TAX HARMONIZATION AND REGIONAL TRADE INTEGRATION IN THE ECONOMIC COMMUNITY OF WEST AFRICAN STATES (ECOWAS)

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Abstract

This paper examined the nexus between tax harmonization and regional trade integration in the Economic Community of West African States (ECOWAS). It particularly looks at the issue of tax harmonization as it relates to regional trade integration, reviewing the main theoretical, empirical and policy issues and the state of play in the debate. Based on the review of the pertinent literature, tax harmonization promotes regional investment and trade. Such policy harmonization in tax regimes benefits member countries in a regional bloc as opposed tax competition that distorts trade, business and investment. The paper recommends that institutional reforms be implemented to harmonize and coordinate tax in order to engender greater regional trade and investment in the ECOWAS sub-region.

Keywords: Economic Community of West African States; Regional Trade Integration; Tax Harmonization

1. Introduction

Regional integration offers a unique opportunity for the drive of Africa's transformation and development. The key features of regional integration mechanisms across the tax harmonization and regional trade integration in the

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Economic Community of West African States (ECOWAS) sub-region are the harmonization, coordination and compatibility of policies and tax regimes. The benefits derivable from policy harmonization and regional integration transcend economic, political and social considerations of individual domestic economies. Such integration and cooperation engenders improvements in production efficiency, economies of scale through operation cost reduction, simplification of formalities and better bargaining capacity (European Union, 2018).

Tax harmonization has an impinging role in regional trade cooperation and integration. Although tax policies are not the most important determinants of trade cooperation, they can have a major impact on trade and investment decisions through their effects on the cost of capital. The ultimate goal of regional cooperation is to ensure that a common economic space among member countries is created. Such cooperation largely evolves from trade links. The process involves the harmonization of macroeconomic and fiscal policies, legal and institutional framework (Ozekhome & Oaikhenan, 2020). Critical to achieving greater and improved regional cooperation and integration in the economic and financial space are the harmonization of tax policies and structures that propels trade, business and investment. While the integration process in ECOWAS has followed decades of coordination and harmonization process and efforts, as patterned in the European model, the institutional and legal structures and the will capacity to implement treaties, protocols and binding agreements required to bring these to reality in the ECOWAS sub-region have been rather slow.

One of the most important challenges facing the prospect of regional trade cooperation is competition in tax structures and rates which lead to differential, complex and multiplicity of taxes in the sub-region. Such multiplicity of taxes reduces the prospect for regional trade and cooperation (Quak, 2018). Since intra-regional and inter-regional trade depends largely on international taxes in the form of tariff, advalorem taxes, custom clearance charges and other boarder payments and charges, the harmonization and coordination of these tax procedures can stimulate regional trade and cooperation. In a globalized world characterized by increased capital mobility, a well-designed and administered tax system can have a strong impact on trade and business. Regional cooperation is intensified from less complicated, competitive and multifarious tax (Florin, 2016).

The non-harmonization of tax (tax competition) in ECOWAS in the past decade has largely distorted trade, investment and regional economic integration (Economic Commission for Africa, 2017). Regional trade and economic cooperation has been drastically affected by conflicting tax environment characterized by tax competition.

Apart from creating a hostile trade, business and investment environment in the sub-region, it has limited the prospects for trade advancement and growth, which are the hallmarks of regional integration and cooperation. Added to this fact is that tax competition increases cost of trade transaction and investment. With increased cost of trade transaction, regional economic cooperation is foot-dragged (Ozekhome, 2019).

The proliferation of non-cooperative tax regimes (tax competition) has also created uncertainty in trade and investment environment and has largely diminished regional productivity, and growth (Quak, 2018). While many studies have examined the effect of tax on economic variables at country specific levels, there is paucity of literature on the link between tax harmonization and regional integration/cooperation, particularly ECOWAS. Against the backdrop of the foregoing aforementioned problems, and perceived gap in the literature, there is need to investigate the link between tax harmonization and regional cooperation in ECOWAS, which is the objective of this study.

