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How can Cambodia, Lao PDR, Myanmar, and Viet Nam Cope with Revenue Lost Due to AFTA Tariff Reductions?

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Kanokpan Lao-Araya

November 2002

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Kanokpan Lao-Araya

November 2002

Kanokpan Lao-Araya is an Economist at the Economics and Research Department. The author wishes to thank V.N. Gnanathurai and Teruo Ujiie for guidance and supervision of the study. The paper also benefited from helpful comments from ADB colleagues Jayant Menon and Ernesto Pernia; and Tri Djandam and Anna Robeniol of the ASEAN Secretariat.

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Foreword

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Abstract

In joining the Association of Southeast Asian Nations (ASEAN) and ASEAN Free Trade Area (AFTA), the governments of Cambodia, Lao PDR, Myanmar, and Viet Nam have agreed to comply with the Common Effective Preferential Tariff (CEPT) Scheme, which reduces intra-ASEAN tariff rates on certain imports and may likely reduce government revenue. This study proposes tax structure and tax administration reforms and other complementary policies that these governments can introduce to safeguard and enhance revenue collection. First, they can strategically allocate goods among the four CEPT scheme lists. Second, the new member countries can improve their tax systems by replacing traditional general sales taxes with Value Added Tax and generally simplifying their tax structures. Third, they can reduce inefficiencies that impede tax collection by improving tax administration institutions and tools. Finally, they can improve their overall legal systems so as to discourage tax avoidance and evasion and reduce corruption among tax officials.

I. INTRODUCTION

For many years before their recent accession to the Association of Southeast Asian Nations (ASEAN), the governments of Cambodia, Lao PDR, Myanmar, and Viet Nam (CLMV) relied heavily on international trade taxes as a source of government revenue. As a precondition of joining the trade association these new member countries agreed to comply with the terms of the Common Effective Preferential Tariff (CEPT) scheme, which requires that ASEAN members reduce tariff rates for and eliminate quantitative restrictions and other nontariff barriers to intra-ASEAN trade. ASEAN adopted the CEPT scheme on the assumption that over the long term eliminating such tariffs will reduce the cost of and consequently increase the efficiency of intra-ASEAN trade. However, the new members, which are also sometimes collectively referred to as Southeast Asian Transitional Economies (SEATEs), generally assume that the presumed increase in trade volume will not manifest itself immediately and, therefore, they expect that in the short term the reduction of trade tariff rates will reduce their overall government revenue.

Assuming that these circumstances will thus reduce the amount of revenue that they derive from trade tariffs, the governments of CLMV will be forced to take one or a combination of three possible courses of action: reduce expenditure, borrow to finance increased deficit, or compensate for revenue loss. The Asian economic crisis of 1997 made governments in Southeast Asia acutely aware of the need to adequately fund poverty reduction and social protection programs. Therefore, the governments of CLMV are unlikely to be able to reduce expenditures substantially. In general, these countries are also reluctant to significantly increasing current levels of borrowing because doing so would not be fiscally sustainable in the long run, would indicate a lack of fiscal discipline, and would greatly increase public debt.

Without recourse to substantial expenditure cuts or increased borrowing, the new ASEAN member countries will need to reform their tax structures in order to find new sources of revenue to compensate for the shortfalls resulting from the reduction of revenue derived from trade tariffs. One major structural reform that some of these countries have already made is the substitution of value added tax (VAT) for general sales tax. This reform is especially promising because VAT is more broadly based than general sales tax and also because VAT complements a more export-oriented economic stance. This paper examines how this and other tax reforms are likely to help the new ASEAN members compensate for the expected short-term loss of revenue from trade tariffs. It also discusses other important tax administration and legal reforms that the governments of CLMV should consider to safeguard revenue collection in general. In addition, the paper analyzes how the new member countries can strategically participate in the CEPT scheme to make tariff revenue reduction gradual and less severe.

II. TAXATION IN DEVELOPING COUNTRIES

A. Developed versus Developing Countries

In considering the most advisable program of tax reform for the governments of the new ASEAN members, it is important to note that differing circumstances necessitate differing approaches to taxation in developing countries compared to developed countries. The incidence of market failure is higher in developing countries than in developed countries because developing markets are relatively less sophisticated and involve fewer market players. Developing countries are also much more susceptible to the immense negative effects of extreme poverty. Therefore, developing countries have a strong justification to intervene in the economy by resorting to such measures as corrective taxes and regulatory instruments. Given the magnitude of the economic and social problems that developing countries face, the potential advantages to be derived from governmental intervention outweigh the potential cost of governments acting unsuccessfully. Therefore, the task of taxation in developing countries is likely to be more substantial than it is in developed countries (Burgess and Stern 1993).

In developing countries governments need substantial resources to finance their activities, but they raise less tax revenue than their more developed counterparts. Total tax revenue to GDP is higher and direct taxes to GDP form a greater portion of total revenue in developed countries. By contrast, in developing countries nontax revenue constitutes a relatively higher proportion of total revenue (see Table 1). However, nontax revenue is neither as consistent nor as sustainable as tax revenue. Nontax revenue is defined as revenue remitted by departmental and public

Table 1. Tax Revenue by Type of Tax in Industrial and Developing Countries

Area	Income Taxes				Domestic Taxes			Foreign Taxes	Social Security	Other Taxes	Nontax Revenue
	Total	Individual	Corporate	Other	Total	General Sales, Turnover, VAT	Other				
Industrial	33.47	24.31	8.99	0.17	29.00	18.60	10.40	0.89	26.41	1.08	9.14
Developing	21.21	9.37	11.41	0.44	31.90	21.31	10.59	16.15	17.06	-5.64	19.31
Africa	23.49	10.75	9.85	2.89	26.55	15.07	11.48	29.51	6.60	-1.49	15.34
Asia	25.76	10.53	16.56	-1.33	32.95	19.11	13.84	14.68	6.65	-1.59	21.56
Europe	14.74	7.83	7.52	-0.61	40.84	27.22	13.62	4.95	27.23	0.55	11.68
Middle East	17.75	13.10	10.34	-5.69	17.01	8.69	8.33	10.01	7.50	-0.90	48.63
Western Hemisphere	23.04	6.64	14.48	1.92	35.20	25.67	9.52	15.49	14.94	-5.30	16.63

Notes: Within the total of 108 developing countries there are 29 in Africa, 19 in Asia, 24 in Europe, 11 in the Middle East, and 25 in the Western Hemisphere region. The total number of industrial countries is 24.

Source: *Government Finance Statistics Yearbook* (IMF 2001).

