2009

RESEARCH Paper

# Export Taxes and EPAs; another Policy Tool under Threat from the EC?

Part of a series of Publications by CUTS-GRC in conjunction with National Partners and under the Assistance of the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), BIEAC Project.

CUTS International
Geneva Resource Centre

gtz

By Richard Watts
CUTS Geneva Resource Centre
7/16/2009

## 1.0 Introduction:

1.1 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 markets, unless they signed interim economic partnership agreements (EPA's).

1.2 The EPA's replaced the non-WTO compatible Lome Convention, which was 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."

1.3 Towards this end, the EU has decided to negotiate EPA's with regional groupings, one in the Caribbean, one in the pacific and four in Africa. One of the four regional groupings, the East African Community (EAC) comprises of the countries Burundi, Kenya, Rwanda, Tanzania and Uganda.

1.4 The EAC signed an interim EPA in late 2007 in order to protect its market access, but the agreement contained several contentious issues, which is currently holding up negotiations in agreeing to a full EPA, which includes agreements on investment and services.

1.5 The contentious issues contained in the interim EPA include 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.

1.6 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 development objectives of EAC countries, promoting value addition, protecting infant industry and improving agricultural productivity.

1.7 The paper discusses the use of export taxes in the EAC, before examining the reasoning behind the European Union'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. Concluding with some remarks and suggestions on the way forward for the EAC.

## 2.0 What is an export tax?

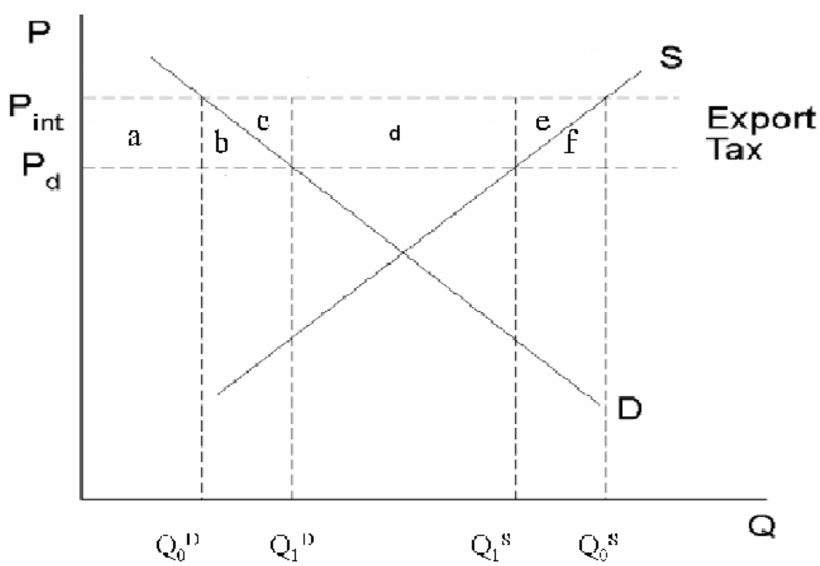
2.1 An export tax is simply a duty applied by countries to products before export, although it can take several forms. Export taxes can be introduced at a standard rate; can fluctuate depending on world prices and can also induce a complete ban on exports.

2.2 Developing countries have tended to use them on exported primary products, due to the volatility and decline in relative prices in world markets (WTO paper), to increase government revenue, and to alter income distribution.

2.3 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, such as the European Commission.

2.4 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. At the country level export taxes will cause a deadweight loss to society, a loss in domestic producer surplus, but a gain in domestic consumer surplus (figure 1).

**Figure 1:**




After a export tax is Implimented

Consumer surplus: gain area a+b
Producer surplus: lose area a+b+c+d+e
Govt tax revenue: gain area d
Net loss to economy (deadweight): c+e

2.5 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.

2.6 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).

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

2.8 While the welfare effects of the implementing country are positive and negative, effects to 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, meaning international consumers would bear the cost of the tax in increased prices.

2.9 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 gain from the export tax are if anything favouring the export 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.

## 3.0 The current state of play – Export taxes and EAC countries

3.1 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% of worlds tea).

3.2 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.

3.3 The East African Community Customs Management Act, 2004 that regulates the Imports and Exports in the region, provides for prohibited and restricted goods and is to the effect that export of certain goods may be prohibited or restricted under the Act, or by any written law for the rime being in force in the Partner states.

4.0 What is wrong with export taxes? An EC Perspective:

4.1 The EC is opposed to export taxes and have for a long time advocated for rules to discipline their application at the multilateral level, arguing that they create distortions to international trade. 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]

4.2 The new European Commission trade commissioner Catherine Ashton also recently stated a commitment to flexibility in EPA negotiations, but not it seems in relation to export taxes. In January 2009 she stated that "removing trade barriers like export taxes must be a cornerstone of EU trade policy."

4.3 This is a message that has been carried throughout the EPA negotiations, even under the previous trade commissioner Peter Mandelson, so an understanding of the reasons why the EU has this position is important.

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

4.5 The European Commission's mantra over export taxes comes very much 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.

4.6 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 to protect 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]

4.7 The second angle of contention over export taxes concerns is at the domestic level, with the failure to achieve developmental gains locally 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 are high and they have also been associated with encouraging rent-seeking behaviour in a number of developing countries.[3]

4.8 Historically there have been pitfalls to the introduction of export taxes. Export taxes may act to reduce production for primary commodities and investment in that sector, resulting in reduced incomes for poor households, something which can be seen to have occurred in the cocoa sector in Ghana in the 1980's.

