UNITED NATIONS

ECONOMIC
AND
SOCIAL COUNCIL

LIMITED
ST/ECLA/Conf.37/L.25
16 July 1971
ORIGINAL: ENGLISH

ECONOMIC COMMISSION FOR LATIN AMERICA

MEETING OF EXPERTS ON FORMULATION AND
IMPLEMENTATION OF STRATEGIES FOR
EXPORTS OF MANUFACTURES

Santiago, Chile, 26 July to 4 August 1971

TAX INCENTIVES FOR EXPORT

by

Israel Gal-Edd *

Working paper

* Former Director General, Ministry of Development, Israel.

71-7-1836

I N D E X

I. NATIONAL POLICY ASPECTS

1. Introduction - The place of taxation in export policies

Talking about taxation for a whole day may give you and me the impression that taxation is the beginning and end of export assistance. While tax legislation is important it is only one part of economic activity - an important part but one which has certain special characteristics.

There is a tendency, regrettable but understandable, for government policy to spread over into the field of business decision and management. While it is the function of government to create the proper conditions for business to flourish, in all countries and not least in the developing countries, those which have to plan allocation of scarce resources and are at the first stages of moving in what may be a new direction, are in danger of finding that government officials not only create conditions but try also to create industry or trade.

From the point of view of a country's economy as a whole, and from the point of view of the individual enterprises, a business must be basically economically sound and competitive. Decisions have to be made as to what product to manufacture, how to make it, and how to sell it. These decisions depend primarily on what comparative advantage the country can present in international trade, whether because of its supplies of natural resources or other raw materials or because of the availability of cheap manpower, or of manpower with special skills. From the point of view of those countries who are in the early years of entering the export market in other than primary products, one hears glibly the phrase that the country should diversify its exports by going into industrial production "from the bottom up", that is by processing the raw material, or from the top down that is by carrying out at home a manufacturing process which enables the country to import a semi-finished article and complete it for home use and possibly for export. Central planning authorities may lay down the guidelines for these policies and may try to create the conditions under which they can be advanced. But, to my mind, it would be a mistake to think that the decision, what to produce and how to produce it is one which government officials are qualified to make.

I would sum up their function in all fields, and particularly the field of taxation, which is not the most popular to entrepreneurs, as creating the conditions the entrepreneur requires to compete in international trade and to administer these conditions as easily and smoothly as possible to relieve the entrepreneur of the task of spending time - which is money - on governmental administrative matters. I say all this, and I will come back to it time and time again, because the task of entering newly into the harsh competition of international export trade is difficult enough for manufacturers in the advanced countries, with sophisticated methods of management and tradition of ease of governmental operation. It can and must be a governmental function in the developing countries to see that government helps would-be manufacturers to export and remove all possible hindrances to their efforts.

Our discussions here centre mainly around exports and foreign trade. This for the developing countries should mean an advance in two directions which are linked. Firstly, an increase of exports and entry into new export products and markets, and secondly, a reduction of imports by carrying out at home more processes, or by manufacturing at home whatever goods can be made. From the point of view of improving the balance of trade of a country, increasing exports or import substitution have the same effect. Import substitution can lead to the development of industry which will also export. What does the investor require before he will go along with this broad government policy? It is unimportant for consideration of this point whether the would-be investor is government or private, or whether the capital comes from domestic sources or foreign investors. The business to compete has to achieve the same results and therefore it needs the same operating conditions. The first thing that must be answered is the availability of a market and though it is not essential that a product should have a local market in order to support exports - for example, oil, gold, diamonds, minerals, and metals, and basic commodities, cam be sold abroad even without a local market - in a large number of products, I would say for the greatest number of products and certainly for manufactured products, a broad based local market is of great assistance.

/Secondly, consideration

Secondly, consideration of comparative costs. Thirdly, if the investor is a foreign investor he is particularly interested in knowing about the security of his investment, and about the freedom of transfer of profits. Fiscal policies have a bearing on these questions, and also on the other important question, and that is - if the investor succeeds in making a profit on his sales either at home or abroad or both, and this is the best way of ensuring his continuing operation and expansion - is he going to be left with any real income after the tax collector has finished with him?

