I. INTRODUCTION

1.1 The purpose of this study is to examine the feasibility of groups of developing countries acting in concert to impose ad valorem taxes on their exports of primary products [1], with the aim of increasing their net earnings in real terms by improving their terms of trade. Under certain circumstances, such a course of action could increase the welfare not only of developing countries but also of the world[2]. The study also attempts to examine the implications for domestic processing of primary products and incomes stabilization of introducing such a policy.

1.2 Primary product exports are of great importance to many developing countries. In 75 countries (excluding members of OPEC) out of 96, for which reliable data are available, their share in total merchandise exports was over 50 per cent in 1980 [3], while in 15 developing countries (excluding OPEC members), it was over 98 per cent. In 1979, non-fuel primary product exports were almost 50 per cent of total merchandise exports from low-income, oil-importing countries and above 42 per cent[4] of those from the middle-income, oil-importing countries. Primary product prices fluctuate severely in the short-term as a result of unanticipated variations [5] in demand and supply; the instability of export receipts from developing countries increased 37 per cent during the 1970s [6] and an instability index showed their variation to be twice as high as that of industrial countries.

1.3 Much has been written on the problems experienced by primary product producers as a result of price and earnings instability and secular declines. While price fluctuations are a recognised feature, a significant body of opinion holds that their adverse effects have been exaggerated[7]. Similarly, since the enunciation of the hypothesis of deteriorating terms of trade for primary products by Prebisch (1950) and Singer (1950), there has been some debate as to whether over the long run the terms of trade have been unfavourable to commodity producers[8]. Over a very long period, there are considerable measurement problems [9]; but whatever the general situation concerning historical trends, there is 'prima facie' evidence relating to easily identifiable periods of declining relative prices for primary product exports (excluding oil and gold) of developing countries [10]. One such period has been from 1957 to 1982 (Annex Table 1), where the price index of thirty primary products exported by developing countries declined at a rate of 1 per cent per annum in real terms. Comparable data relating to major product groups - food, beverages, agricultural raw materials, and metals - also indicated a declining trend except for beverages, where the upward trend in cocoa prices outweighed the declining one in tea prices.

1.4 Furthermore, there is no denial of the considerable terms of trade losses experienced by many developing countries, over considerable periods of time. Sri Lanka, a low-income country, provides a dramatic example of the terms of trade problem, on which the World Bank had this to say:

> "Sri Lanka represents an extreme, although perhaps not unique, case of the terms of trade loss that can affect a specialised, raw-material exporting economy. It also shows the difficulty of adjusting to continuous terms of trade losses despite considerable success in reducing consumption and increasing production"[11].

1.5 Efforts to solve the twin problems of instability and decline have made little progress despite various international initiatives to set up price stabilization agreements including buffer-stock schemes. This approach is embodied in the UNCTAD Integrated Programme for Commodities (IPC) which was adopted as a framework for international commodity policy at UNCTAD IV in 1976. It includes among its objectives, the establishment of commodity prices which are remunerative to producers and take into account, inter alia, world inflation and the prices of imported manufactures (indexation)[12].

1.6 Since the inauguration of the IPC, only slow progress has been made in agreeing and implementing specific measures such as the Common Fund (CF) and new international commodity agreements (ICAs). Only one new ICA (natural rubber) has been negotiated, though four existing ones (sugar, coffee, cocoa, and tin) have been renegotiated. One of the main problems has been the reluctance of the major developed countries to support the new pattern of trading implicit in the UNCTAD programme as originally conceived[13]. In so far as ICAs are concerned, developed countries tend to support those agreements which they regard as not artificially attempting to raise prices above trend levels[14].

1.7 The Common Fund's agreed resources are in any event but a very small fraction of the developing countries' export earnings from non-fuel primary products, which amounted to US$129 billion in 1980[15]. Hence, it could not support depressed prices for more than a short period and would, therefore, be unable directly to bring about any sustained improvement in the terms of trade faced by less developed commodity exporting countries during prolonged periods of decline. The difficulties experienced in reaching agreement between commodity producers and consumers raise the possibility of a different approach involving action by producers alone. Where poor countries are concerned considerable welfare gains could result from such action and we explain in the following chapter a mechanism to obtain such gains.

1.8 Although large potential gains for producers in aggregate as a result of supply controls can be demonstrated for some primary products, international agreement has proved extremely difficult. This has been mainly because of objections to such schemes by some major consuming countries, although there have been problems of sharing the benefits and costs of such controls among producing countries. For example, a sticking point in the negotiations for an international agreement on tea has been the distribution of export quotas between producing countries. One possible alternative means of raising primary product prices is the imposition of export taxes by the producing countries at uniform ad valorem rates[16]. But an export tax will tend to lower the supply price of a taxed commodity. Consequently, the producers with high price elasticities of supply might experience a shrinkage in their export shares. One way of avoiding this is to pay compensation to those producers on the basis of initial (pre-tax year) shares in world exports. The theoretical factors which are conducive to following such a course of action are discussed in Chapter II. The subsequent chapter is concerned with the developing country experience in this area. Chapter IV assesses those commodities which appear suitable for the imposition of export taxes while the final chapter gives the conclusions that can be drawn.

II. THEORETICAL FRAMEWORK

2.1 A case for an export tax policy can be made using the concept of optimum tariff and this is shown in section (a) below. It can also be argued that for activities which generate economic rent (as described in paragraph 2.9 below) because of market imperfections and differential resource endowments, a larger share of these rents can be retained in the producing countries through the levy of export taxes. The latter approach is discussed in section (b). It is followed, in section (c), by a brief review of the literature.

(a) Export Taxes as a Form of Optimum Tariff

2.2 The argument that there is some optimum rate of tax on trade (either on imports or exports, but considered as an export tax for the purpose of this study), at which the marginal gain from improved terms of trade equals the marginal loss from reduced specialization on the basis of comparative advantage, is well established theoretically[17]. It has also been argued that an 'optimum' export tax can be levied which raises world welfare if it represents a 'second best' solution in a world in which there is government intervention with export supply of a less 'efficient' kind. However, we shall, here, be concerned with the case of a tax from the export's or exporter's standpoint alone.

2.3 It has been shown that under partial equilibrium (neo-classical) conditions, a government imposing an export tax on a particular commodity drives a wedge between export and domestic prices[18]: the export price rises to the extent to which the exporter(s) is (are) not (a) price taker(s), while the domestic producer and consumer price fall. Because of lower domestic prices, production falls,