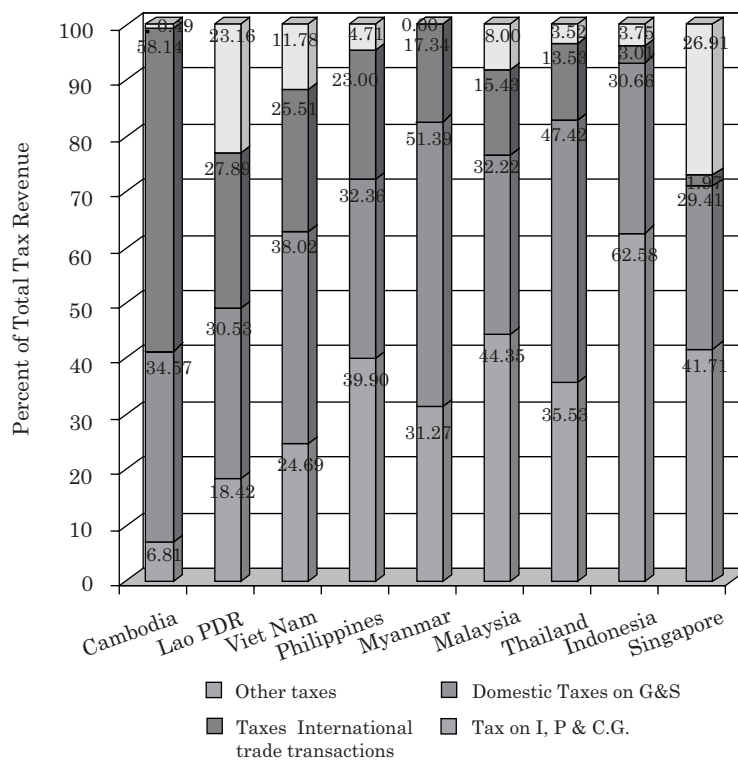
enterprises from entrepreneurial and property income and administrative fees and charges. Many liberalized developing countries plan to privatize public enterprises because the private sector can perform those economic functions more efficiently. Because nontax revenue will therefore decline, these governments must garner more tax revenue. These facts all serve to suggest that, in consideration of overall economic priorities, developing countries urgently need to improve tax collection more than developed countries.

B. ASEAN Countries

1. Tax Revenue Collection

The case of Cambodia provides an excellent example of how important tariffs are as a source of overall tax revenue in the new ASEAN member countries. In 1997, 58.1 percent of total tax revenue collected in Cambodia came from international trade taxes. Among the new ASEAN members, trade taxes constitute an average of 32.1 percent of overall tax revenue compared with the figure of 11.4 percent for old members (see Figure 1). This suggests that among the new ASEAN members trade tariffs have been used not only to protect domestic producers from import competition but also that the governments of these countries have been relying on tariffs as a

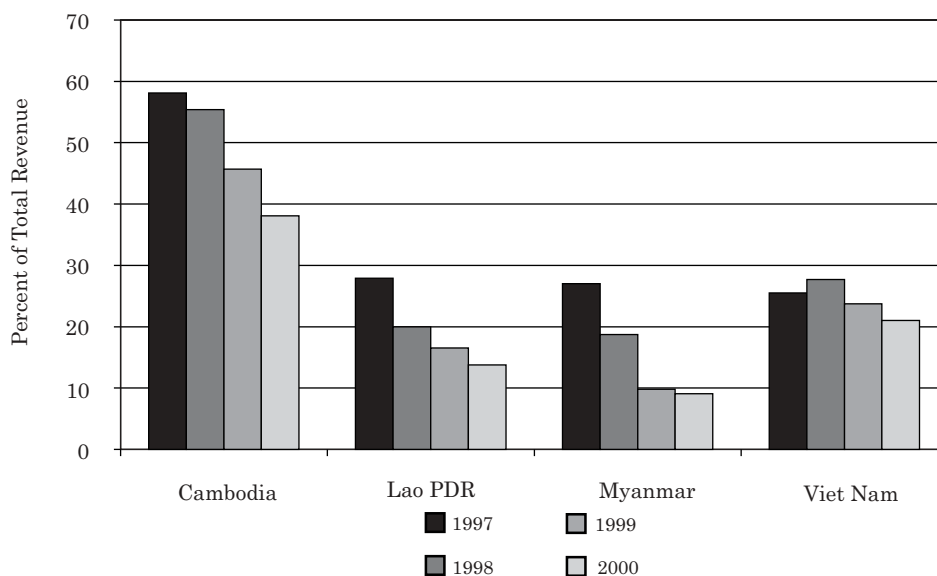
Figure 1. Tax Revenue by Type of Tax in ASEAN Countries in 1997



Sources: *Government Finance Statistics Yearbook* (IMF 2001), IMF's Country Reports for Cambodia and Lao PDR.

significant source of government revenue. Unfortunately for these countries, their adoption of the CEPT scheme is likely to reduce their overall revenue because the scheme reduces inter-ASEAN tariff rates (see Figure 2). This change will be especially challenging for the new ASEAN members because their tax bases have always been quite small, which means that they have limited options for shifting this tax burden elsewhere. Informal and nonmonetarized activities, which by their nature are not taxable, constitute a significant portion of the domestic economies of these countries. The bases for direct taxes on such items as income, profits, and capital gains are also highly restricted.

Figure 2. Taxes on International Trade in SEATEs 1997-2000



Sources: IMF Country Reports and *Government Finance Statistics Yearbook 2001*.

The tax bases of the new ASEAN member countries are restricted because there are very few taxpayers in their formal sectors who have high taxable income or consumption. Consequently, the governments of CLMV have low ratios of tax revenue to GDP. In Cambodia and Myanmar tax revenue constitutes less than 10 percent of GDP (see Table 2). This suggests that Cambodia and Myanmar are not putting enough effort into revenue collection and that perhaps excessive administrative constraints were already limiting their revenue regime prior to their ASEAN accessions. Since their accessions to ASEAN, the ratios of total revenue to GDP in CLMV have been falling. This phenomenon should motivate the governments of CLMV to begin efforts now to compensate for such potential revenue loss throughout the 10-year period during which CEPT is to be implemented.

Table 2. Total Revenue in the New ASEAN Member Countries

Fiscal Year	1995	1996	1997	1998	1999	2000	2001
Total Revenue to GDP							
Cambodia	n.a.	n.a.	9.6	9.0	11.5	11.8	12.8 ^b
Lao PDR	n.a.	n.a.	11.3	9.8	10.6	12.7 ^e	14.9 ^b
Myanmar	n.a.	n.a.	6.7	7.8	7.3	5.3 ^e	n.a.
Viet Nam	22.6	22.3	20.0	19.6	19.2	20.7	18.5 ^b
Tax Revenue to GDP							
Cambodia	n.a.	n.a.	6.5	6.5	8.3	8.6	9.2 ^b
Lao PDR	n.a.	n.a.	9.3	7.8	8.5	10.4 ^e	11.8 ^b
Myanmar	n.a.	n.a.	3.7	4.1	3.3	2.5 ^e	n.a.
Viet Nam	17.5	18.5	15.8	15.4	15.2	14.9	14.4 ^b
Tax on International Trade to GDP							
Cambodia	n.a.	n.a.	3.8	3.6	3.8	3.3	2.9 ^b
Lao PDR	n.a.	n.a.	3.2	2.7	2.9	2.7 ^e	3.6 ^b
Myanmar	n.a.	n.a.	0.1	0.1	0.0	0.0 ^e	n.a.
Viet Nam	5.8	5.6	4.3	4.1	3.6	3.1	3.3 ^b

Note: Superscript b denotes budget. Superscript e denotes estimation by IMF staff.
Sources: Recent IMF Country Reports for Cambodia, Lao PDR, Myanmar, and Viet Nam.

2. Institutional Tax Structure

In considering the tax revenue disparity between developing and developed countries, it is tempting to assume that the cause stems from a difference between institutional structures, or in other words, that developed countries employ superior tax regimes and impose higher tax rates. However, upon closer examination, it becomes clear that the institutional structures and statutory rates do not differ significantly, which in turn suggests that the solution to this problem must be sought elsewhere. This section and Table 3 compare the personal income, corporate income, and domestic consumption tax rates of ASEAN and selected Organization for Economic Co-operation and Development (OECD) countries.

The rates for the top brackets of personal income tax in the selected developed countries are higher than those of ASEAN-6¹ but comparable to those of the SEATEs, except for Cambodia. However, there are generally more brackets of taxable personal income in the ASEAN countries than in the selected OECD countries. This relatively larger number of income brackets suggests that the governments of the ASEAN countries are trying to use personal income tax to effect income redistribution.

