

Benefits of Export Taxes

Preliminary Paper

Third World Network¹

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Executive summary

Whilst developing countries are rich in raw materials, developed countries such as the European Union (EU) do not have sufficient supplies of the raw materials they need for manufacturing. To ensure it can access a cheap supply of raw materials from developing countries, the EU is therefore trying to discipline developing country use of export taxes and restrictions at the World Trade Organization (WTO) and in its free trade agreements (FTAs) including economic partnership agreement (EPAs).

However, export taxes have been used by governments as a tool in their industrial policy and to raise revenue since the 11th century. In fact it was the most important tool in industrial development while England was industrializing.

Developing countries continue to use export taxes today as a source of government revenue, to encourage value added and infant industries, to attract foreign investment, for price stability, to improve terms of trade, or to deal with currency devaluations and inflation and as a method of addressing tariff escalation in importing countries. The paper provides a preliminary description of these uses of export taxes and gives examples and brief case studies such as Indonesia's successful transformation into the largest plywood exporter in the world (from 4% of market share to 80%) in a few years due to a combination of export taxes, export restrictions and government procurement of domestic plywood.

Context

Developing countries are rich in raw materials.² For example, "Over 50% of major mineral reserves are located in countries with a per capita gross national income of \$10 per day or less. This creates new opportunities for these resource-rich developing countries, particularly in Africa." (European Union, 2008: 5).

However, the EU does not have supplies of many of the raw materials that it needs and it no longer has colonies in Africa and Asia to extract raw materials and use preferential export taxes to secure their supply for European manufacturers. Therefore the EU is attempting to limit the ability of other countries to impose export taxes, restrictions and prohibitions. The basis for this is its Raw Materials Initiative in which it is concerned that the EU is "highly dependent on imports of strategically important raw materials" and notes that "Securing reliable and undistorted access to raw materials is increasingly becoming an important factor for the EU's competitiveness" (European Union, 2008: 2). The EU notes that "Increasingly, many emerging economies are pursuing industrial strategies aimed at protecting their resource base to generate advantages for their downstream industries. This is apparent in the proliferation of government measures that . . . include export taxes and quotas. . . Over 450 export restrictions on more than 400 different raw materials (e.g. metals, wood, chemicals, hides and skins) have been identified." (European Union, 2008: 4-5).

One of three pillars of the proposed EU raw materials strategy is "ensure access to raw materials from international markets under the same conditions as other industrial competitors" (European Union, 2008: 5). "Access to primary and secondary raw materials should become a priority in EU trade and regulatory

² See for example

http://ec.europa.eu/enterprise/newsroom/cf/document.cfm?action=display&doc_id=895&userservice_id=1&request.id=0.

policy. Trade and regulatory policy can improve access to raw materials in the following ways. – The EU should promote new rules and agreements on sustainable access to raw materials where necessary, and ensure compliance with international commitments at multilateral and at bilateral level, including WTO accession negotiations, Free Trade Agreements, regulatory dialogue and non-preferential agreements. In this context the Commission will reinforce its work towards achieving stronger disciplines on export restrictions and improved regulation against subsidies at WTO level.” (European Union, 2008: 7). The Communication goes on to note that it wants developing countries to give it pre-establishment rights for investment in mining on a national treatment and most favoured nation basis, (European Union, 2008: 8).

This can be seen for example in its proposal at the WTO for WTO members to bind their export taxes on non-agricultural products at a level to be negotiated.³ The EU has also limited the ability of developing countries to use export taxes and quantitative export restrictions in a number of FTAs and economic partnership agreements EPAs. This is despite Europe’s own extensive use of export taxes to industrialize, see below.

Historical use of export taxes

Industrial development in Europe

Export taxes have been used by governments as a tool in their industrial policy since the 11th century. The most notable account is the use of export taxes in Europe used “...as a source of revenue and a means of preserving raw materials for domestic manufacture” (Goode, Lent and Ojha, 1966: 454).

In England export taxes were applied to raw wool and hides from 1275 to 1660 to promote domestic industry processing (Devarajan, Go and Schiff, 1996: 1). In fact, for Henry VII, export taxes were the most important tool in industrial development. It “ensured that foreign textile producers had to process more expensive raw materials than their English counterparts” (Reinert, 2008: 80).

In addition, policies were implemented to attract foreign investors mainly from Holland and Italy who could then benefit from the domestic raw wool. As wool-manufacturing capacity grew in England “so did the export duties, until England had sufficient production capacity to process all the wool they produced” (Reinert, 2008: 80).

Export restrictions were so valued in English industrial policy that a century after Henry VII began applying export duties to raw wool, Elizabeth I heightened the restriction from export duties to a full embargo on raw wool. However, England was not the first to acquire such an industrial and trade strategy. “Like Venice and Holland, and by the same methods, England had acquired the same triple rent situation: a strong industrial sector, a raw material monopoly (wool), and overseas trade” (Reinert, 2008: 80).

³ Page 47 of the 6 December, 2008 Agriculture Chair’s text, TN/MA/W/103/Rev.3, http://www.wto.org/english/tratop_e/markacc_e/markacc_chair_texts07_e.htm. The proposal allows least developed countries to maintain their export taxes unbound and certain other developing countries can keep export taxes on a negotiated number of tariff lines unbound. Export taxes are not prohibited by the WTO (Piermartini, 2004: 2).

Many have attributed the Tudor Plan as being the foundation of England's industrial greatness. The Florentines were not able to compete with their English counterparts because the export duties on English raw wool ensured that raw wool was going to domestic producers for processing (Reinert, 2008: 80).

In the 19th century export taxes were largely eliminated in Europe; "however, a few duties were continued to foster domestic processing industries or as means of exploiting monopolistic positions in certain raw materials" (Goode, Lent and Ojha, 1966: 454-5). Therefore, although export taxes were no longer the main tool in the tool box, they were still employed when needed.

Colonial use of export taxes

The main place in which export taxes were deployed in this time period was in European colonies in Asia and Africa. "To some extent they were designed to favor the shipment of raw materials to the mother country or other destinations in the empire, and the use of national flag vessels. The main purpose; however, was to raise revenue" (Goode, Lent and Ojha, 1966: 454). In the case of the British Empire, export taxes on colonial raw materials were excluded on exports to parts of the British Empire (Viner, 1926: 588).

