OPM.93/67 No. 898

MEMORANDUM BY THE MINISTER OF TRADE, INDUSTRY & AGRICULTURE

EXPORT REBATE

The Minister of Trade, Industry and Agriculture has been receiving for some time very strong representations from local industrialists and particularly from grant aided industries regarding the urgent need of introducing a system of export rebate. Despite the substantial measure of assistance to them by Government these industrialists contend that they cannot possibly compete fully in overseas markets. There are three main factors which render our industries uncompetitive in world markets, i.e. the very limited domestic market which makes it incumbent on manufacturers to pass on the greater part of their overheads to exports; the high external tariffs imposed by most countries; and last but not least the substantial export rebates, direct and/or indirect, invariably allowed by exporting countries to their manufacturers on exports.

In highly industrialised countries overheads are borne entirely by the domestic market. In other countries at least 60% of overheads is borne by the local market. In our case the local market is so terribly small that almost all overheads have to be borne by exports. This is a serious disadvantage which is dictated by circumstances beyond the contro of the Entrepreneur.

Industrialists in the United Kingdom are not only eligible to most of the financial and other assistance made available to manufacturers in Malta but they enjoy also an export rebate system. This scheme provides for repayment to exporters of sums broadly equivalent to the amounts of specified indirect taxes on oil and petrol duties, vehicle licences and some items of purchase tax which enter into the cost of production of exported goods. Other countries such as Italy and France allow a rebate on added value. This system is permissible under existing Common Market rules. Although export rebates are against the general principles of G.A.T.T., G.A.T.T. is allowing the operation of these rebates because of certain economic considerations and cogent reasons exist which would justify G.A.T.T. extending the same concessions to Malta.

The external tariff imposed by the European Economic Community is rendering Maltese products uncompetitive. Moreover, certain countries, such as Germany, have also, over and above such a tariff, a Turnover Equalisation Tax. With few exceptions, Maltese products do not enjoy the Commonwealth Preferential Tariff, except in the United Kingdom; and in certain Commonwealth Countries, such as Australia, not only our exports are subjected to the General Tariff but a primage duty (a type of equalisation tax) is also charged. These taxes, together with the relatively high transportation costs which have to be paid by the local producer and the passing on to exports of most of their overheads exceed the benefit enjoyed by local industry by way of relatively low wages. In fact certain industrialists hold that even after taking into account the income tax holiday they enjoy under the Aids to Industries Scheme their prices are some 9% higher than corresponding European prices.

There is force in the arguments brought forward by the Industrialist in favour of an export rebate and the Ministry of Trade, Industry and Agriculture is satisfied that without such a rebate system it will not be possible for our industries to reach their maximum production and their full potential employment. A rebate system is considered necessary to give further impetus to our export drive which would enable existing grant aided industries to reach their potential total production of £16 million and their potential constant direct employment of 6,288.

Unless local industries increase their production substantially they will never be able to reach a measure of economic viability and will continue for many years to depend from time to time on heavy financial assistance. The fact that increased production will bring down unit cost is an established industrial tenet and the acquisition of a larger share of the foreign market will result in cheaper production. This in its turn will secure larger orders thus giving a snowballing effect to our expansion drive and to our efforts to reduce unemployment.

Another essential factor is the need to expand into foreign markets and particularly in the E.E.C. countries. This bloc, when considering the grant of a form of Association, has invariably insisted that the starting point of any concession should be the actual import/export position obtaining on the date of entry into effect of any agreement so concluded. It is very essential therefore that every effort be made to reduce as much as possible our relatively high trade gap. Lack of action in this direction might impair, on a cumulative basis for many years, our export potential to that bloc even if an association is formed. On the other hand, an export subsidy even if limited until Association is effected, will have an immediate beneficial effect besides a cumulative one in the years to come.

The various types of export subsidy or other assistance given by other countries do not necessarily imply that such schemes are suitable to this country. There may be a variety of reasons leading to their institution and to the method of applying them.

The industrialization drive in a very limited domestic market, the assistance given by way of loans and grants, the run-down of the Service establishments and consequent effects on the economy as a whole and on employment in particular are determinant factors in the case of Malta. The problem is further aggravated by the variety of products being turned out, which, by world market standards, are of insignificant amounts, the more so in that export trade is again fragmentated to various countries.

These factors do not warrant the establishment of different and made-to-measure remedies for particular products each destined to various countries. A flexible and easily adjustable system is in our case indicated. Such a system should allow for a certain degree of differentiation between industries set up by private capital as against those receiving Government aid; should cater for higher incentives to those industries able to benefit by way of increased exports, should not affect in any way the volume of exports being effected at present and should allow the control to a specified sum of money.

On the basis of these criteria it is proposed to introduce the following system of export rebate proposed in the attached study and summarized hereunder:-

The basis for elegibility to the export rebate will be the export performance of individual firms, i.e.

a) In the case of aided industries who have already entered the export market, the rebate will apply only on exports exceeding 10% of the highest figure attained during the last **three** calendar years called the base unit;

b) In the case of aided industries which have not been exporting for three years, the base unit will be assessed on total exports effected during the 12 months after the employment of full staff (initial figure on which the grant was effected);

c) In the case of unaided industries total exports will rank for benefit, if the industry breaks into the export market. If export has already been effected, procedure at (a) above will apply;

d) In the case of aided expansion, the new base unit will be fixed as soon as production is effected by taking on all the initial additional staff as projected in the expansion project;

e) In the case of unaided expansion, additional exports will qualify immediately.