Corporate income tax rates are generally the same in both ASEAN and OECD countries, the only noticeable difference being that some of the countries employ a single corporate income tax rate while others use multiple rates.

¹ ASEAN-6 refers to the first six ASEAN members.

Table 3. Tax Rates for Major Taxes in ASEAN and Selected OECD Countries

Countries	Personal Income Tax		Corporate Income Tax		Consumption Tax Tax Rates & Type
	Tax Rates (percent)	No. of Brackets	Tax Rates (percent)	No. of Brackets	
ASEAN-6					
Brunei	none	none	30	1	None
Indonesia	5-35	5	10, 15, 30	3	10% VAT
Malaysia	1-29	9	28	1	5, 10, 15% sales tax
Philippines	5-32	7	32	1	10% VAT
Singapore	3-26	9	26	1	3% sales tax
Thailand	5-33	5	30	1	7% VAT ¹
Southeast Asian Transitional Economies (SEATEs)					
Cambodia	5-20	4	9, 20, 30	3	10% VAT, 2% turnover tax
Lao PDR	5-40	8	20	1	5, 10% turnover tax
Myanmar	3-50	11	5-25		10% VAT on services, and multiple-rate (5-30%) turnover tax ²
Viet Nam	10-50	6	45	1	5, 10, 20% VAT
Selected OECD Countries					
Japan	10-37	4	30	1	5% sales tax
United States	15-39.6	5	15-35	4	Different in each state (0-8%), sales tax
United Kingdom	10-40	3	10-30	5	17.5% VAT
Germany	19.9-48.5	3	25	1	16% VAT
France	8.25-53.25	6	33.33	1	19.6 VAT

Notes:

¹ VAT rate in Thailand will be reversed to 10% on 1 October 2002 if there is no further amendment.

² The turnover tax is called Commercial Tax. It is levied on domestically produced and imported goods and services.

In general, the OECD countries employ higher domestic consumption tax rates than the ASEAN countries. Value Added Tax (VAT) is the most popular type of consumption tax both in OECD countries and among the original ASEAN member countries. Among the new ASEAN members, Cambodia and Viet Nam have already adopted the VAT as their comprehensive consumption tax. However, Lao PDR is only considering adopting VAT in 2004 and Myanmar has no plan to comprehensively implement VAT (see Table 4). At present Myanmar imposes VAT on a limited number of services, primarily on hotels in the capital region.

Table 4. Chronological History of ASEAN Membership and the VAT Adoption

ASEAN Membership	
8 Aug 1967	ASEAN was established in Bangkok, Thailand, with five member countries: Indonesia, Malaysia, Philippines, Singapore, and Thailand
8 Jan 1984	Brunei Darussalam joined ASEAN.
28 Jul 1995	Viet Nam joined ASEAN.
24 Jul 1997	Lao PDR and Myanmar joined ASEAN.
30 Apr 1999	Cambodia joined ASEAN.
VAT Introduction	
1999	Cambodia
1999	Viet Nam
2004 ¹	Lao PDR
No plan	Myanmar

¹ According to Draft IMF/WB/ADB Report on Lao PDR: Public Expenditure Review (IMF 2002c).

III. IMPACTS OF CEPT AGREEMENTS

A. CEPT and AFTA

The CEPT scheme is a cooperative arrangement among ASEAN member countries that reduces intraregional tariffs and nontariff barriers (NTBs). Signatory countries agree to remove nontariff barriers within five years after joining CEPT. According to the scheme, members agree to gradually reduce intraregional tariffs on imported goods² to 0-5 percent over a 10-year period. ASEAN-6 countries started to implement the CEPT on 1 January 1993. Cambodia, Lao PDR, Myanmar, and Viet Nam will implement the CEPT Scheme on a different schedule. Viet Nam will reduce tariffs on all manufactured goods to 0-5 percent by 2006, Lao PDR and Myanmar by 2008, and Cambodia by 2010.

The CEPT scheme is expected to make ASEAN's manufacturing sector more efficient and competitive in the global market. AFTA has become a larger market for manufacturing producers within the region. Investors can enjoy economies of scale in production. Through this arrangement, ASEAN hopes to enhance competitiveness, improve the investment climate, and attract foreign direct investment.

B. CEPT Product List

Under the CEPT scheme, each ASEAN member country must independently allocate goods that are subject to tariffs to one of four lists. The four lists determine the schedules according

² Imported goods include both (1) manufactured and processed agricultural products and (2) unprocessed agricultural and products. At least 40 percent of the contents must originate from any member of ASEAN in order to be considered as ASEAN products.

to which each country will reduce tariff rates on listed goods. The names of the lists are: Inclusion List (IL), Temporary Exclusion List (TEL), Sensitive List (SL), and General Exception List (GEL). The schedules for tariff rate reductions are also determined by the nature of the goods; manufactured and processed agricultural products are subject to earlier rate reductions, not the nonprocessed agricultural products.

The IL contains goods on which each country agrees to reduce tariff rates within 10 years to 0-5 percent. The IL is also subdivided into two tracks, the Normal Track and the Fast Track. Each member is free to reduce tariff rates on goods in the Normal Track at any time over the 10-year period. However, members are also encouraged to place as many goods as possible on the Fast Track and to reduce tariff rates on goods in that track within five to eight years.

The TEL is intended to give countries leeway to put off tariff rate reductions on certain goods of concern. Countries need not begin to reduce tariff rates on goods in the TEL during the first three years after joining CEPT. Thereafter, goods in the TEL are to be transferred to the IL gradually. The ASEAN secretariat recommends that members transfer goods from the TEL to the IL in five equal installments so as to evenly distribute the revenue impact of tariff rate reductions.

The SL is meant to contain unprocessed agricultural goods that are of even greater concern to the member than those contained in the TEL. Eventually each member must reduce to 0-5 percent the tariff rates on goods in the SL, but these reductions need not begin earlier than eight years after joining CEPT, and members are given a period of nine years to complete those reductions.

Finally, the GEL contains goods that are not subject to tariff rate reductions. The provision on General Exceptions in the CEPT Agreement is consistent with Article X of the General Agreement on Tariffs and Trade (GATT). Goods may be placed on the GEL if such listing is deemed necessary for protecting national security, public morals, human/animal/plant life, and health. General Exception is also allowed for goods of artistic, historic, or archaeological value. General Exception is normally applied to arms and weapons, alcoholic beverages,³ and tobacco products.

Once a member country has allocated goods to the four lists, it must submit its results to the ASEAN Council for approval. The lists are also reviewed annually and are thus subject to annual revision. Since all members must reduce tariff rates on goods in the IL within 10 years, the ASEAN-6 countries must do so by 1 January 2003, Viet Nam by 2006, Lao PDR and Myanmar by 2008, and Cambodia by 2010. In addition to reducing tariff rates on goods in the IL, countries must remove quantitative restrictions and nontariff barriers on those goods (see Table 5).

³ Alcoholic beverages are classified under the GEL in all ASEAN countries except Myanmar, Philippines, and Thailand.