The US did not use export taxes for exports coming from the country because paragraph 5 of section 9, Article I of the Constitution forbids export taxes (Gorton, 1924: 56). However, previously the US used preferential export duties on manila hemp from their former colony the Philippines from 1902-1913. Nevertheless, oftentimes the US paid for most of the costs of export taxes enacted by the British Empire.

Preferential export taxes to eliminate competition in other countries

Britain heavily used export taxes, not only for revenue, but also for industrial processing and industrial competition (James, 1924: 62). American scholar Gorton James notes: "The earliest British preferential export tax was that on tin ore from the Federated Malay States. There had been for many years a small export tax, for revenue, on shipments of tin ore, most of which went to British smelters at Singapore" (James, 1924: 57). Additionally, in 1916, a similar export tax was applied to shipments of tin ore from British colonies in West Africa.

Meanwhile, the United States was attempting to develop a smelter industry; however, they needed to import the raw tin from the British Colonies. The larger export tax made this difficult for the US and eventually all the new smelters in the US were forced to shut down since the industry was not able to compete. According to the governor of the Federated Malay States the export tax had accomplished its intended objective. He stated that the export tax was exacted "for the purpose of preventing the transfer of the smelting industry to the United States" (James, 1924: 57).

Britain also used export taxes as a tactic to slow supplies to American soap manufactures and defeat German competition. In 1916, Parliament enacted a differential export tax on palm kernels from West Africa to prevent German competition and protect oil crushers in Hull, England. Later in the 1920s, the export tax was changed to an export ban, which cut off supply to American soap manufacturers (James, 1924: 58). Similarly, an export duty of 15% ad valorem "on exports of untanned hides and skins, with a rebate of two thirds of the tax if the tanning was done within the British Empire." The Spanish followed in British footsteps and also enacted an export duty of 20% on hides and skins. As result, US competitors found it very difficult to compete.

In 1922, the British Empire also placed a progressive preferential export tax on crude rubber. This caused a panic among American rubber-using industries.

Export taxes to protect domestic value added processing

In addition, export taxes were applied to raw materials when governments sought to favor domestic industries that were using a particular raw material by enabling them to get it at a lower price than foreign manufacturers had to pay (Edminster, 1930: 90). Britain also applied export restrictions to hides and skins coming from their former colony India. “To protect the new industry of heavy tanning in India and at the same time to resuscitate the older one of tanning skins, an embargo was imposed in August, 1919, on all exports of both untanned hides and skin to points outside the British Empire” (James, 1924: 59).

Although, there are many examples of the use of export taxes by the British Empire, they are not the only user of the trade instrument. For example, Canada placed export restrictions on logs and pulpwood to stimulate domestic processing (Viner, 1926: 589 and Edminster, 1930: 91).

Other countries in Latin America, such as Venezuela and Mexico, also used export taxes as means to promote local processing (Goode, Lent and Ojha, 1966: 455 and Reubens, 1956: 47-48).

Export taxes for government revenue

The Chilean Government levied an export duty on nitrate, which for a long time supplied about half of Chilean Government revenue (Edminster, 1930: 90).

Export taxes also occupied an important part of fiscal structure in some Latin American countries. For instance, in 1939 export taxes provided 16-19% of total tax receipts of the central governments of Guatemala, Haiti and Mexico (Reubens, 1956: 47).

Other countries in Latin America, such as Venezuela and Mexico, also used export taxes as means for government revenue (Goode, Lent and Ojha, 1966: 455 and Reubens, 1956: 47-48).

Export taxes to ensure sufficient domestic supply

In addition, export taxes have been used in times of inflation to reserve certain home-produced commodities for the home market (Goode, Lent and Ojha, 1966: 455 and Reubens, 1956: 47-48).

Export taxes today

In a paper published by the WTO, the author Roberta Piermartini states that export taxes are not prohibited by the WTO. About one third of WTO Members impose export duties. For example, in December 1995, the EU imposed a \$35 per ton export tax on wheat (Piermartini, 2004: 1-2).

According to the Piermartini paper, export taxes are mainly used by developing and least-developed countries (LDCs). Of the 15 LDCs reviewed in the context of the WTO Trade Policy Review Mechanism, 10 impose export duties, while only 3 of 30 OECD countries use them (Piermartini, 2004: 2).

There are many reasons why countries today would impose export taxes, in particular on raw materials. “Most countries, to date, have imposed trade restrictions on commodities or other less processed products. This is logical since the measures such as export taxes usually are intended to promote higher value-added activities” (European Commission Website, 2007). In addition, “trade restrictions and in particular export duties can sometimes generate an important share of the budget of a country” (European Commission Website, 2007). As the examples of Europe’s use of export taxes demonstrate, the two most eminent reasons for the export tax are government revenue and to develop higher value added processing industries (see above).

A plethora of literature has provided a list of benefits and advantages that export taxes can have for industrial and trade policy. In a document from 2007 found in the European Commission documents on trade, writers outlined the different ways in which export taxes are applicable today. These include an attempt to shield domestic consumers from high international commodity prices, price inflation or to capture raw materials for their own producers. They also allow governments to turn high commodity prices into a windfall tax and therefore use export taxes for budgetary reasons, “which in some cases may go hand-in-hand with development considerations” (European Commission Website, 2007).

The remainder of this paper will explore the range of reasons why governments would enact export duties. The main reasons which are identified are: (1) government revenue, (2) price stability, (3) terms of trade, (4) value added and infant industry, (5) currency devaluation, (6) inflation and (7) tariff escalation. The paper will also provide precautionary factors that governments should consider before enacting export taxes in certain situations. Lastly, the paper will conclude with a very valuable and important case study illustrating the conditions in which Mozambique’s cashew processing industry found itself after reducing export taxes on raw cashews.

Administrative advantages

In addition to the economic incentives of enacting an export tax, there are also administrative advantages. According to some staff members at the World Bank, an export tax is relatively easy to administer, there is less uncertainty in its operation and it could potentially raise producing countries’ welfare (Devarajan, Go and Schiff, 1996: 15). Additionally, “as compared with an income or profits tax, the export tax operates more quickly and more directly, although it fails to tap derived gains which may spread through the economy” (Reubens, 1956: 69). World Bank staffers also stated that they favor export taxes over import taxes: “Of course, it is preferable to have lower import taxes and a higher commodity export tax than the opposite because import taxes distort relative prices by taxing all exports as well as nontradables” (Devarajan, Go and Schiff, 1996: 15).