My purpose in this lecture on export incentives through tax legislation will be to analyse what is being done in various national policies, to consider their application particularly to the problems of the less developed countries, and to ask whether more could be done by the less developed countries themselves and by the developed countries to assist in the expansion of trade and more particularly the expansion of exports from the less developed countries.

2. Marketing boards and joint product arrangements

(a) Primary products

We are all familiar with the existence of export marketing boards for primary products not only in the developing countries. There are cocoa marketing boards, citrus marketing boards, egg marketing boards and, of course there are international organizations which consider, from time to time, the measures necessary to maintain stable prices. Generally speaking, the marketing boards are of a kind which may be run by the producers themselves, but have some form of government direct interest or control.The boards therefore operate for themselves what is a form of tax policy which is for the benefit of the exporters as a whole, and in which the board performs a government taxing function. These boards not only raise finance for price stabilization but also for the creation of central organizations and establishments which provide such facilities as transport, packing, shipping and marketing.

This particular subject is one which is much wider than can be covered in a lecture on fiscal policy and covers in the local sense an internal taxation, and in the international sense such fields as compensatory finance and production control. I would just like to mention here the sort of thing that can be done and would serve as an example for products other than primary

/products, when

products, when the country begins to produce for the home market and for export.

Internal price stabilization funds are becoming increasingly popular, their method of operation being quite simply to syphon off an increasing part of profits in good years as a stand-by for bad years. The first man to do this was Joseph, who put aside corn in the seven years of good harvest. We are more sophisticated and we tax in money and put aside money for the bad years. For example, where the price of a product goes way above the trend, a percentage, say 10 per cent of the excess is compulsorily saved. If the price goes even higher 20 per cent of the excess could be funded for allocation to the growers as a stabilization against falling prices.

(5) <u>Other marketing arrangements</u>

This is common ground for primary products. The developing countries however for their own purposes, are undertaking building programmes which require such products as plywood, cement, and for transport, tires. These are heavy items, simple to make, and there is no reason why they should be brought from abroad. Having the appropriate machines anybody can make a hole in a tire and there is no point in paying international shipping interests the cost of transport of this hole. If the local market is sufficiently large, it can serve as a base for supplying neighbouring countries with similar development requirements, or even compete if there is excess production, in the international market.

If the manufacturers in the developing country can support their exports by local production either by joint marketing or by some other arrangement, they could well be helped by government in creating funds, which they receive from money from selling in the local market at a certain price which enables export competition. I know that this smells of that wicked word "dumping", but in the field of international trade everybody is selling products abroad at a different rate from that at home, costing of marginal production being an art in which the customs authorities are becoming more and more expert, but against which they have no real remedy. In brief,

/therefore, there

therefore, there seems to be a field for the more basic and simpler industrial products in which the industry itself, with or without government guidance, can base its exports on a taxation system of levying a toll on products sold in the home market.

3. Forms of government assistance to exports

So far I have mentioned the form of self help by producers and exporters. The government, however, has many ways of assisting exports and I will mention a few of them before going into greater detail on fiscal policies. Governments assist exports by subsidies or premiums, by credit facilities, insurance facilities, export institutes, chambers of commerce, fairs, research, and by a whole host of measures of direct or indirect assistance designed to place exports in a preferential situation, in order to enable competition with other manufacturers abroad. This competition is not only with others who wish to export to the same country, but with producers in the importing country itself which, of course, look to their government to protect them. In addition to all these measures, the fiscal field has an important part to play.

