PROTECTION: Tax Rate, Policy Review

Problem

1. The present tariff rate pattern does not give adequate protection and in some cases gives negative protection.

2. In addition the handling of sales tax in respect to some products is being done in a way eroding protection even though other ways would be in accordance with the Act.

3. The sweeping 1992 removal of import duty on a broad range of products intended to encourage domestic production and thus recoup Customs losses from Sales Tax gains was not analysed in any detail, was not very closely targeted and therefore was subsequently believed to have caused a serious net revenue loss.

4. The equally sweeping early 1993 reversal of the 1992 tariff removals was equally innocent of detailed prior analysis or targeting. As a result, while it probably reverses the revenue loss problem of the initial Customs abolitions, it - thereby - simply reinstates the lack of protection/negative projection problem.

Background

5. To understand what has happened requires going back to the last full scale, overall tariff reform - 1980:

   a. at that time protection did not need fiscal measures because of import controls which de facto meant if a local manufacturer could produce a plausible product at a plausible price no import licence was likely to be issued;

   b. since 1972-74 (last previous overall reform) a host of different rates had proliferated for fiscal, protection and other reasons. Each may (when adopted) have made sense taken by itself, but the complicated set of rates as a whole had become unsound administratively and the protection rates no longer made sense;

   c. as a result four basic rates were adopted: 0%, 25%, 50% 150% plus a few special ones in respect to petroleum, alcohol and tobacco products and automobiles (a handleable number of exceptions, each of which - arguably - poses special problems of unification). 0% was for basic food, pharmaceuticals and a few other goods. 25% was a standard and 50% an amenity revenue rate. 150% was to be semi-preventative (and was largely on goods quite unlikely to secure import licenses).

6. After 1980 (inevitably) rates proliferated - up, down, sideways. Some high rates were adopted for revenue purposes and then reduced under Bank/Fund pressure. In addition, a number of particular rates were adopted for reasons by now obscure to everybody. The result - once again - is a messy structure whose interaction has not been checked systematically.

7. In addition, from 1984 (own funds imports) and especially 1988 (moves toward OGL and import support sold for almost any imports with only a short negative list) fiscal (tax) protection has again become a live issue.

<u>Protection</u>

8. The results (apart from administrative/assessment complications) include quite unintended results on protection:

    a. too low or negative - usually heard about because producers complain;

    b. too high - which are <u>not</u> found out unless there is a study.

9. Two products and one product category illustrate:

    a. crown corks

    b. bicycles

    c. garments

10. <u>Crown corks</u> apparently have a higher tariff on one or more of their imported components than on the finished product. In addition, the same applies to sales tax. (This is not necessarily so silly - in principle - as it sounds. If one or more of imported items is also a final product or an input into amenity consumer goods whereas crown

corks are seen - correctly - as an input into manufacturing with the basic tax that on the final consumer product then the logic is correct except that it overlooks the negative protection problem.)

11. In respect to Customs the rates need to be checked. If the imports are metal blanks and cork sheet both should be at lowest standard rate as neither has a direct consumption use.

12. In respect to Sales Tax something appears to have gone wrong procedurally. If crown corks pay ST (as they do) the major import components (cork, metal blanks) should go to the manufacturer "in bond" under a "registered dealer/user certificate" and not be taxed so long as used in the (taxed) crown corks. That is both provided for in the ST Act procedures and integral in the logic of a single stage (not a cascade) ST.

13. Bicycles pose a different problem. As I understand it there are two customs heads: bicycles and parts for bicycles. Both are at the same customs and ST rates. (In this case the ST issue was not raised to me so possibly National Bicycle do have "registered dealer" status which they certainly should.)

14. Parts should be at the same rate as bicycles because they are a final consumer good. That, however, does not resolve National Bicycle's problem. One way would be to create a new category:

"Bicycles - Wholly or substantially complete knocked down
kits imported by licensed assemblers"
Logically 0% on Customs and on Sales Tax on importation.

15. The sub-category is 'safe' because there is now only one assembler. The Minister can give orders "under his hand" published in Gazette. If another genuine assembler, it can be licensed too. There never will be so many that processing licence applications will be time consuming.

