ABSTRACT

Impact of Import Tariff Reduction on Fiscal Sustainability of Ethiopia: A Recursive Dynamic Computable General Equilibrium Analysis

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This study examines the dynamic impacts of import tariff reduction on major macroeconomic variables and the fiscal sustainability of Ethiopia in the light of the country’s accession to WTO. We have used a Recursive Dynamic Computable General Equilibrium Model (RDCGEM) to assess the dynamic impacts of import tariff reduction on several macroeconomic variables under different tariff reduction scenarios. The model uses base year data from national income accounts, fiscal accounts and from balance of payment accounts for the year 2013-14. The RDCGEM has been initialized and calibrated to the base year data and is verified for the correctness and robustness of the results. Then, the model has been used for simulation purposes for the import tariff reduction under different scenarios. Based on the RDCGEM outputs, fiscal sustainability impact of import tariff reduction is tested using fiscal reduction function and the cointegration method. The results of both the RDCGEM analysis and the cointegration tests have been analyzed and conclusions are drawn. The results indicate that a 95 percent import tariff reduction has a negative impact on several macroeconomic variables especially on fiscal variables including government tax revenue, government saving, fiscal deficit and on public debt accumulation. It also results in long term fiscal unsustainability. However, if the 95 percent import tariff reduction is complemented with 23 percent rise in the average consumption tax rate, it would be possible to maintain the tax revenue loss and fiscal sustainability. Hence, it is suggested that the country should go for joint reform of both consumption tax and import tariff to avoid possible revue losses.

Key Words: tariff reduction, fiscal sustainability, RDCGEM model, Ethiopia