---

[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

4.9 Additionally, an export tax on a product may result in importing countries producers to produce the commodity or that perfect substitutes may well be introduced instead, meaning that the purpose of the export tax will not occur and the opposite can happen, causing production to collapse and economic hardship.

4.10 With its potential adverse effects both at the international and local level, the European Commission has come to view export taxes as a ‘policy sledgehammer’ rather than a scalpel, and that there are many other policies that could be used, that would have less potential for adverse effect on economies and livelihoods.

4.11 EC’s access to raw materials – While the market efficiency and ‘policy sledgehammer’ may well be compelling arguments globally for the re-think of export taxes, perhaps the main reason behind the EC’s desire to ban export taxes lays in the access to raw materials.

4.12 The ‘beggar thy-neighbour’ approach taken by countries like Russia and China for example has meant the ‘neighbour’ who is left out in the cold is the EC. This is because the EC’s raw materials are becoming increasing difficult to access and in short supply, making the region heavily dependent on importation of raw materials, which the processing and manufacturing industries rely upon (and therefore the economies).

4.13 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. For example there has been widespread concern by businesses and governments in the EC about Russia’s export tax on timber, as the EC paper industry is the main importer of timber from Russia, meaning costs have risen in the last 2 years by over 100%.

4.14 This protectionist regime over access to raw materials has been called the ‘new phase of globalisation’ as raw materials become ever more scarce. Since the EU is heavily dependent on imports of raw materials, it stands to be a major loser in this new global power play over resources. As a result, the removal of export taxes has become a central issue, as outlined in the EC 2006 ‘global competitiveness’ model, seeking the removal of export taxes through a three pronged strategy, by:[4]

i) Using FTAs to enforce commitments on reduction of export restrictions.
ii) Using WTO accession agreements to commit accessing members to reduce or avoid levying export taxes. (The Chinese accession package has such a commitment)
iii) Raise awareness and cooperation in all relevant international arenas such as the G8 and OECD as well as in ‘strengthened dialogues’ with the US and Japan.

4.15 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.

[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

4.16 Export tax restrictions have taken different forms in different EPAs. For example the Papa New Guinea IEPA calls for a complete ban of all export taxes, whereas in the SADC and EAC IEPA there is a ban on new export taxes, with a provision for a relaxation, if export tax is shown to be used for 'developmental aims', such as value addition promotion.

4.17 The decision on the whether to allow export tax use due to 'developmental aims' in both the EAC and SADC IEPA is to be decided 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 running can be taken from the Joint CARIFORUM-EC Council.

4.18 The joint CARIFORUM-EU Council supervises the political implementation of the EPA, involving representatives of the Caribbean and EU states (and EC), meeting every two years. The nature of the composition of the council has worried some, as while Caribbean countries have the power of veto, the pressure from the EU may well lead to Caribbean countries agreeing to demands made by EU states in the Joint council. The formation of the joint Caribbean-EC council may well set a precedent for the structure of a Joint EAC-EC council, which could see export taxes continually assessed by the EC, with demands made on countries to deny, change, or ban export taxes from being implemented.

5.0 So, are export taxes a policy 'sledgehammer' or a 'scalpel'?

5.1 The position of the European Commission on export taxes is clear to see. From their standpoint of economic inefficiency of domestic production and global effects, as well as their position on continued access to cheap raw materials they can be justified in there own reasoning. But this is not the end of the argument on export taxes.

5.2 Indeed, 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. The next section will detail some of the successful 'scalpel' like examples of export taxes, and the various reasons for their~~re~~ application.

5.3 Value addition – One of the common compelling arguments for implementing an export tax is to promote value addition of a commodity. Implementing an export tax will reduce the price for domestic consumers, which will mean industry will have access to cheaper inputs, meaning reduced overall cost and therefore greater competitiveness on the world market. Government revenue gained from the tax will also be used in developing industries to take advantage of the cheaper raw material. 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'. An example of successful application of this policy tool is the Namibian beef sector, where 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.[5]

[5] See Article titled Accommodating regional realities: practical issues and challenges for the SADC EPA negotiations. Published in ICTSD Trade negotiations Insights. Volume 7 Number 3 April 2008 available at http://ictsd.net/news

5.4 Infant industry protection – promote local production that is faced with cheaper subsidised imports. Namibia and South African Beer is another example of how Namibia successfully applied the export tax policy tool to effectively deal with the predatory practices of South-African Breweries and in the process led to the growth of its own beer industry that is now very competitive in the southern Africa region.[6]

## 6.0 Way ahead

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

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

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

6.4 Recent developments in the 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.

6.5 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.

6.6 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.

[6] Ibid

## REFERENCES:

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

Lui D. and S. Bilal 2009. Contentious issues in the interim EPAs Potential flexibility in the negotiations (ECDPM Discussion Paper 89). Maasctricht

'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

Accommodating regional realities: practical issues and challenges for the SADC EPA negotiations. Published in ICTSD Trade negotiations Insights. Volume 7 Number 3 April 2008 available at http://ictsd.net/news

This Research Paper is written by **Richard Watts** as part of a series of publications by CUTS GRC in conjunction with national partners and under the assistance of the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ).