Participant Reflection

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CORE ISSUES OF AN ARMS TRADE TAX

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OVERVIEW

The idea of an arms trade tax has been around for some time.[1] It has received limited support in debates on the links between disarmament and development, and development finance and global public goods (bads), but never officially from any government.[2]

Two interrelated, but not necessarily linked, objectives have dominated discussion of an arms trade tax. The first is to curtail the transfer of weapons. It would act as a Pigouvian tax based on the assumptions that arms transfers have negative costs for societies and that fewer arms transfers would lead to more peaceful conflict resolution and to a reduction in armed conflict.[3] The second motive is to generate funding for the promotion of peace, for instance through measures designed to prevent armed conflict, or to compensate persons harmed in armed conflict, negate the negative effects of armed conflict or fund post-conflict reconstruction.

A QUESTION OF SCOPE

Most of the discussion on an arms trade tax has focused on the international arms trade, or some segments of it, rather than on, for instance, all arms purchases or military spending. There are several reasons for this. One is that arms imports are often seen in public discourse on military issues as more problematic than domestic purchases because a large number of arms importing countries are low-income countries, although in terms of monetary value middle- and high-income countries import more; and because almost all armed conflict occurs in poor countries, largely using imported arms. Another reason is that while highly controversial, an arms trade tax may hold greater political promise than a tax on alternative forms of military power. For one, political support would seem to be more widespread and stronger judging by the level of past support for various alternatives. Implementation would also be easier. More data is available on the international arms trade than on weapons procurement, for example, which would make enforcement of such a tax easier.

However, there are also important counterarguments. An arms trade tax charged at the border would affect arms importing countries, which are generally poorer, more than the wealthy developed nations, which largely produce weapons domestically. Depending on the interplay between demand and price, it might lead to higher

[1] I am grateful for the helpful comments and suggestions received from Henk-Jan Brinkman, Gary Milante, Elisabeth Sköns and during the Stockholm Forum meeting on an earlier draft. All the views expressed and any remaining errors are my own.

[2] The idea of an arms trade tax first gained international prominence in 1980 as one of the main recommendations of the Report of the Independent Commission on International Development, chaired by former German Chancellor Willy Brandt (the Brandt Report). Later separate proposals came from the former presidents Oscar Arias (Costa Rica), Jacques Chirac (France) and Lula da Silva (Brazil). The basis for Chirac's intervention was a report on innovative development financing by a group of experts chaired by the then Executive Director for France at the European Bank for Reconstruction and Development, Jean-Pierre Landau, <http://www.diplomatie.gouv.fr/IMG/pdf/LandauENG1.pdf>. Chirac and Lula were joined by the former UN Secretary-General, Kofi Annan, and President Lopez (Chile) in calls to investigate, among other ideas, an arms trade tax as an innovative international financing mechanism, see Organisation for Economic Co-operation and Development (OECD), *Financing Development: Aid and Beyond* (OECD: Paris, 2007), pp. 75–76. The idea was also introduced on to the Agenda of the G8 Summit in Evian in June 2003 by Lula da Silva, see Burrows, G., 'Arms and the taxman', *The Guardian*, 1 July 2003, <https://www.theguardian.com/world/2003/jul/01/armstrade.g8>. See also Brock, G., 'International taxation', eds S. Benatar and G. Brock, *Global Health and Global Health Ethics* (Cambridge University Press: Cambridge, 2011), p. 280.

[3] A Pigouvian tax is a tax on an activity generating negative externalities, that is social costs beyond private costs of competitive markets, named after the English economist Arthur Pigou (1877–1959).

spending on arms in importing countries by providing incentives for an increase in untaxed domestic arms production or otherwise contribute to an expansion of the black market in arms. Finally, while most recent armed conflicts have been fought predominantly with imported weapons, arms imports are not among the major causes of armed conflict.[4]

Clearly, not all international arms transfers carry the same risks of harm. This leads to the idea of taxing only those arms transfers that harm civilians. However, it is often only possible to tell long after the delivery of arms whether they have contributed to human suffering.

INCIDENCE

In terms of who would bear the burden of an arms trade tax, much would depend on the nature of the tax, the way it were collected and the allocation of the revenue raised.[5] In particular, it would be important to distinguish between a goods tax and a country tax, and between the allocation of revenues to the taxing authority or other entities.

A traditional export goods tax, one raised on goods at border crossings, could be raised from exporting arms-producing companies by the exporting state and would enter the coffers of the exporting state. Alternatively, an import goods tax could be levied by arms importing countries and raised from the procurement authorities. The latter would increase the importing government's income but would also increase government expenditure on arms in order to compensate for the higher costs of importing weaponry. While it is easy to identify the entities from which such goods taxes would be raised and those which would receive the revenue, it is more difficult to assess the incidence of such a tax. Because they have an impact on price, demand and supply, the burden of such taxes on the arms exporting companies and importing procurement authorities would depend on the parameters of the arms market and practical issues of tax collection, such as transparency, ease of evasion and the capacities of taxing entities. However, because exporters and importers are linked through the common price of transferred arms, the incidence of 'import goods taxes' and 'export goods taxes' converges, even though revenue will be raised at different locations.

