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Mar del Plata, Argentina, May 1963

PROVISIONAL REPORT OF THE CONFERENCE ON FISCAL POLICY ORGANIZED BY THE OAS/IDB/ECLA JOINT TAX PROGRAM

(Santiago, Chile, 5 to 14 December 1962)

Note: This text is preliminary and incomplete and is subject to changes in presentation before it is published in final form (see paragraph 4 of the Introduction).

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/INTRODUCTION

INTRODUCTION

1. The present report outlines the proceedings of the Conference on Fiscal Policy held at Santiago, Chile, from 5 to 14 December 1962, under the auspices of the Joint Tax Program of the Organization of American States (OAS), the Inter-American Development Bank (IDB) and the Economic Commission for Latin America (ECLA).

2. A brief reminder of the various circumstances which led to the establishment of the Program and the convening of the Conference may be appropriate. They can be summed up as follows:

(a) Since tax systems can be one of the most important instruments for the financing of Latin America's economic development, OAS IDB and ECLA decided, on the basis of the recommendations incorporated in the Act of Bogotá, to launch a long-term joint programme with a view to promoting the reform of tax systems and bringing about an improvement in tax administration;

(b) The programme planned its activities round two meetings of experts. One of these was to devote its attention to the specific study of the problems of tax administration, and the other to the analysis of the principles of fiscal policy which should be borne in mind in view of the underlying purpose to be served: the achievement of intensive economic and social development combined with stability. Special studies on the tax systems of selected Latin American countries would be carried out simultaneously;

(c) At the ninth session of ECLA (Santiago, Chile, 4 to 16 May 1961) and at the Special Meeting of the Inter-American Economic and Social Council (IA-ECOSOC) at the Ministerial Level (Punta del Este, Uruguay 5 to 17 August 1961), resolutions 186 (IX) "Fiscal Policy", and A.3 "Taxation Program" respectively, were adopted recommending to the Member Governments of both organizations that they should give their fullest support to the OAS-IDB-ECLA Program;

(d) From 11 to 19 October 1961, a Conference on Tax Administration was held at Buenos Aires, Argentina, with the participation of fifty-two experts from various countries throughout the American continent, fourteen observers from different countries and 115 Argentine experts designated to attend the meeting by official institutions and universities of the country. The pertinent report was submitted to the ninth session of the Committee of the Whole of ECLA (Santiago, Chile, February 1962) and to the first session of IA-ECOSOC at the Expert Level and at the Ministerial Level (Mexico City, October 1962).[1/]

(e) After the meeting at Buenos Aires preparations were begun - in conjunction with the study of the tax systems of selected countries - for the present Conference; recognized authorities on fiscal policy were invited to contribute panel papers, and distinguished Latin American experts were asked to prepare analyses and comments on them;

(f) By bringing together outstanding international specialists and high-ranking Latin American officials, the Conference afforded an opportunity for discussion between those who approach fiscal problems from a purely theoretical standpoint and those who are engaged in solving them at the practical level. This made it possible for the topics of the agenda to be more comprehensively and thoroughly analysed, within the technical and practical framework which it was thought desirable to give to the Conference so that its findings might be useful to those called upon to take decisions relating to fiscal policy and tax reform.

3. The present provisional report is divided into two parts. The first gives an outline of the proceedings of the Conference and of the membership and attendance, and describes how the work was organized. The second part consists of the summary records of the meetings of the Conference. A complete list of participants and observers is given in an annex to Part I.

1/ See E/CN.12/AC.50/6 and OAS Ser.H.X.3 (background document No. 2), respectively.

4. Certain changes will be incorporated in the definitive version of the final report, which will be published in printed form by the international organizations participating in the Program. In principle, it will comprise the ten panel papers which were discussed as agenda items[2] together with the texts of the commentaries on them. The papers on each topic will be followed by a technically revised version of the summary records which appear in the second part of the present report in the provisional form in which they were distributed during the meetings, although these records have already been amended in the light of the corrigenda received from participants before the prescribed deadline.

Part I

ORGANIZATION AND RESULTS OF THE CONFERENCE

A. MEMBERSHIP, ATTENDANCE AND ORGANIZATION OF WORK

1. Opening and closing meetings

5. The Conference was inaugurated on 5 December 1962 in the Library of the Economic Commission for Latin America (ECLA). Addresses were delivered by Mr. Luis Mackenna, Minister of Finance of Chile, by Mr. Alfonso Santa Cruz, Acting Executive Secretary of ECLA and by Mr. Alvaro Magaña, economist of the Pan American Union, who spoke on behalf of the OAS-IDB-ECLA Joint Tax Program.

6. Messages to the Conference from Mr. Jorge Sol Castellanos, Under-Secretary for Economic and Social Affairs of the Organization of American States and Executive Secretary of IA-ECOSOC, Mr. Felipe Herrera, President of the Inter-American Development Bank (IDB), and Mr. Raúl Prebisch, Under-Secretary of the United Nations in charge of the secretariat of the Economic Commission for Latin America (ECLA), were read out in the course of the opening meeting.

2/ See below, paragraph 16.

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7. At their final meeting the participants in the Conference took cognizance of the present provisional report of their proceedings, and empowered the secretariat of the Program to recast it in its final form and introduce any changes needed to make it as complete as possible.

8. The closing meeting was held on 14 December 1962 in the same place. Mr. Manuel Rapoport expounded his views on the administrative aspects of fiscal reform. The Chairman, Mr. Alvaro Magaña, said a few words in the name of the OAS-IDB-ECLA Joint Tax Program.

2. Membership and attendance

9. The participants attending the Conference comprised forty-four experts on fiscal policy, from the following countries; Argentina, Brazil, Chile, Colombia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Italy, Mexico, Panama, Paraguay, Peru, Spain, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay and Venezuela.

10. In addition, twenty-five experts from some of the above-mentioned countries and Nicaragua were present as observers.

11. Persons specially invited to the Conference were Mr. José Rafael Abinader, Under-Secretary for Finance of the Dominican Republic, Mr. Edison Gnazzo, Director of the Income Tax Office of Uruguay, and Raúl Sáez, Acting Co-ordinator of the Committee of Nine appointed by the IA-ECOSOC. Mr. José María Cazal and Mr. Mauricio Baca attended as representatives of the Latin American Free Trade Association (ALALC) and the General Treaty on Central American Economic Integration (SIECA) respectively.

12. The participants, the observers and the persons specially invited attended the Conference in a personal capacity and not as representatives of their countries or Governments. It should be noted, however, that the OAS-IDB-ECLA Joint Tax Program has the official approval of the organizations concerned, which have recommended to their member Governments on various occasions that they should co-operate in the activities of the Program by presenting papers and facilitating the attendance of national experts at its proceedings.

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13. A complete list of the experts attending the Conference will be found in the annex to Part I of the present report.

3. Organization of work

14. The directors of the OAS-IDB-ECLA Joint Tax Program took the Chair at the Conference and conducted the proceedings in rotation. In the case of each of the topics considered, the authors of the panel papers and of the commentaries on them were invited to lead the discussion by making an opening statement and suggesting lines of approach.

15. The secretariat in charge of the work of the Conference was as follows:

Directors

Alvaro Magaña (OAS)
James Lynn (IDB)
Pedro Mendive (ECLA)

Technical Advisers

Marto Ballesteros (OAS-IDB-ECLA Program)
Wade Gregory (OAS)
George E. Lent (OAS-IDB-ECLA Program)
Milton C. Taylor (OAS-IDB-ECLA Program)

Conference Officer

Juana Eyzaguirre Ovalle (ECLA)

Editorial Section

Francisco Giner de los Ríos, Chief, Editorial Section (ECLA)
Frederick Fuller, English Editor (ECLA)

Administrative Officer

Richard Hughes (OAS)

/B. AGENDA

B. AGENDA AND BACKGROUND DOCUMENTS

16. The business of the Conference was conducted in accordance with the following agenda:

1. Opening addresses
2. Fiscal policy in Latin America's economic development

   Background documents

   Panel paper by Víctor L. Urquidi (CPF-DB-8T)

   Comments by Felipe Pazos (CPF-DB-8/Add.1) and Aníbal Pinto (CPF-DB-8/Add.2)
3. Fiscal capacity of developing economies: issues of tax policy

   Background documents

   Panel paper by Rajanikant Desai, of the Fiscal and Financial Branch, Department of Economic and Social Affairs of the United Nations (CPF-DS-1T)
4. The role of taxation in economic development

   Background documents

   Panel paper by Nicholas Kaldor (CPF-DB-3)

   Comments by Federico Herschel (CPF-DB-3/Add.2) and Rodrigo Núñez (CPF-DB-3/Add.1)
5. Issues of tax reform for Latin America

   Background documents

   Panel paper by Arnold C. Harberger (CPF-DB-4)

   Comments by Carlos Matus (CPF-DB-4/Add.1)3/
6. Public expenditures and economic development

   Background documents

   Monograph sent in by John H. Adler (CPF-DB-10)4/

   Comments by Jorge Méndez (CPF-DB-10/Add.1)

3/ Mr. Matus being ill, his paper was introduced by Mr. R. Ross.

4/ In the absence of Mr. Adler, his paper was introduced by Mr. Marinus Van der Mel.

/7. Personal

7. Personal income tax in Latin America

Background documents

Panel paper by Richard Goode (CPF-DB-2)

Comments by Ifigenia M. de Navarrete (CPF-DB-2/Add.1) and Ulises Flores and Alfonso Moisés Beatriz (CPF-DB-2/Add.2)

8. Taxes on net wealth, inheritances and gifts

Background documents

Panel paper by Dino Jarach (CPF-DB-5T)

Comments by Carlos Casas (CPF-DB-5/Add.2) and Jaime Porras (CPF-DB-5/Add.1)

9. Corporate income taxation in Latin America

Background documents

Panel paper by Alan R. Prest (CPF-DB-1)

Comments by Braulio Jatar-Dotti (CPF-DB-1/Add.2) and Alexander Kafka (CPF-DB-1/Add.1) 5/

10. Production, consumption and economic development taxes

Background documents

Panel paper by José María Naharro (CPF-DB-6T)

Comments by Néstor Vega Moreno (CPF-DB-6/Add.1)

11. Reform of agricultural taxation to promote economic development in Latin America

Background documents

Monograph sent in by Haskell P. Wald (CPF-DB-9) 6/

Comments by Sol Descartes (CPF-DB-9/Add.1) and W. F. Gregory (CPF-DS-3)

12. Fiscal problems in relation to a common market

Panel paper by Cesare Cosçiani (CPF-DB-7T)

Comments by Mauricio Baca, representative of the secretariat of the General Treaty on Central American Economic Integration (CPF-DB-7/Add.1) and José María Cazal, representative of the Latin American Free-Trade Association (ALALC) (CPF-DB-7/Add.2)

5/ The paper prepared by Mr. Kafka, who was unable to attend the Conference, was distributed to the participants.

6/ In the absence of Mr. Wald, his monograph was introduced by Mr. Descartes.

/13. General

13. General discussion

14. Provisional report of the Conference (CPF-DB-11)

15. Closing addresses

17. In addition to the panel papers and comments, and secretariat documents (bearing the symbols CPF-DB and CPF-DS, respectively) included in the foregoing agenda, the following documents were presented at the Conference for the information of the participants:

Tax policy recommendations of technical assistance missions: evolution, pattern and interpretation, by Eugene Schlesinger (CPF-DS-2)

Conventions for the avoidance of double taxation with respect to taxes on income, by Joseph Crockett (CPF-DS-4)

Incentivos tributarios en América Latina, by Pedro Mendive (CPF-DS-5) 7/

Income tax treatment of foreign investment, by Jack Heller (CPF-DS-6)

Resumen de la legislación tributaria de Chile, by Enrique Piedrabuena (CPF-DS-7) 7/

8/ Spanish only.

/C. FINAL

C. FINAL SUMMARY AND CONCLUSIONS[8/]

18. The participants were in agreement that the fiscal policy of the Latin American countries must be closely integrated with the economic development plans which these countries were preparing or implementing. Such integration must encompass the financial plans which make economic development a realizable goal.

19. The participants at the Conference likewise agreed that an overriding problem in the fiscal field in Latin American countries was that of increasing public revenue both by means of taxation and through an increase in the income of public enterprises.

20. Increased revenue was essential to enable the countries of Latin America to spend more on purposes essential for development, and on the mitigation of social and economic inequality. It was essential, also, in order to improve the relationship between the level of expenditure and the level of revenue. At present most Latin American countries had sizable deficits in their public accounts which were a major cause of their continued inflationary tendencies and which, by swelling profits artificially, also aggravated the inequality in the distribution of income and wealth.

21. The participants were agreed that there was ample capacity in most Latin American countries to increase public revenue and that among the most important causes for the insufficiency of such revenue was the failure of the tax system to impose effective levies on the propertied classes and to

8/ The present section of the report is a summary statement of the main aspects of the problems discussed during the Conference. Its purpose is to record the issues on which there was a general consensus of opinion, although in some cases agreement was not unanimous.

The present text, which has been kept as brief and concise as possible, outlines the broad features of the fiscal reform required in the Latin American countries to expedite their development. The specific views of each participant are set forth in the summary records of the various meetings, which are given in Part II of this report and will be included, duly revised and corrected, in the final published version.

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collect those in force.[9] While the great masses of the population bore considerable fiscal burdens, through indirect taxes of various kinds, and also through personal taxes deducted at source, the benefits accruing from the ownership of capital - whether in the form of income, of capital gains or of the spending power derived from the ownership of wealth as such - largely escaped taxation. Considerations of equity and of expediency alike required that any major reform of the tax system should ensure that the propertied classes, as well as the working classes, paid their due share of the common burden.

22. There was agreement that a comprehensive reorganiation of the existing fiscal systems was urgently called for, and that it should encompass a reform of the structure and administration of existing taxes so as to improve their yield, as well as the introduction of new taxes.

23. The participants recognized that the social, political, legal, and administrative characteristics of the various Latin American countries differed, and that fiscal reform, to be effectively put into practice, must be consonant with local characteristics. However, recognition of such considerations did not imply a modification of the objectives or a reduction of the required pace or pervasiveness of tax reform. It was essential, if the goals of accelerated development and improved distribution were to be achieved, that countries should overcome, by special efforts, such barriers as might in the past have prevented a comprehensive fiscal reform.

24. The participants, while firmly supporting the need for raising public revenue and expenditure, were equally emphatic in insisting on the improvement of expenditure policy. Even in the face of today's inadequate revenues, it was recognized that much wasteful expenditure was undertaken in the Latin American countries. Greatly improved methods of over-all investment planning, of project evaluation, of checking the performance of public sector operations, and of control over current expenditures of Governments, were all essential if the burdens of increased taxation were to bear the fruits to which the Conference aspired.

9/ The problems of tax administration were considered during the Conference held at Buenos Aires in October 1961. While the Santiago Conference dealt with the problems of fiscal policy, it was recognized that in practice neither subject can be separated from the other.

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25. The majority of the participants agreed that the most important aspects of a reorganization of the fiscal systems of Latin America related to the following:

(a) The reform, simplification and up-dating of the system of indirect taxation;

(b) The creation of a comprehensive unitary system of progressive personal income tax, which included the taxation of capital gains both on movable and inmovable property, supplemented by a net wealth tax where feasible;

(c) The collection of more revenue from taxes on urban and rural property, which would be additional to personal income taxes on the income derived from such property and which should also be co-ordinated with other forms of special taxation of income from property;

(d) The strengthening of the system of inheritance and gift taxation;

(e) The placing of public enterprises on a self-sustaining basis through the adoption of adequate rates for services rendered;

(f) The harmonization of the tax treatment of the income of foreign enterprises and the taxation of income which residents received from abroad.

(g) The creation of a fiscal climate which, with the cautious use of incentives, would be attractive to the formation of private capital and its investment in productive enterprise;

(h) The reform of budgetary practices and the inclusion in budgets of the operating results of autonomous agencies; and

(i) The establishment of an objective and co-ordinated system of tax administration, using each tax to give more solidity to the others, so as to guarantee that the benefits of substantial reform would not be lost in administration.

26. Though these measures are discussed separately, the Conference recognized the great importance of considering the merits of any tax system, not on the basis of the effects of individual taxes, but on the basis of the total impact on the economy of the system as a whole.

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27. As regards the reorganization of indirect taxation, it was generally felt that such taxation as at present administered was unnecessarily complicated, had undesirable economic effects in distorting the price system, and was also inefficient in terms of yield. It was felt that the reform of the existing systems could be so designed as to produce significant increases in yield and substantial improvements in progressivity while mitigating the economic distortions which such taxation involved.

28. Substantial increases in yield, together with important administrative simplifications, could be achieved by removing the multiplicity of specific taxes that now existed on articles of mass consumption, and by substituting in their place a single sales tax with a low rate and a broad tax base. Improvement in progressivity, as well as further augmentation of yield, could also be achieved by levying more severe excise taxes on luxury goods consumed predominantly by the middle and higher income groups. Luxury items imported from abroad already bore substantial import duties in most cases, but there was no similarly heavy indirect taxation of home-produced luxury articles, which now, in some countries, accounted for the greater part of luxury consumption.

29. Some of the participants considered that there was a case for substituting a uniform value-added tax in replacement of the existing sales and excise taxes. Such a tax would be payable by enterprises on the difference between their total sales and their purchases from other enterprises - a difference which was approximately equal to the sum of the net incomes generated (in the form of profits, wages, salaries, interest, and rent) by each enterprise. A value-added tax, by yielding independent information on the sales of interprises,would also provide the basic framework, for a more effective administration of the whole tax system.

30. With regard to the personal income tax, most of the participants believed that the Latin American countries should aim at the introduction of a unitary system which encompassed all forms of income. It was desirable that a capital gain should be recognized and taxed whenever there was a change in the ownership of either mobile or immobile property - irrespective of whether it was by way of sale, gift, or inheritance. In conditions of substantial inflation, it might be advisable to make some allowance for the

/increase in

increase in the price level in calculating the net gain on capital assets. There was also justification in principle for taxing the imputed rent of owner-occupied dwellings in order to provide equal treatment between owners and renters.

31. It was agreed that an essential requirement for the efficient operation of a personal income tax system was that the rate schedule should be both simple and not immoderate. While it was thought that the exemption levels should be higher in relation to average per capita income than those obtaining in the developed countries, it was felt that the existing exemption levels were too high in many cases. The participants agreed that there was no point in starting to levy tax at a very low rate, as was the custom in many Latin American countries, and that there were too many separate tax brackets. It was also an essential precondition of an effective system that the maximum marginal rate of the tax should be moderate. Excessively high marginal rates made it impossible to extend the tax to all forms of income (for example, capital gains) or to eliminate numerous exemptions. They also made it impossible to secure the willing co-operation of the taxpayer; they were the cause of much waste of time and talent in the search for tax loopholes; and they created too great a temptation to corruption and bribery. Hence they were not productive of revenue.[10/]

32. The Conference gave special attention to the administrative problem of calculating agricultural income for purposes of income taxation. While there was almost universal agreement that some form of presumed income rather than actual income had to be used, there was a difference of opinion with respect to the best way to determine such income. One group suggested that presumed income should be calculated on the basis of average yield of lands with similar characteristics. Others questioned this method as requiring information and technicians not at present available, and suggested that some fraction of self-assessed valuation of property be used as a measure of presumed farm income.

10/ Social and economic conditions in each Latin American country will dictate the appropriate minimum and maximum marginal rates, but for illustrative purposes it is suggested that the minimum chargeable rate for income in excess of the exempted amount should be about 10 per cent, and the ceiling marginal rates should not exceed 50 or 60 per cent.

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33. The participants were agreed that the ownership of property conferred advantages which were distinct from and additional to the income derived from such property. It was suggested, therefore, that in addition to a progressive income tax there should also be a tax on net wealth of individuals or families. For that purpose "wealth" should include property in the form of real estate and financial assets - as well as valuable personal possessions - and "net wealth" should be the excess of the value of such property over liabilities. Such a net wealth tax should be levied at relatively low rates on the wealth in excess of some reasonable multiple of the per capita national income. It was recognized that the net wealth tax required a high degree of efficiency of tax administration, and therefore its introduction in the near future might only be advisable for countries possessing those administrative prerequisites.

34. While the majority of the participants felt that such a tax should be progressive, with low rates (rising, say, from 0.5 per cent to no more than 2 per cent on the excess of wealth over the exempted amount), a substantial minority felt that the tax should be proportional.

35. The participants agreed that the administration of the income and net wealth taxes could be greatly improved if the individual taxpayer were legally required to make a regular and full disclosure of all the real property, stocks, shares, etc., owned by him, and if the tax authorities had legal powers to verify the completeness and accuracy of the taxpayer's returns.

36. Legal and administrative procedures should therefore be established which would enable the beneficial owner of immovable property and of financial assets to be identified. That required the compulsory registration of all real property in the name of the beneficial owner and the adoption of means whereby the ownership and transfer of securities (including bearer shares) were comprehensively registered with the tax authorities.

37. An efficient administration of the income and real property taxes also required the establishment of suitable procedures for the valuation of capital assets at their approximate market value. Under present conditions in Latin America that required a significant strengthening of both the technical and administrative capacity of tax enforcement authorities.

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38. The participants were agreed that in the setting of corporation income tax rates countries should balance the following considerations: the rates should not be set so high as to discourage domestic investment and risk-taking; on the other hand, the rates should not be set so low as to forgo substantial amounts of tax on the income of foreign enterprises where, as was typically the case, a reduction of the tax paid by such enterprises to the particular Latin American Government would only be offset by a corresponding increase in the tax payable by those same enterprises to the Governments of their home countries. While some progression in rates might be justified to favour small businesses, continuous progression through all income levels, similar to that applying in personal income tax systems, should be avoided. Such continuous progression invited corporate split ups and evasion, impeded the exploitation of economies of scale, and rewarded inefficient firms by taxing them at lower rates precisely because their profits were lower than would have been the case had they been efficient.

39. It was felt that an effort should be made to rationalize the taxation of income from different classes of property. Traditional taxes in that area included the corporation income tax, the tax on urban real estate, and the tax on agricultural property. It was felt that, in the interests of equity and also of an efficient allocation of resources, the different forms of capital should bear an approximately equal weight of tax, when income and capital taxes were considered together. That consideration suggested the possibility of imposing, where they did not already exist, additional special taxes on those forms of income from capital - such as the profits of unincorporated enterprises, and the interest paid by business firms - which at present did not bear any tax comparable to the corporation income tax.

40. Taxation of urban real estate and agricultural property was based in most countries on completely out-of-date valuations, and was in urgent need of reform, both to provide an important source of revenue and also to serve major economic and social objectives.

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41. In countries where the ownership of land was highly concentrated, and where the prevalence of absentee ownership militated against the introduction of progressive techniques in agriculture, a progressive agricultural property tax was a potent instrument for inducing efficient use of land, for creating a freer market in land, and for promoting the objectives of agrarian reform.

42. The basic problem in the taxation of urban and agricultural properties was to obtain adequate assessments, i.e., to determine the tax base. The participants considered two methods as possible substitutes for a supplement to the traditional one of direct valuation by fiscal officers.

43. The first was the method of self-assessment - the declaration by the owner himself of the value of his property. That declaration would be placed on public record, and any individual or enterprise would be free to make a bona fide bid to purchase the property. In the event of such a bid exceeding the owner's declared value by a significant amount (say 20 per cent), the owner, if he chose not to sell, would be required to revalue his property up to the amount which was bid. In that case the maker of the frustrated bid would be entitled to a premium, which might be in the amount of the extra tax obtained in the first year following the revaluation of the property. Where inflationary problems were of serious dimensions, provision would have to be made for the automatic readjustment of assessed values during the period between successive declarations required of the owner.

44. Some participants thought that the self-assessment system was likely to be superior to the traditional system even where the latter system was well administered; others considered self-assessment to be desirable over a transitional period during which the administrative means would be developed for an adequate assessment by fiscal officers. A further group felt that the principle of self-assessment was a good one, but that the mechanism for enforcing proper declaration should be legislation authorizing the fiscal authorities, on their own initiative, to acquire properties at the values declared by their owners. That variant had in fact been applied by a number of countries in the implementation of their agrarian reform programmes.

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45. The second method, considered in the case of agricultural but not urban property, was the assessment of land on the basis of its potential yield, taking into account the data provided by cadastral surveys.

46. The Conference felt that there should be progressive taxes on inheritance complemented by similar taxes on inter vivos gifts. Those served the purpose of reducing the importance of inherited wealth in the distribution of wealth and income - an objective which is distinct from the general goal of progressive taxation, namely that of reducing economic inequalities. If the recommendations made above concerning the full disclosure of property in connexion with income tax were adopted, the administration of inheritance and gift taxes would no longer present special difficulties.

47. It was felt that many Latin American republics fixed the prices of services provided by public enterprises at unjustifiably low levels, thus depriving their Governments of an important source of revenue. It was not often realized that the greater part of these services was sold, not to the final consumer, but to private enterprises, with the effect that the profits of private enterprises were artificially raised at the same time as the profits of public enterprises were kept at low or even negative levels. The participants felt that a reasonable goal of price policy for most public sector enterprises would be to obtain profit rates comparable to the gross-of-tax profit rates achieved in the private sector. That was especially important in Latin American countries where the profits earned in public enterprises could provide a significant source of financing for the needed expansion of their operations.

48. It was likewise felt that in the countries of Latin America the provisions of the law relating to foreign enterprises were relatively better administered than other provisions. However, attention was drawn to the fact that in a number of countries substantial concessions might have been granted to attract foreign investment. That was particularly true when the problem was considered from the point of view of the group of undeveloped countries as a whole. Concessions made by any one country, if successful, were more likely to divert the flow of funds from

/other countries

other countries than to increase significantly the total flow of such funds. In addition, attention was drawn to the fact that it was possible in some cases for international companies to understate the value of their exports - or to overstate the value of their imports - and thereby show a smaller profit on their local accounts than the true profit arising from their local operations. The Conference felt that both for the purpose of limiting undue concessions to foreign companies and for the purpose of ascertaining the true profit of such companies to be taxed, there was need for international consultations, aimed at the adoption of uniform principles in the tax treatment of foreign enterprises.

49. The Conference felt that there was a strong case on equity grounds for extending the liability for income taxation to income received from abroad - as was already the case in most European and North American countries - particularly since the residents of many Latin American countries owned very substantial amounts of capital abroad. It was felt that in order to enforce such provisions the co-operation of foreign countries should be enlisted to provide information of income received by residents of Latin America. It was known that some countries already provide such information on a mutual basis under international tax treaties.

50. The participants recognized that tax incentives could be a potent instrument of economic policy, both to induce resources into desired uses and to impede their use in less desired areas. Those incentives, however, had in the past had the effect of producing substantial revenue losses in most cases, while producing limited or even negligible positive economic effects in many others. It was essential therefore, that extreme caution should be exercised so that tax incentives had a high expectation of producing the desired effect with minimum loss of revenue; and it was a reasonable goal of policy, when incentives in a particular direction were contemplated, to contrive methods which accomplished this aim without any revenue loss. In the particular case of investment incentives, it was noted that it was not easy to devise and administer an efficient system, and that the use of those incentives was more powerful in influencing the character of investment than in increasing total investment.

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51. The Conference was in agreement in applauding the recent trend toward the development of common markets among the Latin American countries. It was noted however that as successive reductions of trade restrictions occurred, they might create transitory fiscal difficulties for some of the participant countries. The Conference also emphasized the need for preventing differences in fiscal provisions among the countries involved from producing undue distortions in the patterns of production and trade, and stressed the importance of further research in that area.

52. The participants indicated that for the implementation of reforms, the administration of the tax system, and the analysis of the effects of taxation, there was an urgent need for improvement in the quantity and quality of statistical data, and for a substantial augmentation of the supply of technical experts of the highest professional capacity. They urged that Governments and international agencies should continue their present efforts and undertake new and additional measures to accommodate those needs so as to make the fiscal reforms which had been the subject of the present Conference as effective as possible.

/ANNEX

ANNEX

LIST OF PERSONS ATTENDING THE CONFERENCE

Participants

Mauricio Baca Muñoz, Chief of the Legal and Fiscal Section, Permanent Secretariat of the General Treaty on Central American Integration (SIECA), Guatemala

Carlos Casas, Economic Adviser to the Government, Bogotá, Colombia

José María Cazal, Representative of the Latin American Free-Trade Association (ALALC), Montevideo, Uruguay

Cesare Cosciani, Faculty of Law, University of Rome, Italy

Félix Dardón, Under-Secretary, Ministry of Finance and Public Credit, Guatemala

Rajanikant Desai, Fiscal and Financial Branch, Department of Economic and Social Affairs, United Nations, New York, U.S.A.

Sol Descartes, Economic Consultant, San Juan, Puerto Rico

Mario Fernández Provoste, Adviser to the Ministry of Finance, Santiago, Chile

Ulises Flores, Doctor of Jurisprudence and Social Sciences, San Salvador, El Salvador

Richard Goode, Brookings Institution, Washington, D.C., U.S.A.

Arnold C. Harberger, University of Chicago, Chicago, Ill., U.S.A.

Albert Hart, Columbia University, New York, U.S.A.

Alvaro Hernández, Faculty of Economic Sciences, University of Costa Rica, San José, Costa Rica

Federico Herschel, Faculty of Economic Sciences, University of Buenos Aires, Buenos Aires, Argentina

Dino Jarach, Doctor of Law and Professor of Finance, Faculty of Economic Sciences, University of Buenos Aires, Buenos Aires, Argentina

Braulio Jatar-Dotti, Senator and President of the Congressional Bicameral Finance Commission, Caracas, Venezuela

Nicholas Kaldor, King's College, Cambridge, England

/Carlos Francisco

Carlos Francisco Lessa, Joint ECLA/BNDE Economic Development Centre, Rio de Janeiro, Brazil

Mackenzie Lewis, AID, Washington, D.C., U.S.A.

Pedro Maúrtua, Central Reserve Bank, Lima, Perú

Manlio Martínez, National Economic Council, Tegucigalpa, Honduras

Carlos Matus, Latin American Institute for Economic and Social Planning, Santiago, Chile

Jorge Méndez, National Council for Economic Policy and Planning, Bogotá, Colombia

Alfonso Moisés Beatriz, Salvadorian Association of Industrialists, San Salvador, El Salvador

Sergio Molina, Director of the Budget, Ministry of Finance, Santiago, Chile

Héctor Monterroso, Director of the Department of Economic Studies, Bank of Guatemala, Guatemala

Harold Moss, Director, Foreign Tax Assistance Staff, Internal Revenue, Washington, D.C., U.S.A.

José María Naharro, Central University, Madrid, Spain

Efigenia M. de Navarrete, National School of Economics, University of Mexico, Mexico City, Mexico

Rodrigo Nuñez, General Planning and Administration Authority, Panama, Panama

Felipe Pazos, Member of the Committee of Nine (Alliance for Progress) Washington, D.C., U.S.A.

Enrique Piedrabuena, Professor of Financial Law, Catholic University of Chile, Santiago, Chile

Aníbal Pinto, Director of the ECLA/BNDE Economic Development Centre, Rio de Janeiro, Brazil

Jaime Porras, Chief Adviser, Co-ordination Division Planning Board, Quito, Ecuador

Allan R. Prest, Christ's College, Cambridge, England

/Manuel Rapoport,

Manuel Rapoport, President of the Council of the Internal Revenue Administration, Buenos Aires, Argentina

Eduardo Riofrío, President of the Fiscal Tribunal, Quito, Ecuador

Miguel Rodríguez Molina, General Administrator of Income Tax, Ministry of Finance, Caracas, Venezuela

Alvaro Sánchez, Supervisor of the Department of Economic Studies, Central Bank of Costa Rica, San José, Costa Rica

Edgard Taboada, Under-Secretary for Finance, Ministry of Finance, Asunción, Paraguay

Victor L. Urquidi, Adviser to the Secretariat for Finance and Public Credit, Mexico City, Mexico

Eduardo Urzúa, Director of Internal Revenue, Ministry of Finance, Santiago, Chile

Néstor Vega Moreno, Adviser to the National Council for Economic Planning and Co-ordination, Office of the President of the Republic, Quito, Ecuador

Enrique Vidal Cárdenas, President of the Peruvian Institute for Tax Law, Lima, Peru.

Persons specially invited

José Rafael Abinader, Under-Secretary for Finance, Secretariat of State for Finance, Santo Domingo, Dominican Republic

Edison Gnazzo, Director of the Income Tax Office, Ministry of Finance, Montevideo, Uruguay

Raúl Sáez, Acting Co-ordinator of the Committee of Nine (Alliance for Progress), Washington, D.C., U.S.A.

Observers

Héctor Assael, Institute of Economics, University of Chile, Santiago, Chile

Rodolfo Balbi, Chief Adviser, Department of Technical Supervision, Internal Revenue Administration, Buenos Aires, Argentina

./Pablo Baraona

Pablo Baraona, Catholic University, Santiago, Chile

Maxwell E. Becker, United States Economic Mission, Santiago, Chile

Angel Boccia, Faculty of Economic Sciences, National University of Cuyo, Mendoza, Argentina

José Bordón, Chief of the Department of Tax Studies and Research, Finance Secretariat, Buenos Aires, Argentina

George W. Young, COMAP, Santiago, Chile

Ramón Donis, Income Tax Administration, Caracas, Venezuela

Néstor Fontaine, National University of Cuyo, Mendoza, Argentina

Marion H. Gillim, Barnard College, Columbia University, New York, U.S.A.

Raúl Grien, Venezuelan Development Corporation, Caracas, Venezuela

Augusto Grivot, Internal Revenue Administration, Buenos Aires, Argentina

Jorge Macón, National Investment Council, Buenos Aires, Argentina

Carlos Martínez Molteni, Secretariat for Finance, Buenos Aires, Argentina

Norman D. Nowak, Regional Commission, Internal Revenue, New York, U.S.A.

Oliver Oldman, International Tax Program, Harvard Law School, Cambridge, Mass., U.S.A.

Yamundú S. Patrón, General Inspector of Taxes, Ministry of Finance, Montevideo, Uruguay

Noél Ramírez, General Revenue Authority, Ministry of Economic Affairs, Managua, Nicaragua

Gustavo Serrano, President of the Chilean Tax Law Institute, Santiago, Chile

John D. Strasma, Institute of Economics, University of Chile, Santiago, Chile

Dan Throop Smith, Harvard University, Cambridge, Mass., U.S.A.

David Santiago Tobío, Internal Revenue Authority, Buenos Aires, Argentina

Osvaldo Torres Ahumada, Tax Auditor, Santiago, Chile

Maurinus van der Mel, International Bank for Reconstruction and Development, Washington, D.C., U.S.A.

Marvin Weissman, Director of Technical Assistance for Latin America, AID, Washington, D.C., U.S.A.

/Part II

Part II

PROVISIONAL SUMMARY RECORDS OF THE MEETINGS
OF THE CONFERENCE ON FISCAL POLICY

PROVISIONAL SUMMARY RECORD OF THE FIRST MEETING
held at Santiago, Chile,
on Wednesday, 5 December 1962, at 4.10 p.m.

Chairman: Mr. MAGAÑA

CONTENTS:

Fiscal policy in Latin America's economic development

FISCAL POLICY IN LATIN AMERICA'S ECONOMIC DEVELOPMENT

Mr. URQUIDI said that the fundamental problem of fiscal policy in Latin America today was the lack of a prior definition of development policy. However fiscal policy was defined, and irrespective of whether it was assigned a broader or narrower scope, it was very difficult to carry out a consistent and rational fiscal and financial policy until such time as Governments, political forces and private sectors agreed on a minimum development plan or programme establishing sectoral targets and recognizing the work that both the public and private sectors must carry out to achieve it.