4. Incentives in indirect taxation

(a) Customs Duties - Fiscal and Protective

There is a tendency to suggest that developed countries maintain customs duties for protective purposes only, but that the developing countries require customs duties for fiscal purposes also, and the GATT makes a specific reference to this condition. Where there is local industry, particularly in developing countries, where the industry may be completely new or "infant", and this industry is to serve as a base for exports, the would-be manufacturer wants to be at least assured of his home market, and then there is a possibility on this basis he can export. This means that his home market has to be protected either by a high tariff or by administrative restriction. The problem for both cases is how to create an efficient operation, behind a protective wall, which does not expose the local manufacture to the breeze of international competition.

The tendency here is to suggest that in the early stages infant industry is entitled to complete protection and that this protection should be gradually reduced. Everybody agrees about the early stages, but when it comes to reducing the protection in order to compel increased efficiency, and to prevent unnecessarily high prices in the local market, it appears that a vested interest has been created in the continuation of existing conditions. This vested interest is represented not only by the manufacturer himself, but also by his workers who join with him in claiming that imports will create unemployment. Government must act to ensure that hot-house conditions of manufacture are only temporary, and that after a reasonable period the industry can stand on its feet with a reasonable level of protection against imports. The alternative is that products in the local market will always be unnecessarily high in cost, and this will reflect ultimately on wage levels and cost levels.

There is, therefore, a conflict between granting an exporter complete protection of the home market and trying to persuade him and manufacturers generally to competitive efficiency by opening the home market to imports. It should be remembered that reduction of customs duty has an immediate effect on importation, while increase in efficiency of local manufacture is a long-term effect. Liberalization import policies, therefore, may in the short run worsen the balance of trade.

(b) Excise and purchase tax

A whole range of indirect taxes assist exports where they are applied to the home market and not to exports. They do this by creating conditions under which an exporter may be able to achieve a higher return for products exported than for those he sells at home, or in addition, the local market is limited by the application of the indirect tax, thus encouraging a manufacturer to sell his products abroad. However, if the home market is more profitable than the export market, and helps as a base for exports, the imposition of a high indirect tax may so limit local purchase as to make the whole operation, both domestic and foreign, unprofitable. The other danger is that if prices of these products in the local market are pushed up by taxation, there is an indirect effect on the cost of living which may find reflection in wages and cost of production. For example, theoretically it would be possible to increase excise duties on wines and spirits in order to force

/manufacturers to

manufacturers to export as much as possible. However, nothing is more unpopular than an increase in excise duty on whisky unless it be an increase in excise duty on beer. Unpopularity of the government is not the best way to persuade workers to increase effective production and they will certainly demand that the increased cost of their favoured spirits be refunded to them in increased wages, which may make the whole export operation less worth while than before excise duty was increased.

In this respect, there is little difference between the effects of excise duty mainly for fiscal purposes on wines and spirits or motorcar fuel, and purchase tax on selected consumer goods.

(c) Turnover taxes

(i) General. Excise and purchase tax are applied to specific products and their incidence and rate can be adjusted by review to gain the maximum benefit for export. Turnover taxes, whether of the general type applied at the final sale to the consumer or of the cascade type applied at each stage of production at a lower rate, or of the tax on added value type, applied at a higher rate with compensation at each stage for taxes paid at earlier stages - all these kinds are more general and apply to all products rather than selected products. In a way it would seem that they are therefore a less efficient instrument for influencing exports. However, since they are generally applied to the home market and not to exports, they have the same effect on encouraging exports as any tax levy on the home market does, and in addition, and this seems to me to be an advantage, the whole range of products is covered and the individual manufacturer makes his own decision which product to develop for export.

(ii) Cascade. The United Kingdom operates an excise and purchase tax on several specific products while the general turnover taxes are popular on the continent of Europe and in the United States. The Federal Republic of Germany for example, has a cumulative turnover tax at a rate of 4 % paid at every stage of production. Where an operation is carried out by one concern there is a possibility of saving as against the situation in which a product as manufactured by a number of processes carried out by different manufacturers.

