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Electronic Commerce and Development: Fiscal Implications of Digitized Goods Trading

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Summary. — Crossborder electronic commerce is currently operating in a tax- and tariff-free environment. This, combined with predictions of steep increases of e-commerce during the next five years, has raised concern among governments and tax authorities over the potential loss in tax and tariff revenues resulting from e-commerce. This is of particular concern to developing countries, where import duties comprise higher shares of government revenue and a shift to other revenue sources is economically less feasible. The paper presents data on potential revenue losses from import duties on a number of products that have been traded physically in the past but are increasingly being imported digitally. Findings show that, while for most countries overall shares in trade are still small and thus fiscal losses negligible, some developing countries would be affected considerably by tariff revenue cuts. © 2002 Elsevier Science Ltd. All rights reserved.

Key words — e-commerce, electronic goods trading, tariff revenues, developing countries

1. INTRODUCTION

One of the most debated topics in electronic commerce at the present time, both among policy makers and the business community, is whether and how to collect tariffs and taxes on crossborder electronic commerce (e-commerce). So far, no national or international legislation has been put in place. At the same time, a steep increase in e-commerce during the next decade is predicted: Forrester estimates that total e-commerce accounted for US$657 billion in 2000. This is expected to reach US$12.8 trillion by 2006. [1] Hence, there is legitimate concern by governments, especially in the developing countries, over the potential erosion of their tax base resulting from e-commerce if domestic and international rules are not modified to take account of these developments.

Data on government finance statistics support this concern (Figure 1). They show that taxes are the principal source of government revenue, accounting on average for about 80% of total revenue (all countries). Domestic taxation of goods and services makes up the largest share in tax revenues (38.5%). [2] Revenues from import duties account on average for 12.6% of total revenue and 15.8% of tax revenue. Major differences exist between developing and developed countries: for the former, import duties as a share of total government revenue are 15.2% (compared with 2.2% for developed countries) and as a share of tax revenue 19.2% (compared with 2.5% for developed countries). The combined tax revenues from goods and services and those from imports account for 44% of tax revenues (all countries), or 46.6% of developing countries' and 33.7% of developed countries' tax revenue. Hence, they make up a major source of government revenue in most countries. [3]

How will these revenues be affected by e-commerce? Will the increase in digital trade substantially reduce revenues from import duties and taxation of domestic goods and services? Should e-commerce therefore be subject to border tariffs and taxes?

The question of whether to levy tariffs on crossborder e-commerce has been taken up by the World Trade Organization (WTO). In 1998, WTO member states agreed to a two-year customs duties moratorium on "electronic transmissions." Despite opposing views among WTO members, the moratorium was extended until 2003 at the Fourth WTO Ministerial

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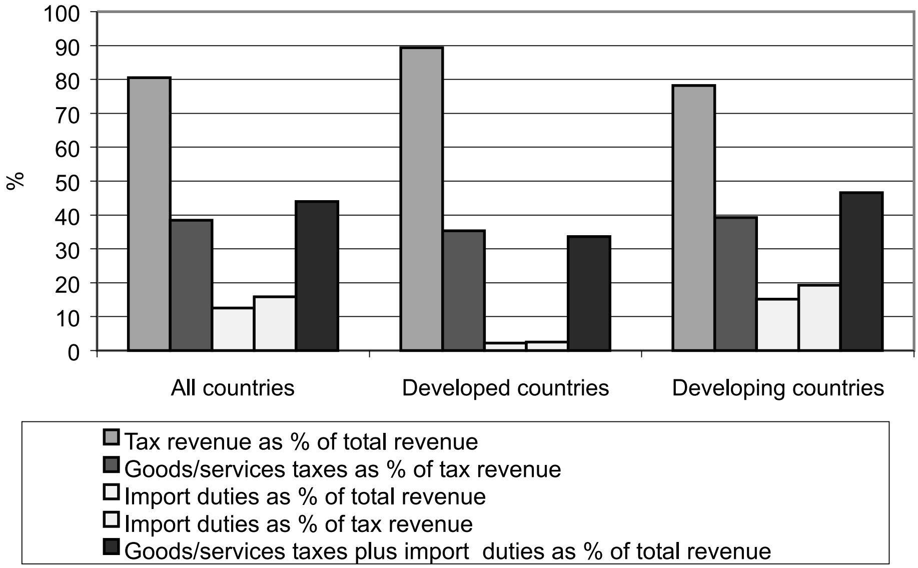

Figure 1. *Government revenue shares. (Source: IMF (2000).)*

Conference held in Doha, Qatar, from November 9–13, 2001.

The broader subject of Internet taxation has been taken up by other fora. A number of proposals are currently being prepared by the Organization for Economic Cooperation and Development (OECD), the European Union (EU) and the United States for harmonizing taxation rules on international e-commerce and thus prevent potential fiscal losses that could result from a rapidly growing number of international on-line suppliers, whose crossborder transactions will be subject to import and domestic taxes.

Developing countries are largely left out of these debates. Within the WTO, they have raised concerns about possible tariff revenue implications resulting from a ban on customs duties on electronic transmissions. They lack resources, however, to provide evidence which could support their concerns. Many of them are still struggling to keep up with the rapid developments in the area of e-commerce, recognizing that it has the potential for substantial beneficial effects on their economies. [4] The taxation debate is very much dominated by the OECD countries, which have little concern for developing countries' interests, given the latter's small share in e-commerce. But, developing countries could be much more affected by fiscal losses resulting from e-commerce in view of their greater dependence on tariffs and taxes as revenue sources for their national budgets.

This paper attempts to bring the developing countries' concerns into the debate on potential fiscal implications of e-commerce by looking at both tariff and tax revenues. Section 2 provides a short overview of the discussion on border tariffs for e-commerce taking place in the WTO. Key to this debate are conceptual and regulatory aspects of imposing customs duties on electronic transmissions. Section 3 looks at Internet taxation issues such as consumption and income taxation and highlights possible implications of current proposals for the developing countries. Section 4 moves to the empirical part of the paper and presents trade data on digitized products, including main importers and exporters as well as recent growth rates. Section 5 calculates import revenues from digitized products, obtained from (a) border tariffs, and (b) other import duties. Based on this, possible revenue losses resulting from electronic goods trading, particularly for the developing countries, will be shown.

2. IMPORT TARIFFS AND CLASSIFICATION OF E-COMMERCE

The definition or classification of e-commerce is a topic that has dominated the discussion in

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