The formulation of adequate development programmes had not made much headway in Latin America and the implementation of important aspects of development policy was deficient. In those circumstances, many of the measures that formed part of fiscal policy were proposed or adopted without a clear understanding of the purposes they were intended to achieve or of their probable effects. Most of them were adopted rather to meet pressing financial needs or public expenditure or for the purpose of promoting or restricting some form of private activity.

However, there was an increasingly clear feeling that the trend towards development programming would have to be accompanied by a re-shuffling of ideas on financing and on the use of different fiscal instruments, and that any public or private investment plan be in keeping with a fiscal and financial plan formulated with the utmost possible precision.

Fiscal policy could not be more precise than development plans; but that did not prevent evaluating it in terms of the targets that today were accepted as essential components of any development policy in Latin America, namely the need to increase the relative volume of public and private investment and to change its sectoral composition, to increase the public sector's current expenditure to provide essential services for economic development, and to improve the distribution of income. Fiscal policies could and should adhere to these aims at any rate in a very general way.

/In order

In order to do so, efficient methods should be adopted for the formulation and control of fiscal policy. In that connexion, it should be stressed that the financial administration of a country needed a unified command: the Minister for Finance should be in a position to coordinate taxation, expenditure and borrowing policies at all levels of government, as well as the financial and price or tariff policies of the semi-public sector, including social security, state banks, and the agencies responsible for regulating supplies.

Fiscal policy was the whole body of measures relating to the tax system, public expenditure, contracting of internal and external debt by the State, and the financial operations and situation of the autonomous and semi-public agencies and bodies, through the medium of which the amount and distribution of public investment and consumption as components of national expenditure were determined and the volume and composition of private investment and consumption were directly or indirectly influenced. The definition implied that the influence of fiscal policy on economic and social development depended in essence upon what each country conceived to be the role of the State. Paradoxically enough, even if it were assumed that in any given country the idea prevailed that the State should have as little as possible to do with matters of infrastructure and that it should only exceptionally undertake activities directly related to production or distribution, fiscal policy would be just as significant and important as in cases where the State played a substantial part in the creation of the infrastructure of development or in the establishment of agricultural, industrial or distribution enterprises, since it was responsible for guiding the multifarious decisions taken with respect to private investment and consumption, reconciling them with national economic development aims and adapting their tempo and distribution to the requirements implicit in the aims in question.

At the time of speaking, most of the Latin American countries were closer to the first than to the second extreme. There were few countries where the public sector accounted for more than 15 per cent of national expenditure, where public investment exceeded 33 per cent of total gross investment, or where tax revenue represented over 12 per cent of the gross

/product. Consequently,

product. Consequently, a fiscal policy conceived as a harmonious and consistent whole and defined with proper clarity was, in such cases, of supreme importance to programmes for the accelerated economic development of Latin America, since the behaviour of the private sector would largely condition the results achieved.

That over-all concept of fiscal policy was not confined to the tax measures adopted by a country's central or federal Government, but also covered the sphere of state or provincial and municipal authorities. Any incongruities between the measures adopted by a central Government and a provincial authority, for example, might adversely affect the rate of private investment and exert an unfavourable influence on specific categories of productive investment. Similarly, the field of fiscal policy had to be extended to embrace autonomous or semi-public agencies and enterprises that were wholly or partially owned by the State, including official banks. If the tariffs or prices charged by such bodies were high, their effect was the same as that of a tax; if, on the other hand, they were low, they really represented a subsidy to the groups or sectors making use of the goods or services concerned.

Another special case that merited separate consideration was that of social security institutions, insurance and pension funds, etc. In some countries, the tripartite nature of the contributions to such institutions made it doubtful whether they could, strictly speaking, be regarded as belonging to the public sector. However, in view of the significance of social security systems for the community as a whole, it was necessary that they should operate as part of that sector, since the contributions made by workers and employers were analogous to a tax assigned to a specific purpose, and the current surplus of income over expenditure (after the transfer of funds from the central Government to the Institutions in question had been taken into account) was often one of the principal sources of saving in the public sector; moreover, investment in hospitals, welfare centres and housing by social security agencies frequently acted as a substitute for the investment that should be directly effected by the State.

/Another factor

Another factor in fiscal policy that was not always fully recognized was the contracting of debt by the different branches of the public sector. The internal or external indebtedness of the central Government or of a provincial or municipal authority presented no problem, but difficulties did arise in relation to financial transactions in the subdivision constituted by semi-public agencies and enterprises. To be consistent with the theory hitherto sustained, debts contracted by semi-public enterprises should be treated as an aspect of fiscal policy, with the possible exception of short-term commitments (for less than a year) entered into purely for the purposes of current or cash operations.

Fiscal policy should also be taken to include exchange measures and the activities of central banks as well as the control mechanisms established by the State to facilitate the marketing of crops, guarantee minimum rural prices, absorb production surpluses, and regulate supplies and stabilize prices of food in urban areas.

To sum up, the legitimate field of fiscal policy was extremely broad, although in practice it was clearly difficult not only to arrive at the figures whereby the policy in question could be expressed in quantitative terms, but also to overcome the administrative, legal and political obstacles to the unification of fiscal and financial policy under a single authority.

With regard to the objectives of fiscal policy, those directly linked to economic development were of more importance than those of a social nature, and were three in number: (a) to create sufficient public savings to cope with the estimated volume of public investment, and to collect, by means of internal and external borrowing, such additional resources as it might be prudent to obtain from private or foreign savings; (b) to absorb from the private economy, by the most equitable and efficacious means, the income required to cover the provision of those public services which the community regarded as indispensable or desirable; and (c) to manipulate various tax, expenditure, exchange, price or rate-fixing and other instruments, in such a way as to provide the private sector with sufficient incentives to generate the volume of savings required for economic development and to effect its proper share of investment.

/The foregoing

The foregoing basic objectives might be supplemented by others in respect of which fiscal policy could play a useful role, without necessarily being the best or the most decisive instrument. One of them was the modification or compensation of short-term fluctuations in the economy. In that case, fiscal policy alone, without the support of other aspects of government policy, could not assume responsibility for stabilization without neglecting objectives of more fundamental importance.

Another aim in which fiscal policy could co-operate, without being the most appropriate instrument, was the improvement of income distribution. But a more progressive income tax, and the various forms of taxation on net wealth and on luxury private expenditure, did not really reduce the disparities between levels of personal income. Such incomes might continue to be generated just as unequally as before, in consequence of a country's agrarian, commercial and industrial structure.

Where taxation was concerned, a tendency had been observable in Latin America in recent years to rely more on direct than on indirect taxes, at least in central government taxation, especially income tax. If a tax structure was to be efficacious, it had to be in line with country's institutional life, viewed both in retrospect and in its current patterns, and it also had to be properly in keeping with the ends pursued. Consequently, efficient fiscal and administrative technique must be combined with sound political judgment if a tax reform was to be anything more than a mental exercise and was to have the backing of the taxpayer. In that connexion, perhaps the first step ought to be a careful revision of many juridical theories which might be unnecessarily cramping the concept of taxable income, especially in relation to individuals, or which in one way or another tended to lessen the effect of progressive rates. The points which should be elucidated and reviewed included the ideas of imputed or potential income from rents; equity or inequity in respect of family exemptions or allowances at various income levels; retroactivity in taxation on capital gains accruing from immovable property; and income deriving from common property in the case of married couples.

/In most

In most of the Latin American countries the income tax system was schedular, with the resulting serious drawback that it precluded the equitable application of family allowances and left room for inequitable taxation on income from different sources through different progressive or proportional rates. It seemed essential that an attempt should be made to simplify income tax in the sense of making a single rate applicable to consolidated personal income and requiring returns from all persons whose income level exceeded a specified and relatively low figure. Nor should efforts to improve the income tax system overlook incentives to investment, which could be safeguarded by the adoption of scales that were not over-progressive and whose average maximum rate did not exceed about 35 to 40 per cent at very high income levels.

The problem of incentives to investment might be more significant, however, in relation to taxes on the gains or profits of enterprises than in relation to taxes on personal income, and that important aspect of tax policy had possibly been neglected in Latin America. Although there were various types of reliefs, the existing system of tax exemptions had not been properly rationalized with respect to its effects on investment. Accelerated depreciation had the advantage, in relation to exemptions, of being accorded in respect of investments already made and not of possible future investments subject to various contingencies. In addition, it was a more positive instrument, since it could be applied in different ways to different branches of industry and could thus be adapted to the growth projections incorporated in industrial development plans or programmes.

Zeal for modernization and improvement of the fiscal system should not lead to neglect of indirect taxation. Export taxes were in some measure a substitute for income tax as applied to primary activities, and had been particularly useful where the need had arisen to impose taxes promptly on the windfall profits accruing to exporters from a currency devaluation or an unexpected and abrupt increase in international prices. But it was a clumsy and inequitable device, since it did not differentiate between the various levels of productivity and efficiency normally reflected in costs, and was shifted back to the weakest link in the chain of production

/and distribution,

and distribution, almost always reaching the agricultural worker. Other taxes on transactions should be regarded primarily as a source of Government revenue, which meant that they should be sufficiently low, in ad valorem terms, not to discourage production or mass-consumption patterns, but sufficiently high to make a substantial contribution to tax revenue.

However, no Government should neglect the opportunities that existed - even in conjunction with the trend towards imposing general sales or gross income taxes - for establishing special rates in respect of particular types of consumption that were associated with the higher income groups or were subject to more pronounced income-elasticity. Such taxes, besides representing an addition to fiscal revenue that might be considerable, constituted an equitable supplement to personal income tax and forestalled evasion by expenditure out of unreported income.

Import duties were becoming increasingly difficult to rationalize from the revenue standpoint. As industrialization progressed in Latin America and the scope of tariff protection was extended, import duties, if they were to be effective as a protectionist device, would have to become less effective as a revenue instrument.

A special type of taxation that in some countries amounted to an important or even the principal source of public revenue was that applied to the profits and activities of foreign investment in primary commodities. Such taxes could be justified not only from the political standpoint but also on economic grounds. In that connexion, two arguments stood out: (a) the extraction of primary commodities implied a drain on natural resources calculated to weaken the country's future economic capacity; and (b) such activities had often involved an inordinately rapid distortion of the economic structure which had made it more difficult to develop other sectors of the economy. Additional taxation on the foreign investments concerned would offset those negative factors, and would be an important element in fiscal policy if it were used to support economic development programmes through public investment in the infrastructure and through the financing of expanded domestic investment in agriculture and industry.

/Tax reforms

Tax reforms would be difficult to justify unless at the same time the Governments of Latin America formulated and carried out public expenditure policies that were more in line with the development and welfare aims they had undertaken to achieve. The technique of programme budgeting, as yet applied only on a limited scale in Latin America, appeared to be the most suitable instrument for ensuring that public expenditure became more effective. By its means the Government budget could be reconciled with development plans, but its adoption entailed special training of budget office personnel and administrative or legal reforms.

Some semi-public bodies had difficulty in financing their own investment, but others were possible sources of savings or revenue for the treasury. They should at least be spurred on by the desire to serve the community as productively as possible, and should aim not at unduly large profits but at providing low-cost goods and services, creating financial reserves for future expansion and adding to the over-all resources of the public sector.

With regard to internal contracting of debts, it was important to consider a problem closely related to monetary policy: that of the limits of such borrowing. Capital markets in Latin America had not much absorption capacity, and it would be inexpedient for the Government to compete in them with the private sector. However, it could create, within the banking system, a growing market of internal debt issues, provided that selective credit controls were maintained.

External borrowing was subject to one general and several specific limitations. The general limitation consisted in the borrower country's future capacity to pay. In determining it, some part was played not only by export prospects for goods and services, but also by the success of the development programme with respect to import substitution resulting from an increase in domestic production capacity in relation to the growth of aggregate demand. If the margin of external borrowing was to be broadened, dynamic import substitution would in its turn have to be based on a coherent public and private investment programme and, of

/course, on

course, on the complete and efficient utilization of domestic savings; in other words, there was a link between the possibilities for contracting debts and fiscal policy. Specific limitations included the credit patterns followed by the international agencies, and the inadequate capacity of fiscal policy to attract foreign private investment.

The enumeration of all the foregoing important aspects of fiscal policy clearly showed that fuller and better studies on the subject were required. Some recommendation might emerge from the meeting on the need for such studies to be carried out and for the private sectors to co-operate in the working out of fiscal policy.

Mr. PAZOS said that Mr. Urquidi's paper on Fiscal policy in Latin America's economic development was the best over-all study on the subject that he had read, and that he fully endorsed most of its arguments and recommendations. There was one point, however, on which he was not in agreement, namely, the secondary role assigned by Mr. Urquidi to fiscal policy as an instrument of income redistribution.

Before reading the paper under discussion, he had reviewed the instruments and policies which the Latin American countries could use to improve income distribution, and he firmly believed that in existing circumstances the only instrument whereby that aim could be achieved over the short term, without causing serious distortions in the Latin American economies, was fiscal policy.

He had arrived at that conclusion after careful consideration of a number of non-fiscal measures: (a) promulgation of legislation to raise wages; (b) promulgation of legislation on minumum wages; (c) strengthening of workers' organizations; (d) intensification of competition between the producer and distributor enterprises (limitation of monopolies): (e) payment of subsidies for foodstuffs and/or other essential goods and services; (f) promotion of technical advances in the agricultural sector, in order to expand food production and reduce costs; (g) agrarian reform; and (h) improvement of the productivity of labour as part of the development process.

/Generally speaking,

Generally speaking, the first three measures did not have the effect of increasing the real income of wage-earners, because as a rule the prices of essential goods rose accordingly. The fourth was difficult to put into effect in countries with markets as restricted as those of Latin America. The fifth was really an aspect of fiscal policy and had been mistakenly associated with the rest; and the remaining three failed to influence income distribution rapidly enough.

If the foregoing analysis was sound, and if the fiscal instrument was rejected as a means of appreciably redistributing domestic expenditure in favour of the lower income brackets, the appalling disparities in standards of living that were prevalent among the Latin American peoples would be indefinitely perpetuated.

In the context of the possibilities of fiscal policy as an instrument of redistribution of income, he compared income distribution in the industrial countries with the situation in Latin America. There was a good deal more inequality in the Latin American countries than in the highly-industrialized group, for whereas in Canada, Japan, the United Kingdom and the United States 10 per cent of the households in the higher income brackets received about 30 per cent of monetary income, in Mexico the corresponding figure had been as high as 46.7 per cent in 1957, while in Venezuela it had amounted to about 45 per cent in 1958. Although those were only approximate figures, very similar results were obtained when other methods of calculation - also approximate - were adopted. The application of such methods to other Latin American countries showed that there too income distribution was much the same as in Mexico and Venezuela.

As fuller information was currently available on income distribution in the Latin American countries, the time had come to modify earlier ideas - still upheld by Mr. Urquidi - as to the narrowness of the tax base for income tax in the economies of the region. The great concentration of income in the hands of the top decile of the population afforded a splendid basis for income tax and for the tax system as a whole. On the assumption that 45 per cent of the personal income accruing to the highest decile was equivalent to 37 per cent of gross domestic production, and that income tax took 20 per cent, the revenue thus obtained would amount to 7 per cent of the gross domestic product, instead of the 2 per cent postulated, a figure which in any case was probably higher than the average for the

/Latin American

Latin American countries. Moreover, if taxes on luxury consumption, after payment of income tax, took 20 per cent of the income of this upper stratum of the population, the corresponding revenue would be equivalent to 6 per cent of the gross domestic product, which again would be a figure in excess of that assumed. By means of those two items, the benefits of the expenditure of the top decile could be effectively redistributed among the remainder of the population, to an amount equivalent to 7 per cent of the gross domestic product.

However, the possible effects of such a redistribution on the top decile would have to be taken into account. The assumption was that the volume of investment would decrease, as a result of diminished resources and a reduction of the incentives to invest. As far as the first of those factors was concerned, it was currently recognized that (as Mr. Urquidi himself had acknowledged) the decision to invest had no connexion with prior formation of savings and that probably personal savings represented a relatively small fraction of private saving in the Latin American countries. Even so, it was possible that private saving might decline at first as a result of redistribution, but in all probability consumption would be readjusted after a year or two and the level of saving would rise as high as or even higher than before.

With respect to the reduction of investment incentives, and the decrease in investment which Mr. Urquidi feared might result, he thought that was unlikely to happen, for several reasons: first, because the bulk of real and directly productive investment was effected by corporations - which should be taxed at a uniform and not unduly high rate, and should not be subject to progressive taxation - and saving on their part would increase inasmuch as a high personal income tax discouraged the distribution of profits; secondly, because the action of the higher income groups was not prompted solely by desire for profit but by other motives, and they would continue to invest in order to keep their establishments ahead of their competitors; and thirdly, because the limitation of their gains also limited the investors' fear of risks.

In view of all the arguments he had put forward, he thought it might be suggested to the Latin American countries that they should tax persons in the highest-income decile of the population more heavily in order to increase fiscal revenue by the equivalent of 5 to 10 per cent of the gross domestic product.

/Mr. PINTO

Mr. PINTO agreed in general with the observations made by Mr. Urquidi, but said he would like to enlarge upon one or two points that he considered to be particularly important.

The first concerned the scope of the State's sphere of action in Latin America and the nature of the instruments it employed. The region was not yet fully aware of the scale and variety of the resources and instruments at the disposal of its Governments and tended to assess them according to the share of public expenditure in the gross national product, which did not give a true picture of the situation. It was thought in some circles that the State had a limited field of action, but in many Latin American countries the Governments had almost complete authority over foreign trade, the monetary system, public utilities, some basic industries, the social security systems and wage and salary negotiations. In fact, the State had a great potential at its disposal which was often not used to its full extent.

Its failure to make use of it was largely due to the constant addition of new agencies to the public sector, which simply overlaid the traditional administrative machinery without replacing or being assimilated into it. The ensuing duplication of work and responsibilities could be found in other parts of the world but was particularly marked in Latin America.

A minor but still significant factor was the widespread tendency to regard legal provisions and their administrative corollaries as substitutes for practical solutions.

The inability to make good use of the resources and mechanisms at the State's disposal was, however, not attributable to those factors alone. He himself thought that the main reasons were twofold: firstly, the fact that the State's responsibilities and, by extension, its relations with the private sector were not clearly defined in terms of policy. In many influential circles the participation of the State was still looked upon as proper for emergencies only instead of as a normal and indispensable part of the economic development process. There was a tendency to take full advantage of such concepts as "free enterprise" while ignoring the public responsibilities involved therein. The divorce

/between words

between words and deeds had not prevented the State from acting but it had undoubtedly hampered the rationalization of its activities and created antagonism between the public and private sectors. The second reason was the difficulty of adopting criteria and taking decisions in particular sectors or situations in the absence of an integrated economic policy and an over-all picture of the aims pursued.

With reference to Mr. Urquidi's remarks on the problems besetting public enterprises, he first wished to lay stress on the increasing importance of State-administered productive enterprises which, in view of the more complex and exacting stage of development that the Latin American countries were entering upon, would make government action, either in isolation or in close association with the private sector, indispensable.

One question that still remained to be clarified concerned the criteria by which the efficiency of public or semi-public enterprises was to be determined. He considered it equally unsatisfactory that the latter should be governed by the same standards as private firms or that they should discard the yardsticks used by private firms before devising others that would be more suited to their particular functions. One measure of efficiency that should be used was the technique of programme budgeting which needed to be more generally taught and applied.

A prerequisite for solving the problem was, as Mr. Urquidi had pointed out, to make the general public aware of the purpose and social implications of the work of State enterprises so as to convince it that what was received as a subsidy was paid out in the form of taxes.

But the problems involved were not merely technical. They also derived from the balance that had to be struck between the need for public enterprises to preserve their autonomy in technical and administrative matters while adhering to the policy laid down by the Government. No definite line of demarcation could be drawn, but it would be helpful to study specific cases in Latin America so as to establish some basic criteria for future action.

With regard to another point - that of taxes themselves - he considered that the time for weighing the relative merits and demerits of different types of taxes was past. What needed to be done was to lay down some

/general guide-lines

general guide-lines that could be adapted to the requirements of individual countries. In that respect, he stressed three considerations: first, one way of resolving the conflict between the prevailing belief that income tax should play a more important part in Latin American tax systems and the administrative difficulties involved was to levy it particularly on the wealthy minority e.g. on persons with a net income at least ten times the average figure. Secondly, other taxes, such as those levied on net wealth and various types of fixed assets, particularly real estate, should make a greater contribution than in the industrialized countries. In doing so, they would help to widen the tax base and to facilitate tax administration. Thirdly, the importance of excise taxes should be maintained without enhancing the regressive nature of income distribution. Some other way of classifying excise taxes should therefore be devised that would take into account their social implications. It would be difficult to do so, except for the fact that the pattern of consumption in the lower and intermediate income groups in Latin America was fairly easy to determine. Provided that that pattern was respected and the possible repercussions of a progressive public expenditure policy allowed for, virtually all indirect taxes would be progressive to some extent.

With respect to the final results of fiscal policy, he pointed out that the tendency to increase transfers of funds for social security purposes was unfavourable in comparison with the alternative of increasing expenditure on education and health which, apart from being intrinsically more equitable, was more apt to raise the real income of the population.

Lastly, he had two objections to make to Mr. Urquidi's observations on the role of fiscal mechanisms in income distribution and compensatory policy. On the first point, he agreed that such mechanisms could not have the same significance in Latin America as in more developed countries. Although any endeavour to change income distribution would have to go beyond fiscal policy, the latter would have an important part to play. In order to determine its responsibility it was essential to understand the different ways in which fiscal policy could bring about a redistribution. One was to take income away from the higher income groups and

/transfer it

transfer it to the less well-off. Another was for the State to tax the wealthy and use the revenue to provide goods and services for the poorer classes, and a third was to use the same source of revenue to influence the factors that underlie income distribution.

He agreed that compensatory policy faced many difficulties in Latin America, but should none the less be resorted to when foreign trade was declining, to maintain the levels of employment and income and to prevent the rate of economic development from slackening.

<u>The meeting rose at 6.10 p.m.</u>

PROVISIONAL SUMMARY RECORD OF THE SECOND MEETING
held at Santiago, Chile,
on Thursday, 6 December 1962, at 9.55 a.m.

Chairman: Mr. MAGAÑA

CONTENTS:

Fiscal policy in Latin America's economic development (continued)

FISCAL POLICY IN LATIN AMERICA'S ECONOMIC DEVELOPMENT (continued)

Mr. COSCIANI, commending both the document on the subject under discussion presented by Mr. Urquidi, as well as the author's verbal comments on the paper at the previous meeting, agreed with him regarding the need to coordinate fiscal and financial policy in its different sectors and at the highest administrative level. He wondered, in that respect, whether the best and most logical way of securing such coordination might not be through over-all economic planning, and whether it might not be advisable to attempt such coordination at the international level.

With regard to the effect of fiscal policy on the distribution of national revenue, he also agreed with Mr. Urquidi that it could only be achieved if fiscal policy was preceded by structural reforms. Although Mr. Pazos was sceptical about the efficacy of such reforms, there was surely no doubt that they constituted a prerequisite for investment, which was only feasible in an atmosphere of peace and social security; a progressive income tax was an effective instrument to achieve that.

With regard to Mr. Urquidi's remarks on public enterprises, he thought it wrong to generalize on the prices of services in relation to cost; instead, in some cases, the use of prices which fundamentally were consumer subsidies might be justified. The opinions of Mr. Urquidi and Mr. Pazos regarding the limitations of fiscal policy or other alternative measures to achieve redistribution of income struck him as over-pessimistic, and he did not share them entirely.

Mr. NAHARRO agreed with Mr. Urquidi regarding the necessity of planning and coordinating fiscal policy with the other economic activities of the country, as well as on the difficulties that involved. He wondered what the coordinating or planning agency should be; as so-called planning boards did not usually have executive powers, a political-administrative machinery capable of achieving such coordination effectively would have to be found. He also agreed with the

/author on

author on the advisability of obtaining the co-operation of the private sector in regard to fiscal policy, to the extent that the latter constituted an instrument or tool of development. Aside from the indirect forms of co-operation obtainable through the parliamentary system and the influence of public opinion, he wondered how it would be possible to enlist the co-operation of the public and private sectors in that field by direct means.

In addition to the foregoing general remarks, he would like to make special reference to certain other matters dealt with by Mr. Urquidi. He wondered, for example, whether it would not be advisable for tax purposes to distinguish between income derived from capital and from work, when such a distinction - in kind and quality - might further the redistribution of income. With regard to rates for essential public services provided by independent enterprises, he pointed out the danger of resorting to the system of price differentials, although he recognized that they might be useful for the redistribution of resources and for economic development if made to favour the more promising sectors. It might be preferable to replace such a system by a system of subsidies which do not produce distortions in relative prices.

Mr. HERSCHEL drew attention to the importance of making a distinction between the theoretical and practical aspects of fiscal policy and of ensuring efficient co-ordination of public and private interest in that field; he agreed with Mr. Urquidi on those points. On the other hand, he disagreed with him regarding the proportion of the public sector's participation in domestic expenditure and the gross national product, at least as far as Argentina was concerned. With regard to tax incentives, in his country they did not constitute the main factors in investment decisions. Customs duties played an important part in the fiscal revenue of some Latin American countries.

/Mr. CASAS

Mr. CASAS emphasized that the objectives of fiscal policy could not be different from those of economic policy which were to obtain an optimum level of productivity and income, to ensure economic stability and to secure a more equitable income distribution. The three aims were inter-dependent. In connexion with the third objective, a redistribution of wealth and income should be such as to ensure an increase in productivity. Failure to understand that had led to a somewhat inaccurate approach to the development of fiscal policy. Fiscal policy could be used to achieve a redistribution of wealth and income by correcting existing inequities and preventing those which might arise in the future. Existing inequities could be corrected through the intervention by the State in the form of an imposition of a progressive tax or an increase in direct taxes. Fiscal policy was an especially important factor in enabling the Government to create conditions beneficial to the private sector and therefore had an essential part to play in creating the conditions required for economic development.

Mr. VEGA observed that in Mr. Urquidi's view the primary objective of fiscal policy was to secure increased revenue for the Government rather than to redistribute wealth and income. The latter objective, however, should not be disregarded. As to which should come first, it was rather a question of timing and methods than of priorities. Fiscal policy alone as a means of ensuring a redistribution of wealth and income was not very effective. Such redistribution could be better achieved through agrarian reform which was not merely an instrument for redistributing land but also for securing a more equitable distribution of wealth and income. Public expenditure was also an instrument for securing redistribution of income although its main aim was to provide more infrastructure works, primarily benefiting those able to invest.

/He did

He did not agree with Mr. Urquidi's view that it would be preferable to present tax rates to the public as average rates instead of marginal rates. It would be difficult to collect enough revenue to finance the budget merely from the use of average rates. To use the latter would be to abandon progressive taxes in favour of proportional taxes. Nor could he support Mr. Urquidi's contention that investment incentives could best be sought through accelerated depreciation rather than tax concessions. He felt that the latter were preferable.

Mr. DESCARTES felt that Mr. Urquidi's concepts of economic development programming were both useful and effective and he was in agreement with the main points made, particularly with respect to the broad scope of fiscal policy. Care should be exercised, however with respect to the responsibility of Ministries charged with specific objectives of fiscal policy, on the one hand, and the position of economic planners on the other. Both were essential to effective action. He fully agreed with Mr. Urquidi regarding the important part that should be played by the Minister of Finance in this area.

While he supported Mr. Urquidi's position with respect to the primary objective of fiscal policy, namely economic development, he felt that the importance of income redistribution should not be minimized. Both were essential to development and did not conflict.

Another important factor was the income tax and the need to educate the public on the benefits to be derived therefrom. That could best be done through advisory committees in which the private sector was represented. Such committees had produced good results in Puerto Rico as a means of ensuring public understanding of some tax programmes.

With regard to autonomous agencies, he felt that they should be self-supporting and that public utility rates, e.g. in the electric power industry, could be lowered in some cases to ensure social benefits without destroying the aim of economic self-sufficiency of the rate structure as a whole. He stressed the danger of adjustments made for social purposes but felt that they could be effected with moderation and common sense, bearing in mind that the over-all rate should cover costs.

/He further

He further stated that a good public accounting system was important to the economic development process and he supported programme budgeting.

Lastly, he shared the concern expressed by Mr. Pinto regarding the proliferation of Government agencies and legal machinery. Attention should be paid to those points and an attempt should be made to remedy existing deficiencies.

Mr. KALDOR said that he was sure that Mr. Urquidi was largely in agreement on the main issues with those who had commented on his paper, and would undoubtedly subscribe to two beliefs held by those present: firstly, that the share of income from property in the national income was too high in Latin American countries, and larger than in other areas, and secondly, that as a result of defects in tax legislation and administration, property incomes did not bear their fair share of the tax burden. He himself agreed with Mr. Urquidi that the redistribution of income from the rich to the poor was not the primary objective of taxation, which must be to collect revenue, and in so doing transfer resources from unproductive to productive use. However, that could not be done without drawing the large mass of income from property into the tax net. The share of the national income paid in taxation could not be increased unless a Government could reach the large proportion of income received from property; for example, to the 46.7 per cent referred to by Mrs. Navarrete as accruing to the top 10 per cent bracket in Mexico, on which little tax was paid. The aim must be to make a larger proportion of the national resources available for productive purposes, whether for recurrent items such as public services, or non-recurrent items such as savings. Even though the objective of taxation was not to redistribute income, it was very probable that that would be its effect.

/Referring to

Referring to pages 15 and 16 of Mr. Urquidi's paper (CPF-DB-8 T), he said that he must disagree, from the standpoint of economic theory, with the views expressed there. The share of income to property in the form of profits depended largely on the levels of consumption by property owners. An increase in taxation yield would improve the balance between public revenue and expenditure; taxation of property, if it reduced the propensity to consume from property income, would also change the respective shares of national production going to labour and capital before taxes. It was no mere coincidence that in countries where there was effective taxation of property income, such as the Scandinavian countries, the United States and the United Kingdom, the share of income going to profits before taxes was lower than in countries where property income was not taxed because of defects in the tax system. In other words, in the latter countries, the share of the national income going to labour was reduced because of the high propensity to consume of property owners, which increased the share of profits in output. He could not therefore agree with Mr. Urquidi that progressive taxation did not tackle the root of the problem of the share of production accruing to different social classes.

Mr. JARACH, while agreeing with Mr. Urquidi that the primary objective of fiscal policy was to increase revenue, could not support the contention that taxation could not lead to income redistribution. He shared Mr. Pinto's view that redistribution depended upon the use made of public expenditure. Moreover, economic development should not be confused with investment since among its aims were the creation and maintenance of essential services in education, public health and housing, all of which led to conditions of social stability conducive to economic development. Income redistribution might not only be an objective per se, it was at the same time a prerequisite of economic growth. Furthermore, it could break up the dynastic concentration of wealth, so that the wealth could be used for productive purposes.

/Mr. DESAI

Mr. DESAI referring to section 3 of Mr. Urquidi's paper, said that he preferred Mr. Kaldor's definition of the aim of fiscal policy as adjusting government spending to government objectives and obtaining the necessary funds. Although, as Mr. Urquidi had said, fiscal policy touched closely on such other matters as monetary policy, public enterprises, and so forth, the definition of fiscal policy should not be made so broad as to include all those areas of economic policy. There was a tendency to attempt to relate fiscal data with the national accounts, although the latter had developed on the basis of premises somewhat different from those relevant to economic analysis of the process of economic development. Mr. Urquidi's presentation had led to the idea that government investment was the prime means of effecting economic development, whereas in fact all government expenditure, current or capital, could be directed towards development, and there were instances of greater misuse of resources by a Government in investment than in current expenditure. He also thought it would be an academic exercise to try to indicate priorities in expenditure, since most Government budgets reflected national priorities, which varied from country to country. In most countries the defence budget was already accepted as a given datum in allocating government expenditure.

Mr. PIEDRABUENA stressed the need for a clear-cut definition of fiscal policy to provide guidance to those responsible for its practical application.

On the question of taxation, care should be exercised regarding the amount of the taxes imposed. Mr. Urquidi's level of 15 per cent as representing the public sector's share of national expenditure had in many cases been exceeded in Latin America. The question was how that 15 per cent was distributed. Moreover, a higher percentage might have unproductive results. The regressive nature of the tax system was demonstrated by the fact that while workers received 40 per cent of the national income they paid more than 40 per cent of the taxes.

He agreed with Mr. Pinto that the ends and means of fiscal policy should be co-ordinated. However, what was needed was a system of priorities regarding the ends of fiscal policy.

Mrs. NAVARRETE said that fiscal policy must be viewed as an integral whole, within the general framework of economic development. Its aim must be to increase national production, leading to better distribution. By way of illustration she referred to her own experiences in under-developed areas in the south of Mexico. Investment in infrastructure, however essential, was not enough in itself, and must be accompanied by other forms of investment, including social investment, that would make it possible to develop such areas by providing the necessary housing, education and industrial training without which industry could not flourish.

Mr. FERNANDEZ PROVOSTE felt that in fiscal policy emphasis should be placed on economic development, since the aim of economic development was mainly to increase productivity and over-all consumption. However, there was no point in increasing production unless a market existed which could absorb the increase. That market could be created through income redistribution. Lack of such redistribution could, as in the case of Chile, result in devaluation of the currency and inflationary conditions.

Mr. HART said that he hoped the Conference's interest in a sophisticated type of fiscal policy would not in any way prejudice the taking of practical steps to improve the present situation. The fact was that present fiscal policies in Latin America were inadequate because tax revenue did not match expenditure. Some of the gap could be filled by more efficient administration and better collection. He referred to his experience with the Chilean tax system, and suggested that there was sometimes a link between unrealistic rates and inefficient application of the taxes, and that administrative reform might require some adjustment of rates. He also pointed out that some forms of government expenditure could amount to a regressive redistribution of income, such as the provision of free higher education if only those in the upper income levels were able to enter the universities, or expenditure that benefited car owners, if they represented only those in the higher income levels. He agreed with Mr. Pinto that public enterprises might be sold to private firms, provided that a fair price was paid, and that public enterprises should not receive disproportionate subsidies.

/A national

A national price policy could solve many such problems. He agreed with Mr. Kaldor that tax revenue must be increased by progressive taxes on property income. He supported Mr. Urquidi's view that public understanding was an important factor, and thought that the essentials should be explained to the public in a simplified form, particularly the salient fact that the revenue now obtained from taxation was insufficient.

Mr. GNAZZO agreed with other speakers that the basic aim of fiscal policy must be to collect funds for current expenditure, and secondly for economic development. However, fiscal policy was also an instrument for the redistribution, not so much of wealth, as of income. Further, it could reduce the structural rigidities that led to an inequitable distribution of income. The principle aim should be to co-ordinate fiscal policy with general economic policy; all the elements concerned should be co-ordinated as part of a single whole, without giving priority to the various components.

Mr. CAZAL thought that three main points had emerged from the discussion: that it was important to establish the aims of fiscal policy, that there must be full co-operation between the bodies responsible for executing fiscal policy, and that due emphasis must be given to the participation of the private sector. In some countries confusion arose because the aims of fiscal policy, not being clearly defined, were either not known to the public or even were not clearly apprehended by the officials concerned. Though the ultimate aims of fiscal policy of various countries were likely to be similar, the intermediate aims might well vary according to the stage of development and particular problems of the country concerned. The first step should be to define both the ultimate and intermediate aims of fiscal policy; the second, to establish an order of priorities for the allocation of resources, and the third, to ensure that all concerned fully understood the aims and priorities.