Government Revenue

An export tax is a device to cope with fiscal policy and foreign trade and can be used as means to obtain resources for development finance (Reubens, 1956: 43- 44). The fiscal importance of export taxes is also cited in other development literature (Goode, Lent and Ojha, 1966: 458-9). The authors point out that export duties and marketing boards’ surpluses have been necessities for a number of primary producing countries in which revenue demands are strong (Goode, Lent and Ojha, 1966: 479). In a WTO discussion paper, the author writes that for many developing countries with a poor tax administration system, primary commodity exports constitute an easily exploitable taxable base (Piermartini, 2004: 14).

Piermartini also cautions that export tax revenues can be unstable due to fluctuations in the international price of primary commodities and supply fluctuations (Piermartini, 2004: 14). However, despite this caution, there are still other mechanisms that a government can use to complement the use of an export tax for government revenue. Piermartini states that governments can limit the adverse budgetary consequences of a tax system highly dependent on export taxes by establishing a buffer fund, where export tax revenues are deposited when prices are high and from which subsidies to producers are drawn when export prices are low. Nevertheless, success of stabilization fund depends on the extent of flexibility of political and social institutions (Piermartini, 2004: 14).

Many scholars have also recommended the use of export taxes during commodity booms, such as what was done by many countries in the commodity boom during the Korean War (Reubens, 1956: 43 and

Goode, Lent and Ojha, 1966: 455). According to Reubens, export taxes were used to obtain government revenue and to cope with price fluctuations (Reubens, 1956: 49).

During a commodity boom “an export tax is intended to cope with these tendencies by siphoning off the gains of the boom and directing them into more desirable channels, for use immediately or at some more advisable time” (Reubens, 1956: 49). The author notes that often times in booms, “a very considerable portion of the export proceeds tends to disappear in payments for foreign services, overseas remittances of interest, dividends and profits, foreign currencies held abroad, and the flight of “hot money” (Reubens, 1956: 51). As result, this can make revenue effects of an export-price boom more uncertain (Reubens, 1956: 54). Export taxes can provide more certainty to governments in this regard. “These complications intensify the need for measures like an export tax which will limit the flow of private income as well as enlarge the government’s financial capabilities” (Reubens, 1956: 55). Hence, resources can then be available for more socially desirable development (Reubens, 1956: 69).

After World War II, export taxes on rice in Thailand became a major source of government revenue. The Thai government levied export taxes on rice during its industrial development from the 1960s to the 1980s to finance the infrastructure and resources need for industrialization (Warr, 905: 2001). “In order to extract more surplus from the rice sector, the government also required rice exporters to exchange their earning to domestic currency through the Bank of Thailand at about two-thirds the market rate” (Choeun, Godo, and Hayami, 107: 2006). By 1965 rice export taxes alone accounted for one-tenth of total government revenue (Warr, 905: 2001). In turn, with the additional revenue Thailand was able to diversify its economy in agriculture, manufacturing and service industries (Puntasen and Preedasak, 93: 1998).

The example of Thailand is noteworthy, but it is not unique. Governments have been using export taxes as a source of government revenue to finance industrial development for centuries (see previous sections). The examples of Europe and the wool processing industry and the British colonies and the preferential export taxes that were levied on raw materials and sent duty-free only to British territories are indicative to how valuable the revenue derived from export taxes can be for economic and industrial development.

Case Study 1: Russia

Russia used export taxes on oil to aid its transitional economic development after the fall of the Soviet Union. “In 1991, repressed inflation worsened and real GDP declined 15%. Rising costs and falling enterprise profits cut budget revenues, bringing the government budget deficit to 16.5% of GDP” (Parker and Thornton, 2007: 525).

In response, “on 2 January 1992, the new Russian government freed most consumer and producer prices, abolished the state foreign trade monopoly, and moved toward external liberalisation, while retaining controls on energy exports” (Parker and Thornton, 2007: 525).

The export tax and the value added tax were assigned as the largest sources of tax revenue for the Russian government in the new tax code legislation (Parker and Thornton, 2007: 515). Russia succeeded in setting up an effective tax-based system where government export duties were set at 100% as of 2004 and income taxes were cut by a flat 13% and profit taxes from 35% to 24% (Parker and Thornton, 2007: 528 and 533). Along with energy resources, the government also imposed rising export taxes on hydrocarbons, metals and other commodities. In addition to the export taxes, a four-fold devaluation of the ruble was also implemented.

The policy outcomes have been mostly a success. “By 2000, Russian recovery was underway. With rising energy prices, federal government budget revenue doubled from 12% to 24% of GDP in 2005 . . . Russian

fiscal balance had shifted from a deficit of 6% to a surplus of 9% of GDP. In 2006, with the price of oil above \$60 per barrel, the central government collected \$38 per barrel of export duties and resource extraction tax on every barrel of oil exported” (Parker and Thornton, 2007: 528).

“Currently, federal government revenues, equal to about 24% of GDP, exceed regional and local revenues, equal to 15% of GDP. Of federal revenues, trade duties (primarily energy export revenues) equal 8% of GDP, with other natural resource taxes providing an additional 4%” (Parker and Thornton, 2007: 532).”

In Russia, export duties and other taxes on energy producers provide the largest source of tax revenue, which is centralised in the federal budget” (Parker and Thornton, 2007: 537). “Moreover, a substantial revenue surplus funded by export taxes and extraction fees on energy is supporting a balanced budget, repayment of government debt, and accumulation of a stabilisation fund” (Parker and Thornton, 2007: 539).

Value-added and infant industries

According to the WTO discussion paper, export taxes can be justified on the basis of the infant industry argument. Countries that specialise in lower value added sectors (less dynamic manufacturing sectors according to a modern version of the infant industry argument) will be locked into a production structure that entails lower growth rates than those of countries specialised in higher value-added (more dynamic) sectors. Temporary protection or subsidisation of a newly established domestic manufacturing industry that is less productive than foreign industries is seen as a way of trying to develop a comparative advantage in that industry (Piermartini, 2004: 11).

