Mobilizing Domestic Resources in South-East Asia through Tax Reforms

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Public finance is the financing backbone for sustainable development and infrastructure investment

The financing demand for the implementation of the 2030 Agenda for Sustainable Development is enormous

- $1.4 trillion of incremental spending annually would be required for low and low-middle income countries alone to achieve the Sustainable Development Goals (SDGs) by 2030;
- The public sector is expected to shoulder half of this financing demand.

Public finance still provides the bulk of the infrastructure financing in Asia-Pacific countries

- In most countries of the region, private investment in infrastructure remain limited;
- Public sector provides important seed investment, guarantees and grants for PPP projects, and in many cases remains the final payer for private sector services;
- Strong public credit also lowers the borrowing cost for PPP projects;

Domestic resource mobilization options for expanding fiscal space

Governments need to raise resources to invest in development

To expand their fiscal space, Governments can:

- Increase levels of debt
- Reprioritize existing expenditure and make it more development-oriented
- Increase non-tax revenues
- Increase tax revenues

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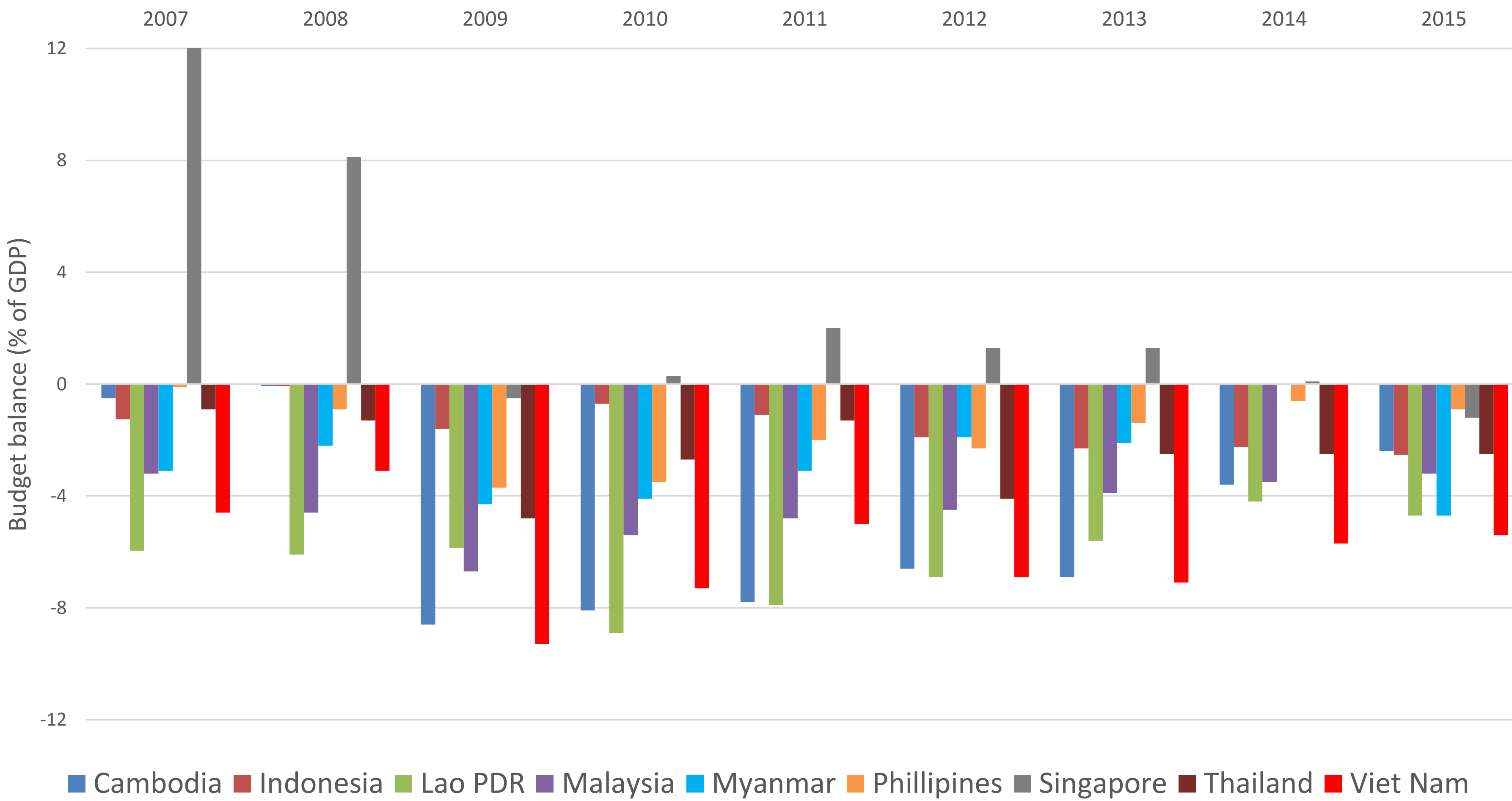
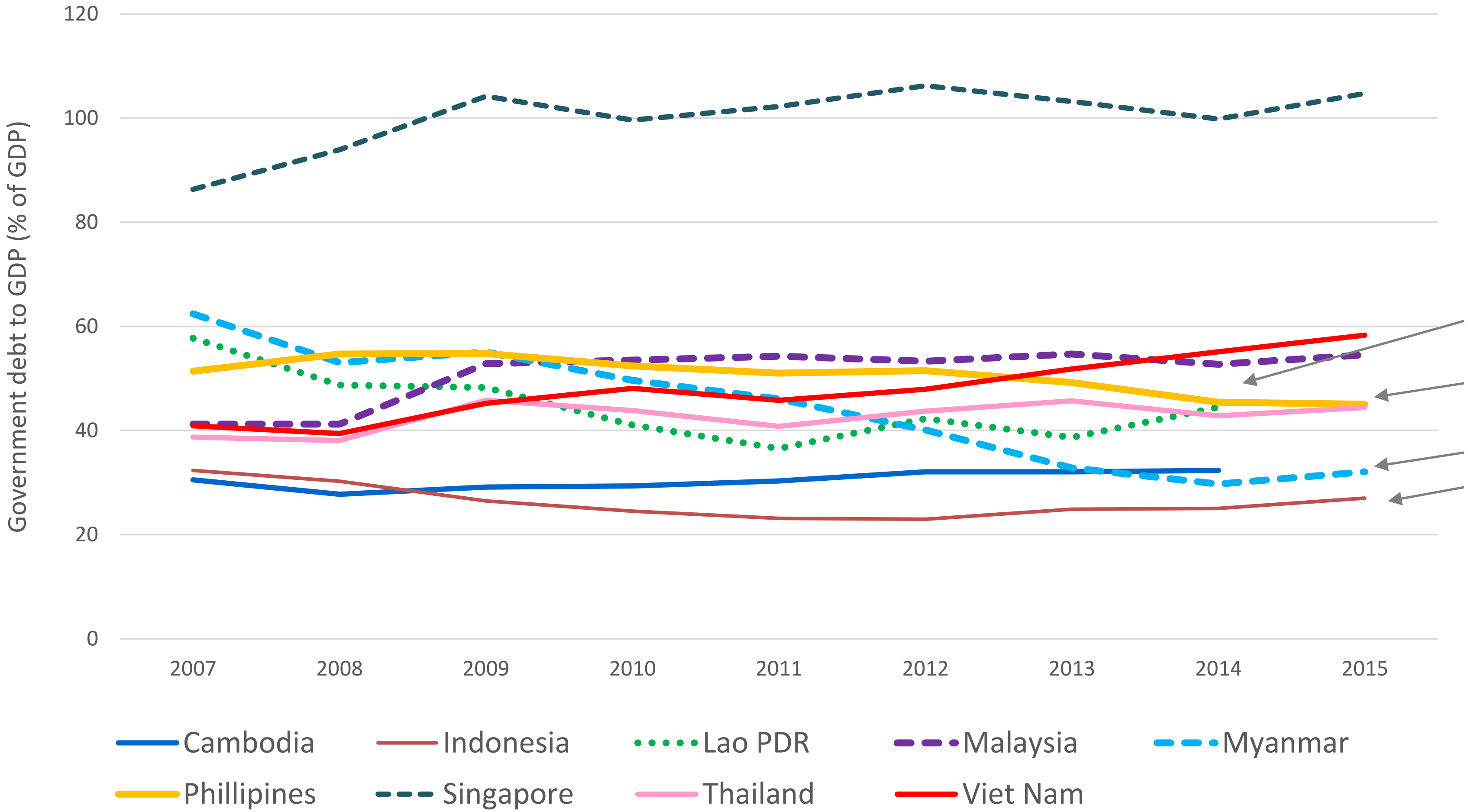
South-East Asian nations running budget deficits for years: a challenge for sustained infrastructure spending



Public debt remains moderate across the region, and some countries manage to reduce their indebtedness