Table 5. Schedule for Tariff Reduction under the CEPT Agreements

Country	Manufactured and Processed Agricultural Goods		Unprocessed Agricultural Goods		
	IL	TEL	IL	TEL	SL
ASEAN-6	(NT) 1993-2003 (FT) 1993-2000	1996-2003	1996-2003	1997-2003	2001-2010
Viet Nam	(NT) 1996-2006 (FT) 1996-2003	1999-2006	1999-2006	2000-2006	2004-2013
Lao PDR and Myanmar	(NT) 1998-2008 (FT) 1998-2005	2001-2008	2001-2008	2002-2008	2006-2015
Cambodia	(NT) 2000-2010 (FT) 2000-2007)	2003-2010	2003-2010	2004-2010	2008-2017

Notes:

¹ IL means Inclusion List. Products in this list are subject to tariff rate reduction of 0-5 percent in 10 years.

² TEL means Temporary Exclusion List. Products in the TEL will be phased into the IL during the first five years in five equal annual installments.

³ SL means Sensitive List. This contains unprocessed agricultural products that will be phased in for tariff reduction in 10 years.

⁴ NT means Normal Track. Products classified under NT are subject to tariff rate reduction of 0-5 percent in 10 years.

⁵ FT means Fast Track. Products classified under FT are subject to tariff rate reduction of 0-5 percent in 5-8 years.

Source: <http://www.moc.go.th/thai/dbecoco/rt/asean/afta.htm>

C. Eligibility for CEPT Tariff Rate Reductions

In order for an exporter to enjoy reduced tariff rates under the CEPT scheme, the exported good must appear in the ILs of both the exporting and importing countries, must have been approved by the AFTA Council as part of a tariff reduction program, and no less than 40 percent of its content must have originated from ASEAN member countries.⁴ Within the AFTA, each ASEAN member country has the right to set tariff rates on imports in accordance with the CEPT scheme. Therefore, one product may be subject to different tariff rates depending on which country in the free trade area imports the good. Under other regional trade agreements such the European Union, all member countries must apply the same tariff rates to the same imported goods.

D. Strategic Compliance with the CEPT Scheme

The AFTA is one of the least restrictive regional trading arrangements.⁵ Although members must remove barriers to intra-ASEAN trade, they are individually free to impose trade barriers

⁴ The local requirement refers to both single country and cumulative ASEAN content.

⁵ Custom unions, common markets, and economic unions require that member countries adopt not only uniform tariff rates on same products but also common external commercial relations such as a common external tariff.

on nonmembers. This stands in contrast to the European Union (EU) and Mercosur (Argentina, Brazil, Paraguay, and Uruguay), in which members must impose uniform tariff rates on nonmember countries. The CEPT scheme also gives members freedom to set tariffs on intra-ASEAN trade at any rate between 0 and 5 percent. Furthermore, due to the Asian financial crisis of 1997, certain long-standing member countries have not fully complied with requirements of the CEPT scheme in spite of written deadlines, a fact that has not resulted in their exclusion from AFTA. Although this is not to suggest that the new member countries should join the free trade area with the intention of not complying with CEPT requirements, they must take into consideration the actual behavior of other members as well as any emergency circumstances that may arise.

According to the CEPT schedule, by 2017 all of the current ASEAN member countries must reduce intra-ASEAN tariff rates on all but General Exception goods to a maximum of 5 percent (Table 5). Consequently, the new ASEAN members have considerable freedom to determine how they will comply with the CEPT scheme. In one respect, the new members are free to set tariff rates on various goods in their IL anywhere in the range of 0-5 percent, which calls for careful consideration. The new ASEAN members must be careful to avoid overambitiously reducing tariff rates to 0 percent, as Lao PDR has done with certain goods. In another respect, the new members are also free to determine which goods they will place on which list according to the strategic importance of those goods.

It is important for the new ASEAN members to identify which goods they can or might be able to produce with a relative competitive edge so that they can add those products to their ILs and benefit from reduced tariffs when exporting those goods to other ASEAN countries. At the same time, they must also identify which of their own domestic industries need more time to adjust to trade liberalization so that they can place those goods on their TELs or SLs. Unfortunately, it is not easy to identify which industries might enjoy a comparative advantage. Doing so requires that countries make accurate projections based on comprehensive information from both the formal and informal sectors.

The ASEAN-6 member countries have not strictly observed CEPT tariff rate reduction schedules, especially since the outbreak of the 1997 Asian financial crisis. Certain countries have yet to add numerous goods to their ILs even though their under-10-year limit has nearly expired. After the Asian financial crisis, the Malaysian government postponed the transfer of certain automotive products from their TEL to their IL from the originally scheduled date of 1 January 2003 to 2005.⁶ Some ASEAN members have recently been calling into question the practicality of rules of origin for intra-ASEAN imports. It is particularly difficult for the less developed new ASEAN member countries to identify the origins of imported goods' content. Singapore has signed and is discussing more bilateral free trade agreements with several other non-ASEAN members. Some ASEAN member countries are concerned that goods from nonmember countries will flow into ASEAN and enjoy the intra-ASEAN lower tariff rates via their routing through Singapore.

⁶ These are 218 line items in Malaysia's TEL that are Completely Build-up and Completely Knock-Down automotive products.

E. Revenue Impact of CEPT

The CEPT scheme seeks to make possible a freer flow of trade by reducing the inhibiting factor of trade tariffs, which in turn is intended to facilitate local specialization and wealth creation. This advantage brings with it the expense of potentially reducing the revenue that member countries derive from tariff revenues. Thus CEPT creates a trade-off between facilitating overall free trade and reducing governmental tariff revenues. Countries that depend heavily on international trade taxes as a source of governmental revenue stand to lose more than others. Thus, countries like Cambodia, where the majority of total tax revenue derives from trade taxes, are more concerned about the revenue cost of participating in AFTA than they are about the benefit that ASEAN membership might bring in terms of export promotion (Menon 1998).

Menon (2000) analyzed the effect that the CEPT scheme would have on revenue in Lao PDR and concluded that the size of shortfall in revenue derived from tariffs would be moderate. Menon discussed several factors that suggest this conclusion, namely: (i) economic growth will lead to an increase in the volume of imports, (ii) a significant share of tariff revenue in the SEATEs is collected on goods that are in the GEL such as alcoholic beverages and cigarettes, and (iii) the share of formal trade on which tariffs can be levied will increase, since there is less incentive for smuggling when tariff rates are low. Menon also concluded that the overall impact of revenue from trade taxes in the absence of significant trade diversion would depend on (i) the size of the tariff reduction; (ii) the growth in recorded imports as a result of tariff cuts; and (iii) indirectly, through the increase in economic activity associated with trade liberalization.

The following sections investigate what impact joining the CEPT scheme will have on tariff revenue in the new ASEAN member countries, taking into consideration how much revenue will be lost as a result of tariff rate reduction, growth in imports, and tax reforms. Table 6 summarizes the framework used to analyze the revenue impact of the CEPT.

1. Tax Revenue Reduction

This section estimates the baseline scenario in which import patterns do not change and no tax reforms are implemented. In estimating revenue loss, one must factor in the scheduled transfers of line item goods from other lists to the Inclusion List. Each new ASEAN member has adopted its own unique initial CEPT Product List and transferring schedule (see Table 5).

Ideally, the estimation for revenue loss should be based on all individual line items of the imported goods in the CEPT Product List. The latest schedule to which each country has committed itself for reducing tariff rates on each line item in the CEPT scheme, called 2001 CEPT package, is available for all member countries including the SEATEs. This information is posted on the ASEAN Secretariat website. Table 7 summarizes the allocation of traded products among the four CEPT lists.