Mr. LESSA said that although the point had not been raised in any of the documents before the Conference, he thought it particularly important to consider what might be called the pre-conditions for the application of fiscal policy in relation to development. In Brazil, for example, the

/institutional structure

institutional structure inherited from the past was one appropriate to nineteenth century Europe, and any government action regarding taxation involved a cumbersome and lengthy process of discussion. In many other Latin American countries any tax amendment was subject to lengthy discussions by legislative bodies and in various committees, which constituted a serious obstacle to tax reform. The scope and use of the fiscal instrument might be greatly increased by certain institutional reforms that would remove such obstacles.

Mr. URQUIDI expressed his appreciation of the favourable opinions voiced by Mr. Pazos and Mr. Pinto in commenting on his paper, and also thanked the other speakers who had participated in the debate. He called attention to the fact that various aspects dealt with in the paper, such as the contracting of debts, taxing of foreign enterprises, regulating agencies, etc. had not been discussed. The omission confirmed his opinion that the manner in which fiscal policy was usually approached and envisaged was unsatisfactory, and indicated the need for a deeper analysis. Actually, he was in agreement with most of the comments made in the course of the debate by the various speakers.

Referring in particular to the questions raised by Mr. Naharro, he reaffirmed his view that the financial authority should at all times take part in any matters calculated to affect fiscal and financial policy. The necessary planning and coordination should be the responsibility of a commission including the Minister for Finance, and endowed with quasi-executive powers, subject only to the approval of the President of the Republic. Functionally, such a commission would divide up its work among as many specialized sub-commissions as might be necessary. The most efficient way of ensuring cooperation from the private sector would appear to be not by having it represented in planning committees and subcommittees, but through special consultative agencies.

With regard to price of services supplied by semi-public agencies, he was opposed to the policy of subsidies, which would ultimately hit the consumer. He did not believe there should be any distinction, for tax purposes, between earned and unearned income, such a system, far

/from ensuring

from ensuring the requisite fair treatment (as witness in the case of the poor rentier) would discourage savings and investment. The problem lay rather in establishing a consolidated personal income tax.

Since the lack of savings and capitalization was characteristic of developing countries, it was essential for them to have recourse to tax incentives, one of which was accelerated amortization; such an incentive would be particularly effective in the case of enterprises with long-term output.

When he said he preferred average rates rather than marginal rates he had not meant that such rates should be proportional; he had merely referred to the manner in which they were expressed: they should be progressive to the extent that the degree of progressivity of the tax was compatible with the promotion of investments.

He stressed that fiscal policy should assign priority to the economic objective as such; he did not feel as pessimistic as some participants believed he was nor as optimistic as Mr. Pazos appeared to be, with regard to the redistributive effects of fiscal policy, which in any event, could be obtained more rapidly by other measures. The creation of public savings for investment in the public sector was a fundamentally important aim in Latin American countries; therefore that aim should be kept separate from current expenses, and it was also desirable to manage fiscal policy in such a way as to encourage private savings and investment also.

When he expressed reservation regarding the redistributive effects that could be achieved through fiscal policy he had been referring always to income and not to wealth, as he had no doubts about the possibility of its redistribution. However, it should not be forgotten that a redistributive policy could discourage investment. In that respect, and provided it did not adversely affect investment capacity, he agreed with Mr. Kaldor regarding the advisability of reducing the consumption propensity of the wealthier classes.

/Finally, with

Finally, with regard to the policy of compensating short-term fluctuations caused by declining external prices, he felt that it should not be supported nor reinforced by fiscal measures such as tax exemptions or reductions, because such measures were liable to cause budget deficits with the well-known inflationary consequences. Monetary policy was more useful for correcting such fluctuations and should be supported by international measures aimed at stabilizing income in the form of foreign exchange from exports of primary products.

<u>The meeting rose at 1.10 p.m.</u>

PROVISIONAL SUMMARY RECORD OF THE THIRD MEETING
held at Santiago, Chile
on Thursday, 6 December 1962, at 4.10 p.m.

Chairman: Mr. LYNN

CONTENTS:

Fiscal capacity of developing economies: issues of tax policy

FISCAL CAPACITY OF DEVELOPING ECONOMIES: ISSUES OF TAX POLICY

Mr. DESAI referred to the previous afternoon's discussion in which there had been almost complete agreement that economic development was the prime objective of fiscal policy. That was also the basic assumption in his paper. The questions he wished to ask concerned the ways in which fiscal instruments could be used to attain such development and the extent to which they could be so used. In exploring those questions he had taken it for granted that fiscal performance in under-developed countries fell far short of its potential level. He regretted that the role of tax advisers on measures of reform could not be discussed separately, since it was clear from Mr. Schlesinger's paper that their views differed considerably, and it would have been interesting to ascertain the reasons for their disagreement.

The first point he had tried to bring out in his paper was the great importance of revenue for fiscal policy. He had then reviewed the capacity of Governments to obtain revenue, which had two ceilings - the economic and the political. Neither seemed to have been reached in the developing countries.

The three main policy issues were revenue, incentives and equity, of which the first was the most important. With respect to the question of incentives, opinion was gaining ground that they had been used too liberally, since they were apt to lose the Government a great deal of revenue, particularly from the industrial sector, and it had not been proved that they played a decisive part in ensuring the success of new industries. The whole question should be reassessed. With regard to the third aspect, he felt that the need for every tax to be equitable had been overstressed. It was more important to have an equitable tax system as a whole, or further still an equitable government tax-cum expenditure policy.

He disagreed with Mr. Urquidi on the importance attaching to considerations of equity in planning economic development objectives. The assignment of first priority to the redistribution of income was apt to impede the achievement of economic growth, and could therefore not be regarded as wholly desirable.

/His treatment

His treatment of the question of fiscal capacity had been exploratory and derived from the need for a more precise quantitative criterion than the general idea of obtaining more revenue. He pointed out that the political and economic upper limits of fiscal capacity were not necessarily commensurate. In rather poor economies the ceiling was fixed by the balance that remained over and above subsistence levels. The political limit might be higher, as in the centrally-planned economies or in other economies during an emergency such as a war. In the short run the political limits were the determining factor, but over the long run opposition to institutional changes could be overcome and public opinion educated.

It was thought in principle that fiscal capacity was essentially determined by the absolute level of per capita national income. Income distribution was also a factor, especially when it tended to be unequal, in view of the great potential of the wealthy groups as a source of revenue. In practice, however, tax performance was largely dependent upon the technical facilities for tax collection and upon the efficiency and integrity of the public administration. That was a particularly important point for the under-developed countries where capable administrators remained an extremely scarce factor.

His view of the relationship between fiscal capacity and national income was rather pragmatic, since he did not consider that the economic surplus should inevitably accrue to Governments, but should go to those who would make the best use of it, and there were specific cases in which Governments had frittered away the resources at their disposal.

There was no real reason why the ratio between revenue and income should be lower in less developed countries, because, owing to the inequality of income distribution and the fact that the private sectors often used resources in a less productive way, the Governments had greater responsibilities than in the more advanced countries and therefore needed a larger proportion of the national income.

He pointed out that fiscal yield as a proportion of national income varied greatly in the different Latin American countries, and no one level could be taken as a definite yardstick. For instance, a critical level of 15 per cent had been mentioned, but that was exceeded by at least

/eight countries

eight countries in the region. What could not be denied, however, was the existence of a potential capacity for raising more revenue in each one.

The question of fiscal policy could be viewed in different ways according to the conditions obtaining in particular countries. When a national revenue represented a fairly large proportion of national income, the Government's expenditure policy required more scrutiny. When the proportion was low the question was primarily one of obtaining more revenue.

He then reviewed certain broad categories of taxes, which should ideally be considered in relation to the political, economic and institutional structure of each Latin American country. Export taxes were becoming less useful than they had been because of the increasingly vulnerable state of the primary commodity markets. Import taxes, on the other hand, could be made to yield more revenue, although that would not be so if present trends continued. He suggested that one way of helping under-developed countries to progress was to tax the lower income groups by means of small levies on imported staples, which would undoubtedly yield a considerable amount of revenue. One type of tax that should be discussed was the levy on capital goods, which were currently made available to entrepreneurs in under-developed countries at preferential rates of exchange. If government revenue was to be spent on the promotion of economic growth, the taxation of capital imports might be consonant with economic advancement. The preferential treatment of new or developing industries was also another aspect that should be re-examined. What was important was to make use of the existing sources of collecting revenue. Since the customs administration had been efficiently developed in Latin American countries, particular stress should be laid on exploiting the revenue potential of import taxes.

With respect to excise taxes Mr. Urquidi had rightly pointed out that they might be gradually developed to replace import taxes as a source of revenue. His main doubts with respect to progressive indirect taxes concerned the possibility of tax evasion on the part of the wealthier groups - which could be dealt with by the choice of commodities with a fairly inelastic demand for the application of punitive tax rates - and the fact that most of the items subject to heavy taxation were imported

/and might

and might therefore have to be restricted because of balance-of-payments considerations. Income tax offered a large field for future exploitation. There were two aspects that required consideration: firstly, the expansion of the coverage to include more groups and, secondly, the tightening up of the concept of taxable income and sealing of loopholes for evasion. Other types of taxes were acceptable since they could be associated with benefits, i.e. social security systems and government lotteries.

As agricultural taxes were to be discussed as a separate item, he would merely point out that their application posed very different problems in Asia and in Latin America because of the sharp disparities in land ownership in the latter. Land taxes were probably easier to apply than other types provided that they did not meet with undue political opposition from landowners, and he hoped that the practicability of the different kinds would be discussed at the conference, when the subject of agricultural taxation came up for specific discussion.

Finally, the improvement and simplification of tax legislation and administration should also be taken into account as an additional source of revenue.

Mr. HARBERGER agreed with Mr. Desai that the cases in which tax exemption was granted to particular industries in Latin America required revision. It was justifiable to accord exemptions and subsidies to those activities which deserved encouragement because the resulting social benefits were different from and greater than the private advantages reaped. But in many countries exemptions had been established without clear proof that they were really necessary. A case in point was Chile, where special treatment was granted to the small and medium-scale mining companies, although investment in that sector had not increased thereby, while a few private individuals had amassed inordinately large fortunes.

He differed from Mr. Desai with regard to the significance of indirect taxation, although he agreed that if a high tax was levied on very precisely specified goods and their substitutes were tax-free, the former were simply ousted by the latter and the tax produced a very low yield.

/Given that

Given that the income-elasticity of luxury goods was higher than unity and the income-elasticity of other consumer goods was usually very close to unity, so that an average income-elasticity approximating to unity could be assumed, 50 per cent of goods had an income-elasticity in excess of unity; and if those goods could be taxed, an element of progresiveness would be introduced in that part of the tax system which might compound for direct taxation when the latter proved difficult to apply.

Mr. PINTO congratulated Mr. Desai on his sound interpretation of the concept of tax capacity, which had usually been a sort of futile and ineffectual figment of the imagination, because it had been estimated on the basis of abstract and unrealistic figures which took no account of the conditions in which the analysis had meaning. It was impossible to talk of tax capacity without due regard to the purpose of taxation. Thus, several basic factors of tax capacity had to be taken into consideration, such as (a) the nature of expenditure; (b) the source of funds; (c) tax collection capacity, which was in his opinion, at any rate in Latin America, limited over the short term; and (d) political capacity to appropriate resources of which the State thought it would be able to make better use than the private sector. If a more realistic approach to tax capacity were adopted, great progress could be made in that field.

Mr. HERSCHEL expressed the view that it was necessary to analyse the distribution of tax potential or the tax burden over the various areas of a given country. He endorsed the opinion of other speakers that empirical studies should be carried out to ascertain the degree of eficacy - if any - of the incentives provided.

Another interesting subject for study would be the evolution of tax revenue as income levels rose. In Latin America specialists in the field were concerned with the problem of the inflexibility of the tax system when taxable or real income increased - an inflexibility attributable to evasion, exemptions and deductions.

/Mr. NUÑEZ

Mr. NUÑEZ felt that all the speakers who had referred to incentives had judged them very harshly, and that the matter merited more careful analysis, since there had been cases in which the desired effect had apparently been produced. Perhaps too little imagination had been exercised in their application for the purpose of encouraging an activity or suppressing it, and in the use of the fiscal system to bring about changes in income distribution.

The most striking feature of Latin America's tax systems was that Mr. Desai had so felicitously described as the statistical jungle, namely, the proliferation of low-yield taxes which had developed because they constituted a means of procuring funds without giving rise to serious concern on the counts of equity or incentives.

The public sector had to weigh the merits of the alternative methods of obtaining revenue, and the decision as to which it would adopt was affected by what Mr. Desai called the political upper limit of tax capacity, apparently referring to the whole series of powerful factors involved.

Mr. Desai had been right in describing the progressivity of income tax as a farce; it was disturbing to think that all the countries were its victims, and it was therefore desirable to seek ways and means of ridding income tax of the stigma.

Mr. NAHARRO wondered what value attached to the estimate of an average income-elasticity of consumer goods approximating to unity, to which Mr. Harberger had referred. If that assumption was realistic, at least 50 per cent of consumer goods would surely have an income-elasticity higher than unity; and that would invalidate the traditional notion of what constituted a luxury article. However, in considering the revenue yielded by progressive indirect taxation on the consumer goods in question, another variable would have to be taken into account, namely, the volume of actual spending. Even if income-elasticity were high, the volume of expenditure might not equal it, and the progressiveness of the tax on consumer goods would be justifiable from the standpoint of equity, but might mean little from that of the transfer of sums on any substantial scale to the Treasury.

/Mr. BACA

Mr. BACA, referring to the allusion in document CPF-DS-1, footnote 2, to the competitive race by the Central American countries to attract industries, said that the problem no longer existed, as the countries concerned had recently signed an agreement to standardize the incentives accorded to new industries.

Mr. HART said that in table 2 of the same document the situation existing in Chile was not accurately presented; no figure appeared under the head of export taxes, whereas actually 50 per cent of the figure for income tax revenue was constituted by taxation applied to foreign companies engaged in export activities.

Mr. KALDOR doubted whether indirect taxes on luxury goods could be applied in such a way as to be the equivalent of a progressive tax. The income-elasticity of a consumer good could only relate to a specific income, and it became very difficult to ensure progressiveness, because there was no way of equating the goods consumed with income levels. That did not affect the social need to tax luxury consumption, but merely implied that progressive income taxes were much easier to adjust to the individual taxpayer's capacity to pay. Those indirect taxes which were really progressive - for example, on domestic help, living space, etc. - would be politically unacceptable.

Mr. GOODE agreed that there was no group of indirect taxes which could be efficaciously applied to obtain the same results as might be derived from a progressive programme of taxation on income, net wealth or total expenditure. But it was unfair to compare indirect with direct taxes on the assumption that the operation and administration of the latter would be flawless, and indirect taxes should not be discarded altogether, even if they did no more than reduce the degree of progressiveness of the tax system as a whole.

Mr. URQUIDI was in agreement with the general tenor of Mr. Desai's remarks, especially with respect to the political upper limits of taxation. For instance, when such expressions as "taxing the poor" were employed, he thought advisable that even in technical

/meetings heed

meetings heed should be taken of the unnecessary opposition which might be aroused by the very terms in which such measures were couched.

With regard to the need to institute severe penalties for evasion and official corruption, he attached more importance to the private sector's willingness to accept taxation. A milder policy of fiscal education would be more fruitful than punitive methods.

Mr. PREST felt that table 1 of document CPF-DS-1 was inconsistent with the discussion in the actual text, since it referred to the proportions of national income represented by tax revenue and not to the proportion of the "economic surplus". Nor did it give a very realistic picture of the revenue of the public sector, since in many instances it failed to include transfer payments.

With respect to the need for a tax system sensitive to variations in national income, he thought that difficulties would arise in two fields: (a) incentives; and (b) the situation of a country whose fiscal revenue largely depended upon the export sector, when abrupt fluctuations in export prices were registered.

Mr. LEWIS thought it was essential not only to calculate total tax capacity, but also to ascertain in which fields it was least efficiently utilized. In Latin America, apparently, the real estate sector was the one in which the level of tax collection was relatively lowest.

Mr. DESAI replying to the comments, did not quite understand whether Mr. Pinto agreed with him or not. To call tax capacity a figment of the imagination was doubtless correct if any claim was made to define its limits with absolute precision. But an estimate was useful even if computing it was a purely academic exercise, since without it there would be a risk of formulating unco-ordinated tax recommendations for want of an integrated framework into which they could be fitted.

In the discussion on indirect taxes, the differences of opinion were not fundamental, but related rather to ways of defining luxury consumption. Nobody called the usefulness of such taxes in question, especially if progressive income tax had a ceiling. But no general rule could be laid

/down for

down for indirect taxation, since all kinds of problems arose in connexion with substitution, the need to restrict imports, administrative difficulties, and so forth, which would affect its application in each country.

He differed from the opinion put forward by Mr. Nuñez, since in his experience the apparent success of tax incentives in the establishment of new industries had been mainly due to other concomitant factors.

To meet Mr. Hart's criticism, a footnote explaining Chile's special situation would be included in the final version of document CPF-DS-1.

The point elucidated by Mr. Baca had already been incorporated in the English version of the document.

Mr. Urquidi's objections did not seem to him valid. He could not see why it was politically undesirable to refer to taxation of the low-income groups. It might be that such a possibility had not yet arisen in Latin America because of the extreme inequality of income distribution, but sooner or later the relevant decision would have to be adopted. Taxation of the low-income groups, besides teaching them fiscal discipline, served other ends. In the first place, the expenditure of the well-to-do was much easier to control and guide into appropriate channels than the spending of the lower-income brackets. Again, as national income rose, the proportion contributed by the various sectors would increase, and the day was bound to come when in order to further economic development the Government would be compelled explicitly to require certain sacrifices of the whole population, including the low-income groups.

<u>The meeting rose at 5.55 p.m.</u>

PROVISIONAL SUMMARY RECORD OF THE FOURTH MEETING
held at Santiago, Chile
on Friday, 7 December 1962, at 10.10 a.m.

Chairman: Mr. MENDIVE

CONTENTS:

The role of taxation in economic development

THE ROLE OF TAXATION IN ECONOMIC DEVELOPMENT

Mr. KALDOR referred to the first two paragraphs of his paper (CPF-DB-3), and explained that he had wished to dismiss the question of incentives as relatively unimportant compared with the main question of revenue. However, he did not wish to give the impression that he believed there was any necessary conflict between the incentive and revenue aspects of taxation. Taxation had both incentive and disincentive aspects, and the form in which taxation was imposed would determine which aspect dominated. Economists distinguished between the income effects of taxation, and the substitution effects, the former being recognized as constituting an incentive and the latter a disincentive. The relative importance of those two factors depended on the relationship of the effective tax burden to marginal rates; high marginal rates constituted a disincentive, and a high effective tax burden an incentive. Various exemptions introduced into the tax system to improve the incentive effect by narrowing the effective tax base often had the opposite effect; the effective burden was decreased, and the marginal and nominal rates were increased to offset the loss of revenue. That represented the vicious process, referred to in several of the papers before the Conference, of taxing more and more on less and less. In some systems the incentive effect of taxation might predominate, and some of the Conference papers emphasized the incentive effect that an agricultural tax could have, compared with the disincentive effect of the lack of such taxation. The main disincentive effects of taxation related to its effects, not so much on individual action, as on the allocative efficiency of the economy; high marginal rates of profit taxation combined with a large number of exemptions had the effect of shielding inefficient enterprises and penalizing efficiency. The result was a reduction in the efficacy of competitive forces in the market.

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Besides, it would be incongruous to argue that heavier taxation would have a disincentive effect in the context of Latin American countries which suffered from continuous inflation; if heavy taxation acted as a disincentive, it would lead to deflation, which could be resolved by easy money policies which stimulated investment. Economists were well aware that low taxation in conjunction with the tight monetary policy necessitated by such taxation, in order to counteract the inflation it led to, was the very opposite of a true incentive to development. The effect was to transfer to consumption resources that should be available for investment. The opposite formula of high taxation and an easier monetary policy would stimulate business investment and development. One special aspect of that subject was the question of whether foreign investment could be attracted by special concessions, but he wondered whether that might not result merely in the transferring of foreign capital to one under-developed country instead of another, rather than attracting a greater total flow of foreign capital.

He believed there was general agreement on the fact that the main need was for more revenue, although not on what that revenue was needed for. He could not agree with Mr. Urquidi that the main object of fiscal policy was to generate more savings for public investment; that was to put the case too narrowly, if public investment was taken in its ordinary sense of non-recurrent expenditure for the creation of physical assets such as factories, roads, schools, or hospitals. That was only one aspect of the fiscal programme; the first need was to provide recurrent expenditure on public services on a wider scale. Experts attached special importance to the quality and quantity of education. Whatever figures were produced to show that Latin American countries spent a certain percentage of their budget or their gross national product on education, the fact remained that it was not enough. More and better educational facilities were essential to a faster growth rate;

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it would provide more efficient administrators and managers, more skilled workers, and a higher literacy level, and would improve the incentives and intelligence of the workers in agriculture and industry. Good Governments were those that provided socially useful services, of the infrastructure type, on a wide scale, bad Governments provided such services only in insufficient quantity and quality, and that lack was the main obstacle to a faster growth rate of the whole economy.

Public savings through budgetary surpluses were also an important means of securing private investment. If taxation and revenue were extensive enough to provide a budget surplus, expansionist financial and monetary policies could be adopted that would stimulate private investment. More revenue was the essential precondition for accelerated development, to establish the proper climate for rapid progress. An economic setting could then be established for expanded investment, instead of a perpetual application of economic brakes in order to deal with problems of inflation and balance of payments.

He believed that the Conference would also agree that the additional revenue must be sought where the money was available, namely, in the top 10 per cent bracket that at present, for a number of reasons, largely escaped taxation in Latin America. Something like 40-50 per cent of the national income went to those in that bracket, and if that income paid only 20 per cent in taxes in addition to the 5 or 6 per cent now being paid, the resulting revenue would represent about 8-10 per cent of the gross national product.

He had identified three areas where radical reforms were needed; the first was agricultural taxation, dealt with separately because of its separate problems, the second was personal direct taxation on income and wealth, and the third was business taxation. One of the main objects of agricultural taxation in Latin America must be to secure a better use of resources, by getting the land transferred to those who could make the best use of it. Land reform was not the only method to secure that end; progressive taxation could induce those who failed to

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use the land properly to give it up. Competitive forces did not operate in agriculture as they did in industry and commerce, and an inefficient landowner could hold on to his land without risk of bankruptcy through competition with the more efficient. Consequently competitive forces must be brought into play by the introduction of a progressive land tax, which would both increase agricultural efficiency and constitute an important source of revenue. He was glad to see the same line of thought in two other Conference papers (CPF-DB-9 and CPF-DS-3). He himself had drafted such a land tax scheme for the Turkish Government early in 1962; it had been rejected because of strong opposition by landed interests, but he was happy to see that the Chilean Government had adopted a very similar scheme, although it was not yet in force.

With respect to income and wealth taxation, he drew attention to the four major requirements he had listed in paragraph 35 of his paper, and said that he would welcome comments on those points. He believed that a really efficient system of progressive taxation of personal income and wealth must be fully integrated; both those elements must be included. There must be a system, jointly administered, for the taxation of income, capital gains, and net wealth (in the form of an annual tax) by means of a scheme of comprehensive returns. Such a system would be largely self-reinforcing, whereas taxation on anyone of those elements alone would not.

He regretted that no separate treatment had been accorded to the taxation of foreign enterprises; it was a complicated issue, with a number of important aspects, that deserved full discussion.

There was one aspect of tax reform to which he particularly wished to draw attention - the value added tax. It could be regarded either as a streamlined form of sales tax, or as a substitute for a business profits tax, and could not be classified exclusively as either a direct or indirect tax. It amounted to a tax on business sales minus purchases of fuel and materials, in other words a tax on gross income, or on gross profits plus the interest,

/rents, and

rents, and wages and salaries generated by each enterprise. That was the same as sales minus purchases, except for the value of the change in stocks. One of the reasons for his wishing to draw attention to the idea of such a tax was that serious consideration was being given by various experts in Europe (including the United Kingdom) to introducing a value added tax in full or partial substitution of a tax on business profits. The tax had great advantages, particularly for Latin America. In the first place, it was fairer in its economic effects and incidence than a sales tax, the weight of which varied, in terms of gross income, with the ratio of gross to net output. The ratio of value added to sales might vary from 10 per cent to as much as 80 per cent in various enterprises. Secondly, the cumulative burden of the sales tax varied according to the number of times the article changed hands before the final purchase; that led to distortions that were avoided with the value added tax. In addition, the self-reinforcing nature of the tax could provide a firm framework for the administration of other taxation, if correctly operated. If the tax was not too low (the rate should be of the order of 10-15 per cent rather than 2-3 per cent), it would be in the interests of each taxpayer to claim all exemptions for purchases. If the purchases were certified by vouchers that included a tax code number, it would be simple, with the aid of electronic computers, to build up an independent source of comprehensive information on the total volume of sales of an enterprise, provided that the tax was comprehensive and universal, and did not exempt a substantial number of sectors. Moreover it would be a great advantage, from the standpoint of economic planning, to have really reliable current statistics on the transaction-matrix, that would constitute an up-to-date input/output table. He would recommend a system with three sets of numbers, the first for the tax district or office, the second for the nature of the business (on the basis of some standard industrial classification), and the third for the number on the tax file in the district concerned. With that system, it would be a simple matter to keep a current record of

/the sales

the sales of each taxpayer on the basis of the purchases of others, and under-reporting would be made very difficult. Moreover, a reliable indication of the gross income of each enterprise would be very useful from the standpoint of other taxes levied. Collusion among businesses would have to be very widespread to defeat the self-reinforcing feature of the value added tax.

As regards other economic effects, the over-all incidence of the value added tax was not very different from that of a corporation profits tax, which yielded the same revenue. Both would be partly transferred. The gross profit element in the value added tax was very high; in the United Kingdom it was about a third, and might be as high as one-half in Latin America. The value added tax made it possible to cut out all irrational exemptions, and instead of taxing the net profit, as at present, the tax would be on the gross profit, at a conveniently low rate. Thus the total incidence, as between profit earners and wage earners, would be much the same. But the distribution of the tax burden as between various enterprises would be very different from the profits tax. The value added tax would relieve the businesses that paid most of the profits tax, and tax those who at present paid nothing; it would relieve the efficient units, and penalize the inefficient. Whereas high marginal rates, in conjunction with many exceptions, shielded the inefficient and limited the scope of growth of the efficient, the value added tax, if imposed in partial substitution of the profits tax, would thus improve the allocative efficiency of the economy; it would have the effect of strengthening the forces of competition.

The creation of an efficient tax system was not difficult, regarded as a purely technical problem. The papers submitted to the present Conference as well as the discussion thus far, showed that experts would have no great difficulty in reaching agreement on the various issues. Unfortunately fiscal reform was not a purely technical matter, and depended mainly, not on expert advice, but on the balance of political forces. It would affect the economic interests of the

/most powerful

most powerful sectors of society, and some believed that consequently it could not be effected without a revolution. Since revolution was unlikely to aim merely at progressive taxation or land reform, it was in the long-term interests of the propertied classes to avoid it by accepting such reforms, even though that weakened their economic position in the immediate future. In the United Kingdom the ruling classes had succeeded in maintaining much of their former position by displaying such enlightened self-interest, but he doubted whether the same attitude would be displayed in Latin America. Tax experts must pursue their pedestrian task of explaining the technical pre-condition of an efficient tax system to Ministers of Finance, but they would have to bear in mind that theirs was perhaps the least important part of the task in hand.

Mr. HERSCHEL said he would base his comments on Mr. Kaldor's paper mainly on actual experience in Argentina. But first of all he would like to say that he was in complete agreement with what Mr. Kaldor had said in the last part of his verbal statement at the present meeting as to the role of experts in tax and fiscal reform, since it was a true reflection of the situation in Latin America. Introducing his comments (CPF-DB-3/Add.2) on Mr. Kaldor's paper, he touched on public expenditure, the incentive problem, inflation as a tax resource, the tax potential, and on certain specific aspects of particular taxes, indicating where he agreed or disagreed not only with Mr. Kaldor's paper, but also with the views of other speakers who had referred to those points at earlier meetings.

Mr. NUÑEZ introduced his comments (CPF-DB-3/Add.1) on the paper on the role of taxation in economic development. He expressed his agreement with many of the points made by Mr. Kaldor, and dealt in some detail with other points that he considered had been overlooked or were incorrect, including the almost complete omission of the tax system's function in redistributing income and wealth, the lack of emphasis on the question of incentives, the relationship between inflation and the tax system, the problem of tax administration costs, and taxes on agriculture. He also expressed views on the strategy of tax reform, which was not mentioned in Mr. Kaldor's paper, although it had been dealt with in his statement at the beginning of the present meeting.

/Mr. URQUIDI

Mr. URQUIDI said he feared that some of the recommendations made by Mr. Kaldor in his paper, particularly the establishment of a tax on agriculture, could not be carried out in Latin America. There would also be practical difficulties in taxing family rather than individual income, because family in the economic sense was not easy to define. A tax on wealth would give rise to alarm and its introduction would involve an administrative operation which might be out of proportion to the revenue yielded.

With respect to the value added tax, which Mr. Kaldor proposed as a substitute for the income tax, he felt that its practical effect would be to tax not only profits but also the payroll. Such a tax, in his view, was both inapplicable and discriminatory, particularly against enterprises which employed a large amount of labour. It would run counter to the objective of generating large-scale employment of labour in countries in the process of development, which was precisely the position of the Latin American countries.

Referring to Mr. Kaldor's suggestion that tax incentives should be abolished in favour of tax reduction, he asked whether Mr. Kaldor meant the specific incentive of accelerated depreciation or whether he referred to incentives in general.

With regard to the much-discussed question of the objectives of fiscal policy, to which Mr. Kaldor had referred directly, he observed that in his own paper he had not expressed any preference for public savings as against current expenditure. However, the budget surplus to which Mr. Kaldor had attached such great importance as an instrument of investment by the public sector was not very different from public savings.

Mr. NAHARRO expressed general agreement with Mr. Kaldor's statement. However, without prejudice to a fuller discussion of the topic when his own paper relating to taxes on production and consumption was taken up by the Conference, he shared Mr. Urquidi's pessimism with respect to the value added tax. However, his position in the matter was only slightly at variance with Mr. Kaldor's since he agreed that an added value tax was

/similar to

similar to a tax on gross product. It was a tax area in which direct and indirect taxation appeared to overlap. However, the substitution of one tax for another implied a change of attitude as to what a tax system should be. To offset the advantages of the added value tax there were also disadvantages, some of them of the utmost importance. Not only would its application involve a heavy administrative task, but it might upset the price system by producing a vertical concentration of productive enterprises aimed at concealing added values and reducing the sphere of free competition. In support of his contention, he referred to the "tax on the volume of sales" applied in Spain in 1927. In spite of the fact that the tax administration was quite efficient, the tax base could not be established, so that the tax had been a total failure, even though all that had been attempted was to assess gross income.

With respect to some of the additional advantages attributed to the tax on added value, he feared that Mr. Kaldor's statement was not altogether clear to him, but he failed to understand how a transaction-matrix could constitute an input-output table since a transaction was not quite the same as an input.

To sum up, while he was not completely opposed to the added value tax, he felt that its application would be dangerous and inadvisable in Latin America.

Mr. FERNANDEZ PROVOSTE said that the statements made by the previous speakers had confirmed his view that problems of fiscal policy, whether in general or in the more restricted framework being discussed at the current meeting, could only be solved if supported by other measures related to that policy. The aims of tax policy were twofold: to channel resources and to redistribute income. In his opinion, the two aims were not mutually exclusive. Income redistribution in favour of the lower income groups benefited economic development since it reduced imports of non-essential items and thus curtailed the flight of currency.

He considered of utmost value Mr. Kaldor's recommendation that there should be a progressive tax on income, supplemented by a tax on business profits. On the other hand, as far as Latin America was concerned the worst form of taxation would be a tax on the cost of production. He was therefore opposed to a value added tax since it taxed the cost of a product before it reached its final stage.

/Mr. JARACH

Mr. JARACH was gratified to note that most of the points made by Mr. Kaldor coincided with the views he himself had expressed in the paper he had prepared for the conference, which was to be discussed at a later stage. That was particularly true of Mr. Kaldor's position on such questions as the role of property taxes, inheritance taxes and the taxation of agricultural land. On the question of incentives, he felt that in the matter of fiscal policy for development undue importance was attached to incentives in the form of tax concessions and rebates which jeopardized the basic aim of maintaining fiscal revenue and providing the essential services and infrastructures of development. Preference should be given to taxes containing automatic incentives by encouraging increased output and discouraging unproductive ownership.

The question had been raised as to how far the views of tax experts and the results of tax conferences could actually lead to tax reforms. He took the optimistic view that recommendations generally agreed upon by tax experts served a useful purpose and could be used as a potent argument to combat the widely publicized views of the vested interests opposed to tax reform which based their stand on pseudo-doctrines.

Mr. BACA observed that the countries of Central America had had some success in the use of tax incentives. However, it should be clearly understood that such incentives were a temporary measure and should only be provided to new industries. He pointed out that when capital-exporting countries failed to take account of income tax exemptions granted for the purpose of promoting industry, such exemptions were rendered ineffective and constituted merely a gift by the country granting them to the capital-exporting country.

With respect to the added value tax, he felt that it could not be a substitute for a tax on gross profits because it became a tax on consumption to the extent that it could be transferred. Moreover, if it was not transferred it discriminated against industries with smaller profits.

He did not think that a general tax on sales could be readily applied in Latin America unless collected at the producer level.

/Mr. GNAZZO

Mr. GNAZZO felt that the question of the effects of taxation had given rise to some uncertainty during the discussions. A tax on luxury goods, for instance, might not be of much practical value if it affected only a very small percentage of the population. On the contrary, it might create dislocations in the supply and demand position by encouraging the illegal entry of luxury items. Export taxes, on the other hand, might create balance of trade problems. A tax on agricultural land, however, could produce practical results. In Latin America, agriculture could play an essential role in reducing existing bottlenecks in the economies of the countries concerned. In view of the low world market prices for primary products, improved productivity could do much to better conditions. Improved agricultural productivity could be achieved through the taxation of unproductive agricultural sectors.

The recommendation in favour of a value added tax should not be rejected out of hand since some elements might be usefully studied for possible application in Latin America.

Mr. VEGA said that several of Mr. Kaldor's tax recommendations were already being applied in his own country, Ecuador, particularly with respect to the social aims of fiscal policy, such as to provide increased educational, public health and other services. Consideration had also been given to adoption of the technique of value added in the sales tax. Other aspects of the tax should nevertheless be studied. An effective tax on agricultural land of the type suggested by Mr. Kaldor, would be difficult to impose under present conditions in Latin America and would have to be preceded by a lengthy process of education and persuasion.

The meeting rose at 1.15 p.m.

PROVISIONAL SUMMARY RECORD OF THE FIFTH MEETING
held at Santiago, Chile
on Friday, 7 December 1962, at 3.15 p.m.

<u>Chairman</u>: Mr. MENDIVE
<u>later</u>: Mr. MAGAÑA

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Issues of tax reform for Latin America

THE ROLE OF TAXATION IN ECONOMIC DEVELOPMENT (continued)

Mr. PIEDRABUENA, referring to Mr. Kaldor's views on incentives, believed that in Chile such incentives would have to be rationalized, established on a traditional basis, and applied in a manner which distinguished between business and personal income.