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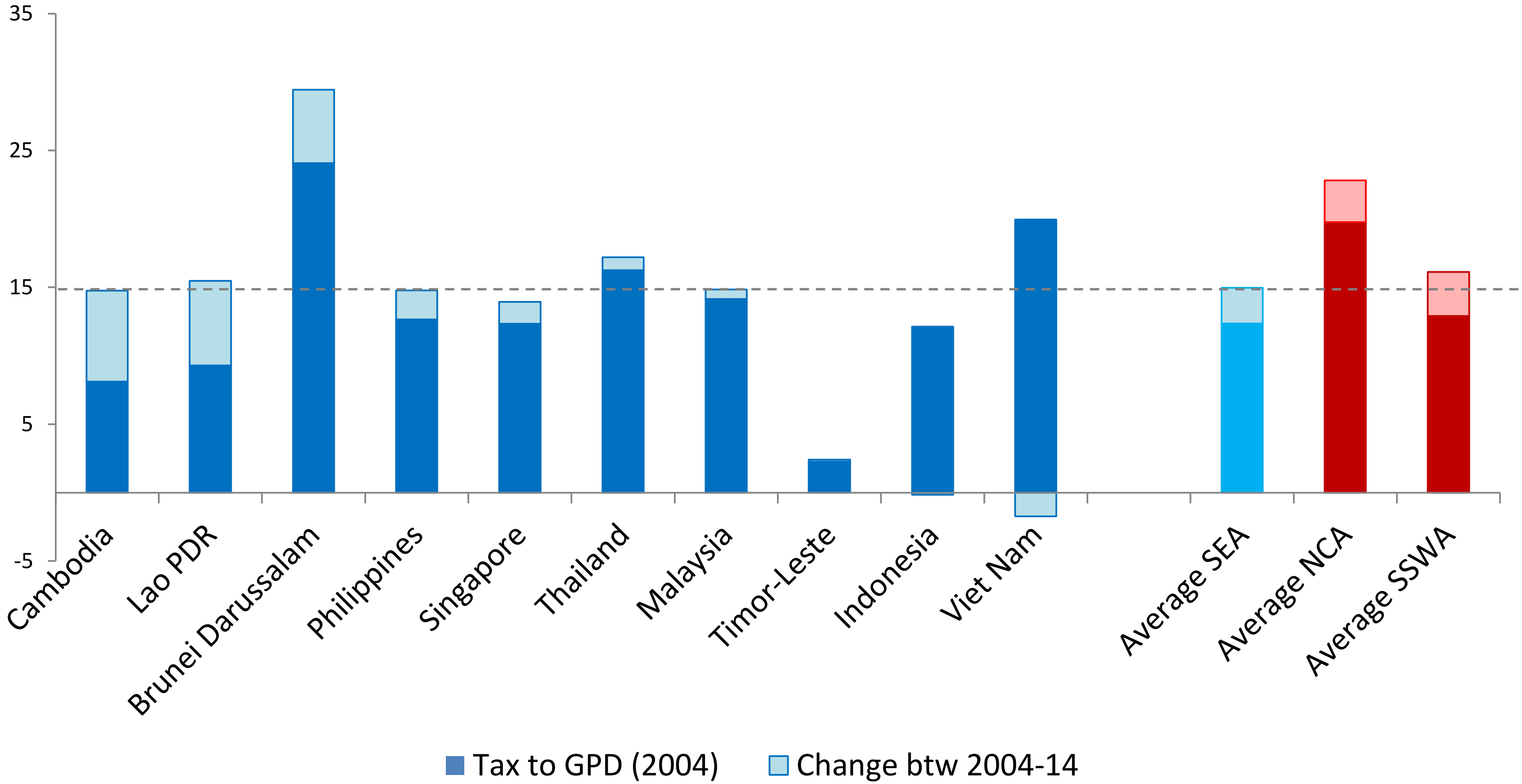
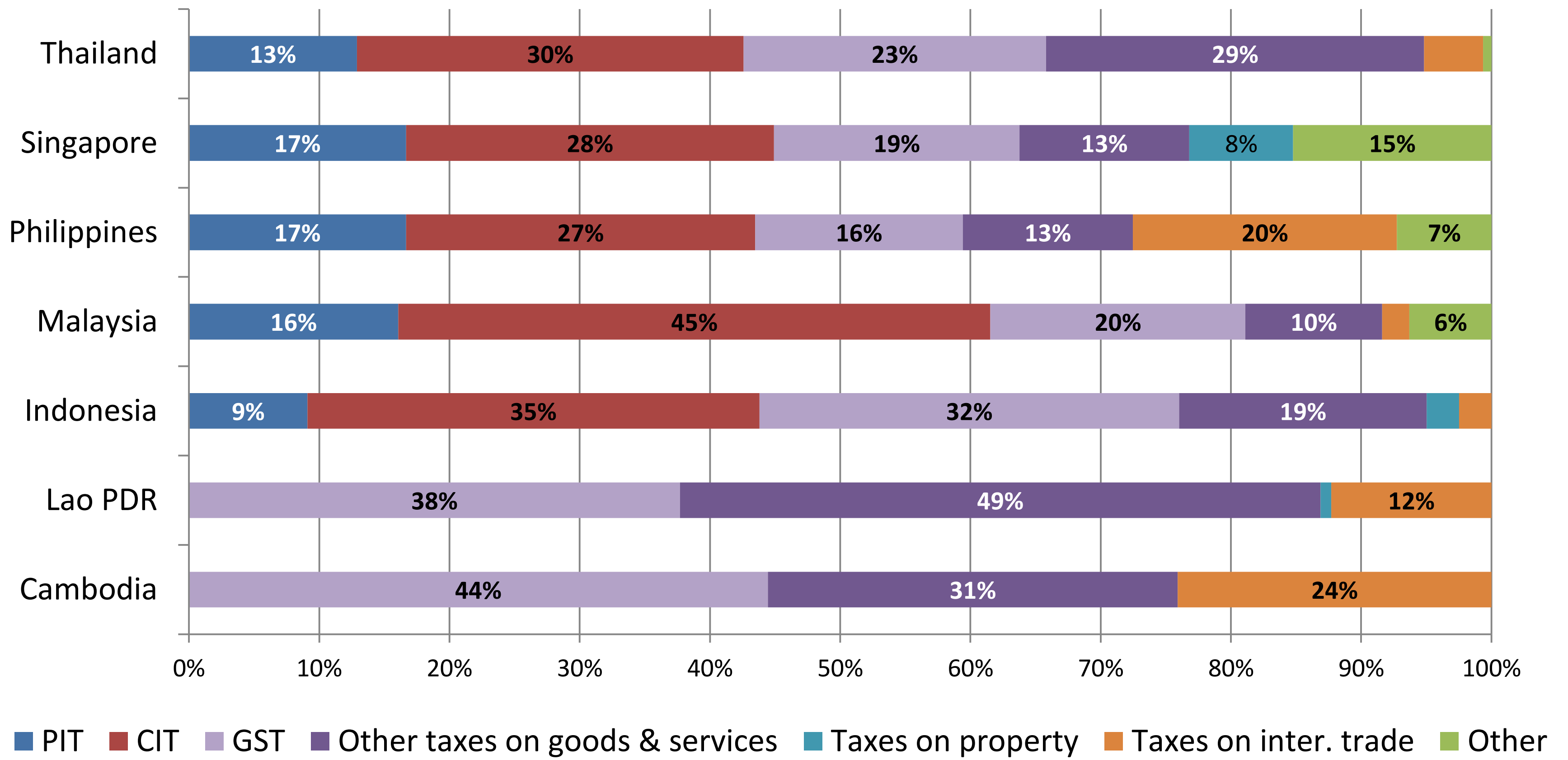
Tax revenue could finance infrastructure development, however SEA tax collection is lower than other subregions



