USDA Foreign Agricultural Service
GAIN Report
Global Agriculture Information Network

Voluntary Report - public distribution

Date: 8/18/2003

GAIN Report Number: E23155

European Union

Trade Policy Monitoring

Tariff escalation

2003

Approved by:
Norval Francis
U.S. Mission to the European Union, Brussels
Prepared by:
Sandie Kipe

Report Highlights:
The basic concept of tariff escalation is that tariffs rise with the level of processing, causing a relatively higher price for value added imports. This report discusses the harmful effects of tariff escalation relative to developing countries and cites cases of tariff escalation in rice and cocoa.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Brussels USEU [BE2]
[E2]

Summary
The basic concept of tariff escalation is that tariffs rise with the level of processing. This report will specifically focus on tariff escalation on agricultural products in the European Union. The data on tariff escalation and trade flows along the processing stages shows evidence that the EU primarily imports raw products with zero to low tariffs from developing and least developed countries, then as the product moves up the processing stages higher tariffs allow fewer imports.

Tariff escalation is not compatible with the EU objective of supporting developing countries, as this system maintains them in a situation where they can be competitive only on raw materials. The EU frequently publicizes that it imports more agricultural goods from developing countries than the United States, Canada, Australia, and Japan combined. Much of these imports, however, are bulk products or only minimally processed. Thus Arlindo Cunha, a member of the European Parliament, in a speech to the Confederation of Food and Drinks Industry (CIAA), cited the fact that the EU is the largest importer of raw materials. Pascal Lamy, EU Trade Commissioner, stated that in the last 15 years growth in exports of processed agricultural products from the EU have increased twice as rapidly as the growth in primary agricultural products. These statements by EU officials iterate the market effects of tariff escalation. In general, the EU is importing low priced goods from developing countries, adding value, and exporting the finished good. This process is facilitated by a well-developed tariff escalation scheme, which aids to maintain European food processors competitiveness.

Background
The theory behind tariff escalation is that tariffs rise with the level of processing; this causes the price of value added imports relative to the raw product to increase dramatically, decreasing demand for processed products in the importing country. Tariff escalation is a significant problem in terms of market access for developing countries, particularly in agricultural trade. Tariff escalation can keep poor countries trapped as raw material providers in the agricultural trading system and prevents them from diversifying exports.

The EU provides preferential market access to developing countries through several means. The Cotonou Agreement, a continuation of the Lome Convention, includes 77 countries in the Africa, Caribbean and Pacific (ACP) region and gives these countries preferential market access to the EU. Secondly, the Everything But Arms (EBA) initiative with the 49 least developed countries, of which 39 overlap with ACP countries also provides zero duty access. The primary aim of these agreements is to promote development through increased exports and export diversification. The EU also uses a Generalized System of Preferences (GSP), giving special and preferential treatment to developing countries. The GSP consists of general arrangements, which this report will focus on, as well as preferences to increase labor standards, environmental standards, and help fight drug trafficking. Preferential market access is allocated uniquely within each agreement; this report will analyze the appropriate preferences where they may apply in terms of tariff escalation.

Rice
The EU rice import regime provides a classic case study in tariff escalation. For rough (or paddy) rice, the EU import tariff is €211/MT. For the two further stages of processing, the rice tariff is based on a margin of preference type scheme, whereby tariff varies to bring the landed price (i.e. the price of the rice plus the tariff) of rice imports up to a multiple of the EU rice intervention price.

For husked (or brown) rice, the landed price of rice is 180% of the intervention price (188% for indica varieties), and for milled rice it is 267% of the intervention price. The EU rice intervention price is currently €298.35/MT, giving a maximum duty paid import price (landed price) of €537 for brown indica rice. Where the tariff calculated by this system is higher than the bound tariff, the bound tariff is applied, as is currently the case. The bound tariff rate for husked or brown rice is €264/MT and for milled rice, €416/MT.

Only limited import preferences are granted for rice. Rice was one of only three agricultural products excluded from immediate liberalization under the EBA Agreement. EBA countries will not benefit from unlimited zero duty access to EU markets until 2009. In the interim, since 2001/02, there is a zero duty TRQ for 2,517 MT, rising by 15% per year. This accounts for roughly 0.6% of EU rice imports by volume.