Some IMF staff members also agree with that rationale and write: “Subsequently, export duties on raw materials became an obvious device to promote local industries based on their processing for export” (Goode, Lent and Ojha, 1966: 454). Piermartini describes how the export tax works to promote higher value added: “Export taxes on primary commodities (especially unprocessed) work as an indirect subsidy to higher value-added manufacturing or processing industries. Export taxes on primary commodities can be used to reduce the domestic price of primary products in order to guarantee supply of intermediate inputs at below world market prices for domestic processing industries. In this way, export taxes provide an incentive for the development of domestic manufacturing or processing industries with higher value-added exports (Piermartini, 2004: 11-12).” Hence, the processing industry will benefit from lower prices of inputs and gain competitiveness in the international market and expand (Piermartini, 2004: 5).

Case Study 2: Indonesian export taxes to develop wood processing industries

One example that epitomizes the use of export taxes and other export restrictions to develop a manufacturing industry is the case of Indonesia and plywood. Indonesia’s wood products industry, in particular the plywood industry, emerged in the 1980s as one of Indonesia’s major manufacturing industries (Thee, 2009: 138). The wood products industry was developed by limiting the exports of logs through export taxes and subsequently by a partial and later by a total ban on log exports (Thee, 2009: 138). By the early 1990s, shortly after these measures were taken, Indonesia became the largest manufacturer of hardwood plywood in the world (Thee, 2009: 138).

In the 1970s, the Indonesian government’s industrial development plan focused on processing raw materials such as timber, rubber, oil and minerals to higher value added products (Hidayat, 2002: 55). Therefore, “the government used an economic strategy that promoted resource-based industrialization.

The strategy stresses on reducing Indonesia's reliance on import goods and building up the technology sector, paying more attention to processing raw materials obtained domestically" (Hidayat, 2002: 56).

The government began enacting many economic incentives for domestic timber producers (Hidayat, 2002: 55). For example, the government provided assistance to timber exporters who faced financial difficulties as a result of government restrictions on log exports (Hidayat, 2002: 57). The government reduced dependence on imported goods and began promoting domestic industries. "Although the market price of imported plywood was about 20% cheaper than domestic plywood, the government encouraged domestic capitalists to develop the plywood industry by buying locally" (Hidayat, 2002: 58).

In 1978, due to the sharp increase in the export tax, log exports declined sharply after 1970. "But the exports of processed wood like plywood and sawn wood rose significantly from 70,000m³ and 756,000m³ in 1978 to 245,000m³ and 1,203,000m³ in 1980 respectively, and increase of 250% and 60% respectively in only two years" (Thee, 2009: 142). It is important to note that "within a short time span, Indonesia was transformed from being the largest log-exporting country in the world into the largest plywood-exporting country in the world in the 1980s" (Thee, 2009: 142).

In the 1980s the government replaced the export tax with an export ban in order to maximize the amount of raw logs available for domestic processing industries. In 1980 Indonesia's share of plywood exports in the world market was only 4 % and in 1983 this rose to 24%. By the late 1980s Indonesia supplied about 80% of the world demand for plywood (Thee, 2009: 145). "As a result of the ban on log exports, domestic and foreign timber companies established wood-processing facilities, particularly plywood mills, which subsequently led to a surge in plywood exports" (Thee, 2009: 142). According to the World Bank, the wood products industry became the second most important contributor to Indonesia's rapid growth in the manufacturing sector.

The plywood industry wasn't the only manufacturing industry that greatly benefited from the export restrictions on raw materials. Other wood products that benefited from the export restrictions include saw mills, block board plants, particle board plants, woodworking plants, furniture plants, chip mills and cement-bonded plants (Thee, 2009: 143). For example, from 1985 to 1992, pulp and paper exports rose from US\$28 million to US\$400 million (Thee, 2009: 146).

Similar to when the British Empire used export taxes, Indonesia's export taxes on raw logs also gave their industries a significant advantage over international competitors. In 1982, when the export ban was introduced a major realignment of the world plywood industry took place. In fact, "many plywood mills in Japan, South Korea and Taiwan were forced to close down or relocate their plywood operations to Indonesia" (Thee, 2009: 144-145). Hence, similar to England and the wool industry and the British Empire, Indonesia was able to industrialize a sector of their economy and attract investors through the use of export restrictions such as export taxes.

Case Study 3: Russian export taxes to develop wood processing

Russia is using export taxes on raw logs to create "national champions" in the Russian foreign industry (CIBC, 2007: 3). The government imposed a 25% export tax on April 1, 2007, part of a previous commitment to gradually raise taxes from 6.5% in 2006 to 80% by 2009. The log tax is aimed at slowing down the shipments of raw logs and encouraging more domestic lumber manufacturing in Russia (Hamilton, 2008).

It is predicted that some of the biggest potential "winners" will be large private companies in the Timber Management Organizations (TIMOs). The biggest "losers" will be those plywood and lumber companies

that depend on raw timber exports from Russia (CIBC, 2007: 7). The commitment to increase export taxes on raw timber has attracted more private companies to Russia. In turn, many predict that the Russian wood processing industry may develop quicker than generally expected (CIBC, 2007: 3).

Case Study 4: Canadian export taxes and bans to develop wood processing industries

Canada had maintained more than 100 years of provincial government policy, and to a lesser extent federal policy, dedicated to stopping the export of raw logs (BCFED, 5: 2006). The Land Act of 1888 established a log export tax. In 1891 the British Columbia provincial government passed legislation making it unlawful to export logs from Crown Land out of the province. Crown Land is public land, whereas private land is owned by timber corporations or individuals. The taxes imposed on Crown Lands were meant to discourage exports. In fact, taxes were withdrawn if the wood was processed in Canada (BCFED, 2: 2006).

The Timber Manufacture Act in 1906 asserted the Canadian government's position of restricting log exports. In the Forest Act of 1912 authorities affirmed their commitments:

“All timber cut on Crown lands or Crown lands granted since the twelfth day of March 1906, or on Crown lands, which shall hereafter be granted or on lands held under pre-exemption record, shall be used in this province or be manufactured in this Province into boards, deal, joists, lath shingles, or other sawn lumber....(BCFED, 4: 2006)”

In 1942, the federal government supported the stance taken by the provincial government and restricted all log exports. For the next 50 years this policy continued and the exports of unprocessed logs were restricted. According to the British Columbia Federation of Labour (BCFED), “This policy of adding value in Canada prior to export reflects a common understanding that the creation of jobs and a viable tax/royalty base was critical to the prosperity of the country (BCFED, 2: 2006).” That common understanding allowed for investment in the value-added forest sector and created thousands of jobs across the British Columbia (BC) province (BCFED, 2: 2006).