Tax mix skewed to indirect taxes



Enhancing tax revenues – rethink tax incentives

	Number of Countries Surveyed	Tax holiday/Tax exemption	Reduced Tax rate	Investment allowance/Tax credit	R&D Tax Incentive	Super-deductions	SEZ/Free Zones/EPZ/Freeport	Discretionary process
East Asia and Pacific	12	92%	75%	67%	83%	33%	92%	83%
Eastern Europe and Central Asia	16	88%	38%	25%	31%	0%	100%	38%
Latin America and the Caribbean	25	88%	32%	52%	12%	4%	72%	40%
Middle East and North Africa	15	80%	40%	13%	0%	0%	80%	40%
OECD	33	21%	36%	64%	76%	21%	67%	33%
South Asia	7	100%	43%	71%	29%	71%	71%	43%
Sub-Saharan Africa	45	78%	62%	78%	11%	18%	64%	82%

Public resource mobilization at subnational levels – the case of cities

Asia-Pacific cities shoulder a large proportion of the infrastructure investment responsibilities

•A-P is at the center of the world's largest rural-urban transition in history;
•A-P is featured by megacities and city clusters, and the costs of provision of public transportation, ICT infrastructure, housing, urban environmental management are in the scale of trillions.

A-P subnational governments are often ill-equipped to meet this challenge

•The lack of fiscal autonomy and proper revenue tools often led to large vertical imbalances;
•Weak spending accountability and efficiency could be an obstacle for revenue enhancement efforts of local governments.

