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Tax revenues convergence across ASEAN, Pacific and Oceania countries: Evidence from club convergence

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ABSTRACT

The goal of the present paper is to investigate the degree of convergence in tax revenues for a panel of 11 ASEAN, Asia Pacific and Oceania countries spanning the period 1990–2012. We apply the methodology of Phillips and Sul (2007) to various categories of tax revenues to assess the presence of convergence clubs. We consider four alternative categories of tax revenues. Overall, the results do not support the hypothesis that all countries converge to a single equilibrium state in such tax revenues.
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1. Introduction

The ASEAN encompasses 10 Southeast Asian nations – Brunei, Cambodia, Indonesia, Lao, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. The ASEAN is currently in the process of

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launching a single common market by 2015 through increased economic integration. In order to achieve this objective, the ASEAN member nations have established mechanisms through which to strengthen the operation of its prevailing economic initiatives including the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS) and the ASEAN Investment Area (AIA) (Jogarajan, 2011). The ASEAN countries planned to complete a network of bilateral tax treaties across all member nations by 2010. Although significant progress has been made towards achieving this objective, the process is still not complete. Some argue that an ASEAN multilateral tax treaty may be better for promoting intra-regional investments (ADBI, 2009). Taxation (among other factors, such as transparency, supply chains, labour markets) has the potential to either be a facilitator or an impediment to greater integration and economic growth across ASEAN and Asia Pacific and Oceania countries, since taxation is associated with the likely increased investments into the region.

Against this backdrop, the goal of this study is to investigate, for the first time, tax policy convergence among ASEAN countries, as greater integration between the tax policies of these countries would accelerate the process of achieving a single common market. We examine tax policy convergence for income–profits–capital gains, social security contributions, property and general taxes on goods and services. The ASEAN group is also exploring the means through which economic integration can be increased amongst its members and the Asia Pacific and Oceania including economies, such as, Japan, South Korea, China, Australia and New Zealand. Therefore, tax policy convergence between the ASEAN and these countries is also examined. The empirical results are expecting to shed more light to questions, such as whether should we expect countries to search for profitable (tax specializations, like tax havens which offer special tax treatments for a specific number of transactions. Additionally, the task of tax convergence is of great importance for the ASEAN and Pacific Rim area, since the countries must face the trade-off between the national sovereignty and the potential of an economic unified market. The search over the effects of globalization on such state sovereignty has been taken up in the strands of the literature of tax convergence, tax competition and tax harmonization (Reuven, 2000). Tax convergence is closely related to tax competition, since governments are pressured to reduce taxes to survive the tax competition.

The literature uses several alternative approaches to identify whether and when convergence occurs. Initial empirical tests of the convergence hypothesis considered β-convergence. Without additional control variables, the test considered absolute convergence, whereas with additional control variables, the test examined conditional convergence. The regressions used to test for β-convergence are generally the log-linearized solutions to a non-stochastic model with an additive error term.

An alternative view of convergence, σ-convergence, argues that a group of countries/sectors/regions converge when the cross-section variance of the variable under consideration declines across time. As noted by Bliss (1999, 2000), however, the underlying assumption of an evolving data distribution introduces difficulties in the interpretation of the test distribution under the null. Moreover, the rejection of the σ-convergence hypothesis does not necessarily mean that they do not converge; the presence of transitional dynamics in the data could lead to the rejection of the null hypothesis of σ-convergence.

Critics of β-convergence argue that if countries/sectors/regions converge to a common equilibrium with identical internal structures, then the dispersion of the variable under study should disappear in the long-run as all converge to the same long-run path. If, however, they converge to convergence clubs or to their own unique equilibrium, the dispersion of this variable will not approach zero (Miller and Upadhyay, 2002). Moreover, in the latter case of specific equilibrium, the movements of the dispersion will depend on the initial distribution of the variable under investigation relative to their final long-run outcomes. Overall, these two approaches suffer not only from specific estimation deficiencies associated with the time series used (Caporale et al., 2009).

Finally, the use of cointegration and unit-root tests for determining convergence are subject to a number of serious drawbacks. First, these tests fail to detect convergence when, more than one equilibria exist. Second, if the countries do converge, but the data available to the econometrician reflect a time period in which transitional dynamics prevail, cointegration and unit-root tests may not ‘catch’ the tendency to converge. Thus, to study the issue of convergence requires that the researcher model both transitional dynamics and long-run behaviour together in a consistent framework.

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