The export incentive will be calculated on a 10% increase or actual export, as the case may be, and will be equivalent to 25% of the added value of such exports.

In order to create a further incentive for increased export performance, the system provides for an additional 1% increase in the rebate for every additional 10% increase up to a maximum of a 50% incrase, e.g.

Increase 10%	Rebate 25% of added value of such increase
20%	Rebate 25% of added value on first 10% increase 26% on remaining 10% or part thereof
30%	Rebate 25% of added value on first 10% increase plus 26% of added value on next 10% increase plus 27% of added value on next 10% increase or part thereof
50% (Maximum entitlement)	25% on first 10% 26% on next 10% 27% on next 10% 28% on next 10% 30% on next 10% Nil on additional exports.

In order to make the rebate acceptable in international quarters it is proposed that the amount payable should be in the form of a rebate on various items e.g. cost of water and electricity, refund of publicity and market research, refund of commission paid to import/export houses, of excess working capital necessary to maintain large stocks because of the shipping problem, the limited capacity of the enterprise, the complete absences of raw materials, etc., provided that the amount refunded shall not exceed the value of 25% of added value of additional exports.

The following shows the impact of such a system on three existing companies:

A.	Phoenix Textile	added value £50,000 on 10% increase	Subsidy of £12,500
B.	International Fibers	added value £19,876	Subsidy of £5,000
C.	Malta Synthetics	added value £3,430	Subsidy of £856
D.	Marsovin	added value £12,200	Subsidy of £3,050
E.	Paste Portelli	added value £2,040	Subsidy of £510

The total cost of the scheme, if existing industries export an additional 20% on the previous year's performance (current total value of an increase on exports being £2 million) would be in the region of £250,000.

Hon. Ministers are asked to approve the introduction of an export rebate system on the lines proposed in the preceding paragraphs.

8th November, 1967--------------

Export Subsidy

In trying to formulate an acceptable scheme we have had to bear in mind the following facts:-

A. The various types of export subsidies and/or other assistance given by other countries do not necessarily imply that such schemes are suitable to this country. There may be a variety of reasons leading to their institution such as necessity of foreign exchange earning; over production, different rates of taxes in the localities of manufacture, accessibility or lack of such amenities of factories, unemployment etc. etc.

B. The run down of the Service Establishments together with the weak recurrent financial position of this country places us in a rather unique position.

C. The variety of products being turned out locally which, by world market standards, are of insignificant amounts as well as their placing, in any country where they can compete, do not warrant the long and laborious research necessary for establishing different and made to measure remedies for each particular product destined for export to particular countries.

D. The temporary vacuum in which we are living, being members of neither European trading bloc and our ignorance of any decision to join either EFTA or EEC.

E. The incentives and aids already granted to industry do not justify additional help unless this is coupled with increased productivity.

F. In view of the variety of processes being undertaken locally, we feel that any assistance should be calculated on "added value" the average of which we have reckoned to be 45%.

G. In view of the present position where there exist, cheek by jowl, industries which have received benefits under the Aids to Industries Ordinance and industries set up entirely by private enterprise as well as expansion carried out of profits and expansion effected under Aids to Industries, a certain degree of differentiation appears necessary.

H. In view of the difficult financial position of the country's economy as well as the unforeseeable result of such aid, a flexible and easily adjustable system is indicated - a system which can increase benefits, should these turn out to be short of the required amount or one which can be retrenched should it open a flood gate.

I Finally it was felt that the system should incorporate incentives whereby more generous aid is granted to industries able to benefit under the scheme by way of showing increased export orders.

Accordingly we are submitting the following scheme based on increases in export by 10% steps. During the first year, it is envisaged that with an average increase in export of 10% the cost of the scheme would be £112,500. The amount is by no means substantial and the scheme would be more amenable to success if the percentage of aid were raised from 25% to 50% thus bringing the cost to £225,000, however the former figure, if resorted to because of lack of funds, should yield results.

<u>Assumptions</u>

Exports	£10,000,000
Average added value of exporters	45%
Expected result of export subsidy	10% increase of total exports by existing firms
Estimated cost of subsidy	

= 25% of added value on additional exports

= 25% of added value of 10% of £10,000,000

= $\frac{1}{4}$ X (45% of £1,000,000)

= £112,500

<u>Export Subsidy Scheme</u>

1. A Unit for each exporting company will be established. Such a unit will be the highest export figure attained during one of the last three calendar years.

2.i. In the case of aided industries which have not been exporting for three years, the unit will be assessed on total production for export effected during 12 months after the employment of full staff (plus or minus 10%) provided that this is effected before the lapse of 3 years otherwise (1) above will apply.

ii. In the case of unaided industries, total exports will rank for benefit, if no export had been effected previously, otherwise unit will be fixed as under (I) above even if period is less than 3 years.

3.i. In the case of "aided expansion, new unit will be assessed as soon as total production is effected by taking on all extra staff on the same principle as 2 (I) above.

ii. In the case of unaided expansion, additional exports will qualify immediately.

Subsidy   Unit 100

25% of added value on amount exceeding unit provided that a minimum increase of 10% is effected.

plus an additional

1% if increase exceeds 20% payable only on such increase

plus an additional

1% if increase exceeds 30% payable only on such increase

plus an additional

1% if increase exceeds 40% payable only on such increase

plus an additional

2% if increase exceeds 50% payable only on such increase

Subsidy on each subsequent year.

Highest rate paid in previous year on all exports exceeding unit

plus

1% of any additional 10% increase on previous year's figures and additional 1% for each additional 10% increase.