/Exports are

Exports are exempt. Norway has a cumulative turnover tax and here, again, exports are exempt. So have Italy and Holland. In addition, in Holland any expenses incurred in importing materials for manufacture or in exporting the finished products are exempted from the turnover tax. France has its famous tax on added value which is becoming more and more popular. This is imposed at the rate of 20 % at each stage of production, but unlike the systems operated in other countries, the tax is not cumulative but credit is given for tax paid at previous stages of manufacture. In France, too, exports are completely exempt from the turnover tax, and this brings me to my next point and that is that if the exemption is carried out simply, it can itself act as a boost to exports or, what is the same, to the sale of local products to non-residents for foreign currency.

(iii) Tax on added value. I cannot emphasize too much the importance of ease in carrying out exemptions and I think the finest example was the operation in France of a system under which foreigners may buy local products by use of travellers cheques, gaining a reduction of 20 % on the price of the product. This 20 % is an added value tax which is not applicable to exports. Such a simple system was not generally operated elsewhere, largely I believe for fear that where there is no exchange control, the extent of the transactions cannot be controlled. This is a question of philosopy - the French had reached the conclusion that it was to their benefit to assume that on the whole the system will bring a large increase in the sales to foreigners, and if there is any internal "smuggling" by local residents, it is of far less importance than the boost given to exports. I believe that this approach is absolutely sound. However, in the past two years the French have tightened up this system, making its implementation more difficult.

/5. Drawbacks

5. Drawbacks and Refunds

(a) Customs Duties - Indirect taxes

Drawback is the name given to the refund of customs and other duties paid on imports to the local market or on products produced in the local market, when these are exported. The principle is that if customs is imposed for fiscal or protective purposes on a product, and this product is re-exported either in its original form or after process, then the duty paid should be refunded. This, of course, is obvious if the country hopes to compete in the export market. Transport in both directions of the product which may be originally a raw material or semi-manufactured good turned into a finished product and re-exported, plus all the bother of insurance,etc., is a sufficient burden of competition for the export producer without expecting him to bear customs duties in his own country on a product which does not stay there. But this principle is widely accepted. The only points I would like to make here are that it should be extended to cover refund of any local indirect taxes such as fuel duties which are heavy in incidence and which hamper competitive ability.

(b) Administration of Exemptions

Secondly, the system should be administered as simply as possible. In this connexion, I would suggest that wherever possible the drawback should be operated not as a refund of a duty paid - because this means that in the meantime the manufacturer has to bear the burden of financing the local duty until he re-exports - but rather as a deferment of any customs duty or local duty for a period on the basis of a guarantee that the product will, in fact, be exported. Such a guarantee should be provided by government as cheaply as possible, but it should be paid for by the manufacturer, in order to encourage as high and rapid export as possible. Should there be concern that the exporter will evade tax by not exporting but selling on the local market, this is a thing which happens once for each exporter and afterwards the taxing authority has every right to be careful. But, generally, the approach should be one of aiding the exporter rather than controlling him. The second problem is that of calculating the size of the drawback, where it is necessary to work out how much of a particular raw material or semi-finished product imported into the local market, in fact, forms part of an exported product. This, of course, leads to such interesting discussions as

/how much

how much cloth you need to manufacture a suit, and recalls the old story of the two tailors, one of whom refused to make a suit for a customer on the grounds that there was not enough cloth, whereas another tailor managed to make the suit for the customer and also for his, the tailor's own son, with the customer's cloth, of course, but without his permission. When the first tailor was asked for an explanation of this and why it was that he could not make a suit with the same amount of cloth, his reply was: "my son is bigger than his". My suggestion here is that the tailor will always be cleverer than the tax official and it might be wise in the interests of exports to accept this situation rather than to try to control any detailed exact quantities for all manufacturers.

(c) Payroll taxes and social security

I mention these under the heading of drawback because the drawback or exemption from the tax does have the effect of aiding exports as against the home market. The most recent example of this is that of the United Kingdom, and the result is to divert manpower to exports in the same way as credit may be diverted to exports. While selective employment taxes of this nature do, in fact, make manpower for export industries cheaper than that for services, they also have the negative effect of annoying the exporters, because many of the services which the exporters used at home in their personal lives are subject to this tax. The theoretical benefit, therefore, of the imposition of the tax may be off-set by disbenefits difficult to calculate.