Table 6. Framework for Revenue Impact of the CEPT

Issues	Considerations	Criteria
Tax Revenue Reduction	<ul style="list-style-type: none"> • Pre-accession tariff rates of tariff lines in the CEPT Product List • Nature of pre-AFTA imported goods: GEL, SL, or normal goods • Import concentration: from ASEAN or non-ASEAN countries 	<ul style="list-style-type: none"> • The higher the proportion is for the low-tariff-rate items in the CEPT List, the lower will be the loss • If a big share of imports will remain in the GEL, then the tariff revenue reduction will not be prominent
Growth in (Recorded) Imports	<ul style="list-style-type: none"> • Smuggling Premium (s), pre-AFTA (t(1)) versus post-AFTA tariff rates (t(2)) • VAT on smuggling goods (v) in the source country (see Menon 1999) • Price elasticity of imported goods 	<ul style="list-style-type: none"> • Unrecorded imports will transform to recorded imports if $t(1) > s+v > s > t(2)$. • Reduction in prices of imports induces a higher volume of consumption such that revenue from trade taxes does not decline much
Tax Reforms	<ul style="list-style-type: none"> • Surcharges on luxury imports • Indirect taxes and direct taxes 	<ul style="list-style-type: none"> • Surcharges on luxury and inelastic imports will lead to higher total trade tax revenue despite lowering tariff rates • An introduction of VAT, a broad-based consumption tax, can supplement tax revenue collection • Improvement of tax administration of direct taxes on individuals and companies can lead to higher total tax revenue

Unfortunately, there are no widely disseminated statistics on either intra-ASEAN import value or on volume for each line item for each of the subject countries. Such statistics can only be obtained by inquiring with the customs departments of the respective countries. Due to resource limitations, that data was not available for this study. Customs departments are generally reluctant to publicly disclose detailed information about disaggregated values and volumes of trade because governments normally use this information to set revenue targets. The sensitivity of such data makes it difficult to quantitatively assess revenue loss from tariff rate reductions.

In lieu of the abovementioned data, it is also possible to assess revenue loss by examining the volume of each country's intra-ASEAN imports along with its average tariff rate and the schedule of tariff reduction. The more each country relies on intra-ASEAN imports, the more revenue will be lost from the reduction to tariff rates in the baseline scenario. Since the CEPT scheme will reduce tariff rates to 0-5 percent, any country that previously imposed tariff rates much higher than 5 percent will lose relatively more revenue as a result of tariff rate reductions.

Table 7. **CEPT Product List for 2001**

Country	IL	TEL	SL	GEL	Total
ASEAN-6					
Brunei	6,284	0	6	202	6,492
Indonesia	7,190	21	4	68	7,283
Malaysia	9,654	218	83	53	10,008
Philippines	5,622	6	50	16	5,694
Singapore	5,821	0	0	38	5,859
Thailand	9,104	0	7	0	9,111
ASEAN-6 Total	43,675	245	150	377	44,447
(percent)	(98.3)	(0.6)	(0.3)	(0.8)	(100.0)
SEATEs					
Cambodia	3,115	3,523	50	134	6,822
Lao PDR	1,673	1,716	88	74	3,551
Myanmar	2,984	2,419	21	48	5,472
Viet Nam	4,233	757	51	196	5,237
SEATEs Total	12,005	8,415	210	452	21,082
(percent)	(57.0)	(39.9)	(1.0)	(2.1)	(100.0)
ASEAN Total					
(percent)	55,680 (84.7)	8,660 (13.4)	829 (1.3)	360 (0.6)	65,529 (100.0)

Source: ASEAN Secretariat (http://www.aseansec.org/economic/afta/tab3_14.htm).

It is difficult to find statistical evidence of the magnitude of intra-ASEAN imports for Cambodia, Lao PDR, Myanmar, and Viet Nam. No single source states which of these countries' imports originate from ASEAN or non-ASEAN countries. The ASEAN website only provides this information for the original ASEAN-6 countries. Fortunately, the *Key Indicators 2002* (ADB 2002) does document the direction of imports from the top 10 imported sources. This information can be used as a proxy for the import volume for the subject countries (see Table 8). The *Handbook of Statistics 2001* (UNCTAD 2001) also provides some insights about imports from ASEAN for these countries but there is no precise data (see Table 9). There is no such data in the IMF's *DOT Statistics Quarterly* either.

Table 8 presents an approximation of intra-ASEAN imports for Cambodia, Lao PDR, Myanmar, and Viet Nam. In 2001 the ratio of imports from other ASEAN members to total imports was highest for Lao PDR (at least 82.7 percent), followed by Cambodia (at least 53.2 percent), Myanmar (at least 41.0 percent), and Viet Nam (at least 24.9 percent).

Table 8. Direction of Imports to SEATEs in 2001¹

	Cambodia	Lao PDR	Myanmar	Vietnam
Value (million US dollars)				
Total	2,183.4	859.7	2,806.2	16,652.7
Thailand	513.2	451.7	390.5	872.2
Singapore	406.9	28.9	465.6	2315.7
Malaysia	66.5	n.a.	224.5	523.5
Viet Nam	100.7	230.8	n.a.	0.0
Indonesia	73.8	n.a.	70.9	428.1
ASEAN ²	1,161	711.4	1,151.5	4,139.5
PRC	169.7	49.4	611.3	2032.9
Hong Kong, China	288.5	9.8	79.8	602.6
Korea, Rep. of	111.7	6.9	255.3	1904.8
Japan	52.4	12.6	199.6	1986.2
India	n.a.	n.a.	73.9	n.a.
United States	n.a.	n.a.	n.a.	499.6
France	52.5	8.4	n.a.	442.4
Germany	n.a.	2.7	25.3	n.a.
United Kingdom	n.a.	3.6	n.a.	n.a.
Percentage				
Total	100.0	100.0	100.0	100.0
Thailand	23.5	52.5	13.9	5.2
Singapore	23.5	3.4	16.6	13.9
Malaysia	3.0	n.a.	8.0	3.1
Viet Nam	4.6	26.8	n.a.	0.0
Indonesia	3.4	n.a.	2.5	2.6
ASEAN	53.2	82.7	41.0	24.9
PRC	7.8	5.7	21.8	12.2
Hong Kong, China	13.2	1.1	2.8	3.6
Korea, Rep. of	5.1	0.8	9.1	11.4
Japan	2.4	1.5	7.1	11.9
India	n.a.	n.a.	2.6	n.a.
United States	n.a.	n.a.	n.a.	3.0
France	2.4	1.0	n.a.	2.7
Germany	n.a.	0.3	0.9	n.a.
United Kingdom	n.a.	0.4	n.a.	n.a.

¹ From the first ten countries with the highest import value.

² This is not the total intra-ASEAN trade value. For the four member countries, statistics are only available for value of trade with Indonesia, Malaysia, Singapore, Thailand, and Viet Nam.

Source: *Key Indicators 2002* (ADB 2002).

If a member country imported a certain volume of a line item from other ASEAN countries prior to the reduction of tariff rates, one may assume that the country will continue to import at least that same volume, if not more. This is because the CEPT concessions will only reduce the cost of importing goods from another ASEAN member country. Hence, the ratio of intra-ASEAN imports to total imports should increase and not decrease for goods in a country's Inclusion List.