Mr. Prest's comments might be supplemented by Mr. Kaldor's alternative suggestion of partially replacing the corporation profits tax by a value added tax; the sales tax could thus be suppressed. The value added tax afforded sectoral control. The difference between the two types of tax was that the value added tax put a premium on efficiency and penalized inefficiency. Consequently, such a tax could take the place of the excess profits tax which actually penalized efficiency.

In his opinion, the transition from a sales tax to a value added tax should not be difficult; as an alternative, provision had been made in Chile to exempt industrial inputs, thus avoiding verticality, since the entrepreneur was allowed to deduct his purchases and taxes.

Referring to tax evasion, he observed that it existed in fact and could not be overlooked; but means should be devised to endeavour to reduce it to a minimum.

He thanked Mr. Kaldor for mentioning the tax reform act recently approved in Chile, and explained that assessments would be made on the basis of the potential value of the current use of land.

He did not believe that the tax on wealth was just; in his opinion, it had been established to compensate for administrative inefficiency; he could not only conceive of such a tax as a comparative test, i.e., it would serve as a minimum but could not be added to income tax, except in the case of inheritance.

Mr. LESSA said that while there was a consensus of opinion in the Conference that economic development was the final objective of fiscal policy, there were differences of approach as to the manner of applying tax revenue to achieve it. Mr. Urquidi favoured spending on infrastructure to change the productive functions of a community and establish its stock

/of capital,

of capital, while Mr. Kaldor assigned more importance to social needs - education, health, etc. - as improving a country's working capital. He personally agreed with the former, since it had often been seen in Latin America that, owing to deficiencies in the structure of production, labour left the country or had to be absorbed by the public administration, which, as a result, became excessively swollen.

With regard to agricultural taxes, a similar system to that favoured by Mr. Kaldor had been tried out in Brazil, but had failed owing to the difficulty of administering it. While taxation might be a help in agrarian reform, it could also be self-defeating, as when an entrepreneur, instead of selling his land, decided to capitalize his productive unit by adopting a more advanced technology, which was reflected in a lowering of the man-land ratio. In such cases, labour was ousted from the land and could not find work in the cities, thus aggravating unemployment, which was serious enough any way in Latin America owing to the rapid growth of the population. In Brazil, for instance, the industrial sector, which had a 9 per cent annual rate of growth, had not been able to absorb even half the population growth.

With regard to the suggestion of establishing a tax on value added, such a system had been established in Brazil in 1957 and had been yielding 30 per cent of the total tax collections for the Federal Government. It would be a good idea to introduce the system in Latin America to correct the regressive nature of the sales tax, which was particularly unfair when there were differences in the degree of development of different regions of the same country, as in Brazil.

Mr. COSCIANI said that taxes on sales, purchases, and value added were all of the same nature in that they were transferred to the final consumer. The value added tax offered certain advantages, and he found it curious that Mr. Naharro assigned to it the effect of encouraging monopolies, since it was a tax neutral in its effect. However, he agreed with Mr. Naharro that the application of such a tax implied that all business firms kept books recording all sales and purchases, and that small firms would be able to evade it.

/Referring to

Referring to taxes on capital gains, he asked Mr. Kaldor whether his suggestions referred to supplementing the income tax or whether they were inspired by the desire to punish speculation. In the latter case, it would be necessary to introduce an index of speculation in applying it in Latin America bearing in mind the period over which the capital gains had taken place and the percentage of the total capital they represented.

Mr. GOODE wished to make a few comments on Mr. Kaldor's suggestion of a value added tax. If it was to be levied on the value of an enterprise's sales or receipts minus its purchases of raw materials without any deduction for capital outlay he feared that it might have an unfortunate effect on investment, since the enterprise would have to pay tax twice over.

Regarded as a partial replacement for profits tax, he doubted whether it could be applied over a larger area than the latter since it was not suitable for agriculture, small enterprises or the professions.

He doubted whether the self-reinforcing features of the value added tax would be as effective as Mr. Kaldor claimed. Even with the aid of electronic computers, he thought that tax collection would remain a problem, and enforcement would undoubtedly entail much field work.

Mr. HART believed that attention should be paid to the possibility of integrating or supplementing the various taxes, and cited as an example the case of taxes on net wealth and income; if both existed an income tax could be applied without any discrimination. If only income tax were applied, a distinction would have to be made between income derived from work and income from property.

He noticed that Mr. Kaldor had not mentioned net wealth taxes in regard to agriculture; possibly taxes on potential income combined both wealth and income aspects.

The value added tax offered possibilities of integrating or supplementing it with sales or production taxes. One of the advantages of such a tax was its simplicity, which was defeated when exemptions were introduced, as in the case of foodstuffs. On the other hand, its introduction demanded a rather high minimum level of administration and

/there was

there was a danger of failure if it were applied before it reached that minimum stage. A strong point in its favour was that it implied a conflict of interests between taxpayers.

Mr. DESCARTES said that, in general, he agreed with Mr. Kaldor's opinion, but he had certain reservations. Mr. Kaldor's views seemed to be directed towards long-term objectives.

He supported the idea of a non-schedular tax on total income based on reasonable rates. He had some reservations regarding the tax on value added. With reference to taxes on wealth, he was concerned about their effect on economic development. As for the use of development funds, it it was extremely difficult to choose between direct development purposes and traditional government expenditure - on health and education, for example. Nevertheless, he did not believe that there was a clear-cut conflict. Each country could and should decide what was best for it. The ideal would be to finance both, but if there was a shortage of funds something had to be sacrificed. Under certain conditions the building of a factory or the capitalization of an autonomous entity providing electric power might be more useful than an increase in expenditure on public health. He agreed that education was vital to economic development and that it would be difficult to sacrifice it for the sake of other ends.

Mr. PREST said that the main point he wished to make had already been made by Mr. Goode. There were three ways of applying the value added tax: without any deduction for depreciation of capital goods, with some allowance made for depreciation or with a deduction for purchases of capital goods, the last being equivalent to a tax on consumption.

In comparing the sales and the value added tax, Mr. Kaldor had stated that the sales tax was less neutral. That depended on the particular way in which each tax was used. There was no difference, for instance, between a sales tax applied at one stage only and a value added tax of the third type.

Mr. Kaldor's idea should be contrasted with the suggestion put forward by Professor Baumol of Princeton University in a recent book that firms should be given subsidies according to the value added from one year to the next.

/In relation

In relation to Mr. Kaldor's comment that the taxation of foreign enterprises should be given separate treatment, Mr. Lewis drew the attention of the meeting to secretariat paper CPF-DS-4, which made a useful contribution to the subject.

With respect to the question of incentives for private enterprises, he thought that some more definite and quantitative answers might be obtained if the subject were approached from the standpoint of the enterprises themselves rather than from that of fiscal policy. According to Mr. Kaldor, the crux of the matter was not whether incentives produced a surplus for the Government, but whether the development of national income and expenditure produced a surplus, which was the optimum condition for the encouragement of private enterprise. In practical political terms he himself thought that such a condition existed in a country where the controlling social and economic classes were able to adapt themselves to economic development.

Mr. KALDOR wished to reply to the comments that had been made point by point rather than according to the order of speakers, as many of them had dealt with the same aspect.

It had been charged that he neglected the redistributive functions of taxation. On the contrary, he felt he held very strong views about them, as witnessed by his work in Mexico, Ceylon and British Guiana. He considered that progressive taxation was redistributive in a double sense; firstly, because if effective, it reduced available income for consumption, and secondly, because the compression of luxury consumption diminished any inequalities that existed before tax. It was not only that profits generated luxury spending; luxury spending also increased the volume of profits. If the share of national resources claimed by the wealthy classes was reduced by progresive taxation, their income before taxation would also be reduced.

With respect to the criticisms of his treatment of inflation by Mr. Herschel and other speakers, he did not wish to say that he opposed inflation under all circumstances but was nevertheless convinced that it was a clumsy and inefficient instrument for mobilizing resources, since when prices rose in relation to income more money was transferred to the profit-earning classes who used it for luxury spending instead of for investment. Thus part of the enforced reduction in consumption of the masses of the population

/was wasted

was wasted in the higher consumption of the recipients of profits. Inflation was also socially unjust in that it enhanced the regressive structure of taxation.

With regard to Mr. Núñez' contention that land taxes were difficult to apply he referred him to the example of Chile. It had been said that he exaggerated the critical role of agricultural surpluses as a determinant of economic development but in under-developed and predominantly agricultural countries the difficulty of developing new industries to the point where they could compete successfully with the manufacturing capacity of highly advanced countries had to be taken into account. The lack of an agricultural surplus could not therefore, be compensated for by imports, which were paid for by the export of manufactures. Doubt had also been cast on whether a progressive land tax could stimulate productivity. He would like to leave that point open for discussion at a later meeting.

With reference to the charge that his ideas were not practical he asked whether that meant that they were unrealizable from a technical point of view or whether they would be likely to arouse opposition among powerful interests. If the latter, he felt very strongly that it was the duty of economists and indeed of experts in any field to consider the public interest and not to bow to political considerations.

As regards the concept of family taxation, i.e. the integration of the unearned income of husband, wife and minors, he referred Mr. Urquidi to his report on tax reform to the Mexican Government, where the idea had been developed in detail. There was no reason to doubt its efficacy since it was being successfully applied in many European countries, India and Ceylon.

It had been said that he had not made the order of priority for his plan for tax reform sufficiently clear. In his opinion measures to enhance the integrity and efficiency of the tax administration should take precedence over all other considerations, since they formed the corner-stone of successful tax reform.

With respect to his suggestion of a value added tax, Mr. Urquidi had said that it would not serve for small enterprises which did not keep proper accounts. He himself thought that if enterprises could be taxed in other ways, there was no reason why a value added tax should not

/be equally

be equally successful, particularly as it was simpler and more practical than sales taxes. He disagreed with Mr. Naharro that it would tend to distort the price system and resource allocation, as it was a completely neutral tax being simply a sales tax with the element of duplication removed. As Mr. Prest had said it was comparable to a comprehensive single stage sales tax. He further disagreed with Mr. Naharro that the tax tended to stimulate the formation of monopolies, but where economies of scale were present it did promote the development of larger and more efficient enterprises and eliminated inefficient units with little competitive power.

With reference to some remarks by Mr. Piedrabuena and Mr. Hart, he agreed that the value added tax had to be judged in relation to the tax it supplanted or complemented. It was best to look upon it as a substitute for the sales tax and partial replacement for the corporate profits tax. In answer to Mr. Goode, he thought that the value added tax was as applicable to retail trade as the sales tax. He agreed that the self-reinforcing features of the tax could be effective only if its coverage was comprehensive.

Mr. Urquidi and other speakers had criticized his neglect of the question of incentives in taxation. He was fully aware of their importance particularly when the objectives aimed at had been made clear beforehand, but did not consider that they were a salient factor in economic development and deplored their haphazard application which often left loopholes for tax evasion.

What he did disagree with was the idea that heavier taxation acted as a disincentive. On the contrary, its stimulating effects were apt to outweigh its potentiality as a deterrent. It was also likely to produce more revenue for investment instead of for consumption.

In answer to a point raised by Mr. Naharro, he agreed that direct taxes were more equitable than indirect taxes in that they were leveid on a person's actual capacity to pay. But since indirect taxes were primarily intended as instruments for collecting revenue, and the criterion that should be applied was one of economic efficiency, the question of equity was less valid in relation to taxes on enterprises than in relation to taxes on persons.

/Since the

Since the value added tax was intended to produce revenue rather than equity, he thought that it should be universal without excluding foodstuffs as had been suggested. Any adverse effects it might have on distribution could be counteracted by the introduction of subsidies at one stage or another. He insisted on the importance of a single uniform rate for the value added tax.

The meeting was suspended at 5.25 p.m. and resumed at 5.35 p.m.

ISSUES OF TAX REFORM FOR LATIN AMERICA

Mr. Magaña took the Chair

Mr. HARBERGER said that his paper (Doc. CPF-DB-4) could be summed up in five main points: (1) Latin American countries faced strong tax increases because the development programmes they had undertaken demanded heavy fiscal expenditures; (2) Latin American countries should have the means to face unforeseen contingencies, such as the fluctuation of international prices of export products which affected government revenues and the sudden rises in wages and salaries; (3) however important reducing evasion might be, it would not produce all the funds required by those countries in the next decade; (4) to obtain a fair distribution of the tax burden it would be necessary to have recourse to several taxes. Although the income tax had been much improved, there were different possibilities of evasion for different community groups and it would be necessary to have recourse to other taxes in order to strengthen the progressive effect of income tax; (5) one way of achieving greater progressivity in the over-all tax system was to apply taxes to groups of luxury or semi-luxury goods. In Latin America a start had been made in that direction through import duties, but as the countries began to

/produce such

produce such goods, thought would have to be given to taxing them, even when they were locally manufactured. In this connexion, and as a matter of secondary importance, he mentioned the fiscal possibilities that the suppression of diplomatic privileges would open up for automobile imports.

Mr. Harberger next referred to taxes on capital income, which should not be applied solely to corporations but should be extended to all enterprises, interest, agricultural activities, and income derived from urban property, without prejudice to applying the personal income tax concurrently. The difficulties in taxing unincorporated enterprises could be solved by means of schedular taxes such as those already existing in many Latin American countries. The taxing of interest, in so far as it represented capital, would not be very difficult because banks and financial institutions used efficient accounting methods and were not in a position to evade taxes. In taxing urban and rural property, recourse might be had to a system of self-assessment, whereby the owners would be obliged to sell to anyone ready to pay, for instance, 20 per cent above the value declared.

Mr. ROSS read the comments made by Mr. Matus (see Doc. CPF-DB-4/Add.1).

Mr. URQUIDI said that many of the points made by Mr. Harberger were excellent, especially with reference to the need for planning taxes to meet contingencies. However, he disagreed with the restriction on consumption of domestically-produced luxury goods, since it might have adverse effects on employment and industrial activity, and consequently on fiscal revenue.

In his view, Mr. Harberger's reference to duty-free imports of automobiles by diplomatic missions was hardly correct, as the yield obtained from a tax on such transactions would not justify the difficulties that would arise.

With regard to taxation of income from capital, he believed that the idea of levying property taxes should be more generally adopted; that was no novelty in Latin America since they were in use in a number of countries in the region.

/Referring to

Referring to the suggestion made by Mr. Harberger of instituting the compulsory sale of property when the owner received an offer of purchase at a certain percentage above the value of his assessement, he believed it would not be feasible. There were other means of establishing gradually a system of honest assessment which were far more practicable than the method proposed by Mr. Harberger. For example, in Mexico assessment by a bank, duly certified by a notary public, was required.

The meeting rose at 6.30 p.m.

PROVISIONAL SUMMARY RECORD OF THE SIXTH MEETING
held at Santiago, Chile
on Saturday, 8 December 1962, at 9.55 a.m.

Chairman: Mr. MAGAÑA
later: Mr. LYNN

CONTENTS:

Issues of tax reform for Latin America (continued)

Public expenditures and economic development

ISSUES OF TAX REFORM FOR LATIN AMERICA (continued)

Mr. PREST referred to section II of Mr. Harberger's paper, on progressive excise taxes. With respect to substitution effects, he wished to draw attention to the possibility of such an effect in relation to the demand for leisure, or the supply of work. Secondly, he said that on the basis of twenty years' experience of progressive excise taxes in the United Kingdom, they could not be regarded as very successful; it was difficult to ensure that comparable goods were taxed at comparable rates, and rates were now being consolidated in order to avoid irrational discrimination. Lastly, European experience with a common market had shown that the different structures of progressive excise taxes in different countries led to problems in establishing a common market; such problems were not insoluble, but they should be given careful consideration before establishing such taxes if they did not already exist.

Mrs. de NAVARRETE, referring specifically to the tax on income from capital, reminded the meeting that it already existed in many countries, including Mexico. After explaining in detail how the tax operated in that country, and pointing out that its rapidly progressive rates climbed to as much as 40 per cent, she said she was not in favour of ad rem taxation. What was urgently necessary, in her view, was a personal and progressive tax on capital. If applied to agriculture, the tax proposed by Mr. Harberger would have a discouraging effect inasmuch as it would hinder capital formation. The author of the panel paper, in estimating the probable income from the taxes he suggested, had not taken into account evasion in respect of capital as a factor reducing the tax base. On the other points raised in the panel paper she supported Mr. Harberger's views.

Mr. NAHARRO said he was in general agreement with Mr. Harberger's excellent paper, and endorsed the proposal respecting a tax on capital, however difficult it might be to apply. However, he asked Mr. Harberger to make clear his solution to the problems arising in connexion with taxation of interest received as profits by banks which were already taxed when paid by the borrower. Similar cases might arise in connexion with other financial intermediaries, subsidiary companies in relation to the head office, investment trusts, etc. While those problems of double taxation were not insoluble, they were complicated and Mr. Harberger's comments on that point were most useful.

/Mr. HART

Mr. HART referred to the question of whether corporations should be subject to a tax on income from capital at the same rate as unincorporated companies. Although a tax on the net activity of a corporation corresponded to the concept of a tax on capital income, the same was not true for unincorporated companies, where to some extent the profit represented the remuneration of the entrepreneur's labour, the labour element being proportionately larger in the smaller companies. He referred to experience in Chile in relation to the possibility of taxing the two categories of enterprise at different rates. Moreover, it was difficult to establish a net income consisting of interest if the current inflation rate was higher than the nominal interest rate.

Mr. RIOFRIO thought that all the papers presented to the Conference were of high quality, though he disagreed with them on a few points. What caused him most concern with regard to the work of experts was the lack of continuity and even the incompatibility of their ideas, since the outcome might be bewilderment and misgivings among those who were anxious to follow their advice. To support his contention, he cited several cases that had arisen in Ecuador.

With regard to the tax on income from capital, in his opinion income, by its very nature, was always net, and that he would be loth to tax gross income. He also saw difficulties in connexion with the multiplicity of taxes on the same source and the problem of determining where progressiveness in indirect taxation began. He thought the best thing was to avoid every kind of discrimination, by establishing a global tax on capital and a further supplementary tax which might play some part in the redistributive function proper to fiscal policy. He asked Mr. Harberger what level of progressivity he would recommend for the taxes on consumption suggested in his paper.

Mr. DESCARTES, referring to the assessment of agricultural and residential properties, said that he viewed with some misgiving a system of assessment or collection which appeared to be over-simplified. He felt that assessment of property raised numerous problems, and hoped that they would be discussed in connexion with the taxation of agriculture.

/Mr. GNAZZO

Mr. GNAZZO took it that what Mr. Harberger meant by a tax on corporate profits was a tax on the capital profits of an enterprise. He wondered whether a distinction could be made between the profits of an enterprise and those of a shareholder. Some enterprises were owned by a single shareholder. He would therefore ask Mr. Harberger whether it might not be better to consider corporate profits as the capital profits of shareholders and to tax them at the time the profits were distributed.

Mr. DARDON, referring to the question of the assessment of property for tax purposes, agreed with Mr. Harberger's proposal of self-assessment based on the declaration of the property owner. The question of a statutory provision, however, required further discussion. The solution must necessarily vary from country to country.

Mr. COSCIANI believed that the organic, progressive tax on consumption proposed by Mr. Harberger had several disadvantages. One of them was that, as the propensity to consume was less in the higher income-from-capital groups, the rate formally applicable to the tax would not correspond to the rate actually charged. An ordinary tax on net wealth seemed to him to be preferable and simpler.

Mr. NUÑEZ referred to Mr. Harberger's position that income from capital should be taxed at a higher rate than income from labour. He understood a capital profits tax to mean a progressive personal tax on capital profits. Such a tax would be easier to collect than a tax on wealth, particularly if based on a progressive rate. There would be some advantage to combining the progressive tax on capital profits with the income tax.

Mr. Harberger's proposed method of assessing property was interesting and he had recommended its adoption in Panama. However, the Panamanian Government had preferred to tax property on the basis of the size of the holdings.

Mr. GOODE supported the idea that there should be an effort to increase substantially the taxes paid in most Latin American countries on urban residential property, as well as on agricultural land. Referring to paragraph 29 of Mr. Harberger's paper, he said that he distrusted the proposal that property should be assessed on the basis of a simple assessment

/of the

of the value of his property by the owner himself. Moreover the idea of obliging the owner to sell his property if offered 20 per cent above that assessed value would introduce the constitutional problem of forced sale. In addition, it might leave room for corruption, or sharp practice on the part of those who had easy access to information about, for example, the building of a road that would lead to an increase in the value of certain properties. Again, there might be no likely buyers for a property that was unusually large or valuable, or at least none outside the social circle in which the owner moved, where social restraints would operate to prevent an attempt to force a sale, whereas there would be a much larger market for small properties. With respect to the adjustment of established values, he doubted very much whether a general price-index would be appropriate for the purpose, especially for agricultural property, in view of the instability of agricultural prices. He sympathized with Mr. Harberger's aim, but could not agree with his views about achieving that aim. Property valuation was a technical problem that the Latin American countries would have to deal with by getting technical assistance and advice from the various public and private agencies that specialized in that field. It would be a lengthy and costly task, but it was urgent and important, and the only true solution of the problem of getting a correct assessment of taxes on property.

Mr. KALDOR suggested an amendment to Mr. Harberger's proposal regarding self-assessment of property values by the owner, which might meet some of Mr. Goode's objections. The scheme might be more acceptable if the owner always had the option of retaining his property if he revalued it above the offer made; for example, if an offer was made to buy the property at the owner's valuation plus 20 per cent, the owner could retain it if he raised his valuation by 25 per cent. That would lead to a correct valuation on the basis of a kind of auction, without involving forced sales. Mr. Harberger's original proposal might lead to certain difficulties; for an example an owner who was particularly attached to his property might over-value it through fear of losing it, which would lead to resentment of the system. As for Mr. Goode's suggestion about the difficulty of finding buyers for large properties, it was quite likely that a syndicate

/could be

could be found to do so if there was the chance of a large profit. If no one came forward, that would mean that the market value of the property was in fact lower than the valuation plus 20 per cent, and that the valuation was approximately correct. The question of self-assessment had been discussed in public finance circles in the United Kingdom for the past fifty years, and the view had long been held that expert valuation was to be preferred, but that view was now changing. However good the expert advice, there would be strong pressure for under-valuation unless the tax administration was entirely free of corruption. No country had found an ideal method of adjusting assessed values. In Latin America assessed values represented less than 1 per cent of current market values; but even in highly developed countries the situation was not satisfactory - in the United Kingdom assessed values represented about 10-30 per cent of market values, and in the United States, where there was no shortage of experts, assessed values in some States were entirely out of line with current values. Whatever expert system was used, values would be out of date within a few years, but if Mr. Harberger's system, amended as suggested, were adopted, assessed values would continue to rise as inflation, or other factors, led to a continued rise in market values.

Mr. HARBERGER, replying to the comments made on his paper, did not think there was any great discrepancy between Mr. Matus' views and his own, since both were in favour of recommending a progressive tax on consumption and felt that capital should be taxed more heavily than labour. The difference in their views would appear to stem rather from their basic outlook, since Mr. Matus had little use for market forces, while he himself had slightly more respect for them. Hence his favourable attitude towards a tax on all income derived from capital, whatever its origin, without prejudice to the possibility of levying higher taxes on the less productive sectors in order to channel capital towards higher productivity.

In view of the lack of flexibility of current tax systems, and so long as it subsisted, recourse should be had to establishing new taxes or increasing existing ones.

As to whether the budget should be balanced or not, he was inclined to say no, provided the size of the deficit - which depended upon a number of circumstances - was not unduly large, as unfortunately was the case in many Latin American countries.

/The fundamental

The fundamental difference in his own position arose from the increasing respect he felt for the complicated economic organization.

With regard to Mr. Urquidi's observations, he recognized that every tax had inherent in it an unemployment effect, but efforts should be made to ensure that the tax system as a whole was designed to ensure maximum yield from taxes with the least possible unemployment. The tax on income from capital outlined in his paper was intended, precisely, as double taxation, as in the case of corporations. Regarding assessments, he recognized likewise that it was difficult to reach a consensus of opinion on the subject; however, it would always be preferable to have some system of assessment and to endeavour to ensure that assessments were in line with the real value of the property. With respect to cars owned by diplomats, while it might be said that the loss of tax revenue was not considerable, the capital gains derived therefrom should be considered. Moreover, the question of principle involved should be looked into. That remark was also valid for the observations made by Mr. Descartes and Mr. Dardone.

While it was true that the progressive tax could discourage the desire to work, as Mr. Prest had pointed out, he did not feel there was cause for concern provided the rates were moderate. The indirect progressive tax he personally recommended for Latin American countries was based on his attitude towards the future that lay before them during the next decade. With regard to the attempt being made to establish a common market and its influence on the tax system, he believed that tax rates on the same goods in the different countries of destination should be the same or equivalent.

Whatever Mrs. Navarrete's views, he believed that systematizing of taxes on income from capital was desirable. It was true that he had not taken tax evasion into account in his paper, in order not to complicate the issues too much.

It was not easy to reply to the doubts voiced by Mr. Naharro, because each of the cases to which he had referred was different. While he would like to think about them at greater length, and recognized that they still needed an answer, he could say at once that he did not feel it was wrong to levy taxes on the interest obtained by tanks, in addition to their own

/income from

income from capital, provided they did not merely act as tax collector intermediaries, since to do so would be unjust.

Mr. Hart's observation was not without some foundation. However, if it were possible to tax income from capital in the case of small firms with lower rates than larger enterprises, the unfavourable effects of the proposed tax would not be so great.

Although he agreed that Mr. Riofrio's scruples were laudable, the aim he had in mind in proposing in his paper that gross income should be taxed was precisely double taxation. To establish progressivity in taxes on consumption, he would recommend that surveys of families be made for different income levels, in order to identify the goods into different groups depending on their income-elasticity. Depending upon the degree to which they were luxury goods, they would be taxed at varying rates - 30, 20 or 10 per cent.

When Mr. Gnazzo made a distinction between corporation income and the income accruing to their shareholders, he was possibly thinking of a single income tax and not of double taxation. If so, they were in complete agreement.

He agreed with Mr. Cosciani that the propensity to consume declined proportionately with the rise in capital income, which would seem to be an argument against the progressive indirect taxes which he himself had proposed. However, the net wealth tax could quite easily be supplemented or replaced by the system he proposed.

Reverting to the system of self-assessment, he insisted that despite all its drawbacks it was fairer than the system based on area only as mentioned by Mr. Nuñez.

In reply to Mr. Goode and Mr. Kaldor, he feared that if the fines paid in order to enable owners to keep their property were included in the system of assessment that he proposed, they might invalidate the objectives pursued. But provided the fines in question were high enough to discourage those who were ready to run the risk of incurring them, he would have no objection to make, since in that case they would not affect the substance of his suggestion.

/The meeting

The meeting was suspended at 11.55 a.m. and resumed at 12.10 p.m.

Mr. LYNN took the Chair

PUBLIC EXPENDITURES AND ECONOMIC DEVELOPMENT

Mr. VAN DER MEL introduced Mr. Adler's paper (CPF-DB-10) on public expenditures and economic development. The first part of the paper dealt with the need for a rational expenditure policy, since appropriate expenditures were the basic justification for the levying of taxes, and there was a close connexion between the effective use of government funds and the willingness to pay taxes. The structure of revenue should be determined in close relation to the structure of expenditure, since the fiscal machinery, in the wider sense, aimed at redistributing income. The need for redistribution of income was more strongly felt in a stagnant economy than in a country where there was a considerable growth rate shared by the low income brackets, but such redistribution might be better achieved through expenditure policies than revenue policies, to guard against too great a reduction of incentives to saving and investment in the private sector.

The paper went on to deal with the budgetary process, touching on the drawbacks of the conventional administrative budget, and the advantages of the functional budget, and of performance budgeting, which made it possible to relate benefits to costs incurred. A related point was the need to have consolidated data and co-ordination of spending policies for the public sector as a whole, especially when expenditure was spread over many ministries, autonomous agencies, public enterprises, etc.

The comments on the level of public expenditures had to be somewhat tentative because of the lack of comparability of the data available. Table 1 seemed to show that there was no simple relation between the rate of economic growth and the rate of public expenditures expressed as a percentage of the gross national product. It could not be established

/whether the

whether the growth rate would have been higher if public expenditures had been higher. The decisive point seemed to be the quality of government expenditure.

The second half of the paper dealt with certain important categories of public expenditure, and touched on public sector capital formation, on the need for full cost pricing of public services and enterprises and on education, defence, and general administration. In connexion with its lending operations, the World Bank had on numerous occasions been confronted with problems of pricing of public enterprises and had been able to exercise some influence for the good. In general the situation appeared somewhat better, although least with respect to railways. Subsidies, where unavoidable, should be regarded as exceptions requiring special justification. The proportion of total public expenditure allocated to education appeared to have increased in recent years, but the additional facilities provided were to a considerable extent absorbed by the population increase. Literacy ratios for 1950 were shown, but were not yet available for 1960. There appeared to be some relation between the literacy rate and the proportion of the gross national product spent on education. Expenditure on such social services as education and health seemed directly related to the willingness to pay taxes; that could be exploited, particularly by increasing local taxes, little used in Latin America as a means of financing government services. Although defence expenditure was an area where experts must tread warily, they had a duty to draw attention to the element of waste involved from the standpoint of economic development in a substantial portion of expenditure under that head in Latin America. Although data on general administration were not susceptible to detailed analysis on a comparative basis, it seemed clear that Latin American government services included a large number of superfluous posts, that efficiency at the low and middle levels was poor, and that there was an urgent need for better pay scales and status for government employees in general.

Mr. MENDEZ said he would confine himself for the time being to making some general comments on Mr. Adler's paper, which he would enlarge upon in a written paper that he intended to present later to the Conference.

/As Mr. Adler

As Mr. Adler had stressed, too little attention had been paid in the past to analysing the structure of public expenditure as a function of development, particularly from the practical standpoint. In his opinion, that was the salient point in Mr. Adler's paper.

He considered that prior over-all development planning was essential whether fiscal expenditure for investment purposes was regarded as a complementary function of the private sector, whether such expenditure was expected to have a redistributive effect or whether the end pursued was to secure the backing of public opinion for economic development plans.

From that standpoint, the basic questions posed by fiscal expenditure were to what extent the State could act in pursuance of over-all development aims without prejudicing the private sector, and how public expenditure could be systematically distributed. The development programme itself would answer those queries and would set the limits for State intervention.

Admittedly it was impossible for the criteria that determined the order of priority for expenditure to be altogether perfect, and it was not always easy to carry out the necessary structural reforms. It was equally true that an intensive investment plan would inevitably lead to higher recurrent expenditure than had been envisaged and that investment outlays that had already begun to be made could not always be abruptly broken off when the plan was initiated. All those considerations would act as so many further obstacles to investment policy. Despite the difficulties, however, it was always desirable to establish a plan and endeavour to keep to it.

Turning to some specific points made by Mr. Adler in his paper, he said he did not agree that the redistributive function of fiscal policy should be applied chiefly in the less developed countries with a stagnant economy; it might tend to aggravate the situation of those countries in some cases, whereas the opposite might occur in others.

/It was

It was likewise possible that the redistributive effects of fiscal policy were more urgently needed in developing countries where the economy was not stagnant. He did not think that a general formula could be advocated which failed to take into account the individual features of each case.

With respect to the prices of public services, he thought all price policies should be an integral part of the respective expenditure policy. Only in that way would it be possible to avert the dangerous distortions from which development programmes were apt to suffer.

In conclusion he wished to stress again that the chief merit of Mr. Adler's paper was that it opened up a fundamentally important avenue of economic development which had hitherto been insufficiently explored.

Mr. NAHARRO wished to stress one point with respect to expenditure on education. Whatever the volume of expenditure on education, it seemed to be the general practice in Latin America that when that volume of expenditure was allocated in the form of specific payments, very little went to pay teachers who taught high-level graduates who constituted an important factor in development. Hence, experts were "produced" who were of lower quality than would have been the case if the production factor constituted by "professors" could devote all their efforts to teaching, which could only be done if they were well paid, instead of having to do other work.

Mr. LEWIS felt that one aspect of the question of public expenditure should be emphasized. In discussing such matters as reforms in the tax structure and tax administration, participants had thought in terms of timing, of what was actually being done at the Government level and in legislative bodies. The same realistic approach might well be taken to the question of public expenditure and budgetary procedures by thinking in terms of what was currently being done, of how many civil servants were needed and of how long it would take to train them, what budgetary procedures should be introduced and what political decisions were needed to enable the necessary legislation to be passed.

Mr. MONTERROSO, referring to Mr. Adler's example of Peru as a country offering an unfortunate combination of low gasoline taxes and wholly inadequate road facilities, observed that road facilities were also inadequate in some countries which imposed a high tax on gasoline. That was due to the fact that the income from gasoline taxes was not specifically used to improve the highway network but went into a general fund. He wondered whether it might not be desirable in Latin America to apply income from certain taxes to specific purposes, perhaps on a percentage basis.

Mr. DARDON, speaking to the question of the price of public services, observed that prices were not always directly related to costs and that costs were usually inflated because of top-heavy bureaucratic administration. The problem might partly be solved by providing for the participation of the private sector, e.g. by transferring some public services to the private sector.

Mr. DESAI felt that Mr. Adler's paper had failed to tackle the real issues. The question of public expenditure could not be viewed on the same basis as tax policy. The functional distribution of expenditure was not a matter for bureaucrats but for legislators. Decisions on national priorities were the prerogative of the legislature and of Ministers of Finance.

He thought that there was still a considerable misunderstanding of the development process itself. First, the national accounts, when developed, were subject to major errors since the problems of imputations were serious and largely affected the estimates computed for the developing economies. The nature of the processes of economic development was also complex. In connexion with his work with ECAFE, one conclusion reached was that the process of economic growth depended upon many things of which capital investment was not always the major factor. Even for countries of Western Europe, that appeared to be so. The multi-variate analysis made by ECE, which had selected three variables, viz. capital input, labour input, and all other elements excluding capital and labour inputs, gave the surprising outcome that

/growth was

growth was most closely related with the balance factor other than capital and labour inputs. Economic growth was a complex process which could not be viewed in terms either of investment activity alone or of any other single area. The human factor must be taken into account. That point should be particularly stressed, especially in Latin America.

Expenditure policy could not be applied in terms where investment was treated as a major element and such questions as education were treated as a side issue. Priorities in public expenditure depended upon specific conditions in each country. The major question was what could be done to make expenditure effective in terms of the objectives sought, and in that field more needed to be done by way of fiscal research.

Mr. URQUIDI was in general agreement with the points made by Mr. Adler, particularly the emphasis he had placed on the redistributive effects of expenditure. He supported Mr. Desai's views on the question of public expenditure priorities. The Latin American countries had to undertake considerable social expenditure which also had economic consequences. Lastly, he supported Mr. Adler's view that programme budgeting techniques should be extended.

Mr. JATAR regretted that the important question of public expenditure and economic development was being disposed of at a single meeting. The point he wished to make was that the contribution of the public sector in stimulating economic development could not be measured solely in terms of the coefficient of real investment. It should be measured by the increase in economic efficiency determined by public expenditue. The question was rather what the participation of the public sector was in capital formation. If a Government purchased a piece of land, it would contribute to economic development only if that land was made available to a large number of people who would thus be given employment.

Mr. MONTERROSO could not agree that, with respect to income redistribution, public expenditure was more important than the collection of revenue. He felt that the fiscal authorities should endeavour to improve national income both by a progressive tax system and an increase in transfer expenditure, i.e. by considering at all times both sides of the medal: income and expenditure.