In 1982, Forest Minister Tom Waterland supported the provincial government's policy to restrict the export of raw logs when he denied an export application for 400,000 cubic metres:

“It is the intent of our legislation to encourage a vigorous wood processing industry here in BC. This will not be achieved by permitting...export of large volumes of un-manufactured logs. The **Forest Act** provides for export of timber that is in excess of our own industrial needs, but this can't be determined until the timber has been cut, sorted, boomed and offered for sale on the Vancouver log market...” (BCFED, 5: 2006)

In the late 1980s, the BC province raised the export tax until the tax was 100% of the difference between export and domestic prices. In turn, exports of logs declined in 1987, 1988 and 1989 (BCFED, 5: 2006). This trend continued in the 1990s, and the export of unprocessed logs remained low. The few that were being exported came primarily from private lands. However, this started to change in the late 1990s (BCFED, 5: 2006).

During this time the Liberal political party reaffirmed their commitment to reduce and not allow exports of raw logs. In the run-up to the 2001 provincial election, the opposition leader Gordon Campbell had previously stated in 2000:

“We’re not in favour of raw log exports. We believe that if we get the industry healthy and our regulatory codes healthy that we will be able to secure those logs and use them in the most effective way in the Province of British Columbia. We don’t want to export logs and export jobs along with them (BCFED, 6: 2006).”

However, commitments were not kept and the outcome was devastating for domestic processing industries and employment. According to the BCFED, “Provincial government data reports that raw log exports between 1996 and 2005 increased by 1,000 percent - reaching 4.7 million cubic metres. In real terms, the government reports that more than six percent of the annual cut was exported in 2005 compared to less than one percent in 1996. In more dramatic terms this represents 125,000 logging trucks worth of timber (BCFED, 6: 2006).”

“The increase in raw log exports also coincides with a dramatic period of closures and layoffs, particularly in coastal communities. From 1997 to 2004, 27 mills closed with 13,000 jobs lost (from 100,000 to 87,000) (BCFED, 8: 2006).”

“Besides the loss of direct and indirect jobs in British Columbia, the export of logs also affects an already struggling pulp and paper industry. The pulp and paper mills rely on a steady supply of chips from sawmills to maintain production levels and keep costs reasonable (BCFED, 8: 2006).”

“Using the 2005 export figures, the number of jobs lost in the forest industry reached 3,300. In direct income to workers, the export of jobs from British Columbia costs \$250 million annually in lost earnings to workers living in forest communities. Using traditional economic models, for every job created in the direct resource industry, an additional 2.5 jobs are created in suppliers and the service sector. That amounts to a loss of an additional \$625 million from the British Columbian economy (BCFED, 7: 2006).”

Rick Doman of Doman Lumber in Vancouver Island noted that the amount of logs exported from BC in 2003 was enough to “run 10 sawmills in coastal BC.” He added, “We’ll be creating forest jobs in other countries and losing jobs here where workers actually get fair wages. They call it restructuring of Coastal BC but I call it the destruction of Coastal BC (BCFED, 8: 2006).”

There are several causes behind the increase in raw log exports. One of the causes is the change in provincial government policies toward the restriction of logs exports (BCFED, 11-12: 2006). The BC Forest Act stipulates that timber cut on public land must be processed in British Columbia. Despite this specification “the volume of trees cut and exported from *public* land has also increased since 1997, to 1.2 million cubic metres in 2001 (Marshall, 1: 2002).”

According to Dale Marshall, a researcher with the Canadian Centre for Policy Alternatives, “The Minister of Forests may allow exemptions to this rule under one of three conditions: the timber exceeds BC’s milling capacity; the timber cannot be processed economically in BC; or the exemption would “prevent the waste” of the timber. A fee may have to be paid to the government in lieu of the employment creation that would otherwise occur by processing the logs within the province. The use of these exemptions has allowed raw log exports from Crown land to increase” (Marshall, 2: 2002).

In addition, raw log exports from private lands have driven the upward trend in raw logs leaving BC (Marshall, 1: 2002). This increase began during the Asian Financial Crisis when major companies such as TimberWest increased their export of logs on private lands to compensate for the decline of lumber and pulp prices during the crisis. In 2002, TimberWest derived 80% of its sale revenue from the sale of logs, mostly from private land (Marshall, 1: 2002). To the public’s dismay, the provincial government has no jurisdiction over the use of timber cut on private lands (Marshall, 2: 2002).

Just last year on May 23, 2008, 1,300 workers and community members held a rally in Mackenzie, BC against the mill closures. In Mackenzie 235 pulp mill workers and 337 sawmill workers lost their jobs when AbitibiBowater shut down local mills. The speakers and participants in the rally called for an export ban on raw logs. They called on the government to keep logs in their communities and guarantee local production. Mackenzie is just one town amongst others in BC that is economically and socially impacted by the export of raw logs (Simard: 2008).

The BC Federation of Labour is recommending that the government increase the export tax on raw logs coming from private lands to ensure there is no economic incentive to export raw logs. They believe that the export tax will shift the focus back to local processing (BCFED, 14: 2006).

It should be noted that these job losses are just from one of Canada's provinces.

Case Study 5: Mongolian export taxes to develop textile industries

Just as Europe used export taxes to support local processing (see previous sections), many developing countries today have realized the importance of imposing export taxes on raw materials to support domestic processing. Mongolia is amongst those developing countries that impose export duties on raw materials; however, as a condition to become a member of the WTO Mongolia, forfeited some of this freedom by undertaking a commitment to phase out and eliminate its export duty on raw cashmere within 10 years of its accession into the WTO.

However, in January 2007 Mongolia filed for a "Request for a Waiver," asking the Council for Trade in Goods for a waiver to postpone the implementation of the commitment for five years. The reason Mongolia requested the waiver is because the export duty on raw cashmere is needed for its economic development.