A system which has a similar effect of cheapening manpower for exports without the unpopularity is used in such countries as Australia and Greece and formerly also France, which have social security taxes which are refunded in one way or another to export industries. Australia, for example, refunds $12\frac{1}{2}\%$ of its social security taxes to an employer who increases his exports in any year by 1%. If exports are increased by 8%, all social security taxes paid by that employer in that particular plant are refunded. Exports in this context include intermediary products manufactured by him which are afterwards exported. France used to have a similar system and so did Greece.

(d) Indirect exports

(d) Indirect exports

Before leaving the subject of indirect taxes I would like to say a word about indirect exports. Tourism is a very important branch of export earnings which should be encouraged also for the developing countries. Tourists not only eat, they also spend money in shops. To the extent that they feel that they are getting a bargain as, for example, in France with the exemption from tax for purchases in travellers cheques, they are apt to spend more on products of the country they visit which, from the point of view of the country they visit, is all to the good. It would still be worth while for developing countries to look into this question of enabling foreign visitors to purchase local products in foreign currency in a way which, in fact, exempts them from taxes which are not destined for exports. It is the task of government administrators of fiscal policy to find the way of doing this and doing it simply. It is no solution to the problem to avoid it.

6. Incentives to direct taxation

(a) Laws for the encouragement of investment

Many developing countries, in order to attract foreign capital and to encourage local investment, have passed special laws covering those fields which can be of assistance - or conversely of a bother to these investors. The broad purpose of these laws is to remove the bother and increase the assistance, and the laws therefore provide tax exemptions mainly in the field of direct taxation which relieve the new, necessary industry from the normal burden of taxation for a period of time. The right to benefit from these concessions is given to what is termed an "approved enterprise", which may be an enterprise which works for export or has been established in, say, a specially developed area. For example, Ireland exempts any enterprise set up in the Shannon area from income tax and company tax on profits from exports. Israel grants "approved enterprise" status to companies which undertake to export. Similar provisions will be found in other countries. The problem is that in the same way as the road to hell is paved with good intentions, so, too, is the road to export. When the investor comes to government and says he will set up an industry employing so many people and that this industry will export, 40, 50 or maybe 80 % of its products - government is so happy that the official convinces not only himself but also the investor that it is possible even to export 100 %. Afterwards, it turns out that for a variety of reasons, all of course outside the control of the investor, the exports have reached only 20 %. However, he still wants the tax exemption which he had hoped to get had he exported more and which he had understood that he would get when he set up his company. This sort of problem is inevitable where the government wishes to encourage a branch of activity.

(b) Reduced rates of income tax on exports and special expense allowances

Some countries operate a system under which export proceeds, or increases in export, benefit from an exemption from income tax or from a reduced rate of tax. For example, Japan exempts exporters of heavy industrial products from tax on 5 % of the value of the exports or 80 % of the net profit on exports whichever is the smaller. Exporters of medium and other products are exempt from 3 % of export turnover, traders are exempt from 1 % of turnover or, in both cases 80 % of the net profit. Australia did not go into the risky fields of trying to determine what were the profits on exports as distinct from profits on the local market or of determining who, in fact, was the exporter - the concession there is given in a very interesting way. For every one pound spent by an exporter on such items as market research, advertising, samples, trade delegations, which are destined to further exports, a deduction of two pounds is allowed in the income calculation as an expense. Whether this methods helps the export of goods is not clear - it certainly helps the export if only temporarily of company executives travelling abroad within the framework of export operations. France again, permits the deduction as a current expense of such outlays, which would normally be considered as capital expenses such as initial publicity expenses, establishment of overseas selling offices, etc.

In addition, this is again most interesting, where a number of small concerns combine to organize export promotion and marketing within the framework of a joint company, their participation in the capital of this company may be treated as a current expense, as if they were current selling expenses, and furthermore, profits of the export company are exempt from tax up to 5 % of the investment.