Mr. VEGA agreed in general with the views expressed by Mr. Adler and, in particular, with the points made by Mr. Desai and Mr. Jatar. With

/respect to

respect to Mr. Mendez' comments, he hoped that recommendations on the planning of public expenditure would ensure that budgetary provision was made for the completion of long-range programmes. The division of the budget into functions did not ensure efficiency even if allocations were made on a percentage basis. For example, if the construction of a highway cost $10 million and budgetary expenditures was spread over fifty years, with an annual allocation of $200,000, that did not constitute efficient public expenditure.

Mr. NUÑEZ felt that the discussion so far had shown that very little was known about the effects of public expenditure. He recommended that an appraisal of those effects should be made.

Mr. VAN DER MEL considered Mr. Mendez' comments an amplification of what Mr. Adler had stated in his paper rather than a criticism of the recommendations made. He fully subscribed to Mr. Mendez' view that planning was desirable, that it raised a number of difficulties, and that it should be adaptable to changing circumstances. He further agreed on the desirability of income redistribution through fiscal machinery and the need for taking into account the individual features of each case. With respect to pricing policies, it was an important factor with regard to public enterprises and the aim should be full cost pricing, allowing for certain exceptions. While the difficulties were clear, the point was worth restating.

On the question raised by Mr. Naharro, he felt that the nature of expenditure on education was important. There would still be much to learn in the field of the economics of education. The International Bank recognized the increasing importance of education in the context of economic development and believed that in the present circumstances more should be done in that field. Lack of data made it difficult to come forward with tangible suggestions. More study and research were needed as to the type of education which gave the best results in terms of economic development.

Replying to Mr. Lewis, he agreed that it would be desirable, in the context of the efforts being made to improve fiscal policy in Latin America, to devote attention to expenditure policies.

/On the

On the point raised by Mr. Monterroso, the question whether it was preferable to have a unitary budget or to allocate specific taxes to specific uses, he felt that the problem should be viewed realistically and that a flexible approach to the problem of assigned revenue should be adopted.

The problems raised by Mr. Dardon could be attributed to inefficient administration. However, in a number of cases it was difficult or undesirable to transfer public services to the private sector.

He felt that some of the misgivings expressed by Mr. Desai were the result of misunderstanding due to the rather general nature of Mr. Adler's paper.

With respect to the functional distribution of expenditure, he agreed that the ultimate decision rested with the legislature. However, it was the task of civil servants and experts to submit sensible recommendations to the legislators. On that point, all that Mr. Adler's paper sought to emphasize was the usefulness of a functional classification of expenditure.

On the question of the economic development process itself, he agreed that statistical data might be inaccurate. However, a paper on public expenditure had to provide some figures, however limited, rather than none at all. After all, statistical data did provide some order of magnitude.

The question of the forces behind economic development raised many problems and he agreed that over-simplification should be avoided. It should nevertheless be borne in mind that capital output ratios drew attention to other underlying factors.

He did not agree with Mr. Desai that the question of education had been minimized in Mr. Adler's paper. He could assure Mr. Desai that the author was fully aware of the importance of education.

With respect to the role of technicians in establishing public expenditure priorities, he agreed that it was limited but repeated that the views of experts should be made available.

/He fully

He fully supported Mr. Desai's plea for further research on fiscal problems.

Replying to Mr. Urquidi, he felt that public expenditure on specific items must necessarily vary from country to country. Some countries in Latin America, as Mr. Urquidi had pointed out, were committed to substantial expenditure in certain fields.

He agreed with Mr. Jatar that high investment figures did not automatically lead to a high growth rate.

In conclusion, he shared the views expressed by Mr. Vega and Mr. Nuñez.

The meeting rose at 2 p.m.

PROVISIONAL SUMMARY RECORD OF THE SEVENTH MEETING
held at Santiago, Chile
on Monday, 10 December 1962, at 10.10 a.m.

Chairman: Mr. MAGAÑA

CONTENTS:

Personal income tax in Latin America

PERSONAL INCOME TAX IN LATIN AMERICA

Mr. GOODE introduced his paper (CPF-DB-2). The practical question was how the personal income tax could be made more effective in Latin America. It was a form of tax that was based broadly on capacity to contribute, it could reduce excessive inequality, and it could provide an elastic yield responsive to increases in real output and inflationary increases in money incomes. Although the tax had been criticized as tending to curtail savings, the evidence to support that contention was not persuasive: moreover high savings ratios were possibly less characteristic of high incomes in under-developed countries than in countries with a long capitalist tradition. Moreover other factors, such as the security of property, the prospective rates of inflation, investment opportunities, the taxation of corporations, fiscal deficits, and government investment, might all have a greater impact on the national saving ratio than the taxation of individuals. It was true that the income tax lent itself to excessive progression, but that was an argument against abuse of the tax, not against the tax itself. There was no scientific method of forecasting the reaction of individuals to progressive taxation, but he agreed with Mr. Harberger that if rates were moderate, and there was due regard for certain aspects such as the definition of net income, adequate allowance for capital consumption, etc., there was not much danger of an adverse effect on incentives to work or invest.

However, the income tax was likely to lose its characteristics in the absence of certain pre-conditions, which include a predominantly monetary economy, a high literacy rate, accounting records that were predominantly honest and reliable, extensive voluntary compliance by taxpayers, a political system not dominated by the rich, and an honest and efficient administration. The last condition was as essential as the others, but perhaps easier to bring about in the short run. In the light of those requirements, Latin American countries differed considerably in the extent to which they were equipped to make effective use of the personal income tax.

With respect to tax design, he thought it was now widely recognized that a global tax had substantial advantages over a schedular form of tax;

/the two

the two might be used jointly, but a schedular tax alone was likely to operate unfairly and ineffectively.

There were a number of reasons for taxing capital gains as a form of income; it was not only correct in principle, but restricted speculation.

In several Latin American countries, income from foreign sources was not subject to domestic taxation, because the tax principle invoked was taxation of income at the place of origin, instead of the place of residence of the recipient. There was no reason why countries should not tax both income generated within their borders and income received from foreign sources by residents. Even in the absence of tax treaties providing for exchange of information on income paid or credited to nationals of the taxing country, foreign countries might be willing to provide such information on a unilateral basis, provided there was a serious intention of using the information to good purpose.

Omission of the imputed rent of owner-occupied dwellings from the income tax base resulted in inequities between owners and tenants and between investors in dwellings and in other assets, and encouraged a relatively less productive type of capital formation. However, in practice there were few countries in Latin America with property valuations that would provide a satisfactory basis for assessment of imputed rent under the income tax.

With respect to personal exemptions and allowances, administrative considerations should probably prevail in most Latin American countries at present. It would not be possible to bring exemptions down to a level as low, in relation to per capita national income or the socially acceptable minimum, as the ratios prevailing in more industrialized countries.

In setting rates, it was preferable to establish a fairly high beginning rate, to reduce the number of payments too small to cover the cost of collection. Upper rates should not be too high, and in Latin America appropriate rates would be considerably lower than in such countries as the United Kingdom or the United States. If the incomes of husbands and wives were not aggregated, the tax would be less progressive than it appeared.

/There was

There was no doubt that the personal income tax deserved a substantial place in the revenue system of Latin America, but the considerable advantages of such a tax could not be obtained without sustained thought and effort. Above all there must be restraint in order to avoid excessive rates and over-refinements.

Mrs. NAVARRETE, presenting her comments (Doc. CPF-DB-2/Add.1), said that she was in general agreement with the paper and would confine herself to the question of the establishment and effectiveness of a personal income tax in under-developed countries. The objections against such a tax could be classified as theoretical or economic, administrative or practical, and political; and she laid special stress on the administrative type, examining the case of non-agricultural wage earners, agricultural taxpayers, and non-agricultural entrepreneurs, pointing particularly to the low real capacity of the agricultural taxpayers, at any rate in Mexico. She believed it self-defeating to impose high rates on enterprises and low rates on the income received by their owners, who usually formed part of a privileged social class though the enterprise itself performed the productive work. She therefore believed that the tax burden on enterprises should be reduced, provided foreign firms whose owners did not reside in the country did not receive the same treatment. She was opposed to granting preferential treatment to income derived from capital not previously taxed (interest, royalties, fees for technical services, rents, etc.); she was also opposed to imputed house rentals being included in the taxable base, although it might be taken into account in calculating national income.

She considered that, in the future, the most pressing tax reforms would revolve around the income tax and that they should tax personal income derived from capital in a progressive and efficient manner. A great effort should also be made to improve the administrative machinery so that taxes actually collected would come as near as possible to what was expected and all taxpayers in similar situations would receive equal treatment.

/Mr. FLORES

Mr. FLORES, introducing the written comments on Mr. Goode's paper which he and Mr. Moises Beatriz had presented jointly (CPF-DB-2/Add.2), said that Mr. Goode had accurately analysed the causes of the relatively unsuccessful imposition of the personal income tax in Latin America. A pragmatic consideration of conditions in Latin American countries must lead to the conclusion that forms of taxation had to be adopted in those countries which were adapted to their economic and social environment, even if that meant a departure from the traditional tax structure. Moreover, the simpler the income tax imposed the better. The social, economic and administrative structure in Latin America, and the type of taxpayers in the countries concerned, precluded the application of complicated forms of taxation such as those used in the more developed countries. Preferential tax treatment should be granted in favour of investment in specific economic activities as a means of directing the economy towards more advanced systems conducive to economic development.

Mr. MOISES BEATRIZ, continuing the presentation of the joint paper, observed that a progressive tax on net wealth was being applied with some success in a few Latin American countries. Such a tax was to be recommended in countries where conditions were least suitable for an effective income tax.

With respect to capital gains and losses, he had no hesitation in supporting the application of a tax on capital gains in Latin America. Provided that capital gains were taxed, the tax would combat purely speculative investment which did not contribute to national income and would channel investments into productive activities. He would exempt capital profits derived from the sale of securities so as to attract investment by persons with small savings and allow them to share in the benefits of increased economic development. Care should be taken in imposing a capital gains tax in order to avoid the unfortunate consequences which might result from lack of experience or foresight.

He felt that extension of the income tax to income from foreign sources would, in most cases, fail to prevent the flight of Latin American capital or to increase fiscal revenue but would only result in an unproductive rise in administrative costs.

He supported the taxation of the imputed rental from owner-occupied dwellings because it was, in fact, a rental whose exemption would be regressive and because it was an economic fact in Latin America that the owner of a dwelling was a privileged person.

/Mr. NAHARRO

Mr. NAHARRO, intimating that he was in general agreement with the paper, went on to refer to the twofold possibility of income tax being considered either strictly from the point of view of collecting revenue or to provide a system of incentives to guide economic development in a specific direction. Without prejudice to the idea of directing it over the long-term with and eye to its yield, in order not to distort the revenue-producing aims inherent in it, the income tax might be used as a short-term instrument to promote development, by means of a suitable system of rebates and exemptions. In that regard, he favoured total exemption of certain forms of savings, limiting the taxable base to the income spent, despite Mr. Goode's objections to such exemption since it was admitted that savings were not forthcoming in sufficient quantities for development. Precisely, to ensure that they reached the desired level, it would be advisable to create additional incentives in favour of savings invested in capital formation favourable to economic development.

Mr. JARACH, referring to what Mr. Goode had said about the taxation of income from foreign sources, pointed out that the main reasons for the attitude of Latin Amercian countries had been a reaction against the position of the capital-exporting countries, which had based the tax on the place of residence of the recipient instead of on the place of origin of the income, and the position of the capital-importing countries themselves, which wished the tax to be based on the source and origin of the income. The situation had now changed for Latin America, in that while capital for investment was being sought, domestic capital tended to leave the country because of inflation or other reasons, and consequently a new approach was required. In some Latin American countries a solution had been sought by basing the tax on the place of residence but under that criterion nationals were taxed while foreigners were exempt, which was obviously unfair.

Another point he would like Mr. Goode to clarify was the question of tax havens against a progressive income tax provided by holdings companies, which might purport to represent investment by foreigners when they did not. There was a need for international co-operation to prevent such an asylum from taxes on income and wealth.

Although there was a case for taxing imputed income from owner-occupied houses, it was necessary to guard against loopholes enabling taxpayers to report tax losses in this connexion that could be offset against other income.

/...

Although he had been living in a Latin American country for many years, he supported the views of those outside Latin America who did not have much faith in tax incentives. One important reason was that the incentive effect was sometimes more apparent than real; if the reduction in government revenue led to a budget deficit and consequent inflation, the result was to transfer the burden to other classes, and the total effect was disincentive. Another argument not mentioned by Mr. Goode was that the tax reductions tended to affect income taxed at high marginal rates, rather than the average levels, and were hence regressive.

Mr. VIDAL said that, in his opinion, the desirability of an income tax with limited progressive rates had been sufficiently well established, and he wondered whether it might be possible for legislation to take into account a system of periodic adjustment of such rates in relation to currency devaluation, in order to prevent rates from remaining stagnant, to the detriment of the taxpayer, as was the case in his country. Regarding the unitary or schedular system, he agreed with the general feeling in favour of the former, although he believed that some decision would have to be taken on the matter of including the sale of bearer securities as personal income. With regard to taxation of income from domestic investment abroad, he said that such income was taxed in his country but, in his opinion, the flight of capital was not strictly a tax problem; he recalled that there had been some suggestions made in that connexion at the meeting of the Latin American Centre for Monetary Studies (CEMLA) in Mexico.

He agreed with Mrs. Navarrete regarding imputed rentals which in practice were distorted in an ad valorem assessment of dwellings. Yachts, race-horses, etc., were in the same situation, not being taken as income. They were capital investments, and until fair standards were available, they should be subject to the appropriate taxation as property. Moreover, in the case of dwellings - which usually paid land tax - they should not be doubly taxed with income tax, particularly if the income was fictitious.

Referring to tax incentives, he agreed with Mr. Naharro regarding exemption of income from savings, but only where they were invested in industry, housing, etc., in a manner determined in advance by the State. Individuals, i.e., private activity, should above all be given the opportunity of helping in the task of economic development. The State should only step in when they did not do so, levying a tax on over-all personal income, in compliance with its social responsibilities.

/Mr. KALDOR

Mr. KALDOR agreed with most of the proposals made by Mr. Goode with respect to the personal income tax. The tax should be comprehensive, free of loop-holes, broadly based, and should include capital gains, which would be taxed as income. The tax rates should be moderate. That applied equally to the developed and under-developed countries. High marginal rates (in some cases they were as high as 90 per cent) made the tax virtually impossible to administer, and thus shielded persons in the higher income brackets, as had been the case in the United Kingdom and the United States.

Mr. Goode had perhaps not dealt sufficiently with the basic requirements of an effective personal income tax in Latin America as it related to capital income. Wages and salaries presented no problem since evasion was most apt to be engaged in by persons with income from capital. Such income would be difficult to tap unless the tax administration had full knowledge of the total wealth owned by individuals. As long as income could be concealed through such systems as bearer shares in corporations, a capital gains tax would be difficult to apply. The Latin American countries should create a system by which the total assets owned by a taxpayer were known and their value could be reasonably ascertained. That might be achieved through requiring a declaration of wealth from individuals as was done for corporations. Such a declaration would include an annual declaration of purchases and sales of capital assets, properly assessed at their market value.

If a distinction had to be made between income from labour and from property, it could not be done by levying two different schedular rates on income but only by applying an annual tax on net wealth combined with a tax on personal income. Property holders should be taxed on the basis of their asset holdings as well as on their income from property. A combined tax on net wealth and on income would facilitate the keeping of records of individual capital assets and of changes in such assets and would be a means of preventing evasion. The problem in Latin America was not only to institute tax reform in order to tax income now excluded from taxation but also to include existing income which escaped the tax net.

/He agreed

He agreed with Mr. Goode that the imputed rental value of owner-occupied dwellings should be part of taxable income. It had been so considered in the United Kingdom but the tax on the imputed rental value of homes in that country was about to be abolished because there seemed to be an irrational feeling about that particular tax.

Mr. HARBERGER observed that the Latin American countries could be among the world's leaders in tax reform. They could not only apply what was being done in other areas but could also point the way. That was particularly true of the taxation of capital gains, which should be taxed as income at the same rate as the personal income tax. It had been argued that to do so would be unfair where the capital gains were obtained in a single year. That objection could be overcome by a simple averaging device.

He wished to emphasize the importance of maintaining a broad base for the personal income tax. A narrow base would require high rates, whereas the rates could be lower if the tax base was broader.

He disagreed with some of the points made by the commentators on Mr. Goode's paper. Mrs. Navarrete, for instance, had objected to the imputed rental from owner-occupied dwellings being considered as income for tax purposes. He did not see why a person living in his own home should be favoured over someone living in a rented dwelling. He agreed, however, that imputed income from other sources should be considered in the same way as the imputed rental income from owner-occupied dwellings.

Mr. Flores and Mr. Moises Beatriz advocated exemption from the capital gains tax of income from the sale of securities. He could not support that view. There were two types of capital gains. On the one hand, there was income from changes in the relative market supply and demand and from increases in the value of some goods. Those might be considered accidental gains. On the other hand, capital gains might be deemed to be normal in the case of corporations which reinvested their profits and it would be wrong to exempt their securities from the capital gains tax.

/He did

He did not share Mr. Naharro's views with respect to incentives to savings, which were not very responsive to the rate of interest. All tax incentives had the effect of raising the rate of interest but savings would not be considerably reduced if there were no tax incentives. If Governments could invest their tax revenue in the private sector by purchasing shares, they would be contributing to an increase in total national savings more than by granting tax incentives.

Mr. PIEDRABUENA felt that the suggested system of first raising the income tax and then admitting a system of exemptions under the heading of tax incentives to promote certain types of investments was contradictory. In his opinion, it was preferable to establish moderate rates of a general nature really likely to be complied with and to suppress all exemptions in personal income tax; however, he would not advocate the same procedure for corporate income tax. In any event, if such exemptions were admitted, it should be compulsory to declare exempted income, in order not to destroy the progressivity of the tax. It was not easy to agree on a definition of personal income or to determine its scope. As to casual capital gains, they should be incorporated into income without prejudice to the possibility of making allowances based on the number of years that had elapsed since the investment was made. The introduction of imputed rental could give rise to great injustice.

Mr. LESSA said the redistributive effect of the income tax had to be balanced against the incentive effect. It the State was to act as the executor of development policy, it must have some means of influencing the private sector, and ensuring that investment was directed to development ends. However, incentives could be established on a progressive basis, with lower exemptions for the higher income brackets. Exemptions should only be allowed for investment in development, and failure to meet the requirements of development planning should be punished by withdrawal of the exemptions.

/Mr. HERSCHEL

Mr. HERSCHEL was of the opinion that the advantages mentioned by Mr. Goode did not really exist, in view of the seemingly inevitable lack of flexibility of the income tax patterns which Mr. Goode attributed to the tax. With regard to exemptions, like Mr. Jarach he had no faith in the results of a policy of tax incentives, which in any event would make the taxable base narrower.

Mr. MONTERROSO agreed, in general, with the opinions set forth by Mr. Goode in his paper, except on a few points, for example, where imputed rentals on dwellings were concerned, a matter on which he shared the objection raised by Mrs. Navarrete. The social need for promoting the construction of housing, which was generally accepted and in itself constituted sufficient argument against Mr. Goode's view, should be taken into account. While it was true that there appeared to be too many luxury dwellings in Latin America, it should not be forgotten that they were also subject to the real estate tax. However, the inclusion of imputed rental based on a percentage of the cadastral value of the dwellings was acceptable, provided that no rebate was allowed for maintenance costs and that non-luxury dwellings were exempted.

With regard to income of foreign enterprises, if the entention was to promote the investment of foreign capital, it would be ineffective not to tax such income in the country where it was obtained if the country of origin of the enterprises concerned allowed the deduction of taxes paid there.

Mr. JATAR, referring to a tax on imputed income from owner-occupied dwellings, agreed with Mr. Kaldor that such a tax would not be very useful in a country which already applied an effective tax on wealth, although it was essential, even if defective, where wealth was not effectively taxed. In that connexion, he felt strongly that luxury housing should be reduced in Latin America since it did not contribute to economic development.

With regard to capital gains, some participants had argued that a tax on capital gains should be applied on a broad base to include income from securities. In Venezuela, the tax was confined to the revaluation of real property and did not cover income from shares and bonds.

He agreed with Mr. Goode that there were certain risks to granting tax exemptions and deductions but felt, as did Mr. Goode, that the possibility of providing for such exemptions and deductions should not be rejected out of hand. They might, for instance, be applied to income which was reinvested and might also be useful to encourage savings.

/Mr. RIOFRIO

Mr. RIOFRIO recalled the theoretical and legislative background of presumptive income which he felt had more and greater disadvantages than advantages, and family income. In regard to casual capital gains, he called attention to the wasting effect of inflation upon them. He beleived that income from foreign sources should not be taxed at the place of domicile, but at the source.

Mr. DESCARTES agreed with Mr. Goode and Mrs. Navarrete on the importance of establishing a tax on personal income in Latin American countries based on relatively moderate rates of taxation. Such a tax was essential in Latin America, even if applied within a narrow range. He supported Mr. Kaldor's suggestion of an annual declaration of wealth, but observed that even the more developed countries had found it virtually impossible to institute such a method. However, he agreed that an attempt to require an annual declaration of wealth should be made by the Latin American countries.

With respect to Mr. Goode's suggestion concerning imputed rental from owner-occupied dwellings, he thought that the Latin American countries would do better to concentrate on other more positive aspects of the personal income tax.

The question of the taxation of foreign enterprises, he thought, should be dealt with through treaties between the countries concerned.

With regard to tax incentives, he agreed with the view expressed by Mr. Mendive in his paper (CPF-DS-5) that the solution applied in Puerto Rico, in view of its special position in the American market, could only partly serve as a model for Latin America as a whole. Even in Puerto Rico, incentives had had to be granted and an aggressive campaign undertaken to seek out industrialists and to offer them tax incentives. The field of tax incentives was a difficult and dangerous one for Latin America and should be entered into with extreme caution.

Mr. CASAS referred particularly to income from the agricultural sector, which had certain peculiar characteristics, and to the disadvantages of granting preferential treatment to that sector for tax purposes. In support of his views he mentioned the experience of Colombia,

/where investments

where investments in agriculture were used as a form of evasion. With regard to the relative advantages or disadvantages of the schedular as compared with the global system, he pointed out that in the recent Colombian tax reform the latter had been preferred because of its simplicity and its traditional roots. However, the schedular system might well be acceptable so as to reduce personal exemptions. Taxing of presumptive income had given satisfactory results in Colombia, although it should be recognized that the revaluation of real estate and perhaps the tax on capital gains which accompanied it helped to obtain such results.

The meeting rose at 1.45 p.m.

PROVISIONAL SUMMARY RECORD OF THE EIGHTH MEETING
held at Santiago, Chile
on Monday, 10 December 1962, at 3.35 p.m.

Chairman: Mr. MAGAÑA

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Personal income tax in Latin America (*continued*)

Taxes on net wealth, inheritance and gifts

PERSONAL INCOME TAX IN LATIN AMERICA (continued)

Mr. GNAZZO thought that the Conference should state its position clearly in regard to personal income tax. There was a tendency for the participants to give undue importance to administrative problems and to overlook the fact that the essential aim was to define personal income tax as an instrument of fiscal policy. Mr. Goode, for instance, had mentioned several prerequisites for the successful application of the tax, which fell into the same vicious circle in that they could not be applied for want of suitable administrative machinery. He agreed with Mr. Naharro that the prime objective of income tax was to promote economic development. The Conference should therefore decide in favour of a solution in absolute terms which would state clearly whether income tax was an appropriate instrument for Latin America or whether others should be sought.

With respect to the imputed rental of owner-occupied dwellings, under Uruguayan law the portion of such rental over and above 30 per cent of the non-taxable personal or household minimum was deemed to constitute income. The rent-payer, in turn, could deduct as expenses up to 30 per cent of the non-taxable minimum.

Mr. BACA concurred with the fundamental points made by Mr. Goode, and congratulated him on his understanding of the real situation in the region, which he appeared to have grasped more clearly than other non-Latin American writers. Taxable income should be fixed at a higher minimum level than in the more developed countries and at rates that did not exceed 50 or 60 per cent.

Foreign experts often recommended a taxable minimum of 200 per cent of *per capita* income, forgetting that in Latin America the annual average was 200 dollars and that if taxation was based on 400 dollars, it would mean whittling away what was a bare subsistence level. They also tended to forget that the purchasing power of money was much greater in the more developed countries than in Latin America, particularly in so far as services such as health and education were concerned. He believed that the minimum taxable income limit ought to be fixed between 500 and 600 per cent of *per capita* income; he had therefore been surprised to hear that in Mexico, according to Mrs. Navarrete, the monthly limit was 500 Mexican pesos (40 dollars). In Costa Rica the Treasury had found that it was unprofitable to tax income in the lower brackets, although the monthly minimum had been set at 63 dollars.

/He disagreed

He disagreed with Mr. Goode on the treatment of foreign investment, because the Latin American countries were not exporters of capital. The effect of the system in force, whereby capital could enter Latin America tax-free, was to make a gift to the Treasury of the country exporting the capital. What was needed in such cases was an over-all solution, not bilateral or temporary agreements.

Mr. VEGA referred to two specific points that had been raised by Mr. Goode: (a) the imputed rental of owner-occupied property; and (b) incentives. The former was obviously taxable income, and where it had been exempted from taxation, the reasons had been of a social and not a fiscal nature. His impression was that Mr. Goode was in favour of allowing a deduction for the unpaid balance of debt on housing. To him that seemed unfair, since the same argument would warrant income from capital loaned and invested in an industry being exempt from taxation.

With respect to incentives, there were many possibilities, but in the case of income tax they should be applied ex post facto and should consist in tax rebates on savings used for investment, instead of for consumption. Capital formation in the country concerned would thus be promoted, and there would be no risk of an inordinately large proportion of savings being channelled into the infrastructure projects for which the public sector was properly responsible; on the contrary, productive undertakings would be encouraged.

Mr. MATUS said that Mr. Goode's paper was an excellent synthesis of the problem and it was therefore difficult to disagree with him. However, it could not be said that the income tax in Latin America was elastic. On the contrary, it was very inelastic on account of inflation and the fact that there was a time lag between the dates when the tax liability was incurred and when it was payable. He thought that an attempt to increase elasticity might result in a loss of equity since tax administration was defective.

In his view, there were flaws in Mr. Goode's argument in relation to the effects of progressivity on savings. It was true that the coefficient of consumption remained relatively constant when income rose over the years but that bore on relation to the purposes of the analysis.

/What mattered

What mattered for the effect of progressivity on savings was that the savings coefficients were very different at various income levels and therefore progressivity affected savings. However, the effects of progressivity were not very important. Moreover, no importance would attach to a decrease in the savings of the sector, since it was the level of total savings that mattered. The vital point was that the progressiveness of the tax system should be reasonable.

In connexion with the use of incentives, he felt that no clear-cut assertions could be made since it depended on the level of taxation, its importance among all the factors which affected the decisions of economic units, the type of reaction sought, the economic unit whose behaviour was to be changed, the influence of extra-economic factors and the administrative capacity to handle them. It was easy to change the structure of consumption through incentives or penalties. On the other hand, it was difficult to control the level of private investment consciously and to subject it to the specific aims of the plan. It was precisely because of administrative difficulties that he viewed certain types of incentives with scepticism.

He did not agree with Mrs. Navarrete's contention that taxation of the lower income groups was a useful source of revenue, since, in his opinion, various alternative patterns of taxation would have to be applied in the case of low incomes.

Mr. GOODE said that he would confine himself to commenting on the most important points that had been raised during the discussion.

With respect to the question of tax incentives, he said that it was apparent from the observations that had been made that the Latin American countries had more confidence in the ability of incentives to stimulate development than was the case in some of the more developed countries. Without exploring the reasons for the difference in opinion, he would point out that in the United States the public finance experts had less confidence in tax incentives than business groups of the public in general, probably because they could see more clearly the difficulty of devising a sound plan and administering it. In addition, as one speaker had pointed out, it was necessary to determine the area to which tax incentives might appropriately be applied, which involved the definition of a new firm and a new industry, etc. Nor should it be thought that a system of incentives was the easiest

/way to

way to promote development. From his own observation, it had often failed to give good results. In fact, they were more effective in influencing the allocation of resources among different uses than in increasing the over-all amount of investment or savings. It should be realized that if one form of investment was encouraged over another, the social gain achieved was simply the difference between the product gained from the favoured activity and the product that would have been obtained from the activity it had supplanted.

As regards the question of income from foreign sources, he had not alleged that the flight of capital from Latin America to other regions was attributable to tax considerations alone. It was, however, anomalous that countries needing revenue and capital formation should give better treatment to those who invested their capital abroad rather than at home. He had taken what was perhaps an opportunistic standpoint in urging Latin America to income from tax capital at its place of origin and place of receipt in common with a number of capital-exporting countries. Although the majority of the participants did not seem to agree with him, he hoped that they would give further consideration to his suggestion.

He did not attach as much importance to the question of imputed rent of owner-occupied property as some of the other participants. But he did feel that property of that kind was tantamount to a source of income for the owner and, if not taxed, would lead to inequity between owners and tenants. He agreed that all consumer durables should in principle receive the same treatment as houses, but did not consider this feasible. He did not feel that the argument should be extended to include cash balances, as Mrs. Navarrete had suggested, since such balances were presumably held in order to take advantage of investment opportunities, and if investment income was taxed upon accrual, the effect would be the same as taxing the gains accruing to the holder of a cash balance.

With respect to the interesting suggestion of tax exemptions for savers to stimulate investment, he would be loath to offer full exemption because of the possible repercussions on income distribution and because it was more equitable to tax income than consumption. A stronger case could be made for selective exemptions, but it would be difficult to decide what type of saving should be promoted or to determine the net increase in saving obtained thereby from one year to the next.

/As regards

As regards taxation of net wealth, he would not go into details, since the subject would be thoroughly discussed at the forthcoming meeting. He would merely say that the idea was attractive and that it would be desirable to have complete information on a person's net wealth as a check on the accuracy of assessment for income tax. He feared, however, that it would be extremely difficult to obtain satisfactory balance sheets from taxpayer.

He thought that capital gains should be taxed at the same rate as other types of income provided that an allowance was made for the fact that gains realized in a single year often had accrued over several years. In view of the difficulty of referring to tax returns for past years, he suggested that capital gains might be taxed in full in the year in which realized but that the tax rate might be that applicable to an increment of ordinary income equal to a third or a fifth of the capital gain. This would be equivalent to prorating the gain over three to five years.

With respect to price level changes, he did not think that allowance should be made for changes in the value of money from year to year, but admitted that countries suffering from great inflation might find revaluation socially expedient.

Finally, he was convinced that a well-administered income tax, incorporating prompt collection through withholding at source would have elasticity of yield, although it had been pointed out at the meeting that the elasticity of the tax had in fact been low in some of the Latin American countries.

Mr. RAPOPORT explained that in Argentina the system of declaring net wealth in tax returns was already in force.

The meeting was suspended at 4.40 p.m. and resumed at 5 p.m.

TAXES ON NET WEALTH, INHERITANCE AND GIFTS (CPF-DB-5T)

Mr. JARACH thought that before embarking upon an analysis of taxation on net wealth, inheritances and gifts it would be well to stress that the objectives of fiscal policy should be constantly borne in mind, together with the advantages and disadvantages of taxes in relation to those objectives.

It had been argued that taxation of the value of property chronologically preceded taxation of income, which was no doubt true of certain partial

/aspects of

aspects of the former, but was not valid in the case of a global tax net wealth, which presented all the administrative difficulties associated with income tax as well as other problems. In his view, therefore, the net wealth tax could only be applied in countries which already had some income tax experience. Nor could a tax on net wealth be regarded as a substitute for income tax, but rather as supplementary to it. The replacement of one tax by another should be approached with the utmost caution, and with due regard to its economic repercussions and its effects on the attainment of fiscal policy objectives.

There was no correlation between the distribution of property and income, although Benini had suggested that if the latter increased in the geometric proportion of 2, the former increased at the geometric rate of 3. Were this so, even the application of a proportional tax on net wealth would result in practice in a form of progressive taxation. The advantages of the tax on net wealth over income tax could be summed up under the following heads: (a) it was more equitable, because it was applied as a function of real tax capacity and could not be shifted; (b) it enabled a clear distinction to be drawn between earned and unearned income; (c) it was neutral with regard to its effect on decisions to invest in enterprises involving high degrees of risk; (d) it corrected distortions stemming from non-monetary psychological causes, such as a predilection for specific types of investment which were not recommendable from the standpoint of their social usefulness; and (e) lastly, for the very reason that it fell upon potential rather than actual income, it implemented the principle termed "productivist" by the Italian school, whereby taxpayers who kept their capital product were rewarded and those held funds inactive or properties unproductive or underproductive were penalized.

As far as the practical difficulties of administering the tax in question were concerned, those of a technical nature were not excessive and should not be over-estimated. It could be combined with a system of taxation on personal income based on yearly returns not only of income but of components of net wealth. As Mr. Rapoport had explained, tax returns of that type had been required in Argentina since 1947, although there was still plenty of room for improvement of the system. Returns of the type in question were also useful as controls in respect of the application of income tax.

/The chief

The chief difficulty lay in valuation, since it was very difficult to keep market values up to date. There was consequently a strong element of presumption in the net wealth tax, as distinct from income tax, where presumed values were reduced to a minimum. A system of making accurate valuations and of keeping them up to date would therefore have to be instituted, especially for periods of inflation.

In his opinion, the net wealth tax ought also to reach all kinds of unproductive assets, such as automobiles, parks, gardens, etc. Clearly, the same problems would arise in that connexion as in relation to the calculation of imputed income.

In countries where administrative technique had not yet reached a level high enough to permit of the introduction of the net wealth tax, taxes on real estate might still be levied. There again the problem of valuation arose, and in a more complicated form, because such taxes were generally applied by provincial or municipal authorities or others distinct from the central Government. The real estate tax was less equitable than the tax on net wealth.

Referring to taxes on inheritances and gifts, he expressed the view that they affected neither incentives nor savings, and could be considered as an alternative to the tax on the net wealth of natural persons. The main effect of the taxation in question was to secure the redistribution of wealth, and that was of great importance in Latin America, where wealth was over-concentrated. Payment of the tax did not affect enterprises except in the case of small individual businesses or partnerships. And even there its effects might be considered beneficial, if it resulted in making foreign capital available to family enterprises short of capital and operating below the optimum-dimension level.

The tax on inheritances and gifts often aroused political opposition among the ruling classes, which were anxious to maintain the permanent dynastic ownership of real estate or businesses. To conceal hostility to the tax, collection difficulties, annoyances caused to small and medium-scale business enterprises and the resulting evasions were magnified.

Among the palliatives suggested to avert the effects of the inheritance tax was the so-called substitute tax that fell on the net assets of business

/enterprises. The

enterprises. The substitute tax could be partially shifted, and was therefore not as equitable as the tax on the net wealth of natural persons or the inheritance tax, nor did it contribute in the same way to the redistribution of wealth, or provided any incentive to economic development.

To sum up, in developing countries it would be desirable to apply income tax supplemented by the net wealth tax and other taxes on property which simultaneously fulfilled several objectives of fiscal policy and, lastly by a progressive tax on inheritance and gifts.