16. Garments pose a yet different problem. Imported garments have a high tariff - against imports of new foreign garments competently made local ones are competitive. The difficulty is used clothes.

17. Because rich country users discard basically sound clothing when out of style or needing simple repairs and the domestic repair cost is

high/resale market low, used clothes of reasonable quality are cheaper than any maker of new clothes' costs. This is especially true of jackets and trousers.

18. What to do is not clear. Poor Tanzanians do benefit from cheaper products. The garment industry is hampered. Simple *ad valorem* tariffs are not likely to be effective - the cost c.i.f. of a sports jacket may well be as low as Sh 1,000 and of a pair of slacks Sh 500. Even 50% to 75% duty does not help much to even prices.

19. The resale by charities issue is peripheral. Resale when duty waived should be banned. But so long as imports of the products are not banned a charity should be able to import/pay tax/sell (to poor people/to raise money for other programmes.

20. An across the board ban would protect. But it would also raise cost - especially of jackets/trousers to poor Tanzanians.

21. A possible structure taking account of what our garment industry actually produces moderately efficiently would be:

a.	Jackets	- 50% but not less than Sh 750
b.	Trousers	- 50% but not less than Sh 1000
c.	Coats	- 50% but not less than Sh 1000
d.	Other	- 100% but not less than Sh 1000

This would not greatly impede jacket or coat imports (no serious domestic production). It should protect any efficient-medium price trouser producer. It would probably cause drastic drop in used shirt/T shirt imports. The specific alternative is put because there is an inherent problem in valuation.

<u>How to Proceed</u>

22. The three products cited all pose special issues and require different approaches. The issues/approaches relate to:

    a. industry structures/capacities

    b. consumer welfare considerations

    c. general economic policy goals and also
    d. structures not creating major administration/evasion problems for Hazina

    It is doubtful a case by case approach along these lines would lead to substantial revenue losses (or gains) including:

    a. customs + sales tax on entry and
    b. sales tax on producers + company tax on their profits.

23. But there are probably 100 cases to be checked. That takes time - as well as industrial expertise. The Treasury does not have the economist numbers to do it nor are its economists specialists on manufacturing.

24. Therefore a practicable approach would be an Inter-ministerial Working Party (or Task Force or Review Group) to include:

    A. Finance (Economist + Deputy Commissioner Revenue for Indirect Taxes)
    B. Commerce and Industry (Economists)
    C. Planning (Deputy Secretary Policy plus Industrial Planner).

    As a 'neutral' party concerned with overall policy Planning could well convene meetings and compile agreed report to the three Ministers.

25. The issue is of some urgency because certain firms - e.g. National Bicycle - might need to shut down if no action. But there is no deadline - this is <u>not</u> primarily a revenue measure so need not be in Budget Bills package. However, more <u>urgent</u> cases could usefully be dealt with by then for inclusion in 1993/94 Budget measures.

<u>Post Script</u>

26. The foregoing deals with protection. There may be a broader case for simplification to reduce rates to 3 to 5:

a. 0%

b. 20% most raw materials, intermediate goods, capital goods

c. 50% amenity consumer goods

d. 100% luxury consumer goods (including video equipment and videos, brandy, saloon cars, extended cab pick-ups, etc.)

27. Such a review would logically parallel an ST review because for revenue what matters is <u>combined rate</u> not ST or Customs alone. (That exercise could also reverse the misguided separation of Excise from Customs.) Again a 3 to 5 rate pattern should be adequate but perhaps alcohol, tobacco, petroleum products, saloon cars/extended body pick-ups would need special rates. This is <u>not</u> inevitable, each <u>can</u> be <u>ad valorem</u> if desired and automobiles can be either high ST or high initial registration (no evident logic in having both but because registration is needed for other reasons no great cost in having two bites at the tax cherry).

28. That exercise is partly general economic policy and partly revenues so probably best chaired by Finance (Deputy Secretary Policy plus Commissioner for Indirect Tax) assisted by Planning (Deputy Secretary Policy). Probably too late for 1993/4 Budget so could begin August to conclude by November as input into 1994/95 Budgetary Cycle.

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