/(c) Special

(c) Special Depreciation for Exporters

The Israel law grants approved enterprises double normal rates of depreciation for the first 5 years of operation. Exporters come within this law. France again, also grants all exporters depreciation of 50 % above the normal rates, the additional depreciation being granted according to the ratio export sales over total sales. Japan has a similar system, somewhat more sophisticated. Here, the additional depreciation is given by reference to the increase in exports and here, too, the rate of additional depreciation can reach 50 %. Increase in exports is measured by the change between the second half of the year and the first half of the year. Austria, too, permits additional depreciation to exporters.

It is true that in all these cases the additional depreciation is really only accelerated depreciation, which means that the investor gets back as an expense the whole investment in equipment, etc. used in the business, but in a much shorter time than that applicable to non-exporters. It is true that this means a deferment of tax, but even a deferment of tax means a saving of money. Again, if the company is one which has a policy of rapid replacement of equipment, the deferment tends to be permanent. Countries like Sweden which have a liberal depreciation policy, do not need the special provisions for exporters.

(d) Reserves for Foreign Trade Risks

Many countries provide exporters with foreign trade risk insurance to cover the risks in transactions in countries overseas, whose systems of commercial operation may not be familiar or whose population is not considered as accustomed to general trade practices as the exporter would like them to be. Some countries carry through into their income tax law consideration for these risks. For example, France allows the creation of a reserve for losses in foreign trade of 5 % of export profits, this being a reserve for doubtful debts from exports. The exports have to be insured for foreign trade risks. Japan allows exporters to deduct as a reserve for possible losses on export transactions 35 % of profits from exports or ½ per cent of the total export, whichever is the smaller. Here both countries provide a good example of an encouragement to the exporter both to export and to cover

/his risks.

his risks. It is, however, necessary that the country should provide, or that there should be available, a foreign trade risk company which has facilities for carrying out this delicate but important operation of foreign trade insurance.

7. Subsidies and Exchange Rate Policies

(a) Subsidies

Direct subsidies to exports are frowned on in international practice, but it must be considered whether instead of or side-by-side with specific export incentives, direct subsidies should not also be used. Subsidies are found in the following forms:

(i) Subsidies on raw materials and intermediate goods, whether imported or domestically produced goods; these include subsidies on the use of power, transport facilities, etc., as well as the foregoing of indirect taxes.

(ii) Subsidies to the factors of production, labour and capital; the latter includes the provision of loans at interest rates below the market rates, investment allowances and accelerated depreciation arrangements which reduce the cost of fixed capital, depreciation allowances for research and development expenditure and running-in costs.

(iii) Subsidies to sales which raise the effective prices received by domestic producers.

A particular advantage of this system is that the subsidy can be directly related to the export.

(b) Exchange Rate Policies

There is a close relationship between export subsidies and other export incentives and exchange rate policies. Some countries, in order to deal with balance-of-payment problems, impose tariffs on imports and grant subsidies to exports. This is occasionally done by having different exchange rates, a higher consideration being required in local currency to purchase foreign currency for import, while a premium is paid on foreign currency earned. As an additional refinement, the preferential exchange rate is also granted on imports for re-export.

/These policies

These policies from time to time bring up the question whether a simple devaluation would not achieve the same object. This matter raises issues going beyond the question of export incentives, and it must be said that while in practice devaluations have given a benefit to export and have made imports dearer, this benefit tends to be swallowed up after a period by increased costs in the local market because of the increased cost of living engendered by the devaluation.

8. Incentives Based on Net Added Value

The gross export income of a country is not the final reflection of the value of the exports to the country. While on locally produced raw materials and commodities the added values to the producing and exporting country is very high, on manufactured products the added values may be very low. For example, where export incentives have been given on the gross export value it could be of interest for a country to import, say, transistors completely made up, change the packaging and re-export. Some countries have avoided this by granting export premiums only on exports above a certain added value, but the fact still remains that the contribution to the economy is the net added value, and if simple administrative solutions could be found it would seem proper to apply export subsidies and assistance by reference to this net added value. Some countries, therefore, have a sliding scale of export premiums applicable to products of different groups of net added value.

