFN principle: WTO members must treat all other members equally in trade

Characteristics:

- **Applied equally** to all WTO members
- **Non-discriminatory** treatment
- **Baseline rates** in absence of preferential agreements

Example: Kenya's Wheat Imports

Kenya imports wheat from both Canada and Argentina. As all are WTO members, both countries' wheat faces the same MFN tariff rate, ensuring equal treatment.

Non-MFN Tariffs

Non-MFN tariffs are higher rates applied to countries without MFN status:

- Politically motivated trade restrictions
- Applied to non-WTO members or in trade disputes
- Generally higher than MFN rates

Preferential Tariffs

Preferential tariffs offer reduced or zero rates under special arrangements:

Types of arrangements:

- Free Trade Agreements (FTAs): Reciprocal preferences
- Generalized System of Preferences (GSP): Unilateral preferences for developing countries
- Regional agreements: COMESA, EAC, SADC for African countries

Practical Example: Ugandan Coffee Exports

- EU market: 0% tariff under Everything But Arms (EBA) scheme
 - China market: 8% MFN tariff
 - Impact: Significant price advantage in EU market affects export strategy
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2.4 Tariff Formats and Their Effects

2.4.1 Ad Valorem Tariffs

Definition: Expressed as a percentage of the product's value

Formula: $\text{Tariff Amount} = \text{Product Value} \times \text{Tariff Rate}$

Example: Australian Wine Imports

Australia applies 5% MFN tariff on imported wine:

French wine (USD 6 per bottle):

- Tariff paid: $\text{USD } 6 \times 5\% = \text{USD } 0.30$
- Final price: USD 6.30

New Zealand wine (USD 8 per bottle):

- Tariff paid: $\text{USD } 8 \times 5\% = \text{USD } 0.40$
- Final price: USD 8.40

Impact: Higher-value products pay proportionally more in tariffs.

2.4.2 Specific Tariffs

Definition: Fixed amount per unit of measurement (weight, volume, quantity)

Formula: $\text{Tariff Amount} = \text{Tariff Rate} \times \text{Quantity}$

Example: Swiss Beef Imports

Switzerland imposes CHF 22/kg tariff on Argentine beef:

Before tariff:

- Low-quality beef: CHF 10/kg
- Prime beef: CHF 40/kg
- **Price ratio:** 1:4

After CHF 22/kg tariff:

- Low-quality beef: CHF 32/kg (10 + 22)
- Prime beef: CHF 62/kg (40 + 22)
- **New price ratio:** 1:1.9

Impact: Specific tariffs favor higher-value products by reducing relative price differences.

2.4.3 Compound Tariffs

Definition: Combination of ad valorem and specific components

Example: German Coffee Substitute Imports

Germany applies 5.1% + EUR 12.7/100kg on roasted coffee substitutes from Sri Lanka:

Calculation for 10kg package worth EUR 80:

- Ad valorem component: $\text{EUR } 80 \times 5.1\% = \text{EUR } 4.08$
- Specific component: $10\text{kg} \times \text{EUR } 0.127/\text{kg} = \text{EUR } 1.27$
- **Total tariff:** EUR 5.35
- **Final price:** EUR 85.35

2.4.4 Mixed Tariffs

Definition: Application of either ad valorem or specific tariff, whichever is higher

Example: Japanese Leather Shoes

Japan applies "30% or JPY 4,300 per pair, whichever is greater":

Branded shoes (JPY 1,000/pair):

- Option 1: $30\% \times \text{JPY } 1,000 = \text{JPY } 300$
- Option 2: JPY 4,300
- **Applied tariff:** JPY 4,300 (higher amount)
- **Final price:** JPY 5,300

Unbranded shoes (JPY 300/pair):

- Option 1: $30\% \times \text{JPY } 300 = \text{JPY } 90$
- Option 2: JPY 4,300
- **Applied tariff:** JPY 4,300 (higher amount)
- **Final price:** JPY 4,600

Impact: Mixed tariffs provide minimum revenue regardless of product value.

2.4.5 Tariff Rate Quotas (TRQs)

Definition: Two-tier system with lower tariffs up to specified quantities, higher tariffs beyond quota

Example: US Cotton Imports from Burkina Faso

- **Inside quota (0-326 tons):** USD 0/ton
- **Outside quota (above 326 tons):** USD 314/ton
- **Impact:** First 326 tons enter duty-free, additional quantities face high tariffs

2.5 Key Analytical Concepts

2.5.1 Tariff Escalation

Definition: Tariff rates increase with the level of processing

Purpose: Protect domestic processing industries

Example: Cocoa Value Chain

- **Raw cocoa beans:** 0% tariff

- **Cocoa paste:** 5% tariff
- **Chocolate bars:** 15% tariff

Impact: Encourages importing raw materials rather than processed goods, potentially limiting developing countries' value-addition opportunities.