2. Conceptual Issues in Tax Harmonization

Tax harmonization simply means the process of adjusting tax systems across various jurisdictions/countries in search of common policy objective. It is a crucial component of the process of fiscal integration. The process by which a number of countries agree to take measures that would lead to higher level of fiscal convergence and ultimate goal being the formulation of a fiscal union is refers to as fiscal integration. Tax harmonization does not spontaneously lead to the formulation of fiscal union, as fiscal union gets to involve in much larger scale project that consist of fully harmonized legislation, fiscal transfers as well as long-run agreement. Emanating from this, "tax harmonization is the process by which a heterogeneous group of countries, federal states or even local governments mutually agree on setting a minimum and maximum level of their tax rates, including also a higher degree of harmonization of tax legislation, in order to attract foreign investors and to encourage local development and investments" (Florin, 2016, p. 6).

The harmonization of tax constitutes an integral aspect of fiscal harmonization and enables the compatibility of existing tax procedures in line with shared or mutual interest and in line with best practices and procedures, which benefits the participating members. It thus, enables the removal of complex tax procedures, payments, administration, and standards in order to enhance tax synchronization and convergence, thereby discouraging tax competition. The harmonization of tax thus entails the simplification, standardization and modernization of international tax process and administration in order to minimise international tax and trade transaction costs. International tax are in the form of tariffs and custom charges and levies (Amoakor-Tuffour et al., 2016), cited in Ozekhome, 2019).

Tax harmonization involves converging tax systems, particularly statutory tax rates. Such convergence reduces trade transaction costs and enhances regional trade, thereby promoting greater economic and trade cooperation (Diakité et al., 2017). Tax harmonization eliminates competition and stimulates interactions, interface and collaborations between countries. According to Quak (2018), three vital elements that describe the harmonization of tax include the national tax bases common definition, the equalization of tax rates and agreed rules uniform application. The latter is mostly essential since the form of tax application can be taken by tax competition of tax rules, like the low audit rates. It designates the condition where countries only cooperate on tax issues and policy.

3. Theoretical Issues in Tax Harmonization and Regional Integration and Cooperation

In theory, intra-regional tax harmonization anchored on a new economic framework can improve regional trade and cooperation and stimulate economic welfare particularly when there is harmonization of tax rates on mobile factors. Tax harmonization enables authorities to have greater incentive for the coordination of their tax rates, thereby reducing discrepancy between tax rates that would lead to one country losing its share of the trade, which may translates to reduction of economic cooperation and welfare. The harmonization of tax tends to remove tax competition and tax war, particularly in the case of international tax, such as tariffs, custom duties and charges and levies. The "general findings of empirical studies that have assessed the performance of regional blocs in Africa is that member countries have failed to achieve their objectives of significantly increasing intra-regional trade and cooperation, and particular, fostering overall policy coordination" (Nnyanzi et al., 2016, p. 935). Following this, with respect to the debate on the role of regional economic integration to the mobilization of revenue, the objectives is dependent on the quality of institutions, the degree of policy harmonization and the nature and extent to which the homogeneity or heterogeneity of the partner countries are. Such inability to attain increased intra-regional cooperation stems from tax competition and fiscal policy divergence. In the presence of strong institutional quality political will and commitment, the level of policy harmonization can be engendered in terms of homogeneity of tax, removing tax heterogeneous among partner countries are (Nnyanzi, 2016).

The European Union across various parts of the world presents a standard for economic integration, in consequence, a model of tax harmonization among sovereign states. Tax harmonization across regional blocs in the African continent is hinged on the European model. Differences nonetheless exist in several ways on account of the limitation in the execution of powers and regional institutional resources. In general, trade liberalization is usually preceded by harmonization of trade procedures, of which international tax policy coordination and harmonization are sacrosanct. The approach of the coordination framework in ECOWAS regional economic communities is basically based on the coordination of EU model. In particular, tax coordination and tax harmonization are more explicit and potent in tackling harmful tax competition among countries, in a bid to minimise the risks of distorting trade and investment as well as the erosion of national tax bases (European Union, 2018). Harmonization of taxes can enhance regional trade cooperation through reduction of cost of trade, increased competition and economies of scale.

