Finance & economics | Mobile phones and taxation

Making the connection

A new study examines the impact of taxation on mobile-phone adoption

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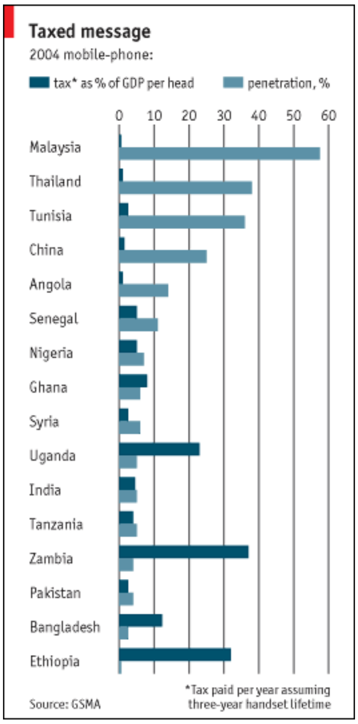

THE global march of the mobile phone passed another milestone last month, when the number of devices in use worldwide went beyond 2 billion, according to Wireless Intelligence, an industry body. In a few rich countries, mobile devices now outnumber people. In the developing world, things are very different. Mobile phones are increasingly recognised as powerful tools in the fight against poverty, since they reduce transaction costs, facilitate entrepreneurship and substitute for slow, unreliable transport and postal systems. Annual subscription-growth rates of over 100% in many countries reflect the strength of demand. But the proportion of people with mobile phones is still very low—around 5% in India and sub-Saharan Africa—because phones are still beyond the means of the vast majority.

The mobile-telecoms industry, which is looking to developing countries for its next billion customers, is doing its best to cut prices. The price of a basic handset will have fallen from $50 at the start of 2004 to below $30 by next January, and below $20 by 2007.

But as prices fall, another barrier to adoption becomes more apparent: the taxes on mobile phones in many developing countries. A study released this week by the GSM Association, which promotes the use of the world's dominant mobile-phone standard, details the variation in tax policies and examines their effects. (The study was the work of four consultancies, Pyramid Research, Frontier Economics, Deloitte & Touche and Tarifica, and is endorsed by the International Telecommunication Union and the World Bank.)

Phones are taxed in many ways. Most countries charge value-added tax on handsets. Many also impose customs duties on imported phones (45.6% in Syria, for example, 33% in Ghana, 27% in Uganda, and $5 per handset in Bangladesh). Subscribers may face further taxes when they sign up ($14 in Bangladesh, $8 in Pakistan and Senegal, $24 in Turkey), as of 50 developing countries. This figure, presented as a share of GDP per head, gives an indication of the burden of mobile-phone taxes.

Hardly surprisingly, developing countries with high mobile taxes generally have far fewer mobile phones per person than those with low taxes (see chart). Cutting taxes can boost adoption: India has reduced its handset import duties over the past three years, helping to boost penetration from less than 1% to more than 5%. Raising taxes can slow adoption: monthly subscriber growth in Bangladesh fell from 11% to 7% after the introduction of a $14 connection tax in June.

Of course, governments have to tax something, and mobile phones are convenient. The job of collecting taxes can be passed on to network operators, who already have to keep track of their customers' usage in order to charge them properly. In developing countries, mobile phones are often the top source of tax revenue, notes Ben Soppitt of the GSMA. But the cost of the taxes, in social, economic and developmental benefits forgone, is high. Most governments say they want to extend access to communications and close the "digital divide". Special mobile-phone taxes have exactly the opposite effect.

So what is the best policy? The study makes no specific recommendations. But it does model the effects of various changes in tax policy. Scrapping all import duties and sales taxes on low-cost handsets (those costing below $30), for example, could prompt 930m additional sales by 2010. Although this would dent tax revenues in the short term, these new subscribers would pay an extra $25 billion to $45 billion in usage taxes over the same period. Less drastically, every reduction of one percentage point in sales taxes on mobile services would result in a 2% increase in mobile penetration between 2006 and 2010 in a typical developing country, the study predicts. Again, although tax revenue would be lost in the short term, it would rise eventually as more subscribers signed up. Cutting taxes and tariffs on handsets would also expand the tax base by increasing the proportion of legitimate handset sales; now, 40% are bought on the black market, according to Mark Williams of Frontier Economics.

But it is the special taxes on mobile phones, particularly on connections, that do most to deter adoption. Cutting these boosts subscriptions, broadening the tax base and offsetting the state's loss of revenue, Mr Williams remarks. It is "short-sighted" to single out such an important agent of development with punitive taxes, says Mr Soppitt. Taxes today or growth and perhaps even more taxes tomorrow? That is the choice—and the opportunity—that mobile phones offer.

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