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Export Taxes and EPAs – Another Policy Tool under Threat from the EC?

Introduction

At the end of 2007, developing countries in the African, Caribbean and Pacific (ACP) were in danger of losing preferential trade access (change to GSP) to the European Union (EU) markets, unless they signed interim Economic Partnership Agreements (EPAs).

The EPAs replaced the non-WTO-compatible Lomé Conventions, which were extended to the beginning of 2008 by the Cotonou Agreement. Under the terms of the EPA negotiations, the EU and ACP are committed to tariff reductions in 'substantially all trade' and bound to the objective of "poverty reduction, sustainable development and gradual integration into the world economy". (http://ictsd.net/downloads/tni/tni_en_7-4.pdf)

Towards this end, the EU has decided to negotiate EPA's with regional groupings, one of which is the East African Community (EAC), comprising of Burundi, Kenya, Rwanda, Tanzania and Uganda.

The EAC signed an interim EPA in late 2007, in order to protect its market access, but the agreement contained several contentious issues, among which are the 'most favoured nation clause', a freezing of all tariffs (including protected products) and a ban on implementing new export taxes. These issues are contentious as they are trade policy instruments and will have an impact on the policy space of countries.

This briefing paper will look specifically at the issue of export taxes in the EU-EAC EPA negotiations. The aim of this paper is to show that export taxes can play an important role in improving the development objectives of EAC countries, promoting value addition, protecting infant industries and improving agricultural productivity.

The paper discusses the use of export taxes in the EAC, before examining the reasoning behind the EU's stance on export taxes in EPA negotiations and finally giving an illustration of where export taxes have been applied successfully in realising a country's development objectives.

What is an Export Tax?

An export tax is simply a duty applied by countries to products before export, although it can take several forms. Export taxes can be introduced at a standard rate; can fluctuate, depending on world prices, and can also induce a complete ban on exports.

Currently, there is no prohibition on export taxes in the WTO, as large developing countries (such as China, India and Brazil, who use export taxes) have rebuked attempts to ban them by developed nations/blocs, such as the European Commission (EC).

Export taxes can produce real revenue for the exporting government, at the expense of the exporter and the importing country's consumers. The main reason for opposition to export taxes is the welfare implications it places on domestic and international producers and consumers.

A tax on an export will reduce the supply of a good onto the world market, which will increase local supply, causing the price to drop, meaning domestic consumers will gain, whereas producers will not, as they receive less for the good than before.

Therefore, there is a shifting of welfare from producers to consumers, although effects may well be neutral if the producers also consume the good (small scale family farm units).

The increased availability and reduced domestic cost of a good may also encourage the processing of that particular good, promoting industry and job creation in other sectors (for example, cocoa pods to cocoa powder).

While the welfare effects of the implementing country can be positive and negative, the effects on the importing country are negative, if the exporting country has a significant proportion of the world supply. This is because the export tax will increase the world price and international consumers would bear the cost of the tax in increased prices.

However, producers of the importing country could potentially gain, if they can produce the good or a perfect substitute, instead of importing it, but this is very much dependent on the availability of the raw material locally (timber or minerals for example). As the potential gains from the export tax are, if anything, favouring the exporting country, the tax has thus been referred to as a "beggar thy-neighbour" policy (WTO paper), which may result in reciprocal export taxes being imposed by other countries, in order to shield domestic consumers.

State of Play – Export Taxes and EAC Countries

None of the EAC member states have a sufficient world market share to cause price increase in the world market through imposing export taxes (the highest being Kenya, which produces 14 percent of world's tea).

Currently, most of the EAC member states do not apply export taxes, the exception being Kenya, where the tax is applied on scrap metal and hides and skins. Uganda also applies a levy on hides and skins in order to encourage value addition.

The EAC Customs Management Act, 2004, that regulates the imports and exports in the region provides for prohibited and restricted goods and it is to that effect that export of certain goods may be prohibited or restricted under the Act, or by any written law in the Partner states.

What is Wrong with Export Taxes? An EC Perspective

The EC is opposed to export taxes and has for, a long time, advocated for rules to discipline their application at the multilateral level, arguing that they create distortions to international trade. It is further argued that they artificially transfer gains from trade between countries (beggar thy-neighbour); create unfair advantages to domestic industries involved in international trade at the expense of other countries' producers and also evade WTO disciplines on export restrictions by shifting to more or less prohibitive taxes on the exportation of goods[1] .

"A policy sledgehammer" **–** The first angle of attack over export taxes is the argument of these being economically inefficient, which leads to a 'beggar thy-neighbour' approach and thus is proving to be a 'policy sledgehammer' (Mandelson speech). In this sense, the EC is of the view that export taxes have a bad effect on everybody (locally and globally) and not just on the EC.

The EC's position comes from an economic efficiency viewpoint. The implementation of export taxes by countries with monopolistic positions of global supply will create rising commodity prices for consumers all over the world.

These global supply problems may lead to an ever-increased risk of food insecurity, witnessed in the last few years with the rising costs of wheat and rice. As countries with a monopolistic supply position implement export taxes, other countries in response will look towards protecting their own citizens from fluctuations, which will lead to increased protectionism throughout the world. Indeed, the use of export taxes and restrictions during the food crisis were widely criticised[2] .

The other reason is the failure of export taxes to achieve developmental gains in developing countries. Indeed, for instance, an export tax designed to promote value addition may, in fact, lead to processing industries that are only competitive with constant subsidies. The government revenue may not be spent wisely or administration costs may be high. In addition, they have also been associated with encouraging rent-seeking behaviour in a number of developing countries[3] .