4. Review of Studies on Tax Harmonization and Trade Cooperation

Empirical studies on the impact of tax harmonization on regional trade cooperation, in particular related to indirect taxation, have shown that tax harmonization improves regional trade cooperation and revenue mobilization in member state.

The study by Simms and Simms (2017) finds that member states in an economic bloc are only willing to relinquish some of their economic, political, fiscal and tax autonomy in favour of economic integration when beneficial prospects are higher.

Azuka (2017) examined the nexus between tax harmonization and sustainable development in Africa, using Nigeria as a case study, as well as the potentials and paradoxes of the harmonization of tax. The paper was premised on the view that striking the accurate balance between the multiplicity of policy options when designing and implementing tax policies is a great problem for governments. He concluded that tax harmonization is a veritable tool for regional trade cooperation and investment.

Extrabay (2017) investigated trade liberalization engenders tax competition using evidence from the OECD countries. The results from the panel analysis showed that trade liberalization and synchronization encourage tax harmonization and regional integration, as tax competition is significantly reduced due to policy coordination and harmonization.

Clausing (2018) investigates the impact of increasing economic and trade integration on corporate tax revenues in the EU countries. He finds evidence that integration has facilitated the harmonization of tax.

Ozekhome and Oaikhenan (2020) evaluated the prospect of regional trade integration in the ECOWAS sub-region through the simplification, harmonization and coordination of trade and other fiscal convergence over the period 2006-2018 for the fifteen ECOWAS countries. The study finds that policy coordination and harmonization positively influence regional economic cooperation, particularly when policy divergence is synchronized for optimal development benefits. Based on the findings, the authors recommend policy harmonization and coordination with respect to trade in order to enhance regional integration in the ECOWAS.

From the review of the literature, there is paucity of literature aimed at investigating how individual country tax structures and performance influence the depth of regional economic integration or the commitment of each country's tax system to regional agreement. Such outcomes are critical especially given the multiplicity of tax policies, administration, execution, which has resulted to considerable variation in tax policy and tax competition.

5. Tax Harmonization in West Africa

Two regional economic blocs in the West African region have made efforts at regional tax coordination harmonization in tax rates and tax policy. For WAEMU, there have been long history of the effort of tax coordination and harmonization as far back as 1994. The constituent countries of WEAMU share a single currency - the CFA Franc- has a customs union, with widespread experience in the coordination and harmonization of domestic taxation. Mansour and Rota-Graziosi (2013) posit that following this, more than 80% of tax in member countries' tax (with the inclusion of revenues from tariffs) emanate from taxes, which are subject to regional policy directives or regulations. The WAEMU Treaty was signed by member states in August, 1994, following the CFA devaluation. The creation of customs union through a common external tariff was finalized in 2000. Similarly, the directives of VAT as well as excises were brought in the year 1998; and, in the year 2009, a set of policy harmonization directives pertaining to capital income taxation was concluded.

The WAEMU Treaty goes farther than the EU as regard tax policy; including the setting of the tax rates and bases coordination aimed at the main taxes by means of regional directives and policy harmonization. For instance, through policy convergence and synchronization, it directs the convergence of the ratio of tax revenue to GDP to be at least 17%, including tax revenue structures convergence (Mansour & Rota-Graziosi, 2013). The ECOWAS represents the second regional economic bloc, where English speaking countries are all members countries together with WAEMU in the region. Recently, however, a move geared towards the coordination and harmonization of tax, through recourse to WAEMU countries experience, in addition to the objective of tax revenue mobilization, creation of a better investment climate in the region, as well as tackling injurious tax competition, specifically, with respect to taxes on indirect consumption.