However, the amount of revenue is also dependent on the parameters of the arms market. Unfortunately, information on price and demand sensitivities in the arms trade are not sufficiently reliable for exact projections to be made of the incidence of goods taxes. However, the scant available evidence on the price elasticities of demand and supply for arms suggests that the cost burden of a tax would be split between arms importers (the armed forces or defence ministries) and arms suppliers (the exporting companies). Arms exporting companies would be likely to increase prices to recover some of the tax whereas arms importers would probably need to offset the increase in prices by reducing the quantity of weapons imported, while possibly also ending up with higher overall costs for arms procurement. A more exact estimation of the distribution of the tax burden between suppliers and importers would be required to determine the probable distribution of the tax burden in order to assess its impacts

A traditional goods tax would increase the tax income of importing or exporting governments, depending on which is collecting the tax. This could be used to partly compensate the losers from the tax—arms exporting companies in the case of a tax collected from exporters or the armed forces in the case of a tax collected from importers. However, this would reduce the effects of an arms trade tax on the level of arms imports, which would also reduce its effectiveness. The tax income could, however, be spent on other objectives, both domestic and international.

An alternative to a goods tax is a tax on arms importing and/or exporting governments (a 'country quasi-tax'), where the tax income goes to some kind of non-governmental, or more likely international, organization. Unless

[4] See the literature reviews on civil wars by Christopher Blattman and Edward Miguel, in which arms imports are not mentioned among the potential factors increasing the likelihood of armed conflict (*Journal of Economic Literature*, vol. 48, no. 1 (2010), pp. 3–57).

[5] For a fuller technical treatment see Brzoska, M., 'Taxation of the global arms trade? An overview of the issues', *KYKLOS*, vol. 57, no. 2 (2004), pp. 149–72.

such a quasi-tax were recovered through arms importing countries reducing spending on arms imports (turning it into an 'imported goods tax') or from arms exporting countries by taxing arms exporting companies (turning it into an 'exported goods tax'), such a tax would not affect the price of arms exports. There would therefore be no effect on the demand for arms and thus on the amount of arms imported. The lack of any effect on the demand for arms would also mean that such a tax would raise greater revenues than a goods tax.

A Pigouvian tax and a quasi-tax on countries best serve the two potential major objectives of an arms trade tax differently. As long as its revenue is not used to compensate the importers (the armed forces) or the exporting companies, a Pigouvian tax will raise the costs of arms and would likely reduce the amount of arms traded. This means that revenues will shrink with higher tax rates, depending on the elasticities of supply and demand. Country quasi-taxes, on the other hand, raise revenue with little or no effect on the amount of arms transferred. The level of revenue can be set without impacting decision-making on arms transfers by arms importers.

COLLECTION CONSIDERATIONS

Goods taxes, particularly those imposed by importing countries but also those of exporting countries, are standard practice. They require the valuation of exports, including those that are transferred at zero cost. The Arms Trade Treaty (ATT) contains some important definitions of which goods to tax.

In theory, an international organization could levy and assess such a tax based on information on international arms transfers. Without an enforcement mandate, however, that international organization would have to rely on the willingness of governments to collect the tax and remit it to an international body.

Country 'taxes', in the proper sense, run contrary to the fiscal sovereignty of states. There are existing cases of quasi taxes, however, in the form of assessments of contributions to international organizations. Most international organizations are funded on the basis of such assessments, which are based on criteria similar to those used in national taxation. Thus, contributions to the regular UN budget are assessed on the basis of a modified calculation of national income, similar to a national income tax. The World Trade Organization is funded by member states' contributions, which are assessed based on their share of international trade, which in turn is based on trade in goods, services and intellectual property rights in the most recent five-year period for which data is available.

A LIABILITY AND INSURANCE SCHEME AS AN ALTERNATIVE

The introduction of liabilities, and corresponding insurance schemes, for the use of weapons against civilians or in violation of international law has sometimes been discussed as an alternative to taxation.[6] Such a scheme could be limited to certain types of weapons, such as small arms, or to ammunition.

Unlike a Pigouvian tax, payment would only be made in cases where loss or damage caused by weapons that had earlier been transferred can be established. For such a scheme to function, the specific uses of the weapons which violate international law would have to be defined. The liability might fall on the exporting company or the exporting government, whichever was deemed responsible for assessing the risk of the unlawful use of the arms.[7] Exporting governments could require arms exporting companies to take out insurance for all arms exports, to avoid default on claims. Such insurance could be offered by private sector insurance companies or, if they found the risk too high, by governments.