Table 9. Import Structure by Main Regions of Origin for SEATEs (percent)

Origin Destination	Year	World (millions of USD)	Developed Market Economy Countries				Developing Countries and Territories			
			Total	EU	US and Canada	Japan	Eastern European Countries	Total	West Asia ¹	Other Asia ²
Cambodia	1990	56	37.5	25.7	0.0	9.0	2.5	60.0	3.5	55.8
	1995	1573	15.6	6.9	2.0	5.4	0.1	82.6	0.0	82.5
	1999	1241	18.6	7.4	3.4	6.0	0.9	68.4	0.0	68.3
	2000	2002	12.1	6.0	1.7	3.1	0.3	79.0	0.0	78.9
Lao PDR	1990	149	25.9	9.0	0.8	14.5	0.0	73.6	0.1	73.2
	1995	589	9.8	1.2	0.3	8.3	0.5	61.6	0.0	61.6
	1999	629	10.4	5.8	0.2	4.0	0.9	86.6	0.0	86.6
	2000	657	13.9	7.9	0.7	4.3	0.4	83.5	0.0	83.4
Myanmar	1980	785	78.0	20.9	7.0	43.7	3.8	18.1	0.0	15.7
	1990	668	42.1	15.5	3.1	16.6	2.2	55.6	0.1	52.6
	1995	2247	17.2	7.7	0.8	7.7	1.0	80.7	0.1	80.5
	1999	2214	16.9	6.1	0.6	9.2	0.3	77.4	0.2	77.1
	2000	2433	15.8	4.9	0.8	8.8	0.5	78.7	0.2	78.4
Viet Nam	1990	2842	16.4	9.4	0.2	5.9	11.4	28.5	0.0	28.1
	1995	8155	23.5	8.1	1.9	11.2	2.5	54.7	0.0	54.7
	1999	13232	28.4	9.3	2.7	13.6	2.2	53.6	0.2	52.8
	2000	15878	27.2	7.8	2.6	14.0	2.0	55.6	0.2	54.9

Notes:

¹ West Asia includes Bahrain, Cyprus, Iraq, Iran, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Turkey, United Arab Emirates, and Yemen.

² ASEAN countries are a subset of the category "Other Asia." Other than ASEAN countries, other Asian countries in this Handbook include Afghanistan; Bangladesh; Bhutan; People's Republic of China; Hong Kong, China; India; Republic of Korea; Maldives; Mongolia; Nepal; Pakistan; Sri Lanka; and Taipei, China.

Source: *Handbook of Statistics 2001* (UNCTAD 2001).

2. Average CEPT Tariff Rates

The average CEPT tariff rates on goods in the new members' ILs vary considerably. In 2001, the average CEPT tariff rate was highest for Cambodia, the newest ASEAN member, at 10.4 percent; Myanmar had the lowest at 3.32 percent. Viet Nam is the oldest ASEAN member among SEATEs, but its average CEPT tariff rate was still relatively high at 7.09 percent the same year. The average CEPT tariff rate for Lao PDR in 2001 was 6.58 percent.

In addition to the evidence presented in Table 10, the effect that joining the CEPT scheme will have on the revenue of Cambodia, Lao PDR, Myanmar, and Viet Nam is indicated by (i) the portfolio of imported products in the CEPT lists presented in Table 7 and (ii) the degree and trend of each country's dependence on imported taxes for overall tax revenue in Figures 1 and 2.

Table 10. Average CEPT Tariff Rates by Country^a

	2001	2002	2003
ASEAN-6			
Brunei	1.17	0.96	0.96
Indonesia	4.36	3.73	2.16
Malaysia	2.58	2.45	2.07
Philippines	4.17	4.07	3.77
Singapore	0.00	0.00	0.00
Thailand	5.59	5.17	4.63
SEATEs			
Cambodia	10.40	8.93	7.96
Lao PDR	6.58	6.15	5.66
Myanmar	3.32	3.31	3.19
Viet Nam	7.09	n.a.	n.a.
ASEAN-10			
Total	3.54	3.17	2.63

^a Average rates are derived from weighted average of all products in the IL only.
Source: ASEAN Secretariat.

Among the four countries, Cambodia will experience the greatest magnitude of tariff revenue loss as a result of committing to the CEPT scheme. This conclusion is suggested by the following facts: (i) Cambodia has the highest average tariff rate for goods in its IL, i.e. 10.40 percent; (ii) Cambodia has placed more goods on its TEL than Lao PDR, Myanmar, or Viet Nam;⁷ and (iii) a higher percentage of Cambodia's total tax revenue derives from taxes on international trade than any of the other new ASEAN members.

Imported goods are generally subject to trade tariffs, excise taxes, and domestic consumption taxes. Since the CEPT scheme reduces tariff rates, it should consequently reduce the amount that consumers pay for consumption taxes on imported products. However, from the perspective of the tax collector this implies both a direct and an indirect loss of tax revenue. In the first place, the government will be able to collect less revenue from tariffs because of reduced tariff rates. Secondly, because the cost of imports to consumers is lower, the government will also collect less revenue from consumption taxes.⁸ This point reemphasizes how important it is for Cambodia, Lao PDR, Myanmar, and Viet Nam to reform their tax structures in order to cushion the potentially negative impact on their tax revenue collection of accession to ASEAN.

3. Import Growth from Tariff Reduction

Trade liberalization in the form of reduced tariff rates may stimulate growth in recorded imports (i) because importers might choose to begin recording imports that they previously did

⁷ Without precise data on the volume of trade for each good, it is impossible to quantitatively predict how much revenue will be lost as a result of tariff rate reductions. Therefore, these predictions are based on the law of possibility.

⁸ Consumption tax collection can be calculated from the following formula: Consumption Tax Collection = [(import value + import duties) x average effective rate of consumption tax]

not report and (ii) because of the price effect. If this were to occur, then governments might be able to maintain previous levels of or even to increase the amount of revenue that they collect from tariffs, even though tariff rates are reduced. In the first instance, consumers of imported goods will increasingly begin to record imports if they expect that the newly reduced tariff rates will be less costly to them than the smuggling premium. This is particularly relevant to Cambodia, Lao PDR, Myanmar, and Viet Nam where unrecorded trade is prevalent. Empirical evidence that the price effect can stimulate growth in imports is provided by the case of the Philippines in the late 1980s. At that time tax reforms and trade liberalization were accompanied by a new surcharge on nonoil imports. As a result, the ratio of trade taxes to GDP and to total tax revenue increased significantly even as the rates of trade taxes declined modestly (Ebril et al. 1999, 11).

While they were implementing the CEPT scheme during the 1990s, recorded imports increased in each of the ASEAN-6 countries. In fact, the average annual rate of growth in imports was higher in the 1990s than it was during the 1980s for all of the ASEAN-6 countries except Singapore and Thailand (see Table 11).

Table 11. Average Annual Growth Rate of Imports (percent)

	1980- 1990	1990- 2000	1980- 1985	1985- 1990	1990- 1995	1995- 2000	1995- 1996	1996- 1997	1997- 1998	1998- 1999	1999- 2000
World	6.1	6.5	-0.5	12.4	7.0	3.8	4.9	3.4	-1.4	4.3	12.4
Developed Countries	7.0	5.7	-0.4	13.3	5.1	4.2	3.7	2.2	2.4	5.2	10.0
Developing Countries	4.3	8.4	-1.6	12.7	12.6	3.0	6.5	5.7	-9.7	4.5	18.3
Asia	6.8	8.2	2.3	14.8	13.8	1.9	6.5	2.7	-14.9	7.5	22.5
People's Republic of China	13.5	12.6	13.8	7.0	20.2	8.5	7.6	2.3	-1.3	18.2	24.3
ASEAN-6	7.2	7.9	0.6	21.5	16.5	-2.0	5.8	-1.0	-24.2	7.1	22.8
Brunei	3.8	4.5	1.2	10.4	15.9	-7.4	20.0	-11.7	-29.6	38.3	-33.5
Indonesia	2.6	2.7	-0.5	15.7	11.4	-8.5	5.7	-2.9	-34.4	-12.2	39.8
Malaysia	7.7	9.7	3.8	21.5	20.3	-1.0	0.9	0.8	-26.2	11.4	32.4
Philippines	2.9	12.0	-8.1	21.5	17.9	1.5	20.4	13.2	-18.5	3.4	3.8
Singapore	8.0	7.8	1.6	20.4	15.6	-1.0	5.5	0.8	-20.9	6.1	21.1
Thailand	12.7	5.0	1.0	32.7	15.5	-5.9	2.2	-13.1	-31.6	17.2	23.0
SEATEs											
Cambodia	-5.0	20.9	-18.7	24.6	46.2	0.9	-9.7	-0.7	3.1	4.8	4.3
Lao PDR	6.6	12.6	15.3	-1.3	32.5	-4.7	17.1	2.4	-21.7	-5.1	-0.7
Myanmar	-4.7	22.6	-7.9	-4.8	29.9	14.4	1.8	50.0	30.9	-13.7	3.0
Viet Nam	8.7	23.3	7.3	7.7	27.9	11.6	36.7	4.0	-0.8	15.1	20.0

Source: *Handbook of Statistics 2001* (UNCTAD 2001).