6. Harmonization of Indirect Taxation

6.1. The Value-Added Tax (VAT) Harmonization

The value added tax (VAT) harmonization was introduced in the year 1998. A key objective for the introduction of the directive of VAT was to render assistance to countries in compensating the loss of revenue that is induced by the tariff rates minimisation on the trade with more efficient tax than surging sales taxes. The harmonization covered the following limited list of items (bottled and powder milk, wheat and other grains; all types of pasta, sugar, rice, flour, agricultural equipment (which include rental and maintenance services); computers; food for livestock and poultry; tourism-related services, including restaurants and solar energy equipment. Similarly, in the year 1998, a set of compulsory exemptions was introduced for VAT, which include: education services, health services and medications; newspapers, books, banking, magazines, and other periodicals; insurance and re-insurance services.

The ECOWAS has a VAT coordination framework, but there is no common legislation in place to institutionalize it. Therefore, member states have a variation of value added tax from Nigeria (5%) to Liberia (10%) to Togo (18%). The Economic Community of West African States member states are working on the harmonization of the exemptions of VAT on the items of basic food in their raw states, pharmaceutical products and medicaments to ensure the treatment of all economic operators are equal in the community. The coordination framework has allowed some convergence of countries' tax systems (notably, statutory tax rates) which have contributed to the performance of positive revenue that is observed in the WAEMU member states since 2000 and enhance regional trade as well as economic integration in the sub-region.

Policy harmonization on value-added tax (VAT) in the West African Economic and Monetary Union (WAEMU) came into force in 1998. A crucial aim of the VAT policy was to help countries to compensate the loss in revenue caused on account of the tariff rates reduction on trade with a more efficient tax than the declining sales taxes. The 2006–2008 food and energy price crisis has necessitated the need to contract the base to respond to social unrests in the region. In the year 2009, a convergence meeting by the Council of Ministers brought the narrowing into force (Mansour & Rota-Graziosi, 2013).

6.2. Excise Taxes Harmonization

Excise tax harmonization was launched in WAEMU in the year 1998, with the aim of harmonizing specific taxes in order to ensure greater transparency and creating a business, trade and investment friendly environment. Three policy amendments were made- minimum and maximum rates on tobacco and alcohol were raised by 5% (to enable alcoholic beverages to have an excise tax that hovers around 15 - 50%; tobacco products would hover around 15 - 45% after the year 2009); and five substances were included to the optional list; and member states were limited only to excise taxes for six items from the optional list. The key argument for harmonizing excise taxes in a common market with fiscal borders is to considerably reduce intra-community cross-border smuggling and shopping. Thus, "while there exist a good reason to harmonize excise tax, there are geographical challenges posed as the region is surrounded by large countries with very porous borders (neighboring Mauritania, Nigeria, and Ghana in particular) and, in some cases, applying relatively low excise taxes" (Mansour & Rota-Graziosi, 2013, p. 14 cited in Quak, 2018). ECOWAS is on the process of harmonizing excise duties on unhealthy products like tobacco that geared towards increasing revenue and reducing the consumption of these various products in the sub-region. The ECOWAS Financial Council of Ministers meeting in Abuja, November 2017 brought this as part of her decisions.

7. Harmonization of Direct Taxation

7.1. Corporate Income Tax Harmonization

Tax harmonization of tax rates as well as tax base has been fully applied across the countries of the WAEMU. Consequent upon this, a holding corporate firm regime was introduced in the year 2011 that exempted company income tax from the holding company's profits and their various dividends distribution (beginning from the level of individual tax, as well as capital gains tax realized from the sales of their shares). The regulation became necessary to provide and ensure stability in the tax regime, both for taxes that are collected at the national level (insuring against rising taxes but enabling reductions of taxpayers benefit), including the royalty fixed regionally. The key provision for incentives are accelerated depreciation as well as tax holiday of three-year from profit and payroll taxes.

Fundamental to tax base competition are the flexibility in setting the rules of tax depreciation; and transfer pricing flexibility and thin capitalization rules designs. While the WAEMU countries has made significant progress in the harmonization of the tax rates and tax base, the focus of ECOWAS countries' is on indirect coordination and harmonization of tax rates and is yet to make significant progress on direct taxation. Although, the initiative was articulated at the ECOWAS Ministerial Council Meetings in 2018.