2.5.2 Preferential Margin

Definition: Difference between MFN tariff and preferential tariff rate

Formula: Preferential Margin = MFN Tariff Rate - Preferential Tariff Rate

Example: Uganda's Cocoa Butter Exports to EU

- **MFN tariff:** 10%
- **Uganda's preferential tariff:** 0% (under EBA)
- **Preferential margin:** $10 - 0 = 10$ percentage points

2.5.3 Tariff Advantage

Definition: Competitive advantage gained through preferential access relative to competitors

Example: Coffee Exports to EU Market

- **Uganda:** 0% tariff (EBA preference)
- **Vietnam:** 7.5% MFN tariff
- **Uganda's tariff advantage:** 7.5 percentage points

Business implication: Uganda can price more competitively or maintain higher margins.

2.5.4 Ad Valorem Equivalent (AVE)

Definition: Conversion of specific tariffs to percentage form for comparison purposes

Formula: $AVE\% = (\text{Specific Tariff} \div \text{Unit Value}) \times 100$

Example: EU Maize Imports

- **Specific tariff:** USD 100/ton
- **Import price:** USD 500/ton
- **AVE calculation:** $(100 \div 500) \times 100 = 20\%$

Importance: Enables comparison between different tariff formats and assessment of protection levels.

2.6 Using Market Access Map for Tariff Analysis

2.6.1 Key Functions Overview

Market Access Map (<https://www.macmap.org>) provides comprehensive tariff analysis tools:

1. **Product Search:** Identify correct HS codes for products
2. **Customs Duties Query:** Retrieve tariff rates by country-product combination
3. **Compare Markets:** Analyze tariff conditions across different destinations
4. **Compare Competitors:** Assess relative tariff treatment of different suppliers
5. **Compare Products:** Examine tariff escalation within product categories

2.6.2 Practical Navigation Steps

Step 1: Product Identification

- Use product search function to find correct HS code
- Verify product description matches your specific item
- Note any classification variations across countries

Step 2: Basic Tariff Query

- Select reporting country (destination market)
- Select partner country (origin of exports)
- Input product code at appropriate level of detail
- Review all applicable tariff types (MFN, preferential, bound)

Step 3: Comparative Analysis

- **Compare Markets:** Identify destinations with lowest tariffs
- **Compare Competitors:** Assess tariff advantages relative to other suppliers
- **Compare Products:** Analyze tariff escalation effects

2.6.3 Practical Exercise Framework

Scenario: Uganda coffee exports analysis

Questions to address:

1. What are the MFN tariff rates for Ugandan coffee in EU and China?
 2. Which preferential agreements provide tariff advantages?
 3. How do Uganda's tariff conditions compare with competitors like Kenya or Ethiopia?
 4. Is there evidence of tariff escalation from green coffee to processed coffee products?
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2.7 Advanced Tariff Analysis Techniques

2.7.1 Weighted Average Tariffs

Concept: Trade-weighted averages provide better representation of actual protection than simple averages

Application: Compare overall tariff levels between countries or product groups

2.7.2 Tariff Binding Coverage

Concept: Percentage of tariff lines with bound commitments

Importance: Higher binding coverage provides greater predictability for exporters

2.7.3 Tariff Peaks and Escalation

Tariff peaks: Exceptionally high tariffs (typically above 15%) **Escalation:** Systematic increase in tariffs with processing level

Business impact: Both limit market access and value-addition opportunities

2.8 Business Applications and Strategy Implications

2.8.1 Export Market Selection

Criteria to consider:

- **Tariff rates:** Lower tariffs improve competitiveness
- **Preferential access:** Existing agreements provide advantages
- **Tariff stability:** Bound rates ensure predictability
- **Rules of origin:** Compliance requirements affect feasibility

2.8.2 Product Development Strategy

Considerations:

- **Tariff escalation:** May favor certain processing levels
- **Specific vs. ad valorem:** Different impacts on high/low-value products
- **TRQ opportunities:** Quota access for priority products

2.8.3 Supply Chain Optimization

Applications:

- **Origin planning:** Utilize preferential agreements

- **Value chain location:** Consider tariff escalation effects
 - **Timing strategies:** Manage TRQ allocations
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2.9 Module Summary and Integration

Key Learning Points

1. **Tariff types** serve different purposes and create varying business impacts
2. **Bound vs. applied** distinction provides both predictability and flexibility
3. **Preferential systems** create competitive advantages for eligible countries
4. **Tariff formats** affect different products and price points differently
5. **Analytical tools** enable strategic decision-making in market selection

Integration with Module 1

This module builds on Module 1's market access foundations by:

- **Deepening understanding** of one key market access instrument (tariffs)
- **Providing analytical tools** for practical business applications
- **Demonstrating** how to use professional market intelligence tools
- **Connecting** theoretical concepts with real-world business decisions

Preparation for Module 3

The next module will examine non-tariff measures (NTMs) and their strategic implications, building on the comprehensive understanding of tariff systems developed here. Understanding tariffs provides the foundation for appreciating how NTMs can be even more complex and impactful for market access.

Critical Questions for Reflection

1. How might tariff escalation in key export markets affect Uganda's industrialization strategy?
2. What role should preferential margins play in evaluating potential FTA negotiations?
3. How do different tariff formats create varying competitive dynamics for different types of businesses?

This module provides essential technical knowledge for analyzing tariff systems and their business implications. Participants should practice using Market Access Map with real products relevant to their business interests.