	Share of Total Public Expenditure				Share of Total Public revenue		
Country	Subnational	Upper Tier	Lower Tier		Subnational	Upper Tier	Lower Tier
Bangladesh	15	5	10		2	1	1
India	66	33	33		33	30	3
Indonesia	35	7	28		8	5.5	2.5
Japan	60	20	40		40	20	20
Republic of Korea	45	15	30		25	10	15
Pakistan	33	28	5		7	6.5	0.5
Philippines	25	11	14		10	2.5	7.5
China	70	20	50		40	15	25
Thailand	10	5	5		2	1	1
Viet Nam	45	30	15		35	25	10

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Public resource mobilization at subnational levels – property taxes

Property taxes are important for subnational governments, despite being minor revenue sources

•Property taxes currently contribute only an insignificant amount of revenue in South East Asia;

•Property taxes in developing A-P are viewed more as a luxury consumption tax and a policy tool to adjust housing market rather than a main revenue source;

•While property taxes are attractive for subnational governments, securing public support and effective tax administration is very challenging.

Subnational property tax as share of GDP, (%)

	1970s	1980s	1990s
OECD countries	1.24	1.31	1.44
(number of countries)	(16)	(18)	(16)
Developing countries	0.42	0.36	0.42
(number of countries)	(20)	(27)	(23)
Transition countries	0.34	0.59	0.54
(number of countries)	(1)	(4)	(20)
All countries	0.77	0.73	0.75
(number of countries)	(37)	(49)	(58)

Subnational property tax as share of subnational revenue, (%)

	1970s	1980s	1990s
OECD countries	17.4	17.0	17.9
(number of countries)	(16)	(17)	(16)
Developing countries	27.6	24.3	19.1
(number of countries)	(21)	(27)	(24)
Transition countries	6.7	8.51	8.8
(number of countries)	(1)	(4)	(20)
All countries	22.8	20.4	15.6
(number of countries)	(38)	(48)	(59)

Public resource mobilization at subnational levels – other revenue sources

Local business taxes

•Pros: easy to administer;

•Cons: “tax exporting” – for example, the burden of high business tax on locally registered businesses could be partially “exported” to partners and customers outside the jurisdiction; tax competition.

Local excise and sales taxes

•Pros: easy to administer; stable and significant revenues

•Cons: misallocation of resources and evasion in different subnational regions

Vehicle and transport taxes

•Pros: well-suited for subnational government given the strong link with the use of local infrastructure and services and with environmental benefits;

•Cons: opposition from automobile owners and producers; evasion in different subnational regions (owners will register where it is the cheapest)

Tax reform initiatives to strengthen revenue mobilization and improve tax administration

A number of Asia-Pacific developing countries have made ambitious reforms to meet the fiscal challenges in the aftermath of the global economic crisis and the financing demand for sustainable development

- Indonesia's tax amnesty campaign
- Cambodia's elimination of the Estimated Tax Regime to integrate the informal sector into formal tax systems
- India's reform of Good and Services Tax (GST)

Indonesia's tax amnesty campaign

Indonesia implemented a 9-month tax amnesty (from July 2016 to March 2017) program In an effort to increase its tax base

- Offer incentives and immunity from prosecution to tax evaders who declare and repatriate offshore funds;
- The incentives were also extended to Indonesians who decide to repatriate their funds and keep their money in the country for at least three years;
- The Tax Amnesty proved partially successful.

Cambodia’s elimination of the Estimated Tax Regime

In 2016, Cambodia eliminated the Estimated Tax Regime (ETR), one of the country’s most significant tax reforms in years

- ETR was designed to encourage small taxpayers in the informal regime to pay taxes. But in practice, it discouraged firms from entering the real tax system;
- The reform aims to streamline tax administration and more importantly better integrate the country’s large informal sector into the formal tax regime.
- It established an integrated corporate tax system with three tiers for small, medium, and large taxpayers;
- It also introduced a progressive tax rate regime based on profit levels and measures to ease the burden of small and medium firms transitioning into the formal tax system;

India’s reform of Good and Services Tax (GST)

The landmark good and services tax (GST) bill became effective in April 2017

- Aim to streamline the country’s fragmented tax system and contribute to the creation of an unified domestic market;
- Integrate 17 different central and state taxes in to a streamlined and more transparent GST system and reduce internal frictions caused by fragmented local tax regimes;
- Introduce the VAT principle to eliminate the cascading impact, reduce the tax burdens of manufacturers, and create incentives for honest reporting through input credit;
- Reduce tax exemptions at the same time.

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