In the official request to the WTO, Mongolia recognizes several functions that the export tax performs in its economy. It stated, "Export taxes are not prohibited under WTO Agreements. They are well-known policy instruments which can effectively provide incentives for the local processing of raw materials. They may assist in adding value to exports, bringing greater export earnings and increasing the diversification of exports, thereby contributing to an overall reduction of the economic vulnerability that affects the Mongolian economy. Finally, the application of export taxes on raw cashmere also serves environmental objectives as it contributes to the regulation of goat heads and is part of governmental efforts to fight environmental damages and desertification (World Trade Organization (WTO): G/C/W/571)." The document also states that preserving the export tax on raw cashmere would create employment.

Export taxes in Mongolia are applied not only to raw cashmere, but also to camel wool, goat skins, and logs. In 2005, the textile industry contributed 4.5% to gross industrial output. Additionally, exports of cashmere products alone accounted for 9% of Mongolia's total exports, making it the third largest export of the country. Despite the success, the textile industry in Mongolia has been facing many problems and a great number of textile and cashmere processing firms had to exit the industry. One main reason driving the firms to exit the market is the heightened global competition for raw materials.

According to the WTO document submitted by Mongolia, "Increased exports of raw wool, cashmere, leather, hides and skins have resulted in the lack of necessary raw materials and a further plunge in the utilization capacity of livestock-based processing industries. About 60% of companies went out of business due to the outflow of raw materials compared to 2003 (WTO: G/C/W/571)."

Despite these shortcomings Mongolia is hopeful that if the export tax is maintained then the cashmere industry will have huge potential to contribute to the growth of the economy, employment at both the herder and the manufacturing levels and ultimately to sustainable development. “The continuation of the application of export taxes to exports of raw cashmere is fundamentally important to sustain the industry in this difficult period. Their elimination at this juncture would add a further burden to local processing firms (G/C/W/571).”

Six-months after Mongolia filed for the waiver, the WTO General Council granted its request and gave Mongolia an additional 5 years until January 29, 2012 to phase out and eliminate its export taxes on raw cashmere.

Tariff escalation

According to Piermartini, export taxes have been recommended by some as a retaliation policy or strategic response to tariff escalation. Tariff escalation is the practice of charging higher import tariffs on processed goods than on unprocessed ones. Tariff escalation in developed country markets can be detrimental to the development of local high-value processing industries in developing countries (Piermartini, 2004: 12).

The UN Food and Agriculture Organization (FAO) demonstrated in a study that tariff escalation is one of the major constraints to vertical diversification of agricultural products in developing countries. Although the food industry is a major export industry for developing countries, exports are usually of food in the first stage of processing. For LDCs, more advanced processed products account for only 5% of agricultural exports and for developing countries this figure is at 16.6%. These numbers are relatively small in comparison to developed countries, whose exports of more advanced process foods are at 32.5% (Raghavan, TWN).⁴

Many developing countries have expressed concern about the adverse effects that tariff escalations have on their economic and social development. Malaysia, Indonesia and the countries of the Africa Group are a some of those that have articulated their concerns about tariff escalations.⁵

Piermartini states that the first best policy to combat tariff escalation is for the country imposing them to remove them. However, all industrial countries practice tariff escalation (Oxfam, 2003: 30). For example, in Canada, the tariff on fully processed foodstuffs is twelve times higher than for products in the first stage (Oxfam, 2003: 30). According to the WTO, Japan imposes a zero tariff on raw coffee and cocoa, but this escalates to a 20% and 22% applied tariff respectively for processed coffee and cocoa (Piermartini, 2004: 12). Similarly, exporters of cocoa to the USA and EU typically face zero tariffs on raw beans, rising to over 15% and 20% respectively if they process beans into paste and chocolate. Such arrangements help to explain why Germany processes more cocoa than Cote d’Ivoire, the world’s largest producer; and why Britain grinds more cocoa than Ghana. Developing countries account for more than 90% of cocoa bean production, less than half of cocoa butter production, and less than 5% of world chocolate production. (Oxfam, 2003: 31). This also occurs for non-food products. For example, the EU imposes a tariff of less than 4% on Indian yarn. But if that yarn is worked into garments, the tariff rises to

⁴ The full article can be found at: <http://www.twinside.org.sg/title/bar-cn.htm>.

⁵ For more information visit: <http://www.twinside.org.sg/title/tariff-cn.htm> and <http://www.twinside.org.sg/title2/wto.info/twninfo060710.htm>.

14%. This practice systematically excludes Indian producers from higher growth, higher value-added segments of the market. (Oxfam, 2003: 30).

Since tariff escalations have not been removed it is important to look at what Piermartini says is the second best policy choice: export taxes (Piermartini, 2004: 13). “An export tax on the unprocessed commodity, by reducing its domestic price, will favour the development of the local processing industry, thus offsetting the distortionary effect created by tariff escalation (Piermartini, 2004: 13).”

Price Stability

Commodity price volatility can generate large trade imbalances in a country whose exports depend principally on that commodity (Piermartini, 2004: 10). For small farmers a drop in price threatens income and food security, disrupts investment, balance of payment problems and raises levels of external debt (Piermartini, 2004: 10).

According to the WTO discussion paper, export taxes can be supported on the basis of a second best argument, in regards to using export taxes to mitigate commodity price fluctuations on the world market (Piermartini, 2004: 10).⁶ (The first best policies suggested are generally more difficult to implement in developing countries).

Piermartini suggests that a progressive export tax system can be useful in this regard. Governments could impose a high tax rate when world commodity prices increase and reduce or remove the export tax when commodity prices fall. This way government “could capture part of the gains arising from increasing commodity prices and could mitigate the adverse impact of falling prices on producer’s incomes” (Piermartini, 2004: 10).

According to the WTO paper, three motives justify the use of an export tax in these circumstances. “First, it would mitigate the spillover of higher world prices into the domestic market (as the impact of an export tax is to lower domestic prices), thus protecting local consumers. Second, it would increase government revenue, thus easing fiscal imbalances. Third, it would tax windfall gains of exporters, thus responding to a principal of fair redistribution of income” (Piermartini, 2004: 10).