Mr. CASAS said that, broadly speaking, he was in full agreement with Mr. Jarach's views. With regard to the tax on the net wealth of individuals, he did not share the opinion that such a tax was discouraging to the investment of small assets, because it was understood that there was an initial level of exemption and more lenient treatment was accorded. Nor did he agree that the tax in question increased the preference for consumer goods among low-income taxpayers; he considered that the composition of consumption would be modified in favour of non-durable goods which would escape taxation. That could be prevented by the establishment of certain exemptions.

He did not think there was sufficient justification for the tax on transfers. He considered that the transfer tax per se had no raison d'être and was only justified if used as a means of taxing occasional profits, in which case it should not be applied to the value of the transfers but to the difference between the purchase and sales price of the immovable item transferred. Moreover, an allowance or credit should be given in order to take into account the seller's right to a profit, the effects of monetary devaluation, and the improvements made by the seller in the item sold. Thus conceived, the tax on occasional profits in transactions had three advantages: (a) it curbed speculations; (b) it channelled savings into productive investment; (c) it compelled voluntary revaluation of real estate, thus improving the tax base for other property taxes.

He added two further considerations with respect to the tax on inheritances and gifts: (a) it was desirable to encourage the distribution of real estate, from the standpoint of its productive utilization, through preferential tax treatment in respect of transfers between living persons and quotas in relation to the inheritance tax; (b) it was neither possible nor advisable to attempt to make the inheritance and gifts tax progressive because of the liquid net wealth of the assignee or legatee.

Mr. PORRAS said he was in entire agreement with the theoretical principles propounded by Mr. Jarach in his paper. He wished to stress one aspect of the subject, however, namely, the extent to which application of the net wealth tax would be feasible. The object of taxation in that instance would be the difference remaining after the subtraction of liabilities from assets, and it might be very difficult to compute that amount, especially as movable and intangible assets were easy to conceal. Moreover, the administration of the tax might imply such heavy expenditure that the financial results obtained would not be worth while. His emphasis on feasibility of application was based on his conviction that the role of an expert was not to formulate recommendations in a theoretical void. If the best was impracticable, the only thing to do was to accept the least unsatisfactory solution.

He attributed the difficulties of administering the real estate tax chiefly to its decentralized character. For example, in Ecuador the tax in question was in the hands of ninety-seven municipalities, not one of which had the slightest possibility of carrying out the land surveys required for accurate valuation. The same difficulty with respect to valuation would be encountered in estimating potential income from rural real estate, and while it was true that the system had been introduced in Chile, he did not think it could be adopted in Ecuador, where even the possibility of taking aerial photographs was limited by the poor light in some districts. He therefore thought that more careful study should be given to Mr. Harberger's proposals for a system of voluntary returns on the part of the landowner, with the modifications suggested by Mr. Kaldor.

He agreed with Mr. Jarach that a tax on the net wealth of business enterprises was undesirable and that its only justification would be the ease with which the resultant revenue could be collected. He also disapproved of the tax on transfers for a valuable consideration, because of the high degree of evasion to which it might lead.

Mr. PINTO considered that although in theory the same tax instruments were at the disposal of all countries, they should be assigned different weighting. In Latin America greater importance should be attached to the tax on property than in the more highly industrialized countries, for a number of reasons: the tax affected typical forms of hoarding which were not the most desirable from the standpoint of development; it was less

/difficult to

difficult to administer than income tax; and it had more powerful repercussions on the inequitable distribution of wealth.

From the social standpoint, the population should de divided into three groups or brackets, and different tax instruments should be applied to each:

(a) In the case of the highest social bracket, which consisted of 5 per cent of the total number of heads of households, absorbed 40 per cent of the national income and was capable of carrying 60 per cent of the tax burden, income tax should be applied, because that tax should be concentrated in the groups which could provide a worth-while yield; also a tax on assets in whatever form; and a tax on expenditure on luxury goods and services.

(b) The middle bracket, which comprised 35 per cent of heads of households, absorbed 40 per cent of national income and should contribute 30 per cent of tax revenue, would be subjected to a tax on expenditure on the so-called "non-wage goods", in Latin American terms, since that was a feasible way of collecting revenue and applying a form of income tax which would not have a heavy payroll incidence.

(c) The low-income group, which was constituted by 60 per cent of heads of households, absorbed 20 per cent of national income and should not contribute more than 10 per cent to tax revenue, would have to be taxed through expenditure, but with the exemption of certain goods such as foodstuffs.

As the income of the last-named group increased, its members would move up into the middle-income bracket and would pay tax in accordance with the tax instruments applied to that group.

Mr. DESAI wondered whether, in the case of death duties, instead of taking into consideration the net wealth of the decedent, it would not be preferable to apply the tax to the total net wealth of the beneficiary, including the inheritance. In India the practice of gifts in the donor's lifetime had become widespread, since after two years death duties were not payable. An accessions tax levied on the beneficiary, if coupled with the net wealth tax, would make it possible to combine the inheritance and gift taxes into an easily administered single tax. One could even think in terms of a separate schedule for gifts and inheritance within the annual assessment and levy of tax on net wealth.

/Mr. VIDAL

Mr. VIDAL considered that the main purpose of the substitute tax in Argentina and Uruguay was to prevent evasion in the case of bearer securities.

Mr. MATUS endorsed Mr. Pinto's suggestion, and regretted that he had not been able to comment on Mr. Harberger's paper on tax reform, since the chief criticism he would level against it was precisely that it did not take into account total fiscal structure and the social distribution of taxation. Thus, in the case under discussion it was less important to consider the details of the net wealth tax than to know what other taxes were associated with it in the system as a whole for the purposes of achieving the desired objectives.

Mr. COSCIANI, in reply to Mr. Desai, said that it was not always possible to determine on whom the burden of death duties fell. Among the wealthy groups the transfer of savings was a residual item; in the middle brackets there was some element of economic calculation. In any event, the tax might have two possible structures; it could either be progressively graduated according to the net wealth of the decedent or applied to the amount received by each heir.

Mr. BACA expressed surprise at what Mr. Desai said of gifts made during the donor's lifetime, since in Latin America they were also taxable.

Mr. HERSCHEL concurred with Mr. Pinto and Mr. Matus on the need for discussing the fiscal system as a whole, but in his view it was also useful to ascertain the effects and implications of each separate tax and the forms they assumed.

The CHAIRMAN said that the comments formulated by Mr. Pinto, Mr. Matus and Mr. Herschel would be included in a document prepared for general discussion.

The meeting rose at 7 p.m.

Additional note to the summary record of the eighth meeting

Commenting item 8 of the agenda (Taxes on net wealth, inheritances and gifts) during the eighth meeting held on 10 December, Mr. Anibal Pinto drew attention to the importance of examining the tax system, as a whole, with special reference to its composition or structure. Subsequently, Mr. Pinto handed to the secretariat the following table, which was circulated among the participants of the Conference, in view of its undoubted interest. The secretariat thanks Mr. Pinto for his cooperation.

OAS/IDB/ECLA
Joint Tax Program

SCHEMA FOR SOCIAL DISTRIBUTION OF TAX INSTRUMENTS

Social group	Percentages			Tax instruments
	Active population	Participation in national income	Reasonable contribution to fiscal revenue a/	
1) High	5	40	60b/	a) Income b) Property c) Expenditure
2) Medium	35	40	30c/	a) Expenditure b) Income (payroll)
3) Low	60	20	10d/	Expenditure

Note: In the above example (and as mentioned by Mr. Pinto in his comments it is assumed that it is desirable to allocate tax instruments on a social basis, according to a classification into large groups representing proportions of the active population and distributed income which are more or less characteristic of the average situation in Latin America. Personal income tax is concentrated in group 1(there is opposition to the "diffusion" of this tax), its progressive effect being reinforced by the taxes on property, which in Latin American tax structures would have decidedly greater weight than in industrialized countries. Taxes on expenditure, especially on the goods and services preferred at those levels of income, would complete the tax incidence. For group 2, taxes on expenditure covering what might be called "non wage goods" would be the main instrument, reinforced by a low rate of tax (e.g. between 3 and 4 per cent, perhaps with a slight progressivity), based on the payroll and deducted.

"Non wage goods" should be understood in a very restricted sense, in keeping with the low average income, that is, covering nearly all consumption goods and services except the most essential, e.g., those consumed by the masses in rural areas and the urban periphery. Finally, the masses in group 3, which would not make a net contribution to public finance in view of the effect of the expenditure, would be taxed to the extent that their consumption crossed the borderline between "wage goods" and "non wage goods".

a/ It is assumed that Fiscal Income represents 15 per cent of National Income.

b/ In making this contribution, group 1 retains for itself, after tax, 31 per cent of National Income.

c/ After tax, group 2 absorbs 35.5 per cent of National Income.

d/ After tax, group 3 retains 18.5 per cent plus the effect of public expenditure, probably progressive.

PROVISIONAL SUMMARY RECORD OF THE NINTH MEETING
held at Santiago, Chile
on Tuesday, 11 December 1962, at 9.50 a.m.

Chairman: Mr. MAGAÑA

CONTENTS:

Taxes on net wealth, inheritance and gifts (*continued*)

Corporate income taxation in Latin America

TAX ON NET WEALTH, INHERITANCES AND GIFTS (continued)

Mr. JARACH, replying to the comments on his paper, thanked the participants, and particularly Mr. Casas and Mr. Porras, for their friendly judgements, though none of the very pertinent comments made had led him to change his views. He had never believed that the tax on net wealth played an outstanding role in relation to income tax, but at the same time he could not regard it as performing a secondary function. He believed that the two taxes complemented each other. He was also of the opinion that the tax on the net wealth of physical persons was a more perfect instrument even than schedular taxes and certainly than the unitary income tax to make an accurate and continuous distinction between earned and unearned income. It not only supplemented them, but it could facilitate the administration of income tax inasmuch as it enabled the latter to be based on the declaration of total wealth.

Nor did he agree with the view that great importance should be assigned to the tax on net wealth only in the case of a demonetized economy, since it had no substitution function. It was precisely its complementary function that made it inevitably more important in those countries where income tax was in full development.

Actually, taxes on property were merely rather incomplete substitutes for the tax on net wealth, as was evident from the case of corporations. In some provinces of Argentina a tax on aggregate estate which was a form of net wealth, was being introduced.

It was not for him to give his opinion on Mr. Pinto's interesting idea regarding the integration of tax systems, although it was certainly intriguing.

With regard to the tax on inheritances and gifts, he referred to the comments made by Mr. Desai and Mr. Cosciani during the course of the debate. He defended the global inheritance tax as a form of posthumous tax on net wealth which would make the progressivity of the tax more effective. As for the individual inheritance tax, it should be graduated according to the net wealth of each heir.

As Mr. Vidal Cárdenas had observed, the problem posed by bearer securities in connexion with the taxes on net wealth, and on inheritances

/and gifts,

and gifts, was not without some importance. However, such problems were peculiar not so much to those taxes as to that type of securities.

With reference to the issue raised by Mr. Herschel, as to the jurisdictional level at which the tax on net wealth should be levied, he felt that it would only be advisable to establish such a tax at the national level, to avoid fragmentation.

In conclusion, he summed up his views by saying that whatever technical or administrative difficulties the taxes on net wealth and on inheritance and gifts might raise, they should not be magnified to the point of discarding such taxes and replacing them by others which might distort the whole tax system.

CORPORATE INCOME TAXATION IN LATIN AMERICA

Mr. PREST introduced his paper on corporate income taxation in Latin America (CPF-DB-1), and said that he had attempted to steer a middle course between attempting a textbook exposition of general principles and entering into the details of corporate income taxation in Latin America, by indicating the main principles involved that provided scope for thought and possibly action. Section I dealt with the general arguments for a corporation tax, including the need to catch undistributed profits, the comparative administrative simplicity of taxing corporations, the fact that corporations had no votes, and the possibility that the tax would be at the expense of foreign government revenue. Where a corporation income tax already existed, the inequity of allowing some to make windfall gains argued against removing it. The arguments against the tax included the possibility that it might retard the development of the corporate sector, the danger of hampering development by reducing saving and the need not to discourage the inflow of foreign capital. The reconciliation of the tax with personal taxation raised the question of differential treatment of distributed and undistributed profits, which involved both economic effects and equity issues.

/Section II

Section II was a factual summary. Tables I and II gave data on income and wealth taxation in Latin America, and although full data were not available for all countries, the tables showed that there was a wide variation in the ratio of income from corporate taxation to total government revenue. Table III, which summarized characteristics of Latin American corporate income taxation, had been compiled from a large number of sources, since the information concerned was not available in standard reference books, and he hoped that any errors that had crept in would be corrected by participants from the countries concerned. The table showed some of the principal ways in which corporate income taxation could vary from country to country, with respect to separation from personal income, withholding of dividends paid out, taxation of dividends received, additional taxes imposed such as excess profits tax, and discrimination against foreigners (with respect to foreign and national resident shareholders or dividends paid abroad or in the country). It was clear that there was a great diversity in the arrangements for corporate income taxation in the various countries.

Section III considered the concept of income, the need for simplicity, the rate structure, the integration of corporate and personal income taxes, intended and unintended discrimination in present tax arrangements, and special concessions. Referring to the discussion at the seventh meeting, he said that the income basis chosen could be income originating, income received, or a world-wide concept, of which the first and third were relevant to the present discussion. The difficulty of measuring income originating included arm's length pricing, and the overlapping of tax jurisdictions with respect to subsidiaries of foreign companies; he had not touched on those points, but they were covered in the paper on the income tax treatment of foreign investment (CPF-DS-6T). A number of factors influenced the effect of corporate income taxation on the flow of international capital, including the income basis, i.e. whether originating or world-wide, the relative sizes of gross yields and tax rates in different countries, whether or not tax credits were allowed on income derived from other countries, and the relative treatment of resident and non-resident enterprises.

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The great complexity of arrangements for corporate income taxation in Latin America seemed hard to justify. Corporations might be subject to more than one tax on income, to taxes on excess profits or business assets as well as on income, there were distinctions between resident and non-resident enterprises, rates of withholding tax depended on the types of recipient, and so forth. From the standpoint of administration and the preventions of evasion, such complexity was a serious disadvantage.

The rates of the tax should not be high enough to retard the growth of the corporate sector, or low enough to make unnecessary presents to companies or foreign Governments. A progressive corporate income tax did not appear justified on equity grounds, since a small corporation might have rich shareholders, and a large one comparatively poor shareholders; in addition a progressive tax would serve as a disincentive to growth, and would encourage the splitting of corporations into small units, resulting in the need for preventive measures to enforce aggregation, which would be an unnecessary complication. As for bearer shares, unless some way was found of identifying the ultimate recipient, the only method was to subject dividends on such shares to a high rate of withholding tax.

Integration of personal and corporate income taxes could be achieved by making a tax credit to the individual shareholders in respect of his dividend, or by affording relief at the corporation level on dividends paid out, so that the corporate income tax became a tax on undistributed profits. The same effect as that due to the latter course could be achieved by the withholding method, whereby dividends paid out were grossed up so as to allow for corporate tax paid, and taxed as personal income but with a credit for the corporate tax. Clearly the rate of tax on retained profits should be not less than that paid by the average shareholder if profits were distributed. The optimum balance between distributed and undistributed profits was a difficult question; retention of profits favoured corporation savings, but it might be important to force out savings through the capital market, and there was always a danger that existing corporations would build up an entrenched monopoly position. Larger retained profits would be more likely to result in capital gains, which raised the question about the adequacy and comprehensiveness of the capital gains tax.

/With respect

With respect to unintended discrimination, he pointed out that excess profits taxes were only justifiable for short periods or emergencies, and as a long-term measure were likely to impede growth. Discrimination between large and small corporations would be likely to hamper growth, although unincorporated enterprises might be encouraged to become incorporated. There was much scope for further study of the relative tax rates applying to unincorporated businesses and small corporations, which varied widely from country to country. There might also be differentiation between the rates of taxation, applied to non-resident and resident subsidiaries of foreign companies, and to oil and mining companies compared with companies engaged in other activities.

With respect to special concessions to encourage development and investment, a distinction might be made between net investment and the replacement of capital goods but that was very difficult. It was not easy to determine how far tax relief for investment purposes was merely a gift to those who would invest in any case, and thus simply represented a net reduction in the total tax revenue. It would be advisable for the countries concerned to take a common line on concessions to foreign corporations, otherwise the result might be free gifts to foreign Governments or corporations. He concluded his review of the document by stressing the need for good accounting standards, with respect to corporation balance sheets and profit and loss accounts and for clear and firm legislation and administration.

The value added tax, and the possibility of using it to replace a corporate income tax, constituted a third form of taxation, the first two being taxation of the income stream in the form of wages and profits, and taxation on expenditure, in the form of excise and sales taxes on consumer or possibly capital goods. If the value added tax were substituted and the graduated personal income tax retained, the result would be a much more favourable treatment of undistributed than distributed profits, with no incentive to distribute. Moreover, rich shareholders would escape liability. Tax on capital gains resulting from retained profits was not satisfactory because it was not easy to operate and tax was only collected

/sometimes after

sometimes after the profit retention took place. The precise effect of substituting a value added tax for a corporate income tax would depend on whether the existing corporate tax favoured distributed or undistributed profits. The effect of combining a value added tax with the personal income tax might or might not be desirable, but it should be recognized as not being neutral.

Mr. JATAR-DOTTI, introducing his comments, (CPF-DB-1/Add.2) on Mr. Prest's paper, said that the concept of the income tax was relatively new in Latin America, having been introduced in most cases in the third decade of the present century. As far as the scope of the tax was concerned, both the principle of origin and of residence was applied. In that connexion, one of the features of capital-importing countries was that their gross national product was greater than their national income, while the opposite was true of capital-exporting countries. That feature had to be taken into consideration in determining which of the two concepts of tax applicability - income originating or income received - should be adopted for developing countries, where only a small minority received income from abroad. For the reasons outlined in his paper, he preferred the concept of income originating.

One of the problems related to the above two concepts was that of international double taxation. It could be solved either through unilateral action, in which a Government granted relief from taxation in respect of income already taxed in another country, or through agreements between the Governments concerned.

On the question of multiple and unitary taxes, he observed that in many Latin American countries the income tax consisted of a series of schedular taxes at different fixed or proportional rates and of a progressive global or complementary tax. While the undue diversity of income taxes in some countries was to be deplored, it was unavoidable in some cases where schedular and complementary taxes were imposed on all types of activities, as was done in Venezuela. While a unitary tax structure would be desirable, it should only be achieved through a combining of schedular and complementary taxes and must not result in the same tax

/rate being

rate being applied to individuals and corporations. Unfortunately, in many Latin American countries no distinction between individuals and corporations was made for income tax purposes. Venezuela had done so by creating a new progressive tax on corporations at a somewhat higher rate than the personal income tax and by reducing the number of taxable categories, the complementary tax on personal income being left at its previous rates. The new system had produced increased revenue from the tax on corporate income.

On the question of the taxation of corporate profits and dividends, and the need to avoid the double taxation which might result, he felt that the best method of granting the necessary relief would be the withholding tax approach, the merits of which were outlined in his paper.

With respect to incentives to savings, he supported the view that that could best be done through provisions for loss carry-overs but he would limit such carry-overs to a period not exceeding three years.

With regard to incentives to capital formation, the income tax was a useful instrument in creating such incentives. In Venezuela, for instance, the income tax laws had been amended to allow a taxpayer who made net investments in the country to claim a partial rebate of the complementary tax. The new provision applied both to individuals and corporations.

In concluding, he referred to some of the difficulties which Latin American countries faced in collecting income taxes and to the prospects for a successful taxation of income in those countries, details of which were set out in sections 9 and 10 of his paper.

Mr. IESSA said that high profits had been related to efficiency by some speakers, and asked whether that concept was really in line with high social productivity of enterprises in the framework of economic development. Mr. Prest had seemed to imply the same view. But it was very doubtful whether in Latin America high profits were due to efficiency, in view of the various privileges and exemptions that were granted by Governments. In the absence of organized capital markets in Latin America,

/the large

the large financial resources called for by modern technology precluded the free entry of competitors to the market required by classical economic theory, hence there was more monopoly and less competition than in more developed countries. Moreover, high corporation profits were largely due to production functions that did not lead to the proper use of economic resources; the high capital intensity characteristic of industrialized countries was not well suited to an area where labour was plentiful and wages low. Consequently he thought the tax on corporate income should be progressive.

With respect to the stimulation of investment at the enterprise level through the treatment of distributed and non-distributed profits in corporate taxation schemes, he believed that it was not defensible to allow exemptions solely to the enterprises, and that the discrimination against personal income would accelerate the process of the concentration of wealth. If there were a progressive tax on corporation profits, they could either be distributed to shareholders, or alternatively they could be added to capital by the distribution of bonus shares, but should be taxed in both cases. It was more appropriate in the Latin American context to provide investment incentives at the shareholder level than at the enterprise level.

Mr. KALDOR felt that the incidence of taxation on corporate profits had not been given sufficient attention in Mr. Prest's paper. That was a complicated question and to some extent depended on specific tax provisions such as the relative treatment of distributed and undistributed profits. He felt that the incidence of the tax had substantially shifted. The context should therefore be clearly defined in order to determine whether it was considered as a substitute for other taxes or as an addition to the total revenue which would have been obtained otherwise. In the former context, the distribution of income between profits and wages was not very different from what it would have been if the same revenue had been obtained from indirect taxation. The shift in the incidence of taxation on corporate profits was a macro-economic process which did not leave the distribution

/of net

of net profits unaffected. If it was agreed that the role of the tax had shifted, it was a convenient revenue-yielding device. If the view was that it had not shifted, then it had an important role in the equity of the tax system.

With respect to Mr. Prest's comments on the value added tax, he agreed that if it was Mr. Prest's view that the incidence of the tax on corporate profits had not shifted, it was correct to say that the value added tax should not be regarded as an alternative to the tax on corporate profits but as an alternative to a general tax on sales. Some European countries had considered the substitution of a value added tax for some parts of the corporate profits tax.

He agreed with Mr. Lessa on the relationship between the efficiency of a corporation and its profits. In comparing different branches of industry, the level of profits was not an indication of efficiency. However, if a comparison was made between enterprises engaged in the same branch of industry, the difference in profits would reflect their degree of efficiency.

Mr. Lessa had rightly observed that competition in industry occurred far less in developing countries than in the more industrialized States. There was nevertheless some competition and a heavy tax on corporate profits would militate against more efficient firms which showed higher profits. He supported Mr. Lessa's suggestion that corporations might be required to issue bonus shares in respect of their undistributed profits and that such shares should form part of the income of shareholders. That was a most valuable recommendation but unfortunately it had been rejected constantly by tax commissions and administrations because it would make the raising of capital by joint stock enterprises more difficult. In connexion with bonus shares, it should be borne in mind that undistributed income was not quite the same as distributed income. The shareholder did not derive the same advantage from bonus shares as from cash dividends since the market value of such shares would undoubtedly be lower if the owner wished to convert them into cash. They should therefore be taxed on their market value rather than on their nominal value. A possible alternative would be to tax income received in the form of bonus shares, and not as cash, at a lower rate than income received as cash.

/Mr. DESAI

Mr. DESAI, referring to the treatment of domestic and foreign capital, said that there was some justification for a higher tax on income sent abroad. It was a matter of establishing equity between such income and investment income remaining in the country, since the former avoided future liability to taxes such as the inheritance tax.

Mr. GOODE, on the question of the shifting of the incidence of the tax on corporate income, agreed with Mr. Kaldor that little statistical data was available. Not much weight should be given to statistics on the subject in the United States, which were suggestive rather than conclusive. His own view was that the greater part of the tax rested on the profits received by corporations.

With regard to the jurisdiction of the corporate income tax, or the place where the income was taxed, a country might take the position that in measuring the taxable capacity of its nationals or residents, total worldwide income would be the appropriate measure. In his opinion, that would not be an unreasonable standard for measuring taxable capacity. It was true that if every country adopted that standard, double taxation might well result. However, relief could be granted through unilateral action by the Government concerned or through bilateral or international agreements. The unilateral method was applied in the United States and the United Kingdom, which recognized the priority of the country of origin. However, even if a country did not wish to grant relief from double taxation to corporate income, the financial implications were not likely to be very serious. It might discourage movement of capital to the more developed countries, which was not in fact an undesirable effect. Moreover, the flow of capital from developing countries was not primarily due to the tax system but rather to other reasons.

Mr. RIOFRIO said that the dual personality of corporations was an invention of jurists applied by financial theorists for tax purposes through the taxation, on the one hand, of the profits of the corporations themselves and, on the other, of the income received by shareholders. Income was thus taxed twice. He also referred to the omissions in Mr. Prest's paper to which the author himself had referred, and pointed

/out that

out that there were others as well. After describing the background and case history used in support of corporate income tax, he concluded that in spite of the reasons of equity which could have been adduced against that form of double taxation, the only arguments advanced had been based purely on expediency.

Mr. DARDON said that, in his opinion, the great merit of Mr. Prest's paper lay in the fact that he suggested alternative methods for taxing corporate enterprises; that principle should be part of the general findings of the present Conference in respect of all the topics. It was not possible to establish an over-all tax reform pattern which would be valid for all the Latin American countries, since each one had its own peculiar characteristics insofar as the historical background of its particular tax system was concerned, so that any reform would have to be firmly and harmoniously adapted to the particular economic development needs of each country. Nevertheless, the concentration of wealth, property and income in the hands of a small percentage of the population was a common occurrence. That fact pointed to the advisability of a global progressive tax on personal income and on the income of corporate and non-corporate enterprises, as well as a tax on wealth or, specifically, property.

In the case of corporations, a curious phenomenon had taken place in Guatemala, where enterprises organized as partnerships made up of two or three partners, generally with various integrated activities and domestic capital of a family type, had been turned into two or three companies for the purpose of evading tax. The original partnership, with its assets compact and subject to a progressive tax on its profits, would undoubtedly have had to pay more tax.

The same thing had happened with the organization of corporations in which all or most of the shares were in the hands of a single person. In other words, the transformation or establishment of joint stock companies had been due to motives far removed from the channelling of savings.

He therefore considered that the alternatives proposed by Mr. Prest were valuable criteria for each Government to use in accordance with the particular conditions prevailing in the country concerned.

/Mr. HARBERGER

Mr. HARBERGER said that corporate income taxation must be regarded as a global, not a partial tax, applying to one part of the income, the income received as a production factor in the form of a net return on capital. One possibility was the transferring of the tax so that the net return on capital was no less, on the same lines as with an indirect tax, and the other was the reduction of the net return by the extent of the tax. With a weakening capital market, capital would not support the whole burden of the tax, and it would be transferred to the labour sector. The bearing of the whole burden by capital must be regarded as an intermediate possibility; for further explanation he referred to his article in the Journal of Political Economy for July 1962. As regards incentive to invest, the exemption of corporations might direct investment to a number of different ends, and could effect changes in the distribution of investment, but he was doubtful of the value of tax incentives as a stimulus to total investment. Savings and investment were equivalent, and the problem was how to increase savings in order to increase the volume of investment. He believed that the over-all effect of exemptions was a loss of revenue rather than an increase in total investment.

Mr. NAHARRO said that the corporate tax benefited reinvestment in that it encouraged savings in the form of undistributed profits. The corporate tax also favoured distinctions among undistributed profits, according to the type of enterprise concerned, for the purpose of directing reinvestment into channels most suitable to economic development. With respect to the progressivity of the corporate tax, it could be graduated in terms of the type of yield of the corporation itself. He wondered, in that connexion, whether that formula could not be used for Latin American corporations. It was a question of fixing progressive rates as the percentage which represented the net profit in relation to capital and reserves increased.

Mr. ABINADER, referring to Mr. Prest's comments on the income tax established in the Dominican Republic in May 1962, described the structure of the tax and mentioned the additional advantages enjoyed by corporation executives. Those advantages fully justified the tax criterion adopted. The new income tax was expected to yield an amount equal to 25 per cent of the country's budget. The revenue would fill the gap left by the indirect taxes which had been abolished, since they had contributed another 25 per cent of the public sector's income.

/ Mr. JARACH,

Mr. JARACH, referring to the relationship between the corporate tax and the personal income tax, recognized that the subject was controversial and that economists and tax experts were divided in their opinions. He suggested that dividends paid to shareholders and the value of the bonus shares distributed to them should not be included in corporate income tax, and suggested, as a practical solution, aimed at bringing the level of the corporation tax into line with that of the tax on natural persons, that corporations should be taxed on their whole profit, whether distributed or not, at a rate close to the highest average rate applied to personal income. Natural persons could thus claim partnership treatment for themselves, i.e. they could include in their declaration of total income the share of the corporation's profit corresponding to their shareholdings and to calculate as tax already paid on account the tax paid by the corporation on its share of the profit. The proposal avoided the difficulties inherent in dividends, the fluctuations in share values arising from capital profits and losses, and share dividends, and allowed every taxpayer selecting the system to have applied to him the rate corresponding to his total income, including his share of corporate profits.

Mr. MATUS said he was in general agreement with the views expressed in Mr. Prest's paper, but would like to refer to certain omissions therein. ECLA was concerned about the problems posed by tax manipulation as a method of changing the normal behaviour of economic units with a view of bringing it into line with the behaviour stipulated in development plans; the problem had not been mentioned by the author nor by the Conference, which appeared to discuss tax problems in a manner entirely divorced from planning objectives.

In that connexion he posed two problems: (a) the possible use of taxation on foreign enterprises to mitigate in part the impact of foreign trade fluctuations, and (b) the use of taxation on corporations as a method of guiding the investment rate and structure along the lines of a development plan.

With regard to (a), it was a well-known fact that the Latin American countries were suffering the consequences of export fluctuations, although in some countries the effects tended to be the exact opposite of those felt in developed countries. In industrialized countries a decline in exports produce a depressive effect on the economy, whereas in certain countries of Latin America, the same decline had an expanding effect. The reason for that lay in the fact that export fluctuations had a fundamental effect on remittances of profits abroad, the availability of foreign exchange, and fiscal revenues,

/because there

because there were strong political pressures to maintain the employment of labour and, consequently, to reduce the effect on the volume of production. He believed that taxing of foreign enterprises in the countries that produced a very high percentage of total exports might be used to help to stabilize import capacity and fiscal revenue. If instead of taxing real profits a system of taxing minimum average profits were established - in the sense of the profits determined on the basis of average prices and volume of production over the past few years - the effect of fluctuations would be greatly mitigated. When export prices declined, import capacity and fiscal revenues would decline to a much lesser degree, and when prices rose, foreign enterprises would be taxed on real profits but would not be permitted to deduct the excess tax paid previously because of the effect of the average.

He recognized that such a system might discourage foreign investments; however, it could be graduated, since the stabilizing effect depended on the number of years covered by the average values. If the system of calculating the average covered a number of years in a full cycle it would completely stabilize import capacity and fiscal revenue, thus transferring the fluctuations 100 per cent to the large foreign enterprises. Averages below the cycle, on the other hand, implied sharing the effects of fluctuations between enterprises and the public sector.

Such a system would only be useful in countries where exports were in the hands of foreign enterprises.

He went on to refer to the orientation of private enterprises by taxing their profits. Non-Latin American economists seemingly had more faith in market forces and in sound business returns as a sign of efficiency than Latin Americans, as mentioned in a previous meeting of the Conference. Mr. Kaldor's opinion was not the only exception, and he did not believe there could be any doubts in that respect. The very unsatisfactory distribution of income in Latin America was more than sufficient argument for such scepticism, because it determined the structure of investments and of production. Just as in politics nobody would respect an election where a privileged few were entitled to ten votes while the rest of the population had only one, he saw no reason to respect an investment and business structure under which certain minorities had twenty or more votes because their incomes were twenty or more times as large as those of the majority. Moreover, it was an indisputable fact that there was a very high degree of monopoly in Latin America and distortion of price systems, etc.

/Therefore, there

Therefore, there was reason for concern not about the neutral nature of the tax, but rather about the way of using the corporate tax to penalize certain activities and promote others. A development plan might contemplate very high rates of production growth and investment in sectors with low commercial returns, and vice versa. That posed an interesting problem of tax manipulation. The growth of certain enterprises had to be checked and the growth of others promoted. By penalizing the reinvestment of profits in certain sectors it was possible to encourage the distribution of profits. In other cases, it was advisable to withhold profits at the expense of reserves for depreciation, without increasing total corporate savings. Therefore he would ask Mr. Prest what was the available experience in the matter, or what ideas he had for making the transfer of savings from the sectors he wished to penalize to those he wished to promote a sound propostion. Thought might perhaps be given to putting a premium on the purchase of securities issued by enterprises included in the latter group or the purchase of government development securities.

Mrs. de NAVARRETE observed that a progressive tax on corporate income had among its other advantages that of reducing the difficulties arising from the difference in the size of corporations. With respect to the incidence of the tax, it would not have a direct effect on the profits received by shareholders. She supported both her arguments by giving examples based on actual legislative and administrative experience in Mexico.

Mr. COSCIANI, referring to the total or partial substitution of the profits tax by the value added tax, as suggested during the debate, observed that the two taxes belonged to different tax groups. The value added tax, in the final analysis, taxed prices, which meant that it was levied on consumption. That might create major dislocations in the market. He therefore advised careful study before any conclusion was reached in the matter.

Mr. PIEDRABUENA observed that many Latin American corporations contributed to the economic development of their countries. In general, however, intangible property was viewed with suspicion in Latin America and an attempt should therefore be made to strengthen the structure of corporations. One way to do that was to grant them some measure of relief from double taxation and to tax them on their undistributed profits. While action to ease the tax burden of corporations might have an adverse short-term effect on economic development, it would be most

/useful to

useful to encourage small investors to contribute to that development and that could only be done by ensuring a fair return on their dividends. Moreover, an unduly high rate of taxation on the distributed profits of corporations would cause corporations to refrain from distributing such profits. The best solution in his view, and one referred to by Mr. Prest in his paper, would be to have the corporate tax take the form of a tax on undistributed profits.

Mr. URQUIDI hoped that Mr. Prest would give his views on the question of the revaluation of assets, a particularly important problem in countries with inflation problems or where the currency was devaluated.

With regard to the rate structure of corporate income taxes, he felt that a progressive tax, particularly in countries with inflation problems, would ensure elasticity in the collection of revenue.

Mr. VIDAL said that while he would like to stress the importance and thoroughness of Mr. Prest's paper he must call attention to one or two errors into which the author had fallen in referring to the income tax in Peru. The excess profits tax had not existed since 1958. Neither was corporate capital taxed in Peru, nor the dividends of corporations registered in Peru, except when they were payable to foreign firms. Furthermore, accelerated depreciation was recognized in Peru.

Apart from the above reservations, he would only add, with regard to double taxation on the corporation and the shareholder - a matter appropriately pointed out by Mr. Riofrío - that it was mitigated by two provisions, i.e. incentives for investment, whereby it was possible to deduct from the tax base up to 40 per cent of profits provided they were invested for improving production, and reduction of the tax on capitalization of earnings to one third of the maximum rate. Neither of those measures prevented a shareholder from obtaining dividends should he choose to sell the shares appreciated by investment or capitalization; and there again the profit was not taxed in Peru.

Mr. GNAZZO said that his country, Uruguay, favoured a single tax on corporate profits and had established a tax on the undistributed profits of corporations. He wondered whether Mr. Prest would express his views on the Uruguayan solution.

The meeting rose at 1.35 p.m.

PROVISIONAL SUMMARY RECORD OF THE TENTH MEETING
held at Santiago, Chile
on Tuesday, 11 December 1962, at 3.50 p.m.

Chairman: Mr. MAGAÑA

CONTENTS:

Corporate income taxation in Latin America (*continued*)

Production and consumption taxes and economic development

CORPORATE INCOME TAXATION IN LATIN AMERICA (continued)

Mr. PREST said that he would not reply to each individual speaker but would deal in a general way with the different points that had been raised.