While they were continuously reducing tariff rates on intra-ASEAN imports from 1994 to 2000, the ratio of intra-ASEAN to total imports generally increased for all of the ASEAN-6 countries (see Table 12 and Figure 3). By analogy, it is also expected that the new members' intra-ASEAN imports will increase throughout the 10-year period within which Cambodia, Lao PDR, Myanmar, and Viet Nam will be implementing the CEPT scheme. However, the increased import

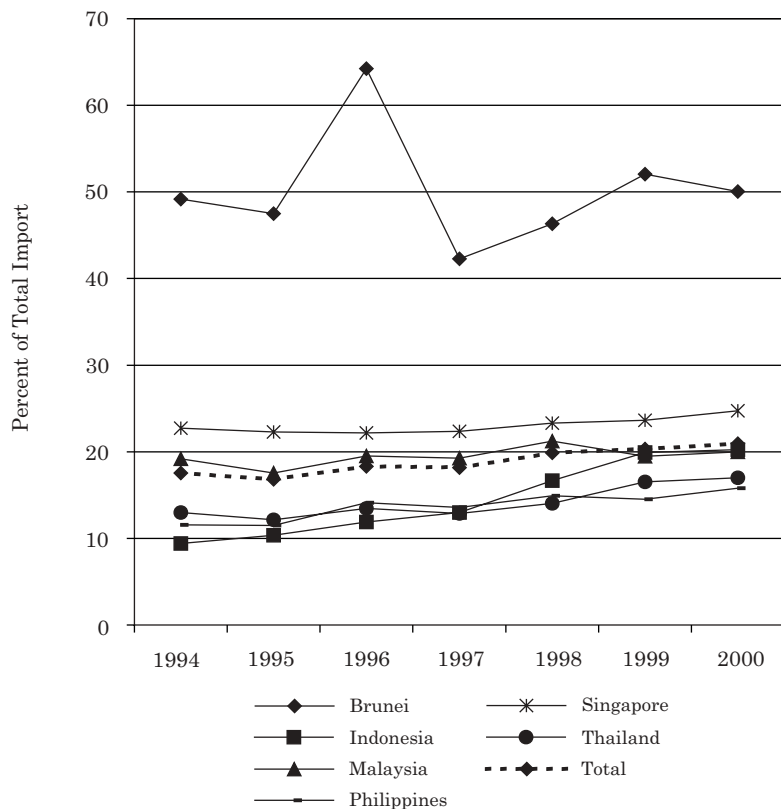
volume under the new tariff regime may still not provide sufficient revenue for these governments. Government revenue under the new tariff reduction scheme must be kept consistent with the governments' increasing responsibility in a changing environment. Even though the governments of these four countries have been reducing their activity as central planners, they should not allow this to translate into reductions of effective social programs for the poor and underprivileged. In order to maintain such important social programs these governments must compensate for revenue lost from reduced rates on import duties by recourse to other buoyant taxes.

Table 12. Intra-ASEAN Imports as a Percentage of Total Import

	1994	1995	1996	1997	1998	1999	2000
Brunei	49.16	47.50	64.23	42.27	46.31	52.06	50.05
Indonesia	9.40	10.38	11.90	12.99	16.68	19.93	20.23
Malaysia	19.19	17.53	19.50	19.28	21.22	19.49	20.01
Philippines	11.57	11.50	14.13	13.56	14.93	14.51	15.79
Singapore	22.72	22.28	22.17	22.36	23.30	23.64	24.72
Thailand	12.98	12.15	13.47	12.87	14.05	16.53	17.00
Total	17.55	16.83	18.31	18.15	19.89	20.32	20.95

Source: ASEAN Secretariat Website (<http://www.asean.or.id/1024x768.html>).

Figure 3. Intra-ASEAN Imports as a Percentage of Total Imports



IV. TAX REFORMS

Due to their commitment to reduce tariff rates according to the schedules under the CEPT scheme, the governments of Cambodia, Lao PDR, Myanmar, and Viet Nam will have to rely less on trade taxes as a source of total tax revenue. Consequently, these countries now realize the urgency of reforming their tax structures to cope with the expected losses in the medium to long term. As Pich Rithi, Deputy Director-General of Ministry of Commerce, Cambodia stated in his speech (see http://www.moc.gov.kh/econo_intergration/impaga_economic-trade.htm) on the impact of economic and trade liberalization on Cambodia, the first challenge that Cambodia will be facing in joining ASEAN is the expected loss of import tax revenue. He concluded that, “Cambodia needs to reform its tax structure in order to compensate for the expected loss of import duties in the coming 10-15 years.”

Effecting the type of tax reforms referred to above normally involves replacing trade taxes with domestic indirect taxes, which are less distorted in terms of resource allocation and consumption. Developing countries generally tend to depend on import duties to generate revenue and to protect domestic import-substitution industries. These import duties raise the domestic price of imported goods. Therefore, they discourage the domestic consumption of imported goods and consequently encourage the allocation of resources to inefficiently produce the same goods domestically.

A. Introduction of the Value Added Tax

In order to facilitate trade liberalization, many developing countries have introduced Value Added Tax (VAT). Implementing VAT can help to compensate for the revenue that is often lost when a country reduces or eliminates import duties. This form of tax also complements a policy of trade promotion because VAT is broad-based and a trade-neutral, domestic indirect tax. VAT is normally administrated using the *credit mechanism* and is based on the *destination principle*. The credit mechanism allows sellers to claim credit for any VAT that they pay when purchasing inputs that are required to produce the goods or services that they sell. The sellers are eligible to redeem those VAT credits against any VAT that they are liable to pay when they sell the goods or services. Sellers claim those VAT credits by providing invoices for the VAT that they paid on their inputs. In this regard, VAT has the advantage of discouraging tax evasion because taxpayers themselves wish to pay and obtain receipts for VAT paid on inputs purchased in order to be able to claim credit against the VAT they themselves will be required to pay at the point of selling their end product or service. Since receipts are required at both ends of the transaction, taxpayers themselves provide checks against one another. The same cannot be said for other types of general sales taxes such as turnover tax and retail sales taxes.

The destination principle is consistent with the General Agreement on Tariffs and Trade (GATT) guidelines, which stipulate that taxes on goods and services be levied in the country where they are consumed (destination principle) rather than where they are produced (origin principle).