With their potential adverse effects both at international and local levels, the EC argues for use of other policies with less adverse effect on economies and livelihoods.

EC's Access to Raw Materials

While the market efficiency and 'policy sledgehammer' may well be compelling arguments globally for a re-think on export taxes, perhaps the main reason behind the EC's desire to ban export taxes lies in the access to raw materials.

The 'beggar thy-neighbour' approach taken by countries like Russia and China, for example, has meant that the 'neighbour' who is left out in the cold is the EC, making the region heavily dependent on importation of raw materials, which their processing and manufacturing industries rely upon (and, therefore, the economies).

Over the past two years, there has been a surge of export taxes by China, Russia and India to protect their raw materials, such as timber, metals and minerals. These taxes have had a dramatic effect on the costs of raw materials for importing countries, such as the EC.

As a result, the removal of export taxes has become a central issue, as outlined in the EC 2006 'global competitiveness' model, seeking their removal through a three-pronged strategy:[4]

- Using FTAs to enforce commitments on reduction of export restrictions;
- Using WTO accession agreements to commit accessing members to reduce or avoid levying export taxes. (The Chinese accession package has such a commitment); and
- Raising awareness and cooperation in all relevant international arenas, such as the G8 and Organisation for Economic Cooperation and Development (OECD), as well as in 'strengthened dialogues' with the US and Japan.

Introducing export tax restrictions in bilateral agreements could potentially lead to increased pressure on countries to agree a multilateral agreement on export taxes at the WTO.

Export taxes restrictions have taken different forms in different EPAs, for instance the Papa New Guinea Interim EPA calls for a complete ban of all export taxes, whereas in the Southern African Development Community (SADC) and EAC interim EPA there is a ban on new export taxes with a proviso for relaxation of the rule if its shown that the tax is to be used for "developmental aims" such as value addition.

The decision on whether to allow export tax use due to "developmental aims" in both the EAC and SADC EPAs is to be made by the joint EPA council, with continuous investigation of its effects. While the formation of the joint council in the EAC has not been completed, a guide to its operations can be taken from the joint Caribbean Forum of African, Caribbean and Pacific States (CARIFORUM)-EC Council already in force.

In the CARIFORUM-EC EPA the joint council supervises the political implementation of the EPA, and is constituted by representatives from both regions, with the mandate to meet once every two years. While the Caribbean countries have the power to veto, the pressure envisaged from EC may lead them to agreeing to their demands at the joint council. This structure is the likely one to be adopted in the other EPAs including the EAC.

Merits of Export Taxes

Although some export taxes have been misused by developing countries in the past, and some have caused commodity prices to rise dramatically, no export tax is the same and the reasons for implementing them are not always the same either.

Export taxes have been successfully applied in promoting value addition. Implementing the tax on a given item reduces the price domestically making inputs cheaper for the local industries involved in the processing of the item and therefore affording them competitive products on the world market. Government revenue collected from the tax could also be used in developing industries to take advantage of the cheaper inputs. This is more so in the agricultural value chains, where the use of export taxes ensures supplies to the processing industries during droughts, which would otherwise affect the industry leading to less investment and thereby less value addition.

The Namibian beef sector is an example of the successful implementation of this policy tool. The use of export taxes encouraged the development of a slaughtering and meat processing industry, as well as a tanning and leather working industry, which have since grown and created thousands of jobs in the country.

Export taxes are also used to protect infant industries, by protecting local production from cheaper and often subsidised imports. The Namibian and South African beer industries are good examples of how Namibia successfully applied the policy tool to effectively deal with the predatory practices of South-African Breweries. In the process Namibia led to the growth of its own beer industry that is now very competitive in the region.

Conclusion and the Way Forward

It is important for the EC to understand the vast array of uses that export taxes have in the EAC and in the wider context in sub-Saharan Africa. Therefore, the development aspect in allowing new export taxes should take precedence.

Export taxes do not necessarily constitute a 'sledgehammer' and there are few options available, such as broad-based subsidies employed in the EC, which are not affordable policy options in the EAC context.

The EC should be wary about the consequences on developmental aims, with the continued intrusion on EAC's policy sphere. Export tax promotion is often designed for long-term planning (R&D and value addition), which may be harmed by constant reviews by an EAC-EC council.

Recent developments in the Southern African Development Community (SADC) EPA indicate that the EC is willing to exercise flexibility on this issue. It is reported that they have agreed to relax disciplines on export taxes and will discuss the criteria for the introduction of new taxes. EAC can borrow from the SADC region and demand a similar arrangement.

It is clear that by introducing disciplines on export taxes in the EPAs, the EC is trying set a precedent, hoping that it would eventually be adopted at the multilateral level, which is their real target. The EAC countries could, therefore, demand that where an export tax is a revenue measure, the EC should at least replace the revenue by a binding commitment to provide foreign aid.

The EAC could also support the EC in establishing its principle, since their purpose is only symbolic and not commercial. However, in doing so, the EAC should go for specific exceptions that will swallow the rule on export taxes and, thereby, continue with the *status quo*.

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ENDNOTES

1 See Communication from the European Communities to the WTO Negotiating Group on Market Access TN/MA/W/11/Add.6 available at http://www.wto.org

2 For further discussion, see Lui D. and S. Bilal 2009. Contentious Issues in the Interim EPAs Potential Flexibility in the Negotiations (ECDPM Discussion Paper 89). Maasctricht. Pg 14

3 *Ibid*

4 'European Commission Proposes New Strategy to Address EU Critical Needs for Raw Materials', Press Release, available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1628

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