SPEED – Support Program for Economic and Enterprise Development

COMMENTS ON THE PROPOSAL FOR A PIGEON PEAS EXPORT DUTY

Note[1]

1. The Government is proposing a 20% duty (*ad valorem*) on the export of pigeon peas for a period of 5 years. The arguments put forward by the Government in its proposal are: (i) the need to protect an emerging/infant pigeon pea processing industry, and (ii) the opportunity to generate additional government revenue, not only through the collection of the export duty but also by reducing and/or eliminating the potential occurrence of under-invoicing pigeon pea exports.

2. The history of the imposition of export duties is long and diverse. The economic reasoning for the imposition of export duties is based on assumptions raised by the Government, but the impact of an export duty varies according to the country controlling or not controlling the market of the product that is object of an export duty. In the case of countries with a relatively small and open economy, such as Mozambique, the imposition of an export duty on peas will without a doubt create distortions and disincentives in the pigeon pea market, with all conceivable negative implications for the production and export of pigeon peas and for the economy.

3. An export tax in economies that do not determine the world price (economies accepting the prices established at international level or *price takers*) means that the purchase price to the domestic producer will have to be automatically reduced at least by the amount of the export duty. This means that, in the specific case of this proposal for a 20% duty, the purchase price of pigeon peas to the producer will at least be reduced by 20% of the export price, i.e., more than 20% of the purchase price to the producer. So, who will pay the duty is the domestic producer and never the exporter. And this payment will be above the duty rate.

   $P_{exp2} = P_{exp1}$ => There is no change in the export price since the exporters are price takers.

   $I = (20\% \ P_{exp1})$ => Export tax per unit of exported pigeon peas;

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$$P_{prod2} = (P_{prod1}) – (20\%\ P_{exp1}) \Rightarrow \text{Reduction of the selling price to the producer above 20\%, since } (20\%\ P_{exp1}) > (20\%\ P_{prod1})$$

4. According to the 2009–2010 Agricultural Census there are 1,760,243 small, medium and large agricultural holdings, producing pigeon peas and occupying approximately 11.18% of the cultivated area for food products. The production of the reported 146 thousand tons of pigeon peas exported between 2012 and 2014 means that the average annual export is approximately 50 thousand tons. Assuming that a rural family can on average produce and sell 50 kg of pigeon peas per year, this means that there are approximately 1 million farming families involved in this export per year. A 20% duty on this export would automatically reduce the monetary income of these 1,000,000 families by more than 20%, i.e., 20% of the price paid to the exporter per kg sold. This is the price paid to benefit possibly 1,500 jobs in an industry of which we do not know if it will be realized and when.

5. Export is vital for all economies since it constitutes additional demand (opening the boundary of the market) for their products. Without exports the domestic production of countries would be limited by the size of internal demand. At global level it is common practice that exports shall never be burdened by taxes if these economies are small and open. There is however an argument for the protection of an emerging/infant industry which, if protected, may grow and pay back. At this moment, there is a case of protection in Mozambique, namely the sugar industry. This is a totally different industry since it produces sugar cane as well as sugar.[2] Thus, the industry controls the agricultural part and the industrial part and it does not compete with the millions of poor rural producers, in spite of having a negative impact on them as they have to buy national sugar that is more expensive than it would be if imported. It does not seem comparable in any way with the case of the potential pigeon pea processing industry.

6. Mozambique has experience with the imposition of export duties for a few agricultural products, such as cashew nuts – based on an industry protection argument. The export duty for unprocessed nuts has decreased from 60% in 1991-1992 to 14% in 1998/99 and increased to 18% in the year 2000 until today. But has the export duty for cashew nuts (in force for more than 20 years) resulted in a strong and competitive cashew nut processing industry?

7. A tax for the protection of the industry is a fallacy. The export tax will decrease the purchase price of the peas to the producer and the impact of this will be twofold: i) reduction of the financial income of rural families who are already very poor; and ii)

[2] A small (20%) percentage of the production of sugar cane is already being produced by private farmers contracted by the industry.

reduction of the very production of peas on the part of these rural farmers – lower prices imply/induce lower production. Thus, the income of rural families will fall, not only because of the reduction of the purchase price but also due to the physical reduction of production itself. This reduction of the production will also reduce the amount of peas that may be sold to said emerging industry. This emerging industry will never be able to survive and the export of pigeon peas and its industry will eventually perish. (See Figure 1)