[6] A Group of eminent persons chaired by the former Prime Minister of France, Michel Rocard, and the President of Mali, Alpha Omar Konaré, suggested compulsory third party damage liability insurance for small arms transfers in a White Paper published in 2000 and presented by the Government of Mali to the first UN Conference on the 'Illicit Trade in Small Arms and Lights Weapons in all its Aspects', <http://archive2.grip.org/bdg/g1754.html>.

[7] This would require a political decision to allocate responsibility to either exporters or governments. Both are a possibility and have their merits. Such an approach would require courts to settle disputes.

One advantage of such a scheme would be the direct link established between the harmful effects of arms transfers and the funding of remedies. It might also lead to more cautious behaviour by arms exporting companies and governments. However, the legal and practical aspects of attributing arms transfers to particular instances of illegal or harmful use are daunting. Nonetheless, there are enough historic cases of arms transfers being linked to illegal and harmful later use of weapons, resulting in major damage, to make such a scheme worthy of further consideration as a measure to curtail the most egregious and risky arms transfers.

A VOLUNTARY SCHEME

Mandatory schemes would clearly be preferable in terms of achieving the aims of an arms trade tax, but they are far away from the current political reality. This raises the idea of voluntary schemes. Goods taxes and country quasi-taxes could both be introduced on a voluntary basis. A goods tax imposed only on some exporters would reduce their competitiveness. However, there are already many areas, including domestic taxation, in which governments in arms exporting countries affect the competitiveness of their arms exporters, so that cannot count as a principal objection. A voluntary importer goods tax is counterintuitive, as its objectives could be achieved simply by refraining from spending on arms imports.

A proposal that is technically less attractive (because of the lesser effect on levels of arms transfers) but more politically feasible is a voluntary exporter country quasi-tax. Governments willing to participate could pay a percentage of the total value of their arms exports into a dedicated fund earmarked for conflict prevention, peacebuilding or post-conflict reconstruction. This would demonstrate their willingness to recognize that arms exports can potentially have negative effects, which is politically sensitive in several ways. On the one hand, it might suggest that governments are not scrutinizing arms exports sufficiently before licensing, which governments will deny. On the other hand, arms exports might be more acceptable to internal critics of the arms trade if governments showed an increased willingness to contribute to mitigating the harm caused by arms transfers. An alternative might be to link a voluntary schemed to a pre-set amount of income for a purpose clearly linked to the negative effects of conflict, instead of a fixed percentage of the value of arms exports. This would make it very similar to the assessments of contributions to international membership organizations. Even a small number of arms exporting countries could start such a scheme.

USE OF TAX INCOME

Spending the income from an arms trade tax on preventing violent conflict or mitigating the consequences of armed conflict has some plausibility. In contrast to some other recent international agreements on arms, the ATT contains limited provisions on international assistance for the implementation of the treaty but none on victim support or compensation. Thus, while the Ottawa Treaty on anti-personnel mines and the Oslo Treaty on cluster munitions encourage governments to cooperate—including financially—on mitigating the costs of earlier uses of banned weapons, the ATT restricts such calls to the implementation of the treaty itself. However, there are existing voluntary financial mechanisms, such as the Peacebuilding Fund, that could benefit from an arms trade tax.

ESTIMATED REVENUES

The financial volume of the arms trade has been estimated at about US$ 100 billion.[8] Even a comparatively low tax rate, of say 10 per cent, would raise sizeable revenue. However, US$ 10 billion would represent an upper maximum that is hard to reach. First, a good tax, whether on exports or imports, would be likely to result in a reduction in

[8] The *SIPRI Yearbook 2016* published a conservative estimate of US$ 94.5 billion for 2014, based on published government data that is far from complete.

arms exports as price elasticity of demand is not perfectly inelastic. However, as noted above, the relationship between price (including tax) and demand is not well established. In the case of an exporter or importer country quasi-tax, the volume of revenue would depend on political decisions on whether and how to finance the costs of the tax. Second, substitution by domestic products and an increase in black market trade are likely to reduce revenue.

POLITICAL SUPPORT AND OPPOSITION

Support for an arms trade tax (or further thinking on it) has so far been limited to prominent individuals,[9] former politicians and expert commissions. Although it does not seem to have been discussed in the negotiation process of the ATT, the treaty might provide new momentum for discussion of an arms trade tax. However, as the ATT clearly distinguishes between legitimate and illegitimate international trade in arms (the latter is not permitted), the link to the harmfulness of the transfers that have been licensed by governments is not immediately obvious. However, there are strong arguments for such a link, such as the later misuse of arms that had been delivered earlier under different circumstances, or through the retransfer of arms. The empirical foundation for these arguments could be made stronger through additional research.

[9] One example is the US philosopher Thomas Pogge, see Tran, M., 'Would tax on arms exports and protectionism help poor countries?', *The Guardian*, 15 May 2013, <https://www.theguardian.com/global-development/poverty-matters/2013/may/15/tax-arms-exports-protectionism>.