Piermartini advises that governments properly define their trade tax and suggests that “a flat export tax that would not differentiate between price increases and price falls would not be effective in smoothing the transmission of world price shocks to the domestic economy.” Additionally, governments must be ready to enact policy changes congruent to the changing commodity prices. For instance, they will have to save in periods of high tax revenue and spend more in periods with low tax revenue (Piermartini, 2004: 10-11).

Piermartini provides a few examples in which governments have used export taxes to reduce domestic price instability for export producers. She states that many developing countries have used a system of variable tax rates, imposing high tax rates when export prices are high and vice versa. “For example Papua New Guinea established an export tax/subsidy rate for cocoa, coffee, copra and palm oil equal to

⁶ First best policies are described as: “Developing more efficient stock markets and financial markets, introducing a flexible exchange rate regime, extending the tax base and improving the tax administration system could all contribute to solving the problems discussed above without distorting the economy and therefore at a smaller economic cost” (Piermartini, 2004: 10).

one half the difference between the reference price- calculated as the average of the world price in previous 10 years- and the actual price for the year” (Piermartini, 2004: 10).

Terms of trade

For decades, economists have also pointed to export taxes as a device that can be used to improve a country’s terms of trade (Reubens, 1956: 45 and Goode, Lent and Ojha, 1966: 481). Terms of trade is the relative prices of a country’s exports to imports. In a research paper written by World Bank staff, it is mentioned that a country with market power can levy an optimal export tax, which targets distortion, to improve its terms of trade and welfare.

The authors go on to write: “While there are several possible interventions which could improve the country’s terms of trade, an export tax is preferred instrument on analytical grounds because they precisely correct this underlying distortion without inducing others” (Devarajan, Go and Schiff, 1996: 4). In addition, the authors argue that a country with market power will benefit from imposing an export tax, regardless of the behavior of other exporting or importing countries (Devarajan, Go and Schiff, 1996: 6 and 8).

In a WTO research paper, Piermartini agrees with that argument and writes that “in the case of a “large” exporting country [a country with market power that represents a large share of the world’s exports for that taxed good] the implementation of a tax on exports may raise national welfare (Piermartini, 2004: 3). In addition, if a “large” country implements an export tax there will be “an improvement of the terms-of-trade for the exporting country, but a worsening of the importing country’s terms-of-trade (Piermartini, 2004: 3).

“The terms-of-trade gains in the exporting country arise because of the increase in the commodity export price caused by the implementation of the export tax” (Piermartini, 2004: 4). “An export tax imposed by a large country will increase the world price of the taxed commodity, and this, in turn, will increase the relative price of exports compared to imports. For each unit of the exported commodity, the country imposing the export tax will be able to import more, and thus increase welfare” (Piermartini, 2004: 7).

Piermartini claims that the terms-of-trade gain is not applicable for a “small” country that represents a small share of the world supply of the taxed good (Piermartini, 2004: 3). The gain depends on the ability of the country imposing the export tax to increase world prices. Thus, the overall welfare effect of implementing a tax on exports will be negative in the case of a “small” country (Piermartini, 2004: 3).

However, she points out that in recent decades various international commodity agreements (ICAs) have been signed among developing countries with this purpose in mind. But many of these ICAs have involved quantitative export limitations rather than taxes (Piermartini, 2004: 7). According to a staff paper from the International Monetary Fund (IMF), “the strongest case for a prolonged use of export taxes is in support of an international commodity agreement that involves the deliberate limitation of exports” (Goode, Lent and Ojha, 1966: 481). Therefore, the argument may be made that it is worth exploring the possible benefits for “small” countries that export the same commodity to use an ICA and coordinate export taxes to increase their terms of trade.

In a World Bank Working paper, Bela Balassa also makes a similar case for the use of export taxes in ICAs: “Export taxes will be the optimal measure also if a country is subject to quotas on its exports. Such will be the case under an international commodity agreement or under foreign quotas and so-called voluntary export restraints. In these instances, export taxes can be used to appropriate the quota profits enjoyed by the exporters. They should be set so as to ensure that exportable production equals the amount of the quota.” (Balassa, 1989: 10)

Currency devaluation

In an IMF staff paper, authors note that export taxes can be used to compensate for a country's currency devaluation (Goode, Lent and Ojha, 1966: 454). The authors explain that in the circumstances in which a country that devalues their currency is exporting commodities with little short-run elasticity of supply,⁷ "the additional receipts of exports make no more than a small immediate contribution to the correction of the payment deficits." Therefore, temporary export taxes can be levied on exports with low short-run elasticity of supply so the state can attain revenue which would help to control private expenditures and thus support the devaluation (Goode, Lent and Ojha, 1966: 475).

The authors offer four examples in history in which export taxes were increased or enacted to compensate for devaluation. In May 1963, Uruguay devalued its peso and increased all export-tax rates. As a result, export-tax revenues rose by about 80% between 1962 and 1963. Devaluations occurred again in 1964, 1965 and 1966. The government increased export taxes each time. Mexico also successfully raised export taxes during devaluations of 1938, 1947, and 1954. In 1955, total revenue from export taxes amounted to 15% of export value (Goode, Lent and Ojha, 1966: 477).

After devaluing the drachma in 1953, Greece, in order to avoid a steep decline in export prices in terms of foreign currencies and absorb windfall profits, imposed export taxes on basic commodities such as cotton, rice and olive oil. India export taxes on numerous commodities to compensate for devaluations in 1966. As result, "at the new exchange rate, the net rupee proceeds to the exporter of tea and jute goods would be about 18 per cent more than previously." (Goode, Lent and Ojha, 1966: 477)

Authors have also mentioned benefits of using an export tax during a trade surplus: "According to Lau and Stiglitz (2005), an export tax would render the country's exports more expensive to the rest of the world in apparent similarity to an exchange rate appreciation, but, unlike the latter measure, an export tax would not inflict financial losses on holders of assets denominated in foreign currencies or induce currency speculation. Moreover, an export tax would generate revenue for the government and could be easily lifted if developments to the trade balance warrant" (Zee, 2007: 138). However, Zee notes that he believes the success also depends on whether a country is "large" and whether it faces a downward sloping demand curve for its exports (Zee, 2007: 139).