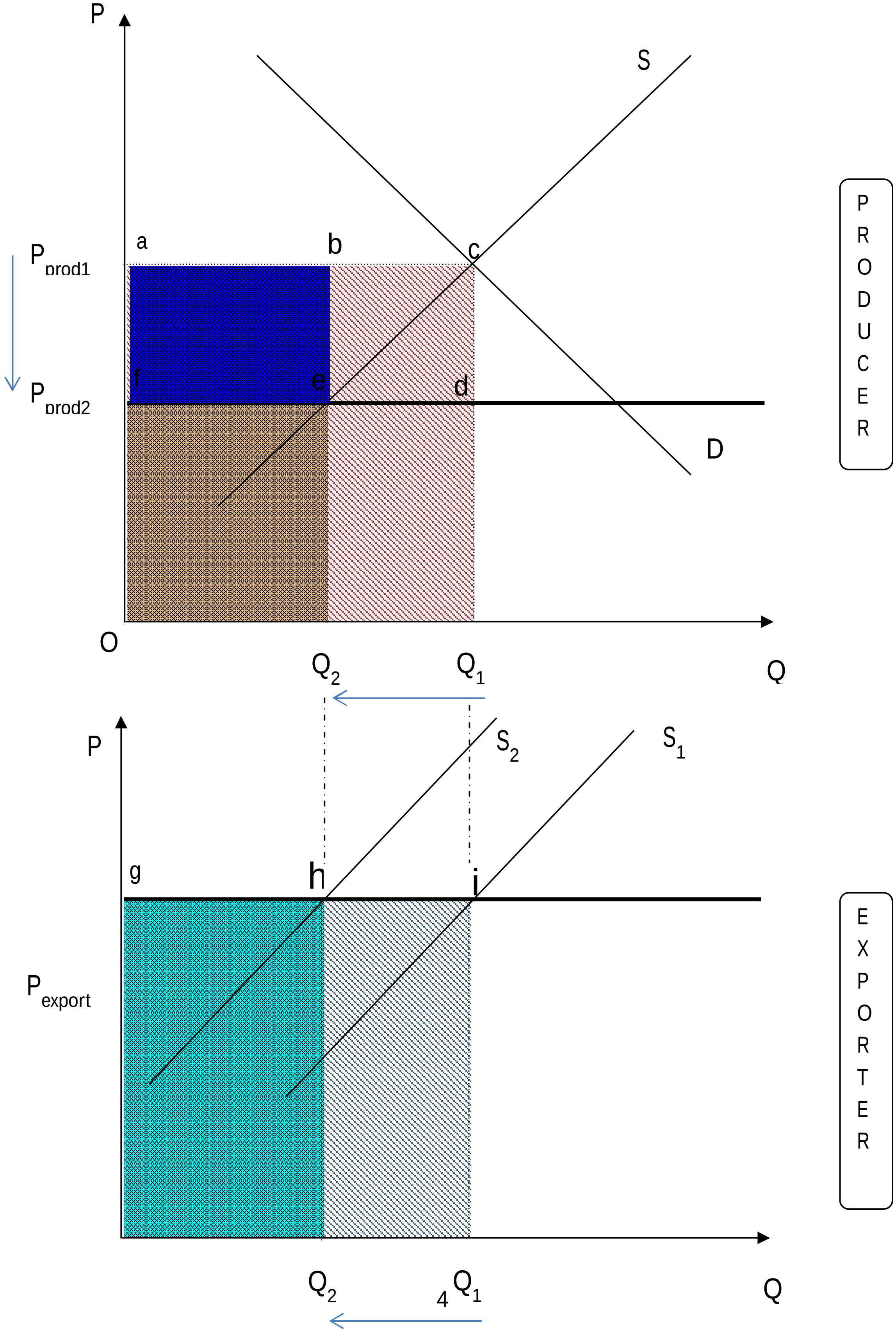
8. The argument of protection of an infant industry should never be used for the introduction of an export tax. And more important still on the export of a product that will affect as many as a million family farmers. There are other instruments. On the basis of the available information and presented in the justification of the draft law, it is not easy to understand a reason for the tax. If the domestic industry is concerned about the quantities of pigeon peas they need to buy, this argument is always solved through the following strategy:

    a. Compete with the prices offered by the exporter. This will result in an increase of internal prices, which will stimulate the family farmer to produce increasingly more peas since his financial returns will be increasingly higher.

    b. An unlimited increase of prices to the domestic producer is not sustainable in the long run since the world price defines (is related to) the domestic price. In order that the production continues to grow and its price is sustainable with the export price, it will be essential to invest in the productivity of this crop, which will reduce its costs. This increase of productivity should be financed and introduced. If this does not happen, the production and export of pigeon peas will run the risk to be unsustainable due to a price war between the industry and the exporter.