The following table presents a picture of the bound tariff escalation scheme for rice as it moves through the processing stages. All tariffs are *ad valorem* and subject to tariff rate quotas (TRQs), which become much more complex. This is a simple breakdown of the base tariff rate, escalation, and value.

Table 1. Tariff Escalation in Rice Imports to the EU, Euros per 1000kg, 2002

Description	World	ACP	GSP	EBA
In the husk (paddy or rough)	211.00	69.51	211.00	0.00
Husked (brown)	264.00	88.06	264.00	0.00
Semi-milled or Milled	416.00	133.21	416.00	0.00
Broken	128.00	41.18	128.00	0.00

Source: EU Common Customs Tariff, EU Common Customs Tariff, Official Journal C 104 A, vol 45, 30 April 2002

Tariff escalation in the EU rice imports scheme is clearly expressed in Table 2. There is a 21 percent increase in tariffs for husked rice versus paddy or rough rice; the EU primarily imports husked brown rice, consisting of two-thirds of total rice imports. The tariff on rice that has moved to the next stage of processing more than doubles; a 57 percent tariff increase is imposed on rice that is semi-milled or milled. This rise in tariff effectively limits semi-milled and milled rice imports to fewer than 20 percent of total imports. The total tariff escalation is over 97 percent from rice in the husk to semi-milled or milled for all countries excepting those in the ACP agreement, for which there is a 91 percent increase. The only countries exempt are those in the EBA agreement, which accounted for only 2.5 percent of semi-milled and milled rice imports and is limited to .6 percent of total EU rice imports through TRQs.

Table 2. Tariff Escalation by Percentage Change, 2002

Description	World	ACP	GSP	EBA
In the Husk to Brown	21.11%	26.68%	21.11%	0.00%
Brown to semi/milled	57.57%	51.27%	57.57%	0.00%
In the Husk to semi/milled	97.16%	91.64%	97.16%	0.00%

Calculated from EU Common Customs Tariff, Official Journal C 104 A, vol 45, 30 April 2002

The EU imported over one million metric tons, valued at over €390 million of rice in 2002, €284 million of which came from all developing countries, €40 million from the Africa Pacific and Caribbean (ACP) countries. Of the €390 million of rice imports, €273 million, or 70 percent, were either in the husk or husked but not milled. Only 19 percent of rice imports were either semi-milled or milled; the remaining is broken rice. Developing countries account for €198 million of the brown rice imports, or 72.5 percent of brown rice, and 65 percent of semi-milled/milled rice imports into the EU. The import data corresponds with the tariff scheme, as most imports are in the form of brown rice where tariffs are 57 percent lower than semi-milled and milled rice. The increasing tariff effectively limits imports of semi-milled and milled rice from both developing and developed countries.

Table 3. Quantity of Rice Imports to the EU, Metric tons, 2002

Description	ACP	GSP	EBA
In the husk (paddy or rough)	1	211	3
Husked (brown)	112,285	248,602	177
Semi-milled or Milled	3,071	93,511	3,305
Broken	19,552	120,246	2,700
Total	134,909.00	462,570.00	6,185.00

Source: Eurostat, 2003

Through this tariff escalation scheme, the EU is extracting over €127 million a year tariff rent from developing countries in the ACP and general GSP arrangements in rice imports alone. Although ACP countries receive preferential treatment, exporters of ACP rice still pay over €10 million a year in tariffs. More importantly, the tariff inhibits imports of processed rice from developing countries. Discriminating against these imports also prevents developing countries from investing in a processing sector in order to increase export diversification. Since the bulk of exports are not ready for consumption, the final processing stages occur in the EU, allowing European firms to capture the marketing margin from processing. The EU exports the semi-milled and milled rice on the world market with export subsidies; 96 percent of EU rice exports are semi-milled or milled and 45 percent of rice exports go to developing countries.

Cocoa

Tariffs in the EU cocoa import regime classify more as peaks within the processing sector more than basic tariff escalation. Cocoa beans, whole or broken, raw or roasted, are imported duty-free as well as cocoa shells, husks, skins, and other waste. However, cocoa paste (liquor) is imported at a high tariff relative to other cocoa products aside from chocolate. This is the case for the MFN tariff as well as the GSP tariff. Cocoa paste is the first step of processing beans into chocolate. The paste can be used to make cocoa butter, of which the remnants of processing are pulverized into powder; paste is also directly added along with the butter to make the finished chocolate.

