Fiscal Challenges of Regional Integration

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Outline

- Regional integration – what and why?
  - Borders and logistics
- Specific issues
  - Import tariffs; preferences
  - Customs unions
  - Other tax and border issues
  - Corporate taxes and incentives
  - Resources
  - VAT and excises
  - Coordination issues and priorities
- Concluding remarks

What is Regional Integration? Why?

Why Regional Integration?

- From a narrow fiscal perspective, an opportunity to reduce dependence on trade taxes in favor of more efficient, more equitable, broad-based taxes that are also less prone to at least some forms of rent seeking
  - But rent seeking not confined to trade taxes; needs to be dealt with through more general state-building, legal system reform and fiscal management (expenditures as well as taxes)

More Broadly

- Regional integration can assist in achieving higher productivity growth through more effective participation in global markets
- And it is far more than tariff preferences; it can be enhanced by a wide range of complementary fiscal and regulatory reforms
  - Example: Indonesia in the 1980s-90s – reform of trade, taxes, ports and customs...

Borders, Logistics etc.

- Regional logistical efficiency is of special importance in much of Africa, especially in light of the importance of connection to global production networks (‘import-led growth’)
  - Geographic barriers aggravated by regulatory impediments (shipping costs high)
  - Investment in infrastructure important, but there is a critical role to be played by regulatory and fiscal/administrative reform (recall Indonesia)

Some Specific Issues

Import Tariffs

- We are the main beneficiaries of our own tariff reform
  – Tariff reform is in a country's own self-interest; it is not a 'concession' to other countries
- But tariff revenues are important, and developing other revenue sources remains a struggle, esp. in lower income countries
  – Possible role of technical and financial assistance as part of regional integration agenda

Preferential Tariffs

- MFN reform should continue alongside preferential tariff reductions (regional integration as a tool for integrating with *global* markets)
- Preferential tariff agreements (PTAs) work better with low and similar tariff structures among members
  - Trade 'deflection,' rules of origin, trust in customs administration (illustrative examples from SADC)

Customs Unions

- A number of Customs Unions (CUs) exist or are being considered throughout Africa
- Can contribute to regional integration by reducing costly border controls
- But fiscal borders are still important for other taxes (more later)
- And getting to a CU requires dealing with some key tariff issues

CU-Specific Tariff Issues (1)

- Need to agree on a common external tariff (CET) structure
  - Difficult when tariffs are important, and when pre-CU structures differ (importance of MFN and preferential tariff reform as complements)
  - A CET constrains members wanting to reform tariffs more quickly (slows reform) and more slowly (speeds reform); and it might exclude those that have already reformed (Mauritius in a SADC CU?)

CU-Specific Tariff Issues (2)

- Rules re contingent and other special tariffs; implications for trade facilitation
  - Procedures, applicability and enforcement of anti-dumping duties, safeguards etc.
  - Rules and conditions for ‘infant industry’ protection; CU-wide or country-specific? (This arises in PTAs as well; more later)

CU-Specific Tariff Issues (3)

- Sharing of customs revenues
  - Difficult and contentious as long as revenues are large; need for simple and transparent rules
  - Dangers of using for redistribution to poorer members: volatility, non-sustainability, perverse incentives for public sector and longer term revenue mobilization (SACU)

Other Tariff and Border Issues

- Trust in partners' customs administration is critical; importance of customs cooperation
- Efficient transit rules and procedures can play a large role in facilitating trade and investment
  - Examples from SACU/SADC
- Many ways to deepen regional integration without moving directly to a CU, or even a PTA (customs admin., transit rules, taxes…)
  - These will facilitate the eventual adoption of a CU

Corporate Taxes and Incentives

- Dangers of tax rate and incentives competition
  - They are costly – revenue erosion; ambiguous signal to investors; prone to rent seeking; deflect attention from more important issues
- Are incentives necessary, esp. in countries with a weak history of attracting investment?
  - No (Board Paper re Mauritius; Indonesia – abolished special tax incentives and doubled share of ASEAN FDI); other fiscal and regulatory reforms far more important

Regional Investment Codes

- Possible role of investment codes to restrict harmful use of discretionary incentives
  - Danger of presumption that incentives are good from a single country's perspective
  - But might help governments resist rent seekers
- Similar case for more general restrictions on state aid to investors
  - Infant industries; finance; energy & utility pricing…
  - Difficulties with SOE utilities and industrial firms

Resources

- Do regional and global integration cause harmful resource tax competition?
  - Cooperation in developing and employing best practices?
- Export taxes & other beneficiation incentives dissipate resource rents and revenues
  - Economic costs can be high (Indonesia – logs, rattan)
- Include this in regional investment codes?

Sales Taxes – VAT and Excises (1)

- Importance of collections at the border
  - Moving collection to external borders problematic, even in the EU; much more so in Africa (in EAC, what would it do to Uganda VAT?)
  - As with customs duties, differences in excise rates create subsidies for smugglers and put pressure on customs enforcement
  - Implications for border controls and trading costs

Sales Taxes – VAT and Excises (2)

- Scope for cooperation and coordination
  - Administrative reforms to reduce compliance costs (VAT in SACU; Lesotho-SA cooperation)
  - Base and rate restrictions to reduce compliance costs and incentive to smuggle (common excise in SACU; minimum rates and exemptions elsewhere)
  - Concerns about leakage in transit shipments; excess enforcement costs are borne by neighbors and impede regional integration

Priorities for Tax Coordination

- Query: if best practice is well known, why is coordination necessary?
  - negotiations vs race to the top; demonstration effects
- Coordination, improvement and simplification of tax administration at borders is certainly useful
  - Cooperation, technical assistance and information sharing among revenue agencies; improving trust and effectiveness

Sequencing Tax Coordination

- No ‘golden rules’ for sequencing tax coordination and harmonization
  - What might work best in African countries?
- Possible prioritization for harmonization of bases, rates and exemptions (differs from EU)
  - First, excises (rates and structure – smuggling)
  - Second CIT (exemptions and minimum rates) and state aid (latter has helped in EU);
  - Third, VAT (exemptions and minimum rates) (difficult even in EU)

Concluding Remarks

Fiscal Reform & Integration

- Fiscal reform is important
  - Mobilizing new and better revenue sources to meet resource requirements
  - Cooperation and reform to avoid unnecessary and often heavy-handed and harmful fiscal administration and enforcement

Growth & Fiscal Mobilization

- Economic growth is the surest route to sustained revenue mobilization
- Focus on facilitating trade and growth as well as immediate revenue implications of fiscal reform