The first question concerned the shifting of corporate income tax. As Mr. Kaldor had pointed out, he had not indicated the extent of the shifting precisely for the reason that he did not know the answer. The statements made with respect to the incidence of the tax by statisticians and businessmen were not convincing in his opinion. The chief concern was to define the question, since much of the difficulty experienced in reaching a definite position was due to the multiplicity of factors involved. The first task was therefore to decide what tax would be replaced by corporate income tax and the second to determine the real meaning of incidence. On the latter, the view generally held was that it signified the effects of the tax on income distribution, which again were many-sided. Three main variables were involved in tax substitution: (a) the effects on the relative prices paid for factors of production; (b) the effects on direct tax collection from individual taxpayers; and (c) the effects on relative prices. He pointed out that it was easy to become entangled with absolute prices, which were irrelevant. Generally speaking, any single tax could operate on one or all of the three variables.

In some circumstances, the main effect of corporate income tax on income distribution might be to alter the relative prices of goods. But as an example of the opposite kind, he referred to enterprises that were mainly concerned with export trade. In their case, corporate income tax would be borne by shareholders or other factors of production.

He presumed that those speakers who upheld the taxation of corporations would agree that the same arguments applied to unincorporated enterprises. That immediately opened up the whole question of the justification for progressive taxation.

With reference to the interesting suggestions made by Mr. Harberger of a model for corporate income taxation, he doubted whether his ideas would be wholly applicable outside the United States.

His second main point related to the value added tax. He agreed with Mr. Lessa that there was no obvious reason why the substitution of that tax for a corporate income tax should conduce to raising efficiency. The ratio of profits to wages might increase because of one of three factors:

/greater efficiency,

greater efficiency, more inputs or a more monopolistic position. The suggestion had been made that a value added tax operated in the same way as a multi-stage tax. He disagreed with that suggestion, since the great merit of the value added tax was precisely that it made allowance for capital outlays and was applicable to all types of business, incorporated or unincorporated.

In regard to the conflict between income originating and a world-wide basis for assessment, he had little to add to Mr. Goode's statement. He would merely say that he did not advocate taxing income where received, as some speakers seemed to think, and, in regard to the point made by one speaker that income from foreign sources was not worth taxing because much of it would undoubtedly evade taxation for one reason or another, he maintained that it was better to obtain some revenue than none at all.

Some speakers had raised the question of the adjustment of the tax system to inflationary conditions, one possibility being the LIFO method and the other the revaluation of capital assets so that the money value of depreciation allowances was increased. The answer depended on the end that was pursued. If the intention was to use the tax system to check inflation, both these methods of applying it were wrong.

Another point concerned the progressive taxation of companies. Mrs. Navarrete had doubted whether it was justifiable since it penalised small business firms with little access to the capital market. He agreed, but reiterated his conviction that businesses should not be taxed on a progressive basis like individuals. Small firms could be helped through some kind of tax relief or easy credit facilities as in the United States and United Kingdom. The statement that progressive taxation of corporations would give more elastic yield was true theoretically as income levels rose in periods of inflation but nevertheless the disadvantages outweighed the advantages.

With regard to investment, it had been asked whether accelerated depreciation was an effective stimulus. Did it add to the over-all volume or simply conduce to the transfer of resources from one sector to

/another. In

another. In general, accelerated depreciation had two effects: it produced (a) a reduction of interest rates and (b) more funds for business firms. In one or both ways it could stimulate the level of investment. Experience with accelerated depreciation in the United Kingdom had clearly demonstrated that its effect was to raise the total level of investment.

His seventh point concerned tax concessions for investment. He agreed that they were liable to have an inflationary effect on the economy and that compensating revenue had to be collected at some other point.

In the same field, there was the question of exemptions for invested retained earnings of corporations. Two possibilities were involved: differentiation in the taxation of undistributed and distributed profits and tax relief for capital investment. But then those two policies should not be confused, as was the danger with this device. An interesting suggestio had been put forward that companies making retentions should issue corresponding bonus shares which could then be taxed. That was tantamount to the partnership principle that undistributed profits should be allocated to shareholders and taxed accordingly. The case for that was a long-standing one, and seemed to him to have a number of advantages in theory but he thought it would be difficult to apply in practice.

His last point related to the appropriate rate of taxation for dividends paid abroad. He was not sure whether he agreed with the suggestion that foreign dividends should be taxed more heavily than domestic dividends because the latter might also be subject to inheritance or other taxes. The answer depended on the territorial jurisdiction of inheritance taxation and whether the principle of taxing the estate of a resident in his home country or abroad or both was applied.

The meeting was suspended at 4.15 and resumed at 4.25 p.m.

/PRODUCTION AND

PRODUCTION AND CONSUMPTION TAXES AND ECONOMIC DEVELOPMENT

Mr. NAHARRO explained that in his paper he had begun by locating production and consumption taxes within the framework of public finance as a whole. To that end he had used the old classification of direct and indirect taxes.

Like Mr. Kaldor, he held that two aspects of such taxation had to be taken into consideration in any analysis of the subject, namely, its revenue-producing effect and its implications for the economy, particularly the possibility of providing an incentive to activities. With regard to the former, he thought that taxation of the type in question, although already widely applied in Latin America, could be extended still further. With respect to the second aspect, various reservations would have to be taken into account, such as the possibility that such taxes, by affecting levels of consumption, might reduce consumption below minimum subsistence levels, and the difficulties inherent in its application because some sectors of the Latin American economies were not monetized. The region also showed a preference for indirect taxes falling on the external sector, as against those applied to the internal economy.

The effect of indirect taxes as incentives could not be defined with the same precision nor, in general, as effectively as that of direct taxes.

Although import duties, for example, unquestionably exerted an encouraging influence on certain productive activities, he had in general been more concerned with studying the effect of indirect taxes on some of the variables of economic development, such as distribution of resources, savings and investment and the labour supply. He was less concerned with their probable effect on income redistribution, since to him that had only a relative incidence on economic development.

In connexion with production and consumption taxes applied to the external sector, he drew a distinction between export duties, which were direct taxes, and import duties. He realized that in Latin America there was a trend towards protectionism and he realized the danger of waving a flat of opposition in ECLA but he confessed that he was in favour of a moderate degree of protectionism or - if that term was preferred - a moderate policy of free exchange rates. There were undoubtedly instances in which customs

/protection contributed

protection contributed to economic development, as in the case of incipient industries or other activities producing beneficial repercussions on the rest of the economy. He considered that in Latin America the system of external indirect taxes should be overhauled and remodelled, since in the past a lack of logic had been observable in their administration.

Broadly speaking, he believed that indirect taxes constituted the main source of the additional funds required by Latin America for its economic development. Nevertheless the proliferation of indirect taxes of every kind in Latin America was inconsistent with sound principles of tax administration. To reform the system, a widespread sales tax, for instance, might be levied, to be applied either at the level of the producer, the wholesaler or the retailer, although he would have it applied to the producer. Alternatively, consideration might be given to a reorganization of the excise tax on more progressive bases for some assets. To eliminate risks of multiple taxation it had been suggested that an over-all sales tax should be replaced by a tax on value added. That idea failed to convince him, since he did not believe that, in its application, such a tax would be as neutral as was claimed, and, in addition, it presented much greater administrative difficulties.

Mr. VEGA noted that there had been a consensus of opinion among the participants to the effect that direct taxes needed strengthening, but in underdeveloped countries the budget could not be financed solely on the basis of such taxation, even though it was more equitable.

Indirect taxes were applied because direct taxes could not suffice to finance development and because it was desirable that all the inhabitants of a country should contribute to its economic improvement.

He pointed out that Mr. Naharro had not touched upon certain infra-structure projects, such as highways, etc., for which the users had to pay through indirect taxation.

Although Mr. Naharro had said that the nature of production and consumption taxes was the same, and that the difference between them lay in the tax technique adopted, he personally held that they differed essentially inasmuch as the former taxes fell on inventories and the latter did not.

/He suggested

He suggested that the technical and administrative issues which Mr. Naharro had not dealt with in his paper were often of decisive importance for economic development since one of its basic prerequisites was the efficiency and flexibility of tax administration.

He agreed with Mr. Naharro that development was based on saving, and as the latter was very limited in under-developed countries, recourse to the compulsive action of taxation was essential in order to enforce saving. It should not be forgotten, however, that objections might be raised to taxation as an instrument of compulsory saving on the grounds that it discouraged voluntary saving.

In analysing the tax burden in ten Latin American countries, Mr. Naharro related the tax revenue collected by the central Government to national income, but took no account of the taxes levied at other governmental levels, which were sometimes considerable; so much so that if they were ignored a completely false impression of the tax burden might be formed. It also seemed to him illogical to measure tax pressure by taking national income as a counterpart to taxes, since in the Latin American countries indirect taxation accounted for a major proportion of government revenue, and the taxes in question did not form part of national income but of the gross national product.

In relation to internal production and consumption taxes, he said that to prevent a decline in savings and investment and, consequently, in production employment and wages, it was necessary to establish incentives to voluntary saving within the system of direct taxes.

Referring to customs duties, he dissented from Mr. Naharro's view that the Latin American countries were preponderantly protectionist. Protection had not been arbitrarily established, but in order to prevent the countries from remaining peripheral. ECLA had advocated the establishment of common markets with a view to fuller liberalization of intra-regional trade, and although protectionism might be said to exist in Latin America vis-a-vis countries outside the region, within it a free-trade policy prevailed

Mr. FERNANDEZ maintained that tax policy should be analysed strictly as a function of economic development. Mr. Naharro had expressed the view that production and consumption taxes were one and the same thing, although there was a marked difference between their effects on economic development.

/The former

The former pushed up production costs and consequently increased capital requirements, which was a very serious drawback in countries where there was a shortage of capital. On the other hand, a tax on consumer goods, whether specific or generic, was applied at the time of purchase for final consumption, and its only effect consisted in restricting the purchasing power of the individual for the benefit of the State, which would use it for development purposes either directly or through redistribution of the income obtained.

Furthermore, taxes on consumption should be applied, within the framework of an over-all policy, in conjuction with income tax, and the balance between the two systems should vary according to the country concerned and to its gross national product. It should not be forgotten that one of the major problems of the Latin American countries was the size of the market, and therefore consumption could not be unduly restricted. In his view, a perfect balance between the two types of taxes might be achieved if 50 per cent of tax revenue came from indirect taxes, especially those on luxury consumption, and the rest from taxes on income and capital.

Mr. HERSCHEL endorsed Mr. Lessa's view that the tax system served as a means of influencing the direction of aggregate demand. The possibility of using sanctions or disincentives instead of incentives to channel such demand in the best interests of development should be analysed, as well as the question of whether indirect taxes could be used to steer aggregate demand along new lines and influence the structure of production. Custom duties might be applied as a disincentive to industrial inputs or purchases of capital goods for industries which it was not deemed desirable to encourage. A good deal of caution would have to be used in interpreting the conclusions shown in the table in Mr. Naharro's paper on the distribution of the tax burden, which in Argentina amounted to approximately 19 per cent of national income (Federal Government Taxes).

With reference to the tax on value added, he said that the sales tax applied in Argentina was of a similar type, since it allowed deduction of inputs forming a constituent part of the goods produced (principle of physical integration). Moreover, it only reached the manufacturer's level.

/Argentina's experience

Argentina's experience suggested that such a tax could be established in Latin America.

Mr. PINTO considered that the views and arguments put forward by Mr. Naharro represented an old-fashioned approach and were out of touch with the real situation in Latin America. It was not the idea of self-sufficiency that had prompted the Latin American countries to adopt a protectionist policy. They were anxious to achieve structural reforms which would enable them to develop along other than the traditional lines, and were using any tool that came to hand. In essence, their aim was to alter the pattern of the international division of labour. The key point lay in the fact that the development of Latin America's traditional exports, on account of the terms-of-trade effect, no longer sufficed to mobilize the resources required by the region for its economic growth. The obvious solution was industrialization, which did not imply any suggestion of self-sufficiency or isolation, but merely the desire to compete in the world market on less unfavourable terms.

Again, while taxes on luxury consumption might be one of the components of the tax system, another type of consumption - that of manufactured durable consumer goods - would have to be taxed. In Latin America a prematurely wealthy society, formed by the new well-to-do middle classes, had arisen, and the goods and services consumed by those strata should be taxed, especially as from 60 to 70 per cent of the Latin American population were still living at the merest subsistence levels. The process of industrialization in Latin America had been directed towards production of the goods and services required by the well-to-do classes in question, to the detriment of the interests of the community as a whole. The problem might be solved through the tax mechanism.

Mr. URQUIDI fully concurred with Mr. Pinto's remarks on protectionism, and considered that the general conception of taxation expounded by Mr. Naharro was influenced by an economic liberalism that would seem to be out-of-date in Latin America.

/He did

He did not share Mr. Naharro's view that the purpose of indirect taxation was to facilitate the private sector's activity. If such taxes were not used for purely revenue-producing ends, they constituted a powerful weapon with which to exert a negative influence on production and/or imports of certain goods. In a planned economy, the State had to watch over the interests of the country as a whole and restrain specific types of production, while allowing others to develop.

The paragraph quoted in Mr. Naharro's paper with reference to the application of indirect taxes as a cure for the predilection of idleness displayed by the indigenous population of Guatemala seemed to him absurd. A predilection for idleness was surely not exclusively characteristic of the indigenous populations of Latin America, but pertained to a certain cultural level which might also be found elsewhere.

Mr. Naharro ought to have taken into account the incidence of indirect taxes, especially when they were shifted backward until they reached the rural wage-earner. In considering this incidence, allowance should be made for the level at which the taxes were established, since at 2 or 3 per cent their influence was nil. The criterion governing a development plan should be whether or not such taxes constituted an obstacle to a specific branch of activity.

He endorsed Mr. Fernandez' opinion that such taxes should be applied at the stage of final consumption and removed as far as possible from earnings in productive or agricultural activities. It was also important that a sales tax should not be identified with particular industries. It was better to tax consumption of beverages than to apply taxation only to certain producer enterprises. Again, the Conference should recommend the simplification of the system of consumption taxes. The ideal solution seemed to be that of a global tax at a rate of, say, 5 per cent, plus taxes on specific branches of consumption by groups or categories of items which would be multiples of the over-all rate.

Mr. LESSA explained that indirect taxes were the basis of tax revenue in Latin America. He did not think they would alter investment patterns, since Latin America's experience had shown that relative prices too had proved ineffectual in that respect. Nevertheless, indirect taxes might be very useful for economic development purposes when they were applied to goods with a high consumption-elasticity and substitution possibilities.

/They might

They might result in a saving of foreign exchange if import duties made it possible to purchase lower-cost goods abroad; where they fell on domestic consumption, goods which had a sale on the world market might be released; and the same instrument might be used to reduce domestic consumption of goods in short supply within the country and needed for development.

The tax-by-tax method of analysis was unsatisfactory, since what mattered was that the various fiscal measures should be mutually compelementary. Thus, for example, a high duty on imported whisky might encourage domestic production of beverages unless other steps were taken to discourage it.

Mr. BACA said he could not agree that indirect taxes were inequitable, and that in the context of the discussion the term did not refer to the classic taxes of that type but to those indirect taxes whereby discrimination could be practised in respect of the middle class.

Indirect taxes accounted for 90 per cent of tax revenue in some Latin American countries. Moreover, they responded more readily to administrative measures, which should be improved by the introduction of order and method.

With reference to Mr. Naharro's contention that exemptions from direct taxation were more effective as an incentive than exemptions from indirect taxes, he said that would not be true in Central America, where the best incentive was provided by exemptions in respect of raw material imports. In fact, under the terms of the agreement on standard tax incentives to industrial development, exemption from taxation on raw materials was granted in favour of those industries which enjoyed priority in industrial development planning.

Mr. LEWIS stressed that the basic consideration before the meeting, with which he hoped Mr. Naharro would deal fully in his summing-up, was the question of indirect taxes, which produced from 30 to 90 per cent of total revenue in the different countries. The meeting should concentrate its future discussions on that question, with particular reference to practical aspects of application in a given country. Since the problems were quantitative the answers should be quantitative as well. His suggestion for a new approach should be linked up with Mr. Porras's

/statement on

statement on the previous day regarding the content of the net wealth tax. The property tax might be less efficacious than the net wealth tax, but from the practical point of view he supported Mr. Porras' contention that for the Latin American countries in the immediate future the property tax was best suited to deal with their revenue problems.

He also thought it would be helpful to hear about Chile's experience in introducing the recent reform in the field of excise taxes.

Mr. DESAI referred to the question of the terms of trade of the under-developed countries, and Latin America in particular, which had been raised by a previous speaker. The concept of "terms of trade" was open to misinterpretation, since their value at any given time depended on the year that had been taken as a base year. The general tendency was to choose years following the Second World War or during the Korean war when the prices for raw materials had been abnormally high, which falsified the present picture of the terms of trade. Moreover, commodity prices were only one element in the income received by the under-developed countries. He suggested that, instead of linking questions of aid from the industrialized countries to the fall in their terms of trade, it would be best for them to concentrate on the basic trade problems, such as supply factors, and the difficulty of changing from one type of commodity to another in response to demand.

Mr. NAHARRO congratulated Mr. Vega on his excellent paper, which expanded and elucidated many of the ideas in the background document. He acknowleged that, for the sake of brevity, he had devoted little attention to development problems and that he had shelved the benefit principle, since he thought it was more properly applicable in relation to prices and tariffs for public utilities not paid for by taxation.

He dissented from Mr. Vega's opinion that production taxes fell on inventories and taxes on consumption did not. As an example he cited the tax on tobacco consumption in Spain, collected through a monopoly. The tax was already included in every packet placed on sale. He admitted that the opposite might be true in other cases. In his paper he had not gone into technical and administrative details on the application of such taxes because he thought that aspect had been sufficiently discussed at the previous Conference in Buenos Aires. As far as using national income

/instead of

instead of the gross national product for purposes of comparison was concerned, he regarded that as an error of terminology and not a substantive issue. Mr. Vega held the same views but had used different names. He pointed out that in his paper he had not used the national income but the net national product, i.e. NNP - depreciation. If indirect taxes were subtracted from the net national product, the cost of factors would be estimated but not at market prices. It was clear that the author had not done that. He agreed that he had not taken tax collection by local authorities into account, but he did not think the omission affected the validity of his conclusions in every case. That, of course, had been a mistake but he had been unable to obtain the data needed for the calculations. He hoped to correct his figures, particularly in view of Mr. Desai's estimate. Nor did he consider that taxes on consumption could reduce the level of savings; on the contrary, they were reflected in compulsory savings which passed into the hands of the Government.

He agreed with Mr. Desai that the terms-of-trade argument was a fallacy.

He did not understand why Mr. Fernández advocated a perfect "fifty-fifty" balance between direct and indirect taxes, and in his opinion there would be no grounds for so exact a division.

He had unfortunately not clearly followed the points raised by Mr. Lessa and had therefore been unable to give them the attention they deserved in his comments, although in general he accepted them by sharing Mr. Herschel's ideas on the possibilities of channelling aggregate demand by means of indirect taxation. He explained that he had included Musgrave's table in his paper as background information, but its validity was no doubt limited, and he was aware of that.

In reply to the comments formulated by Mr. Pinto and Mr. Urquidi, he confessed that he was a conservative liberal, - a very rare species which should be wiped out - but he also thought that however old-fashioned the terminology he employed, it expressed his ideas clearly enough. After all, everyone knew what protectionism and free exchange meant. They were old terms which might harbour new concepts. He fully understood the situation

/of Latin

of Latin America and the need for developing the region beyond the traditional patterns and he assured Mr. Pinto that he understood his position and agreed with him.

He could not accept Mr. Urquidi's views on the private sector, since without its co-operation economic development would be impossible. He was surprised that Mr. Urquidi dismissed as absurd the paragraph he had quoted on the pressure which indirect taxation might exert on the labour supply, especially as Mr. Kaldor, without using exactly the same words, had expressed identical ideas, and Mr. Urquidi had raised no objection. The paragraph had no value other than as an example of theoretical "hair-splitting" which, perhaps, it was. More particularly, it was inhuman but in his paper he had avoided value judgements as far as possible. He thought Mr. Urquidi's suggestion of a combined system of general and specific taxes on consumption was greatly preferable to the proposal of a tax on value added which had been discussed at other meetings. While agreeing with Mr. Lewis, he referred him to Mr. Jarach, who was an expert in the questions raised.

<u>The meeting rose at 7.10 p.m.</u>

PROVISIONAL SUMMARY RECORD OF THE ELEVENTH MEETING

held at Santiago, Chile
on Wednesday, 12 December 1962, at 10.05 a.m.

Chairman: Mr. MENDIVE

CONTENTS: Reform of agricultural taxation to promote economic development in Latin America.

REFORM OF AGRICULTURAL TAXATION TO PROMOTE ECONOMIC DEVELOPMENT IN LATIN AMERICA

Mr. GREGORY, introducing Mr. Wald's paper (CPF-DB-9), said that agricultural taxation should be discussed in relation to the general aim and objectives it was to achieve. Those ranged from the usual fiscal objectives of raising revenue to proposals primarily aimed at providing incentives to the agricultural sector. The revenue and incentive aspects of agricultural taxation were at some point bound to conflict and the kind of tax policy suggested would depend upon the views held on the role the agricultural sector should play in the over-all economic development - whether it should be a source of capital for the rest of the economy or whether it needed capital to be brought into it. It was unfortunate that the terms "agricultural taxation" and "land taxation" were often used synonymously for there were other taxes in addition to a tax on property which should be levied on the agricultural sector, even though a tax on land was probably the most important from the standpoint of revenue potential, distribution effects and, to some extent, incentive effects. A tax on land could serve as an excellent lubricant for land reform and the two programmes should therefore be developed together.

His remarks were based on the following assumptions: (a) that at present the amount of tax revenue paid by the agricultural sector was not only far less than its legal tax liability but also much less than it was capable of paying; (b) that the reason for under-payment of taxes was the manner in which tax laws were written and administered, and the nature of the agricultural industry which made tax evasion relatively simple; (c) that under-payment of taxes tended to perpetuate the existing pattern of very unequal income distribution as well as to encourage inefficient use of resources, particularly of land and capital; and (d) that the objective was therefore to find some way of levying taxes which would greatly increase the amount of taxes paid by the agricultural sector and, at the same time, redistribute incomes and provide some incentives for improved use of resources.

With respect to his proposal that the best way to ensure a fair assessment of land for taxation purposes would be for the owner himself

/to assess

to assess the value of his holdings, he realized that the proposal had some limitations but felt that the disadvantages did not offset the benefits to be derived from that method. The problem of correct property assessment was particularly acute in Latin America and its solution required a corps of well trained technicians who would need much time to get the necessary data on which a fair assessment could be based. Self-assessment therefore seemed to be the only method susceptible of immediate application. Under-evaluation could be guarded agains by providing that land reform agencies could acquire the property at the value placed on it by the owner. The latter could then either pay taxes on the full value of his property or run the risk of capital loss through having his property bought at his own assessed value. Carrying the proposal somewhat further, some fraction of the property value declared by the owner could be used as the presumed income of his property for the purposes of a tax on farm income.

With respect to incentive taxation as a means of improving the use of land, he thought that the same objective could be better achieved though a progressive tax on land. Incentives to improved farming practices should be determined through variable rather than fixed costs. In view of present conditions in Latin America, a combination of a progressive land tax and a tax on presumed agricultural income, applied equally regardless of land used, would be more effective than a programme of discriminatory incentive taxes.

Another useful tax on the agricultural sector would be a specific tax on water, which was one of the most critical inputs in the area and was often used inefficiently. A progressive tax on water would improve its allocation and use, help to redistribute water rights and increase revenue. Such a tax would ensure that the use cost of water could only be paid if it was used on highly responsive crops. The progressive feature of the tax would discourage farmers from bidding for large quantities of water, thus ensuring its availability to small farmers. The latter would not be exempted from the tax, but a system of subsidies or credits could be devised to help them pay the tax if they were unable to do so.

/Mr. DESCARTES

Mr. DESCARTES agreed with the objectives sought by Mr. Wald in his proposals but had some reservations on the feasibility and effectiveness of the methods suggested.

With regard to the self-assessment of property by the owner, he had no objection provided that all that was intended was a mere declaration of the value of a piece of property. Mr. Gregory, however, had gone further in suggesting that a Government should be able to purchase the property on the basis of the value assessed by the owner. He opposed that suggestion because it might be at variance with the constitutional position in some countries. Moreover, land reform should not be based on purchase of property merely because an owner had understated its value. Land reform was an instrument of economic development and it would be wrong to complicate its implementation. Land could be more properly acquired by other methods. The method proposed might well be considered an undesirable form of expropriation. The right of expropriation was undeniable provided that adequate compensation was paid to the owner.

Even more objectionable would be a proposal to allow individuals to purchase property by paying 25 per cent more than the value set by the owner. Such a scheme would affect the stability and productivity of the agricultural sector, even if it were applied as a provisional measure. A better system would be to tax land on the size of the property concerned and its productive capacity, and to use the revenue for the purchase of land by the State. At the same time, an attempt should be made to obtain more data on which to assess land values.

The suggestion that a tax might be imposed on the imputed income of agricultural property was less objectionable than self-assessment of its value. Such a tax could be used as an expedient to facilitate taxation of the agricultural sector, although the rate of taxation should not be based on the value set by property owners.

Emphasizing the need for an efficient tax administration, particularly in the Latin American countries, he said that much depended upon public goodwill, which could only be ensured through the participation of the public at large. He stressed that specific tax policies with respect to agriculture should be adapted to the conditions prevailing in each country and should be in harmony with the other taxes. Changes in agricultural taxes should be made in the light of the tax system as a whole.

Mr. MOISES BEATRIZ congratulated the organizers of the Conference for including in the agenda the study of agricultural taxation, a subject of fundamental importance, since the Latin American economy was primarily agricultural; agriculture taxation afforded the least possibilities for effective application of income tax while calling for the greatest economic and social reforms. For those reasons, the tax could contribute to higher productivity of the land and a better distribution of holdings.

Although the ingenious methods proposed in the papers by Mr. Wald and Mr. Gregory to obtain the economic and social effects sought were most intriguing, he believed that before complicated methods could be applied it would first be necessary to establish a sound land register. He would therefore be interested to know the results obtained in the application of the new agricultural tax laws in Colombia and Chile.

The tax on exports was one way of taxing agricultural income. In El Salvador, in view of the problems which had arisen in the application of income tax on income derived from coffee-growing it had been replaced by an export tax on the product with progressive rates adjusted to international prices. The result had been satisfactory from the standpoint of tax yield, since it was easily and cheaply administered and almost perfect fiscal control was possible. To make the tax on coffee exports more equitable, it would be advisable to integrate it with income tax so that the taxpayer could apply all or part of the pertinent export tax against income tax.

As to extending income tax to capital gains, he said that such a measure would be valuable in obtaining fair distribution in the agricultural sector.

Mr. CASAS observed that in the Latin American countries agricultural production was often cyclical, with all that that implied. Hence he did not consider it possible to apply in Latin America the same systems as were in use in other countries whose agricultural economy was more highly developed and where price supports and other measures contributed to its stability. Since it was a very sensitive sector of the economy, care should be taken that any measures adopted did not discourage it

/still further

still further. As to the revaluation system and the presumptive income tax suggested by Mr. Gregory as possibilities for agriculture, he entirely agreed with the idea, and disagreed with Mr. Descartes on the subject. Optional assessment of property by agricultural landowners for purposes of the tax on occasional profits was provided for by the 1960 tax law in Colombia; failing which the State made the assessment on cadastral or commercial bases. Both the self-assessment and the tax - fixed at a rate of 6 per cent per annum - had been placed at the service of the 1960 agrarian reform in Colombia. He explained the rural tax and the tax on net wealth as applied in Colombia and referred to the decline in the value of land in that country, which could be attributed to the prevailing insecurity in certain areas and the shortage of cash, which had reduced demand in relation to supply. As to the progressive water tax, he disagreed with Mr. Gregory's views.

Mr. DARDON, referring to certain comments made by Mr. Wald with regard to land tax in Guatemala, pointed out that actually the tax on the capital value of land was integrated with other taxes which likewise affected land, such as the tax on free conveyances (tax on inheritances, legacies and gifts, which taxed land at an equal rate in each case) or transfers against payment (tax on purchases and sales, and on exchanges of land).

Recently as a result of the enactment of the progressive personal income tax law, the agricultural sector was included in it with a 10 per cent reduction on the net income tax rate. In his opinion, such taxes represented the maximum tax-paying possibilities of the agricultural sector. With them it was to be hoped that Guatemala would be able to implement its economic development programmes in the next few years.

With reference to revaluation of rural property for the purpose of increasing fiscal income, an obstacle had been the lack of cadastral survey maps, although some progress had now been made in that respect. To solve the problem temporarily in accordance with the laws of Guatemala the system of personal returns had been adopted. To supplement it, banking institutions had been required to send to the tax collectors' offices the property revaluations which served as a basis for granting loans. Furthermore, before filing their returns, the owners themselves usually requested the services of professional appraisers authorized by the Ministry of Finance and properly trained for the purpose.

/Mr. BACA

Mr. BACA said that in Latin American countries there were two problems connected with agrarian reform which aroused tremendous interest because of the difficulty of solving them, namely the problem of determining what land was subject to expropriation, and that of fixing its value. Both had political overtones and adequate solutions to them had been suggested by Mr. Gregory. Experience in Colombia had shown that the suggestions were feasible.

Mr. DESAI observed that land taxation involved social and political objectives and was therefore difficult to implement in practice, although it was possible to do so in theory. It gave rise to diverse questions such as the social redistribution of land (land reform proper) where the tax machinery was used to break up large estates into small holdings, taxation of land in relation to inflationary conditions where the value of the land increased as a result of inflation, the backward sloping supply curve, the breakdown of traditional farming methods in order to improve efficiency, and the need for cadastral maps.

He agreed with Mr. Gregory's view on land redistribution. If land reform measures were defeated by the opposition of the landowners, land taxation measures would be defeated as well. If land reform was important it should be tackled directly; taxation of land was not the most effective means to achieve it.

His own country, India, had had considerable experience with cadastral maps, but experience with land taxation had been rather unsatisfactory. The Government had been unable to take effective action in that field because of the political value attaching to land and the strong opposition from large and small landowners alike.

Land redistribution did not necessarily contribute to efficiency in the agricultural sector. While large landowners were mainly responsible for the problem of idle land, a small landowner might not be able to increase productivity because of such factors as lack of capital and credit.

While more revenue might be obtained by taxing the small landowner, such a tax might defeat the other aspects of rural reform, such as community development programmes. A better method of increasing revenue from the small farmer might be through excise taxation, which was less objectionable from the political point of view.

/Mr. GNAZZO

Mr. GNAZZO agreed that a distinction should be made between land distribution and productivity. However, he could not support Mr. Desai's view that a land tax could not make a useful contribution to land redistribution.

On the question of the assessment of agricultural property, he pointed out that in Uruguay authority to tax land was vested in the local Governments which, for constitutional reasons, chose to raise the rates without touching the assessments.

With respect to the over-all tax on income, he pointed out that in Uruguay a system had been established for determining income on the basis of an average potential yield according to property assessments mathematically brought up to date.

A major problem in Latin America was the concentration of wealth in the agricultural sector, usually in the hands of corporations belonging to the same family. The danger of tax evasion by such corporations could be overcome if they were not permitted to issue bearer shares.

Mr. PREST said that although he was in sympathy with the idea of a proportional land tax, he did not believe that a progressive land tax would be practicable. If land owned by one family was split up among the various members to reduce the incidence of a progressive tax, it would not be easy in practice to take counter measures to aggregate family holdings for tax purposes, and forms of evasion might develop such as the formation of corporations with bearer shares. If family holdings were in different parts of the country, the tax administration would have to be centralized, although land taxation would be easier to administer on a regional basis. In establishing the relative capacity of different land, the annual tax liability would have to be adjusted in accordance with some measure of output or price or income changes. The relative prices of the crops grown on different land units would change from year to year, hence it could not be assumed that the relative capacity to pay of such units would remain the same. He could not agree that a land tax affected the level of fixed costs, and that action should therefore be based on what would be a suitable course if fixed costs changed. A graduated land tax would affect the capitalization of the existing land owner; if he sold the land immediately, its value would be reduced, and there was no way in which

/he could

he could avoid the tax by changing his occupation, as an industrialist could if his product were taxed. He asked if Mr. Gregory's belief that a land tax would not lead to better utilization of land would still apply if he accepted the proposition that the tax was not in fact reflected in the level of fixed costs.

With respect the the use of water, it would be reasonable to levy a tax, but he could not agree that it should be progressive in accordance with the amount used, which would be analogous to levying a progressive tax on such inputs as electricity or transport.

Mr. GOODE said that he could not accept as a long-term goal Mr. Wald's proposal on page 12 of his paper (CPF-DB-9) that the land tax should be integrated with the personal income tax; both equity and economic policy demanded that both forms of tax should be imposed in the agricultural sector. Referring to what Mr. Prest had said about capitalization, he said that if the land tax was reflected in land values it amounted to a once for all tax, and if subsequently revoked would bestow windfall gains on any landowner who had bought the land after imposition of the tax. Secondly, personal income tax was levied in view of the total income of an individual in the light of his personal circumstances, at graduated rates according to the income received, whereas a land tax was an impersonal tax that had no regard to the total situation of the landowner; consequently one form of tax could not replace the other. Thirdly, a land tax was at least partly a benefit tax, reflecting the landowner's payment towards the cost of public improvements, such as irrigation or road building, that benefited landowners, and consequently could not be replaced by the income tax. In any case, he did not believe that Mr. Wald would argue that it would be possible in the near future to apply personal income tax to agriculture effectively enough to make it possible to do without a land tax.

He agreed with Mr. Prest that a land tax could not be regarded as a fixed charge that did not affect farming operations, and in fact Mr. Gregory had withdrawn somewhat from that position by referring in his paper (CPF-DS-3) to the possibility that effort would be diverted from one agricultural sector to another.

/He did

He did not believe that progressive tax charges on water use would increase allocative efficiency, and supported what Mr. Prest had said on that point. If the aim was the social one of redistributing water rights, there were more effective means of doing so. On the other hand there should be adequate charges for irrigation water from public projects.

He shared Mr. Descartes' doubts about land valuation by self-assessment, which might prove arbitrary and erratic in application. The method would be more acceptable if used in connexion with government acquisition of land under a land reform scheme than if third parties were allowed to force a sale on that basis, but although the present system was not very good, it would be better to try and improve it than to resort to self-assessment.

Although Mr. Desai was correct in saying that a good cadastral survey was not a guarantee of a good land tax, it was an indispensable condition, and if supplemented by technical capacity and political determination, could result in a good land tax. Land tax arrangements in India might not be very good, but were better than in Latin America as a whole. At one time the Indian land tax was an efficient means of mobilizing resources, but pressure from landowners, especially small landowners, had prevented assessments from being kept in line with prices, because political leaders were afraid of losing the support of the small landowner who had expected to find himself much better off when India became independent. Once a good cadastral survey had been made, it must be kept up to date, otherwise adjustment to real values after a lapse of time would result in a large increase in the tax which would be strongly resisted.

Excise taxes were not a good mean of reaching the agricultural sector, because in many countries small farmers depended largely on a non-money economy, so that much consumption would escape the tax; nor were they a good method of reaching the large landowner.