II. INTERNATIONAL ASPECTS

9. Comparative Tax Systems for Export Encouragement

(a) Direct Versus Indirect Taxation

Countries of the continent of Europe, and in particular France, are moving more and more towards indirect taxation and away from direct taxation, or, at least, the balance of their fiscal structure is weighted in the direction of indirect tax. Since it is possible and generally done, to exempt export proceeds from indirect taxes - and this is accepted in GATT - whereas it is more difficult to exempt export proceeds from income tax, and also far less common, it would appear that those countries like the

United Kingdom, which have a comparatively heavy income tax, place their exporters in a more difficult position than those of the countries whose main fiscal revenue is collected from the home market only and not from exports. The United Kingdom remedied this by granting export incentives. One reason which the government openly gave was to redress the fiscal balance as between the U.K. exporters and manufacturers of other countries benefiting from a different tax system.

It would appear on balance, therefore, that an economy with a high ratio of direct to indirect tax, places its would-be exporters in a worse competitive position than those who live under a different regime, and this would be something that less developed countries looking for fiscal revenue would do well to consider. On the other hand, where questions of investment from abroad may arise, it should be remembered that there is provision in international arrangements for credit for income tax paid abroad but not for indirect tax.

(b) Selective Purchase Tax Versus Turnover Tax

Where there is a comparatively heavy income tax there may also be found a selective purchase tax as distinct from an over-all turnover tax, and here, too, it would be worth considering the comparative effects of the two systems on exporters. The Federation of British Industries did this and reached on balance the conclusion that the over-all turnover tax was preferable. Arguments were found on both sides. It was contended that turnover tax raised prices generally in the home market, thus leading to an increase in the cost of living and wage rises which hamper competitive production.

Secondly, an exemption from turnover tax on exports is only an incentive to exports of those products whose demand is elastic and for which it is not possible to pass the whole or part of the tax on to the consumer. Where the demand is inelastic the producer will prefer to pass off this tax on the purchaser in the local market, and is therefore not concerned about having to pay it and not interested in being exempt for export because, in any case, he is left with the same consideration. On the other hand, where there is purchase tax, generally at a much higher rate but only on specific products, it is far more difficult to pass off the tax even if demand is inelastic, and therefore a tax exemption is a real incentive to export.

/The main

The main arguments for turnover tax were that they are comprehensive and apply to all products, thus having the power to encourage a much wider range of export products than those covered by selective purchase tax. Furthermore, income from a general turnover tax is likely to be much larger even at the lower rate and this enables the operation of a much lower rate of direct tax which is recognised by all as a burden on the producer.

10. Customs Concessions on Exports of Less Developed Countries

(a) Preferences

I would now like before concluding to discuss some matters of general policy in which less developed countries can help themselves, and developed countries can also assist the export potential of the less developed countries. This is not the place to go into a detailed discussion on the question of preferences for the export products of the less developed countries. The GATT has given a great deal of thought to this and to the implications of departure from the most favoured nation principle. So has the United Nations Conference on Trade and Development. Agreement was reached on the desirability of exempting in the developed countries, from all import duties and restrictions, primary products of the less developed countries. This is not a protective problem and not even a problem of competition because, generally speaking, the products spoken about are produced almost entirely only in the less-developed countries. Their position may be worsening by the advance in the developed countries of synthetic substitutes. But there has been sympathetic and broad support for aiding the export drive of the developing countries by removing barriers to trade in them.

However, as regards manufactured products in which the question of competition with exporters from developed countries, or with manufacturers in the importing country rises very seriously, there has not been wide support for the philosophy that real preferential conditions should be given to the exports of the less developed countries. An interesting initiative was taken within the GATT by Australia, but the general attitude was that Australia could try if it wanted to, but its lead was not likely to be followed by the main countries of the developed world.