9. An export duty on pigeon peas will depress the price of pigeon peas on the domestic market, which in fact means effectively subsidizing the processing of pigeon peas. The end result is an inefficient allocation of resources, which at medium-long term will discourage the production of pigeon peas. An export duty is not the best tool to promote the creation of added value in the value chain of pigeon peas.

Figure 1: Effect of the introduction of an export duty



Where:

S – Pigeon peas supply curve in the domestic market.

D – Pigeon peas demand curve in the domestic market. It is assumed that the entire supply is exported;

D' – Pigeon peas demand curve in the international market.

P_{prod1} – Initial purchase price of pigeon peas to the producer;

P_{prod2} – Purchase price of pigeon peas to the producer imposed by the exporter, i.e. with the export tax deducted;

P_{export} – Price of pigeon peas on the international market;

(P_{prod1} – P_{prod2}) – Tax on each exported unit;

aOQ_1c - Producers' income before export tax;

fOQ_2e - Producers' income after export tax;

OQ_2gh – Exporter's income after the introduction of the duty.

Losses:

bcQ_1Q_2 – Loss to the economy;

$abcdQ_1Q_2ef$ – Loss of producers' income;

bcQ_1Q_2 – Loss to the economy;

Q_1Q_2hi – Loss of exporter's income

Assumptions:

- The entire production is exported. This means that all of it is affected by the export duty;
- The exporter has power over the price since this is a case of monopsony/oligopsony.

10. The argument of **protectionism for the benefit of the emerging industry** falls flat since it will result in an inefficient and uncompetitive pigeon peas processing industry. There are other policy instruments that cause less market distortions and that can promote the

emerging pigeon peas processing industry. Depending on the objectives of the policy, the question arises: Why should the infant pigeon peas industry be protected? Who gains and who loses with the protection of this infant industry?

11. In addition to the issue of efficiency and competitiveness, an export duty aimed at promoting the processing of pigeon peas only benefits the few industrialists who are going to process pigeon peas and create a few jobs to the detriment of the majority of pigeon peas producers. In the long run, the price distortion resulting from the imposition of the export duty will discourage the production of pigeon peas.

12. The duty on pigeon pea exports creates an opportunity to generate **additional government revenue,** but the opportunity cost of this additional revenue does not justify the imposition of a "tax" on the pigeon pea producers (who will receive a lower price). Will this be the most adequate mechanism to increase the collection of income in the rural sector?

13. Concluding, for Mozambique, as an economy without influence on the international pigeon peas market, the imposition of an export duty is a rather ineffective policy instrument to promote the emerging pigeon pea processing industry, both in terms of efficiency/competitiveness and in terms of social justice. There are other policy instruments that can be more efficient for supporting the emerging industry.

14. The issue of **export under-invoicing** is a totally different subject. It is certain that the exporters are not losing money and suffering losses. The inexistence of a tax in no way affects the revenue of the Mozambican Tax Authority. Until now, because this tax does not exist, exporters don't have to pay anything and there is no revenue whatsoever of the Tax Authority that was lost. Eventually, foreign exchange is lost that would enter into the economy and doesn't enter, as indicated in the justification of the draft law. The value of the losses, reportedly 4 to 6 million USD per year, seem too small to affect an economy exporting around 4 billion USD and importing around 8 billion USD per year. The under-invoicing factor depends a lot on:

    a. Political stability (which is currently not the best in Mozambique).

    b. Taxation policy, particularly if the income tax rates are very high, if the VAT return process is very bureaucratic and lengthy, and if the payment of taxes and other duties is in general complicated and time-consuming.

    c. Restricted exchange regime. Exporters practice under-invoicing when they need to pay their imports of goods and services in foreign exchange and have difficulties to acquire foreign exchange in the country. Under-invoicing allows them to keep the foreign exchange abroad, which will then allow them to pay in full or in part for their import needs.

15. As shown above, the practice of under-invoicing is not solved by the imposition of more taxes but rather by their simplification, modernization and lower rates.

16. **The other dimension**. The prices indicated in the reasoning may be erroneous and suggest the potential existence of under-invoicing of pigeon pea exports, a potential occurrence of illicit financial flows. If it is the case, the export duty is definitely not the adequate tool to solve the problem. The Government has other mechanisms to limit/eliminate the problem of illicit financial flows. Inter-institutional capacity building and the strengthening of mechanisms for the supervision, detection and repatriation of potential illicit financial flows through under-invoicing the export value, should be applied. Relevant institutions in this area include the Tax Authority, the Central Bank and the Financial Intelligence Unit, which are in the best position to act, if there are signs of the occurrence of illicit financial flows.