Scholar Peter Warr noted that when a country is a major exporter in a commodity and possesses a degree of market power in the world market then the country's government can impose an export tax when the currency is devalued to derive government revenue. The export tax will allow the government to benefit from the windfall gains received by the exporter due to the devalued currency. "An export tax thus offers the potential to contribute to foreign exchange earnings by exploiting the country's international monopoly power, to raise government revenue and to reduce the price faced by consumer," Warr wrote (Warr, 903: 2001).

According to Warr, Thailand presents a good example since they are a major exporter of rice. During the economic crisis of 1997, Thailand devalued its currency. The government began searching for new sources of revenue and was concerned that the devaluation would provoke large consumer price increases

⁷ Price elasticity of supply refers to the degree of responsiveness of a product's supply (increase, decrease or supply stays the same) when the price of that product changes. Numerically, it is expressed as the percentage change in the quantity supplied divided by the percentage change in price.

for rice. Warr suggested that if an export tax had been imposed, it could have potentially contributed to the foreign exchange reserves (Warr, 903: 2001).

Inflation

Export taxes have been identified as a useful tool to combat inflationary pressure. During the Korean War and the commodity boom many countries uniformly enacted export taxes to gain windfall profits. After the end of the war and the commodity boom subsided, countries experienced inflationary pressure and export recession. One author notes that export taxes helped countries facing these pressures. Reuben explains that “the export tax presents itself as an important and effective device to insulate the domestic economy from some of the inflationary effects of an export boom; and in times of export recession the tax provides something of a cushion against the full impact” (Reubens, 1956: 68-69)

In the WTO paper, author Piermartini explains the rationale behind using an export tax to combat inflation. She states that “an export tax reduces the domestic price of the taxed commodity, thus partially offsetting the inflationary pressures coming from higher prices abroad. Second, an export tax on primary commodities will be reflected in lower costs for processing industries, thus furthering lowering consumption prices for processed goods (Piermartini, 2004: 11).”

However, Piermartini cautions that if markets have an oligopolistic structure, consumers might not benefit from lower prices for the processed commodity (Piermartini, 2004: 11). She attributes the failure of export taxes on the palm oil industry in Indonesia to control inflationary pressures to this reason. Therefore, export taxes can be an effective tool to control inflation if there is a conducive market structure.

China successfully used export taxes to decrease domestic grain prices and cut off grain exports during the 2006/2007 food crisis. Food prices in China began rising in 2006 and in 2007 the Chinese government made controlling the inflationary impact of food prices a top priority. Prices in China were rising partly because of the increasing world commodity prices and also due to China’s inability to boost domestic production. As result, the government reacted with policy changes in 2007. The government withdrew rebates for value added taxes that encouraged exports and introduced temporary export taxes on grain and flour to cut off grain exports and cool domestic grain prices. Hence, export taxes were used to control inflation and ensure adequate domestic supply of food (Lohmar and Gale, 14: 2008).

Considerations when imposing export taxes

Export taxes can be a highly valuable tool for industrial development and trade policy. In addition, they can provide governments with additional revenue, improve terms of trade, ease inflationary pressure, compensate for devaluation and tariff escalation and most importantly preserve domestic raw materials for local processing to develop high-value added industries.

However, as mentioned throughout this paper there are some factors that governments should pay attention to before increasing or imposing an export tax. Like many policy tools and instruments, export taxes have proven to be extremely valuable to industrial development, especially in Europe (see above sections); however, it is not a magic tool and still requires a few considerations.

The factors that should be considered are commonly mentioned in the diverse literature that highlights the benefits of export taxes. A few of these factors include: long-run demand and supply elasticity, competing goods that are substitutes on the world market, oligopolistic market structure and the optimal level of the export tax.

Additionally, export taxes have supplied governments with needed development finance. However, it is at the discretion of every national government to decide which sector(s) of the economy to supply with revenue. Therefore, depending on where a government chooses to invest, the distributional effects may be disproportionate amongst different societal groups.

Case Study 6: Mozambique and the effects of export tax reduction on the cashew processing industry

Historically, the cashew sector has constituted a large part of Mozambique's economy. In 1960, the country produced half of the world's total cashew nuts. Domestically, the cashew industry employed several million people, providing income to individuals across the country (Raman, 2004:13).

The country began processing the raw cashews in large, mechanized factories and became the first African country to process cashews on an industrial scale (McMillan, Rodrik and Welch, 2002: 6). By the 1970s the country had 14 processing factories and in 1973 Mozambique processed 149,800 tonnes of cashews for export. In the 1980s, production slowed due to the civil war; however, in 2001 processing of raw cashews was utterly halted due to significant export tax reductions on raw cashews, as advised by the World Bank. The Bank focused on eliminating the export tax on raw cashews and hoped that its elimination would increase the export price and also the producer price.

The stages of liberalization are explained by Raman:

“The export ban on raw cashew nuts was lifted in 1991/92 and limited quantities of raw nuts were allowed to be exported. However, a 60% tax on the difference between the FOB and factory gate prices and a quantitative restriction of 10,000 tonnes were imposed.” In 1994/95, the quantitative restriction was removed and in 1997/98 the export tax was reduced to 14%. In 1999, due to domestic opposition, Mozambique's Parliament passed a Bill that increased the tax to between 18 and 22%, the exact amount to be determined each year, depending on market conditions.

To the dismay of millions employed in the industry, the Mozambique government and the World Bank the benefits of the reform were very small in economic terms. According to McMillan, Rodrik and Welch “the efficiency gains generated by the removal of the export restrictions could not have amounted to more than \$6.6 million annually, or about 0.14% of Mozambique GDP.” The gains are even more depressing for farmers' income. The additional income obtained for farmers was no greater than \$5.3 million annually, or \$5.30 per year for the average cashew growing household.

Although the benefits were small, the costs of the reform were severe. The biggest impact has fallen on the processing industry and employment, as the cashew processing industry came to a standstill. Although the estimates for those unemployed after the reform varied, one BBC news report in 2003 reported that 10,000 people who were directly employed by the industry lost their jobs and another million nut collectors lost their income (Raman, 2004:17).

Raman notes that from the viewpoint of the owners of the processing factories, the export tax reduction is the primary reason for the industry's failure. Without a ban on exporting raw nuts or a prohibitively high tax, the processing factories could not obtain enough raw cashew nuts to operate (Raman, 2004:17).

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