/The Common

The Common Market itself which, on the one hand, has created new problems of competitive tariffs for third countries, has gone a long way to helping those less developed countries connected with it in their mutual fiscal relations. Greece, Turkey and the Yaundé countries all benefit from immediate reduced rates of customs duty on exportation of their goods to Europe, while being permitted to maintain for a longer period protective rates which will enable their own infant industries to develop until they are strong enough to compete. A time table is laid down in these treaties for a much more gradual reduction of tariffs in the developing countries. Monsieur Brasseur, formerly Minister for Foreign Trade of Belgium, proposed, not on the authority of the Common Market as a whole, but as a basis for discussion, that this sort of plan could be operated between the Common Market or between any developed country and the less developed countries, namely, that the less developed countries should undertake to reduce their necessary protective tariffs for a determined but not short period in return for which the major countries would immediately open their markets on preferential terms to the less developed countries. The dicussion still continues, and no real solution has been found for the assistance in the field of tariff policy which is so needed to enable new industries of less developed countries to compete in their early stages with the established industries of the developed countries.

(b) Duty on added value

One aspect which has already arisen for some of the more developed amongst the less developed countries is the problem of duty on products which have been processed in the less developed countries. Generally speaking, the less developed countries are not themselves producers of processed industrial raw materials or semi-finished products. They may be able to produce finished products competitively, or alternatively to carry out for manufacturers in developed countries, processes on raw materials or semi-manufactured goods, which are afterwards returned to the developed country. The present situation broadly is that these goods when re-entering the developed country, pay full duty on the total CIF value. What has happened is that a product has left the developed country, been transported to a less developed country, processed there and transported back. The less

/developed country

developed country has earned only the added value, but is required to compete by paying customs duty on the total value. This places the less developed countries in an inferior competitive situation for processing than that faced by manufacturers living in a developed country, which has an industry producing raw materials and semi-finished products for its own. It is true that if tax is imposed only on the added value, it places the manufacturer in the developed country in the same competitive position as the manufacturer in the developing country. This would seem to be a desirable objective and I would suggest for consideration the introduction of a system applying to processing in less developed countries, which would enable them to be taxed at a lower rate than that applicable to goods coming from developed countries, where it can be shown that what the less developed country has done is to import for re-export after processing.

There are in existence customs procedures for dealing with this type of operation, which is called "trafic de perfectionment". If a major country were to decide as a matter of policy that they wish to do this, the customs people would ingeniously solve the administrative problems. If, however, they are asked whether it is possible, they will only list the problems. If the purpose of the exercise is to assist the export industries of the less developed countries, ingenuity should be used to solve problems rather than to enumerate them.

11. International Treatment of Direct Subsidies

When talking about export incentives I made the point that in many cases the simplest thing to do would be to give a direct export subsidy based on the net added value to the economy. However, the GATT in its rules forbids such subsidies and permits importing countries to impose countervailing duties against such subsidies. The GATT is under pressure to assist the exports of developing countries by requiring that developed countries allow products of the developing countries to enter on preferential terms. This infant industry import argument could well be supplemented by an infant industry export argument, namely that developing countries should be permitted to use export subsidies for a period to create for their exports the possibility of competing. These subsidies should be limited in time and gradually reduced. Though this idea

/seems to

seems to go to the very root of one of the hallowed principles of GATT, the measures which GATT, has allowed to assist exports are tantamount in many cases to direct subsidies.

12. Conclusion

I have again come back to my central theme, and that is that much can be done by the developing countries themselves to create the proper type of fiscal structure to encourage exports, based on the proper atmosphere and infrastructure for economic development. In considering what policies to implement, some thought should be given as to what incentives will attract manufacturers to export. The old adage "a little of what you fancy does you good" applies also to export encouragement. But in addition to what the developing countries can do themselves, much can be done bilaterally and multilaterally and, not least, unilaterally by the developed countries to carry out in their fiscal systems policies which will consciously assist the export effort of the developing countries.