In other words, the destination principle requires that taxes be imposed on imports while exports are not subject to taxation. Therefore, domestic and foreign producers are able to compete on an even playing field because their goods are subject to the same consumption tax rates.⁹

VAT is levied on a broad-based domestic consumption but effectively leaves a zero tax rate on exports. Therefore, VAT complements the type of export-oriented economic stance that all of the AFTA members have adopted. VAT collections in Cambodia and Viet Nam have proven to be very buoyant. From 1996 to 1998 the government of Viet Nam collected an amount of revenue through turnover tax equivalent to 11.1 to 11.8 percent of its GDP. Since VAT replaced turnover tax in 1999 the government has collected through VAT revenue amounting to more than 17 percent of its GDP from 1999 to 2001 (IMF Country Report No. 02/5). In Cambodia, the sales tax-to-GDP ratio prior the VAT introduction in 1999 was only 0.7 and 0.9 percent in 1997 and 1998. Since 1999, the ratio increased to 2.7-3.2 percent from 1999 to 2001 (IMF Country Report No. 02/24).

B. Surcharges on Luxuries and Nonessentials

While reducing the intra-ASEAN tariff rates, new ASEAN member countries can temporarily impose surcharges on luxuries and nonessentials in order to safeguard tariff revenue loss.¹⁰ However, such surcharges must also be levied on domestically produced luxuries according to the General Most-Favored-Nation Treatment Principle of the GATT. Most luxury products are not locally produced in the new ASEAN member countries. This temporary revenue measure can compensate the tariff revenue loss without damaging local industries during the transitional period of greater liberalization. The governments of CLMV should also note that the GATT allows countries that experience a Balance of Payment Crisis to raise custom duties and impose quota restriction of importation.¹¹ However, such relief must be approved and is subject to periodic review by the World Trade Organization in consultation with the International Monetary Fund.

C. Simplification of Tax Structure

The governments of Cambodia, Lao PDR, Myanmar, and Viet Nam should simplify their tax structures and make them more transparent in order to improve the efficiency of tax administration and to make it easier for taxpayers to pay taxes. International experiences suggest the following reforms. A single tax rate is preferred to multiple tax rates in corporate income tax and general consumption taxes (with exemptions on some necessary goods such as unprocessed food and medicines). The corporate income tax should be levied in a single statutory rate equivalent

⁹ Of course, imported goods are subject to additional costs, such as overseas shipping and handling costs and import duties before consumption taxes are levied. By contrast domestic goods are not subject to handling costs and import duties.

¹⁰ Examples of luxury goods include yachts, perfumes, chandeliers, lead crystals, air conditioners, wool carpets, cigars, etc.

¹¹ See details in GATT Articles XII and XV.

to the highest personal income tax. The top marginal rates for personal income taxes should be kept between 30 to 50 percent so that they do not discourage individuals from earning more income or evading taxes. Tax exemptions and allowances or tax expenditures should be minimized. These provisions not only erode the already narrow tax bases in developing countries, but also complicate tax administration (World Bank 1991).

D. Tax Administration Reforms

The governments of Cambodia, Lao PDR, Myanmar, and Viet Nam have considerable room to improve both their tax administrations and their tax collecting efforts. These governments collected low levels of revenue as a percentage to GDP prior their ASEAN accessions. The commitment to the CEPT will only put more pressure on these governments to improve their tax efforts and administration while implementing other structural reforms.

Tax administration reforms involve the following issues: administrative and legal arrangements, organization, management, functions, and resources of tax administration.

1. Legal Arrangements, Organization, and Management

The responsibilities of the two main administration bodies responsible for tax collection and tax and customs administration must be clearly defined and their efforts must be synchronized with the entire tax and public administrative systems. In order to establish efficient, effective, and targeted tax arrangements each government must assess the (i) respective levels of administrative capacity and (ii) must coordinate the activities of the tax and customs administrations. Each government must decide which of the two administrations is responsible for collecting what aspect of VAT and under what circumstances. They also need to clearly define the responsibilities of both national and subnational tax administrations. The governments should also aim to improve coordination among all VAT collectors. Some recent innovations regarding tax administration organization include the creation of a separate Tax Police and a Large Taxpayer Unit. The purpose for establishing a Tax Police is to assess accuracy of tax filing and payment so as to discourage both tax avoidance and evasion among taxpayers as well as rent-seeking activities among tax collectors. The purpose for establishing a Large Tax Unit is to increase cost efficiency in collecting taxes. Due to the existing high income disparity, large taxpayers contribute a relatively higher proportion to total revenue in Cambodia, Lao PDR, Myanmar, and Viet Nam than do large taxpayers in other ASEAN member countries.

2. Functions and Resources

The main functions of tax administration include (i) information-related functions in dealing with taxpayers, (ii) actual tax collection and sanctioning noncompliance, and (iii) international tax cooperation with other tax administrations.

In dealing with taxpayer information, a tax administration largely involves gathering and processing information. To obtain information from taxpayers, an effective and efficient tax administration must employ a good system for assigning identification numbers to and registering taxpayers. The information function also encompasses the tax withholding system, assessing asset ownership, and educating taxpayers about tax compliance in order to keep their compliance costs low.

In terms of tax collection, an efficient filing system and accurate assessment of taxpayers' tax liability improve the efficiency and effectiveness of tax administration. A reliable and effective tax auditing system is also necessary to improve tax compliance. Actual tax collection requires mechanical collection of taxes from both taxpayers who make payments on time and from those who delay tax payments.

In an increasing globalized world, international tax cooperation with other administrations has become increasingly beneficial to improve tax administration. Exchanging information on lessons learned and cooperating in tax collection puts tax authorities in a better position to cope with tax collection problems in a more complex environment. In the Asian and Pacific region, the Study Group on Asian Tax Administration and Research (SGATAR) holds annual meetings to discuss issues related to tax administration and cooperation among group members.¹² The governments of CLMV have not yet been actively involved in SGATAR, but they should consider getting involved now as they have been engaging in greater liberalization.

Computerization, modernization, and harmonization of import declarations should be made a priority in order to facilitate effective and efficient tax administration. More importantly, good systems and equipments must be operated by capable and honest tax officials.

V. CONCLUSIONS

Over the long term, the ASEAN seeks to improve the efficiency of trade among member countries by reducing tariff barriers to intra-ASEAN trade. This objective assumes that free trade will benefit all participants by allowing each to develop those goods and services that they can produce more efficiently and cost effectively than can their competitors. Unfortunately, for late joiners of the Association, ASEAN membership will likely reduce the amount of revenue that their governments will be able to derive from trade tariffs because it forces governments to reduce tariff rates.

There are four measures that new ASEAN member countries can implement in order to reduce the negative impact on the amount of revenue that they derive from taxation. First, they

¹² SGATAR was established in 1970 for organizing loose and informal meetings among selected Asian tax administrations. Members of SGATAR include Australia; People's Republic of China; Hong Kong, China; Indonesia; Japan; Republic of Korea; Malaysia; New Zealand; Philippines; Singapore; Taipei, China; and Thailand. So far, there are 31 meetings held in different member countries. The 32nd meeting is in Thailand in November 2002.

can strategically allocate goods among the four CEPT scheme lists so as to minimize the tariffs that will be imposed on the goods that promote the production of goods that they most wish to export while simultaneously maximizing the amount of revenue that they are able to garner from imports. Second, the new member countries can improve their tax systems by replacing traditional general sales taxes with VAT and generally simplifying their tax structures. Third, they can reduce inefficiencies that impede tax collection by improving tax administration institutions and tools of tax administration such as information systems, statistical indicators, etc. Finally, they can improve their overall legal systems so as to discourage tax avoidance and evasion and reduce corruption among tax officials.

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