8. Lessons Learned from Tax harmonization

(i) Harmonization framework permits reasonable level of convergence in countries' tax systems (notably statutory tax rates), that has in turn contributed to the positive revenue performance observed of some participant countries. This is mostly for the case of value added tax as well as excises on alcoholic beverages and tobacco products. However, "the future of the CIT (other than on resource activities) is uncertain in the region, as there is little evidence that the CIT harmonization directives have had any impact on corporate tax competition" (Mansour & Rota-Graziosi, 2013, cited in Quak, 2018, p. 11).

(ii) With the help of effective institutional framework, the harmonization of tax can foster the accountability of government and ensure the prevention of leakages of public funds. Scarce public resources efficiency can also be stimulated and improved, thereby maintaining fiscal stability and meeting the need of social development. Nevertheless, the credibility of framework largely depends on the credibility of regional institutions, which are necessary to undertake effective surveillance (IMF, 2014).

(iii) Government and policy makers in the ECOWAS sub-region largely underestimate the benefits realizable from tax harmonization framework, particularly the provision of the necessary institutional support, directives and regulations to achieve domestic resource mobilization objectives.

9. Prospect of Tax Harmonization and Trade Cooperation in ECOWAS

A number of important policy issues can be generated from this policy paper. The various submissions give indication that uncoordinated tax regime characterized by complex and differential tax regime in ECOWAS have destabilizing effect on regional trade cooperation. Invariably, competing tax regime will limit the capacity and size of regional trade and reduce the prospect for further growth in the sub-region. This is because complex and unsynchronized tax process tend to diminish trade policy harmonization. The various discussion also show harmonization of taxes in the sub-region will reduce multiplicity of tax, reduce business and trade uncertainty and promote greater regional trade cooperation. Without doubt, the ability of the sub-region to maximize trade potentials lies in harmonization the trade environment through tax management coordination approaches. In the same vein, the various discussions give clear indications that tax war in the form of tax competition may jeopardize the business and trade environment in ECOWAS since it makes the environment uncompetitive, complex and challenging. Given such a challenging business and trade environment fraught with differential and non-harmonized tax regime, the push towards increased regional trade and investment cooperation is diminished. Thus, in order to engender engenders trade and business expansion in the ECOWAS sub-region, there is need for tax harmonization that will create uniformity in tax process in the sub-region.

10. Conclusion

Tax harmonization holds a lot of economic and financial benefits ranging from business, trade, and investment to the ECOWAS sub-region. As opposed to tax competition, it creates a solid basis in the form of fertile economic environment for trade cooperation among member countries in an economic block. It eliminates differential tax rates and structures, engenders equalization of taxes, a common definition of tax bases as well as a uniform application of agreed tax rules. Tax competition among member countries of an economic cooperation may have detrimental impact on business, trade and investment and thus, limits the scope of regional economic cooperation. Apart from unifying and equalizing tax rates, structures, rules, administration and policies, it simplifies the tax process as opposed to multiplicity of tax in a complex tax environment. The prospect for increased regional trade and cooperation can only be enhanced under a fiscal regime of tax coordination and harmonization, rather than differential and multiplicity of taxes. The European Union (EU) provides ample evidence of tax coordination and harmonization among sovereign states. The harmonization of tax can only be fostered through strong political will and the necessary legal and institutional support (backing) for trade cooperation enhancing tax reforms.

It is an established fact that the provision of the right fiscal environment through coordinated and harmonized tax will greatly encourage the expansion of trade in the sub-region. Greater intra-regional trade in turn implies greater regional cooperation. The quest to significantly drive the ECOWAS economy to rapid economic growth that will foster significant job creation and substantial poverty reduction cannot be achieved without a vibrant trade environment supported by harmonized tax regime. Given the high positive spillovers of trade expansion brought about by tax harmonization in terms of growth, business, investment, enterprise, innovation, and employment creation, there is need for a favourable tax regime that is built on tax coordination and harmonization.

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