The most obvious peak is in the finished product, chocolate. The actual ad valorem percentage on the good is not a large increase. The peak is in the additional specific tariff per 100kg that is placed on MFN, ACP, and GSP countries. In addition, in the chocolate manufacturing process, sugar is a main ingredient, on which an additional duty is added. The actual tariff on chocolate will be higher than what is stated in Figure 6 due to this additional tariff on sugar.

Table 6. Tariff Escalation and Peaks in Cocoa Imports to the EU, ad valorem, 2002

Description	World	ACP	GSP	EBA
Cocoa Beans, Raw or Roasted	0.0	0.0	0.0	0.0
Cocoa Shells and other Waste	0.0	0.0	0.0	0.0
Cocoa Paste	9.6	0.0	6.1	0.0
Cocoa Fat, Butter, Oil	7.7	0.0	4.2	0.0
Cocoa Powder, No Sugar or Sweetener	8.0	0.0	2.8	0.0
Chocolate and other Food w/ Cocoa	8.2	0.0	4.3	0.0
Additional tariff on chocolate(1)	22.2	12.9	22.2	0.0
(1) Additional specific tariff per 100 kg additional to ad valorem tariff, also additional duty on sugar				

Source: EU Common Customs Tariff, Official Journal C 104 A, vol 45, 30 April 2002

Table 7. Quantity of Cocoa Imports to the EU, Metric Tons, 2002

Description	ACP	GSP	EBA
Cocoa Beans, Raw or Roasted	1,035,240	22,514	31,939
Cocoa Shells and other Waste	14,981	470	105
Cocoa Paste	133,152	16,020	0
Cocoa Fat, Butter, Oil	63,509	41,971	400
Cocoa Powder, No Sugar or Sweetener	14,230	3,934	0
Chocolate and other Food w/ Cocoa	8,835	14,468	3

Source: Eurostat, 2003

The actual tariff escalation does not seem relatively high, especially not enough to distort trade. However, it is evident in the data that ACP exporters of cocoa products, benefiting from duty-free market access on paste, export more paste than butter, fat, and oil. This is not the case for MFN and GSP countries that face higher relative tariffs on paste than butter, fat, and oil. A reasonable conclusion from this is the relative tariff is high enough to hinder imports.

Conclusion

The two cases highlighted here represent the basic concept of tariff escalation and tariff peaks. The trade flow data combined with the tariff scheme supports economic theory that tariff escalation inhibits imports of value added goods. Rice and cocoa are good examples, however, tariff escalation is apparent in many other industries and overlapping sectors in the EU import regime. For example, the tariff on soybean imports, which is primarily used for animal feed, is zero. The finished product of beef, pork, and poultry are protected by extremely high tariffs and tariff escalation within meat processing. This form of tariff escalation is more discreet, but is the same concept with the same market affects.

The most important facet of tariff escalation in the EU is that the value is added in the EU and then exported, often back to developing countries with export subsidies (see Gain Report E23156). As previously discussed, adding value in the EU allows European firms to capture the marketing margin on adding value to the good as it moves through the supply chain. Additionally, the tariff escalation discourages developing countries from investing in processing sectors, which provide employment and increased economic activity within the country. Developing countries do not have incentives to promote export diversification and become dependent on several primary product exports for their main source of export revenues.

Visit our website: our website **www.useu.be/agri/usda.html** provides a broad range of useful information on EU import rules and food laws and allows easy access to USEU reports,

trade information and other practical information. More information on tariff escalation and export subsidies can be found at http://www.ers.usda.gov
E-mail: AgUSEUBrussels@usda.gov

Related reports from USEU Brussels:

Report Number	Title	Date Released
E23156	Export Subsidies	08/18/2003
E23149	Everything but arms: declining agricultural exports from least developed countries	08/06/2003
E23117	EU restricts cumulation rules for rice and sugar imports from LDCs	06/20/2003
E23030	Overview of the EU Rice Import Regime	03/05/2003
E23056	EU Sugar Annual	04/10/2003