Mrs. NAVARRETE brought up the question of the relationships between the redistribution of land and the increase in productivity in the agricultural sector, expressing scepticism on the subject. In support of her views she cited the case of Mexico, where there were wide differences in

/productivity between

productivity between modern industrial-type farms using advanced technology, established in areas that had recently been opened up to cultivation, and highly productive, and others where farmers cultivated the land for their own consumption, and not for markets, using rudimentary techniques. In the latter case, it was possible that structural improvements, revaluation, and land taxation might have some influence in increasing productivity. Furthermore, drift from the land and migration of the population towards the cities were phenomena which undoubtedly militated against the productivity of the land; notwithstanding, it was possible that in certain cases they should be encouraged. It should also be taken into account that the tax on land ownership was usually a local matter, while taxation of income was under national jurisdiction.

Mr. KALDOR said that he and Mr. Wald seemed to have arrived independently at very similar views as agricultural taxation. Agricultural taxation was very important in Latin America for three reasons. Firstly, the agricultural sector tended to be heavily under-taxed in under-developed countries, apart from the large plantations producing cash crops for export, which were sometimes over-taxed because they were also subject to heavy export duties or corporation taxes. But under-taxation was the rule, especially as regards the production of food for domestic consumption. Secondly, agricultural taxation could improve land productivity and help to secure a freer land market. One reason for backward agriculture was the ownership of land by those who had so much that they were not interested in making good use of it. On the fixed charge aspect of the land tax, he agreed with Mr. Goode, and not with Mr. Gregory. Incentives to improved management should be in the form of pressure rather than concessions. The effect of the land tax was greater turnover of ownership, which would result in the average farmer being more efficient than he was at present. The third point was that where land ownership was as concentrated as it was in most of Latin America and in the Middle East, the resulting income, if untaxed, represented a dead burden carried by the community. Luxury consumption based on large corporate incomes could to some extent be regarded as a reward for getting the economy to produce through the market mechanism, but the landowner was supported by the community even if he failed to produce. He believed that the social burden of supporting the large landowners in Chile, for example, was larger in terms

/of the

of the total gross national product than the whole military expenditure of the United States in terms of the United States gross national product. A progressive land tax seemed to be the only way to tap those resources, and he agreed with Mr. Goode that an agricultural income tax was not the ultimate goal, and could not be an alternative to an efficient land tax.

He did not agree with Mr. Prest that land taxes should not or could not be progressive; in the early days the same had been said of the income tax. The problem of dividing up family holdings could equally well arise in relation to income tax, and could be countered by aggregation of the property of husbands and wives and minor children. In general the danger of evasion was less than with income tax, because marginal rates were lower.

He agreed with Mr. Goode that Mr. Harberger's self-assessment proposal was open to objections as it stood, but if it was combined with a method under which the owner was free to retain his property if he raised his valuation, as he himself had suggested, it would be a valuable means of ensuring that the owner would be forced to increase the valuation to the full market value. Even so, the market value was not such a satisfactory basis for a land tax as the potential annual yield determined by objective criteria. Consequently he favoured a cadastral survey in conjunction with a points system to establish potential fertility and potential yield in relation to the average yield in the region or in the country as a whole. The valuation could be kept up to date on the basis of the current value (or five-year moving average value) of net agricultural output per hectare. However, he was certainly in favour of self-assessment on the lines indicated until such time (which might be a long one) that the necessary classification of lands could be completed; he was also in favour of land taxations being the responsibility of the Central Government and not of the local authorities.

He agreed with Mr. Goode that excise taxes could not be an alternative to land taxation. Referring to what Mr. Desai had said, he pointed out that India had once had a good land revenue system, but unfortunately the five-year revaluations had not been kept up after the nineteenth century. Under the new constitution land taxes had been assigned to the States, where the political pressure of land-owning interests was very strong.

He agreed with Mr. Goode and Mr. Prest that there was no point in a progressive water use tax apart from a progressive tax on the value of land holdings. A progressive land tax on potential yield would have income effects but no

/substitution effects

substitution effects, and there would be a strong incentive to additional effort to make more money. Land values would be reduced, and large landowners would sell part of their land in order to get into a lower tax bracket. There would be a free land market, making possible an improved relationship between the supply of efficient users of land and the distribution in the ownership or control of land.

Mr. MONTERROSO, although in general agreement with the views set forth by the various speakers, said he would like to make some reservations. Thus, in his opinion, excessive use should not be made of agricultural taxes through taxes on exports in under-developed countries. To support his statement, he mentioned the case of coffee exporters in Guatemala, who had exerted such pressure that the tax on exports had had to be reduced when the international prices of coffee dropped. He also believed that in the less developed countries the tax on value added might give good yields - and contribute to the prevention of unequal ownership of land - as the experience in Colombia suggested. Taxes on inheritances, legacies and gifts were also important and easy to apply indirectly in relation to agriculture because of the concentration of real property and he felt that it might even be advisable to increase them. Taxes on production were being applied in Guatemala at the minicipal level, which could give rise to arbitrary action. However, the system would prevent evasion if properly established.

Mr. DESCARTES, replying to the comments made by different speakers in the course of the discussion, said he agreed with them as to the importance of making good use of taxation on real estate. He emphasized that it should be extended to urban property. Like Mr. Moisés Beatriz and Mr. Monterroso he believed that taxes on imports should not be overdone. The same applied to taxes on production and he stressed the danger of applying them at the local level. He agreed with Mr. Casas' comments regarding the cyclical effects of agriculture, and with his objections to the progressive water tax and his recognition of the undoubted influence of assessment on non-agricultural taxes.

He believed, with Mr. Desai, that a land register did not in itself improve the yield of land taxes, unless it was kept up-to-date. He nevertheless considered it very important. Credit was due to Mr. Desai for having raised the problem of agricultural productivity, in relation to agrarian reform, a subject also referred to by Mrs. Navarrete. He agreed with them both that certain areas were better suited to cultivation on large estates; however, the pertinent

/measures would

measures would have to be adopted to destroy the social power to which the concentration of property gave rise.

In his opinion, the stimulating effect of the tax level on productivity, as mentioned by Mr. Gnazzo, Mr. Kaldor and Mr. Goode, could not be gainsaid; referring to Mr. Prest's preference for a tax system based on a proportional land tax, supplemented by personal income tax, it appeared to him that it would be best if such a system were used according to the conditions prevailing in the country where it was applied.

Despite the views set forth by Mr. Casas and Mr. Baca, he was still opposed to self-assessment. He did not believe it could facilitate implementation of agrarian reform nor reduce the political opposition which any change in a land tenure system brought about. Rather, self-assessment could lend itself to manipulations that would make it still more objectionable and create strong opposition.

He concurred with Mrs. Navarrete in believing that there was not necessarily a correlation between productivity and agrarian reform. He stressed the importance for taxation of the difference between commercial and subsistence agriculture. Commercial agriculture could be taxed in the same way as in the more developed countries. Probably the contribution of the modern agricultural sector to the gross product was larger and could be taxed effectively but he felt that the sector should not be abused. He also agreed with Mrs. Navarrete as to the importance of jurisdictional differences, as he believed that local autonomy should be encouraged.

Lastly, he agreed with most of Mr. Kaldor's comments and, in view of his training and experience, with Mr. Goode's statement.

Mr. GREGORY said that he had confined himself in his paper to attempting to indicate where fiscal reform in agriculture and agricultural reform would complement each other. Where a small number of farmers produced the bulk of income in agriculture, the tax must be aimed at the large landowners and agricultural producers. The details of the tax programme must fit the needs of each country, but certain basic principles of agricultural taxation applied to all countries. His proposal for self-assessment of land values had been criticized on the grounds that the redistribution of land under agricultural reform programmes should not concentrate on land under-valued by the owners. But acquisition should not be confined to under-valued land; it must be objective, and not exclude land with a high valuation. The difference between

/his own

his own viewpoint and that of some other speakers related mainly to the time factor. How soon could a start be made on taxing away the excess accruing to large agricultural producers? If assessment was based on cadastral surveys and appraisals of productive capacity it was hard to see how any tax action could be taken within the next two or three years. The only answer was self-assessment combined with safeguards against under-valuation and possible substantial capital losses.

He agreed that excise taxes could not provide a large source of agricultural taxation. With respect to a tax on presumed income, he thought there were reasons for relying on the self-assessments under property taxation, rather than on production calculated on the basis of average practice and yields. The latter method would require trained staff and <u>data</u> that was not available, whereas with the use of a multiple or factor of an assessed value an early start could be made with the tax. The possibility that tax liability might be higher than farm income was not a reason for not imposing a tax on presumed income, since it would have the desired effect of increasing productive effort. He added that the self-assessment system would have the virtue of relying less on the tax administration and its officials, compared with other systems.

The main reason for defferentiating between fixed and variable costs was that high fixed costs were known to act as an incentive in determining the exit and entry of firms. He recognized the need for more than a mere choice of enterprises; there must also be a choice of practices and quality and quantity of inputs. Such marginal choices of good or poor managements were not affected by fixed costs.

He agreed that the progressive feature of a water tax might hamper the allocative effect, but water distribution in Latin America tended to follow land holdings, and in the absence of a good water tax, redistribution could not be effected. He did not believe that the social principle would conflict with the criterion of efficiency, since the small farmer, who would have no access to water use if the tax were not progressive, would not use it less efficiently than the large farmer. Water, being a scarce resource, was not in the same category as fertilizer or electricity; moreover the allocative criterion should be used with respect not only to use, but also to the owners who controlled water.

/His position

His position with respect to a progressive land tax was that the highest rates should apply to the largest units, either ownership units or operating units, whichever were the larger. He concluded by saying that many of the practical difficulties attending land valuation, with respect to cadastral surveys, references to price indexes, and so forth, would be solved automatically by the self-assessment system. In addition it was suited to tax policies for different kinds of farming in different countries, and the relationship of output to land values in different areas. It would avoid tax pressure on farming areas with poor resources and low production levels.

The meeting rose at 1.15 p.m.

PROVISIONAL SUMMARY RECORD OF THE TWELFTH MEETING
held at Santiago, Chile
on Wednesday, 12 December 1962, at 4.05 p.m.

Chairman: Mr. MENDIVE

CONTENTS:

Fiscal problems in relation to a common market.

FISCAL PROBLEMS IN RELATION TO A COMMON MARKET

Mr. COSCIANI explained that his paper had been based mainly on European experience in the field of economic integration, and that possibly, therefore, some of the lines of approach adopted might not be applicable to the Latin American situation. He would have liked to expand the part relating to Latin America, but had not had at his disposal sufficient statistical and legislative documentation on the fiscal systems of the region. He was therefore glad that Mr. Daca and Mr. Cazal would be giving additional information on the Latin American Free-Trade Area and the Central American integration system.

He suggested that it would be a mistake to attach too much importance to fiscal problems bearing on the establishment of a common market, and especially to take for granted that they might be a cause of distortions without sufficient evidence that the latter really existed.

In his paper he had defined two extreme cases of economic integration, namely, the customs union and the common market. The former was essentially a commercial union among several countries which retained their sovereign independence with respect to their economic policy. A common market, on the other hand, implied closer economic ties and the unification of the monetary, credit, economic and social policies of the member countries, as well as the establishment of a juridical structure capable of exerting a more direct influence on production and trade. The basic principles of a customs union could be summed up as follows: (a) the prohibition of fiscal discrimination; (b) a ban on the formation of tax havens; (c) the co-ordination of fiscal policy for development; and (d) the problem of dual taxation. In the last connexion, he indicated the desirability of multilateral conventions like those formulated in Mexico City and London, or the treaty currently being perfected by the Organization for European Co-operation and Development.

/The limitations

The limitations affecting fiscal legislation within a customs union related to the principle of taxation in the country of destination, in which context various methods had to be considered, such as exemption at the time of export, export drawbacks and compensatory import duties. A customs union implied the abolition of economic frontiers - those whose purpose was economic protection - and the maintenance of tax frontiers. The first of the limiting factors to be noted in connexion with the principle of taxation in the country of destination was the question of indirect taxes. The usual method of calculating the drawbacks and compensatory duties corresponding to the legal incidence of taxation on imported goods, was based on approximate averages implying discrepancies that were often impossible to eliminate and difficult to identify. The simplest solution would be to convert all multiple-stage taxes into a single tax on final consumption; or a tax on value added might even be introduced. The greatest difficulty lay in the dissimilarities between the fiscal systems concerned.

In its final form, a common market was analogous to an internal market, and should therefore be characterized by complete freedom of movement not only of goods and services but also of the factors of production. In that case the principle of taxation in the country of origin was applied, since the tendency was to do away with tax frontiers. To that end, some degree of harmonization of the fiscal systems of the various countries was essential, and its ultimate expression would be the establishment of a federal fund.

He thought that the fiscal problem was not yet very important for the Latin American Free-Trade Area, but that it was so in relation to Central American economic integration, owing to the fact that integration was rapidly being intensified. It would be desirable to set up a group of experts to study the problem.

/The CHAIRMAN

The CHAIRMAN explained that Mr. Cazal and Mr. Baca, who were commenting on Mr. Cosciani's paper, had been chosen not in their personal capacity but as representatives of the Latin American Free-Trade Area and the General Treaty on Central American Economic Integration, respectively.

Mr. CAZAL said he did not oppose Mr. Cosciani's view that a customs union and a common market constituted extreme cases, but in his opinion Mr. Cosciani's definitions of a customs union and a common market were relevant to Europe and differed from those applicable to other parts of the world (see CPF-DB-7/Add.2).

Although it might very well be that in other regions problems of fiscal policy did not arise, they did arise in Latin America, because there were many countries whose revenue depended for example, upon customs duties, and when the various countries agreed to include a revenue-producing good in the common schedule of exemptions, the countries affected had to replace that source of revenue by another. Consequently, in Latin America a genuine problem of fiscal policy came to the fore even in the initial stage of product-by-product negotiations.

The basic objectives of the Montevideo Treaty establishing the Free-Trade Area were the progressive liberalization of existing trade through the gradual elimination of tax barriers, and an increase in the number of goods in which intra-Area trade was carried on.

As Latin America had no previous experience in the field of integration, study had been devoted to the problems that might arise and solutions had been sought before any measure was adopted. In that connexion, he thought Mr. Cosciani's remarks on some of the fiscal problems that had presented themselves in Europe, where considerable previous experience of integration had existed, were of great interest inasmuch as Latin America could profit by such object lessons and avoid stumbling into the same pitfalls. With reference to Mr. Cosciani's suggestions as to the establishment of a federal fund, he concluded that political integration would be needed to solve most of the difficulties, and that would lead to the definition of a principle which should be stated to the effect that the intensity of the problems was in inverse ratio to the intensity of integration.

Since all the Latin American countries were currently overhauling their fiscal policy, and in addition were striving after economic integration, it would be highly advisable to take future fiscal problems into consideration

/especially as

especially as many of them stemmed from the diversity of fiscal structures - and solve them in advance by endeavouring to introduce uniformity into the structures in question.

Mr. BACA described the events leading up to the General Treaty on Central American Economic Integration and the principles by which it was inspired (see CPF-DB-7/Add.1).

With reference to tax havens, he said that for the present there was no such problem in Central America, nor that of dual taxation, because the systems of direct taxations were very similar and because the tax on bearer securities, which offered most opportunities for evasion, was collected at the corporate level and at the same rate as personal income tax. The solution was not altogether satisfactory, since it discriminated against the large-scale business enterprise, which was precisely the type that should be encouraged.

In Central America the principles of taxation in the country of destination was always applied, since it was considered to be more equitable, especially as there were countries at a less advanced level of development than others, and it would not be fair for a less developed country to derive no revenue from the services rendered by the State for the protection of property and the development of enterprises belonging to foreigners.

Broadly speaking, fiscal problems did not seem very difficult to solve in Central America because the systems of the countries concerned closely resembled one another.

In reply to Mr. Cosciani's concluding remarks, he said that it had already been decided in Central America to set up a group of experts to study the problems in question, and the assistance of the Joint Tax Program would undoubtedly be requested.

Mr. PIEDRABUENA drew the attention of the meeting to the Montevideo Treaty. From the preamble it appeared that integration would soon be approached but the articles themselves were often too unspecific in their phraseology and made no provision for some aspects of fiscal policy that were liable to cause difficulties in future, and which, as Mr. Cazal had pointed out, were extremely important.

One of the first gaps in the Treaty was the lack of measures to rationalize or limit the use of incentives in Latin American countries to entice foreign capital. No mention had been made of the problems of double taxation, nor was

/there an

there an explicit statement as to whether countries had a unilateral right to exempt exports from payment of duty. The question of fiscal subsidies had been left unclear, and no attempt had been made to solve problems of monetary devaluation. Lastly, insufficient attention had been paid to the burden that social security contributions represented for enterprises and individuals taxpayers, which was a high proportion of the gross national product.

Mr. JARACH considered that the matter of tax havens was highly important in relation to a customs union or common market. The achievement of economic integration at the cost of fiscal disintegration would defeat its own ends. Mr. Baca's view was that in Latin America the repercussions of the problem on corporations were inconsiderable. Clearly, however, even if dividends were taxed at the corporate level, there was still a loophole for evasion, as holdings might be falsified and a shareholder might thus evade personal income tax. Systems of corporate income tax would have to be brought into line with those applied to natural persons. A possible solution would be to maintain a relatively high level of taxation on corporations, but to give the shareholder the option of having his share of the profits taxed as personal income, a corresponding credit being allowed for the tax paid by the corporation.

Mr. MENDEZ supported Mr. Cazal's points of view with respect to the gaps in the treatment of fiscal problems in the Montevideo Treaty which had just been pointed out by Mr. Piedrabuena.

The Free-Trade Area created by the Montevideo Treaty should be regarded as the first step towards a more complete type of integration. Since it was about to advance towards that goal, the problems that might arise should be studied without delay in order not to delay the subsequent stages of integration. Unless immediate consideration were given to those problems and their solution, the results would be as serious as those of failing to devise a system of payments which would ensure rational multilateral equilibrium in the Free-Trade Area.

Since the Free-Trade Area was already being beset by fiscal problems at its present stage of development, it was clearly necessary for the signatory States to take steps to remedy the lacunae in the Montevideo Treaty

/either through

either through a standing committee or by means of resolutions taken at the annual conferences which could subsequently be incorporated into the Treaty. Otherwise there was a danger that discriminatory practices or exchange, fiscal and monetary manipulations would invalidate the concessions negotiated under the Treaty.

Mr. MATUS considered that there were two major aspects of the analysis of fiscal problems in relation to the common market, and although it was true that one of them - the question of how to perfect fiscal mechanisms for economic integration - had been sufficiently elucidated, it was equally undeniable that the other, which concerned the reconciliation of the use of fiscal mechanisms for economic integration purposes with their application in favour of planning aims, had not received enough attention. The operation of a common market or customs union entailed the rejection of certain instruments that had been applied by planners, because they might have discriminatory effects on trade.

Moreover, there was good reason to fear that in the early stages the Free-Trade Area might aggravate the inequity of income distribution, since there would be a tendency to invest in the introduction of technological improvements in existing industries; and at the same time, a price policy designed to create better competitive conditions would be pursued. If political and social structures were taken into account, such competition in Latin America would probably not be reflected in a reduction of entrepreneurs' profits, but would affect wage policies. Such a situation would be counteracted if the common market encouraged the establishment of new industries, but that would not happen during the early years.

He agreed with Mr. Piedrabuena that social security contributions raised a serious problem in that context; a common market might possibly restrict the scope of such systems, and that would also help to perpetuate the existing inequitable distribution of income.

Mr. CAZAL explained that the reason why he had not touched upon the points raised by Mr. Piedrabuena and Mr. Matus was because he had wished to confine himself strictly to the agenda item under discussion, and he felt that the topics in question could not properly be regarded as fiscal matters. He concurred with Mr. Piedrabuena's opinion that though the preamble to the Montevideo Treaty spoke of final objectives, the operative part was much

/more cautious

more cautious without providing clearly-defined rules. It should not be forgotten that the Montevideo Treaty was not only describing a fait accompli but also sketching a programme of future achievements. As its objectives were gradually attained, solutions would be found for the different problems. Thus, for example, the Montevideo Treaty took no decision on the maintenance of concessions and the problems of discrimination that might arise therefrom. But at the most recent meeting of the Latin American Free-Trade Association (ALALC), a specific decision had already been adopted in that connexion. By degrees, all the aspects arising from the implementation of the Treaty would be covered.

With reference to Mr. Matus' comments, he did not see what limitations on the use of fiscal instruments for planning purposes were implicit in the establishment of a Free-Trade Area. On the contrary, ALALC was also concerned with planning, and a meeting of planning experts to discuss such matters had already been convened for the first quarter of 1963. In Latin America the problem was not so much lack of co-ordination in the use of fiscal instruments for economic integration and planning as the lack of planning itself, even in countries which carried great weight in the region.

Mr. MOISES asked Mr. Cosciani how the Treaty of the European Economic Community had dealt with the difficulties that might be caused by the existence of State monopolies. For instance, a State monopoly in a given country might try to eliminate competition by levying an indirect tax on the item produced at home or abroad or by charging lower prices than its competitors.

Mr. NAHARRO referred to the harmonization of indirect taxation for purposes of economic integration, which he regarded as a serious problem that was likely to cause great difficulties in Europe in the near future and should be given immediate consideration by the Latin American countries. The theoretical drawbacks and advantages of harmonization had been fully dealt with by Mr. Cosciani, but he was anxious for him to give the participants his personal opinion on the practical problems faced by the European Economic Community in that respect and their possibilities of solving them in future, because he was aware that Mr. Cosciani had closely followed the question.

/Mr. MONTERROSO

Mr. MONTERROSO referred to the question of monetary planning in the Central American market. One institution set up for that purpose was the Central American Integration Bank of which the five countries parties to the Treaty were members. The Bank took an active part in the work of planning since, before granting credit for new industries, roads, etc. it determined whether the use to which the funds were to be put would aid the process of integration.

Another institution was the Cámara de Compensación Centroamericana at Tegucigalpa, which had created an accounting currency - the "Central American peso" - that was equivalent to the value of the dollar at a given date, thus averting the dangers of monetary devaluation in any of the member States.

The Central American system was therefore more advanced than ALALC in that it was already making specific provision for the future.

Mr. COSCIANI, referring to Mr. Cazal's remark that the definitions of a common market and a customs union applied in Europe were different from those current in Latin America, said that he had put two extreme cases merely for simplicity's sake and that each treaty adopted brought into being unions which might resemble others in greater or in lesser degree.

With regard to the problem of the reform of fiscal structure, he thought that both short-term and long-term reforms would have to be applied. The former related to changes conducive to the creation of a customs union. With respect to the latter, which would pave the way for the establishment of a common market, it was advisable to proceed with caution to avert the risk of failure.

He agreed with Mr. Cazal that when a higher degree of integration was attained, it became easier to solve the fiscal problem and that it would ultimately be possible to move from economic to political integration.

He then referred to Mr. Baca's remarks to the effect that it was more equitable to tax goods in the country of origin than in the country of destination, because the taxes concerned could be regarded as payment for the public services by which an enterprise benefited, and ought therefore to be collected by the State providing the services in question. In his opinion, the tax ought to be applied in the country of origin of the good - as he had pointed out in his paper - subject to the necessary compensation because in that way uniform taxation on the consumer market could be

/achieved. The

achieved. The principle was not valid, however, in the case of trade between industrial and agricultural countries.

With regard to what Mr. Piedrabuena had said of the gaps in the Montevideo Treaty, he expressed the view that it was a trade treaty rather than anything else. He also agreed that there should be a high-level regulating agency.

He did not think that drawbacks could be established in respect of social security contributions, which were a form of taxation impossible to compute. In Europe no such drawbacks were made, but it was a problem that would have to be taken into consideration if the United Kingdom joined the Common Market, since social security costs were charged to the national budget.

In his opinion, the problem of specific taxes on consumption was insoluble, because the economic structure of the various countries differed, and if an attempt were made to tax similar goods and apply similar rates in all of them the financing of their budgets would be jeopardized.

With regard to the difficulties indicated by Mr. Naharro in the context of the harmonization of indirect taxes, he thought that the so-called "cascade" or multiple-stage taxes could be abolished, and that each country might establish whatever over-all tax it deemed most appropriate (a tax on value added or any other), with a system of exemptions.

In reply to Mr. Monterroso's question as to how the problem of monopolies might be tackled within a common market, he said that once such a market was established the creation of new monopolies would be prohibited, and that as far as fiscal monopolies were concerned, a distinction was drawn between fiscal revenue and business income.

The meeting rose at 7.10 p.m.

PROVISIONAL SUMMARY RECORD OF THE THIRTEENTH MEETING

Held at Santiago, Chile
on Thursday, 13 December 1962, at 10.20 a.m.

Chairman: Mr. MAGAÑA

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General discussion: Provisional report of the Conference on Fiscal Policy

GENERAL DISCUSSION: PROVISIONAL REPORT OF THE CONFERENCE ON FISCAL POLICY

The CHAIRMAN read a statement by Mr. Victor Urquidi, one of the participants at the Conference, whose pressing duties had compelled him to leave Santiago the previous day. Mr. Urquidi felt that the task of the experts at the Conference had not been to speculate on new forms of taxation, ingenious and interesting though they might be, but to deal with fiscal policy within the framework of existing political and social institutions and to guide it into areas which would, above all, increase the resources a Government needed in order to give greater impetus to economic development programmes as soon as possible. A critical examination of Latin American tax systems disclosed major defects, and as a result the countries concerned might be tempted to experiment with fiscal techniques which had been proposed in many parts of the world. He felt that while new possibilities should be studied, the basic course to follow was to improve existing systems, create improved fiscal structures and ensure a more efficient administration in order to overcome the many obstacles to reform, through public acceptance and a full understanding of the objectives sought.

In his view, the Conference had made it clear that most of Latin America was not lacking in the factors needed for a good tax policy directed towards economic development. There was growing awareness of the fact that fiscal policy as a whole - of which tax policy was a part - was but one feature of economic planning. Taxes were conceived in terms of their function in development plans, and that meant that the structure of demand and of supply had to be modified continually without necessarily following the indications provided by the free play of the market. Thus, many of the criteria which had so far prevailed in the more developed countries with respect to fiscal policy, and especially as regards the best way of combining the different taxes, would have to be revised and continually adapted.

/Discussions such

Discussions such as those held at the Conference should therefore continue, with the participation of experts from all over the world and of Latin American government officials and experts. At some future stage a joint meeting should be arranged between fiscal experts and tax administration experts and officials. Moreover, strong encouragement should be given to empirical research in fiscal questions, both in the Latin American countries themselves and in regional agencies such as the OAS, ECLA, the Latin American Institute for Economic and Social Planning and the IDB.

Lastly, Mr. Urquidi pointed out that while tax reform was a very powerful instrument contributing to the economic and social changes to which the Latin American countries had committed themselves under the Punta del Este agreements, there must be a clear definition of the scope of fiscal policy. It was not a question of either instituting forthwith a drastic tax reform, or else suffering a major economic and social catastrophe. There were many other elements militating in favour of the structural changes implied in economic development that were essential to an improvement in social conditions. Once the objectives were fixed, fiscal policy, in conjunction with other measures, could gradually and firmly be directed towards their attainment without having to bear the full responsibility for it. Moreover, it would be irresponsible to construe the delay required in the adoption and practical application of particular reforms as a weakening of the resolute aim of progress and social justice which the Latin American Governments had set for themselves and which were fully supported by the experts at the present Conference.

Speaking in his official capacity, the Chairman explained that the draft report before the Conference (Conference Room Paper No. 3) was an attempt to capture the sense of the participants with respect to the questions discussed, in the hope that the recommendations would prove useful to the Latin American countries. The comments made during the general discussion would no doubt require revision of some of the

/statements in

statements in the provisional report, which would be amended accordingly. The participants should bear in mind that the Conference was being held within the framework of the conclusions reached at the Punta del Este Conference regarding the economic and social objectives of the Latin American countries. The emphasis placed in the report on certain recommendations reflected the guidelines laid down at the Montevideo Conference.

Mr. PAZOS attached importance to Mr. Pinto's table on the social distribution of tax instruments. (See additional note to CPF/SR.8). He suggested that Mr. Pinto's percentage breakdown of the active population (5 per cent for the upper income level, 35 per cent for the middle income level and 60 per cent for the lower income level) should be changed to, say 15 per cent or 20 per cent for the middle income groups and 75 per cent for the lower income groups. He felt that would better reflect the true situation. He also suggested that the tax burden as given for the respective income groups was the desirable objective. The upper income group at present carried only 33 per cent of the tax burden and the lower income group was carrying 60 per cent.

Mr. WEISSEMAN stressed the need to relate fiscal reform to over-all economic and social development, and agreed that there was no dividing line between the legal structure and administrative techniques in the field of taxation. The report should emphasize the dedication of the countries concerned to move ahead in the field of fiscal policy within the framework of their legal structure.

Mr. NAHARRO said that while he realized the work which had been involved in preparing the draft report, recourse should be had to what was known in parliamentary circles as a "drafting committee" in order to correct not only a few drafting errors but also to make some changes relating to concepts.

Thus, with respect to the second paragraph of point 1, private investment and consumption was influenced by State action as a whole, particularly by certain types of action related to well-defined and

/accepted areas

accepted areas such as monetary, labour, industrial policy and so forth. Even if Mr. Urquidi's broad conception of fiscal policy were accepted, some limits must be set since the scope of the concept was somewhat vague. The danger of the text in the draft report was that it was less the exposition of a concept than the drawing up of a list. The solution might be to relate the fiscal instruments proper (revenue and expenditures) to the others by inserting the words "through them" before the reference to private investment and consumption.

In the first sentence of point 3, it was stated that the single most important cause for the insufficiency of public revenue was the failure of the tax system to impose effective levies on the propertied classes. That was but partly true since the insufficiency should also be attributed to deficiencies in tax administration. However, even if the statement were correct, it would seem impolitic to single out a segment of society which, after all, was part of the nation with the same rights as all other citizens. He therefore suggested that the administrative deficiences should also be mentioned, and that such clauses as "one cause" or "another cause", etc. should be used.

With respect to the last paragraph of point 7, he thought that a more suitable place should be found for it in the draft report since it dealt with a thorny subject - the added value tax - on which the views of participants had not been sufficiently aired. It would be wise, in any event, to delete whatever the paragraph included in the way of a potential threat to taxpayers in describing the possible use which the tax authorities could make of the data presented.

At the end of point 12, he suggested the addition of the words "and sometimes put a premium of inefficiency" on the part of enterprises with low yields resulting from poor organization, etc., in other words, the exact opposite of the economies of scale.

Lastly, he deplored the fact that, save for an inadequate reference in point 12, nothing was said in the draft report about the important function of tax incentives.

/Mr. PREST

Mr. PREST said that an economist should not compromise on his technical expertise because of political or allied considerations. There were three levels at which an economist could operate - he could analyse the effects of different taxes on prices, outputs, capital formation, etc., he could advise a Government that if it wished to follow a given policy, it should apply a particular tax or taxes, or he could tell a Government that income distribution should be changed, and indicate how that could be done by taxation. For the last two courses of action detailed statistical data were required, and the third involved political preconceptions. He believed that the lack of substantial statistical data before the present Conference precluded any expression of precise views as to what should be done. Tracing the effects of a tax was something very different from recommending that Governments should adopt it, particularly with reference to twenty different Governments.

With respect to the draft report itself, he was strongly opposed to the first six paragraphs. The first sentence in point 2 seemed to imply that increasing public revenue should take priority over all other political and social changes, and in the light of the declared aims of the conference, appeared sweeping and even somewhat arrogant. The next sentence stated that increased revenue would enable Latin American countries to spend more on development, whereas in fact it would enable Governments to spend more for such purposes; that implied a judgement of a political character which would be out of place in a report issued by the present Conference. The draft report went on to suggest that sizeable deficits in the public accounts in Latin America aggravated the unequal distribution of income and wealth, although no evidence had been produced at the conference in support of that view. There were other statements not thus far supported by any evidence, with respect to the low revenue obtained from high marginal rates (point 9), the tendency towards a growing concentration in the ownership of wealth (point 16), excessive concessions to foreign enterprises (point 17), and the proportion of sales from public enterprises going to private enterprises (point 19).

/In addition,

In addition, there seemed to be possible inconsistencies in the arguments set forth - for example, was agricultural income to be taxed both under personal income tax and under the land tax? And how was it proposed to combine a system of high excise taxes on locally produced goods with the protection of developing local industries? Lastly, he doubted whether it was advisable to go into the degree of detail included in the draft report with respect to certain taxes, such as the specific rates of taxes on income and net wealth.

Having dealt with the faults of the draft report in its present form, he turned to the question of the form it should take, and suggested that it should be confined to a summary of the different views expressed by the participants, including as many shades of opinion as possible, such as the opposing views on whether land taxation should be proportional or progressive, the relative merits of the corporate income tax and the value addedtax, and so forth. It would not be advisable to state that the conference as a whole agreed on particular points, or to include detailed recommendations about policy, and the report should go on further than to draw the general attention of the Governments concerned to the issues raised in the papers and discussions. It would be quite inappropriate for a conference organized by respected international organizations to express views that were essentially political rather than economic. If it appeared that other participants did not share his views, and the document retained its present form, he must ask to be disassociated from it.

Mr. MONTERROSO congratulated the sponsors of the conference, and expressed his general agreement with the draft report. However, there were some points on which he disagreed. Firstly, he thought the definition of fiscal policy was too broad, and should be amended as suggested by Mr. Naharro. Secondly, the report did not seem to attach much significance to the redistributive aim that fiscal policy should have, or to give sufficient emphasis to the importance of the role that public expenditure should play both in redistributing income and in economic development in the various countries. Nor was there much

/recognition of

recognition of the importance for under-developed countries of increasing their expenditure on education and on transfer payments, or on the economic effects of public expenditure and of the national debt. Thirdly, he could not agree with the statement in point 8 that there should not be exemptions of income tax on such income as the interest on government bonds; if such exemptions were appropriate in highly industrialized countries such as the United Kingdom, the same type of tax incentives must be regarded as necessary in much less developed countries, where there was only a rudimentary form of stock market. Fourthly, he suggested that the second paragraph of point 7, stating that there was no substantial indirect taxation of home-produced luxury articles, which now accounted for "the greater part of luxury consumption", should be amended so that the reference was to "a large part of luxury consumption", since even the most developed Latin American countries did not produce a substantial proportion of such goods.

Mr. ABINADER thought that it would not be appropriate to suggest specific rates of taxation in the report and that the section on the taxation of agricultural property should be drafted very carefully since it was a controversial subject. He agreed with Mr. Pazo's remarks on Mr. Pinto's table.

Mr. GOODE said that he could not agree with the Chairman as to the relative importance of the report of the Conference, and thought that the papers presented, and the record of the discussions, should overshadow the report. It would be imprudent for the Conference to adopt such a specific and detailed document as the present draft.

He did not believe that the statement in point 3 that the failure to tax the propertied classes was the single most important cause of the insufficiency of public revenue was based on confirming evidence, and he would not endorse it as a general proposition applying to all countries. The last sentence in point 7 referred to a universal value added tax, which presumably meant one applying to agriculture and self-employed professionals, as well as industrial and commercial

/enterprises, but

enterprises, but the Conference had never discussed a value added tax of that nature. Nor could he accept the general pronouncement against exemptions such as interest on government bonds or mortgages, in point 8, which though usually inefficient might sometimes be useful. The specific rates mentioned in point 9, though useful as illustrations in the discussions, were out of place in a final report that would be widely read; rates must depend on conditions in the country concerned. The statement in the next paragraph that all change of ownership of capital assets should be recognized and taxed as capital gains was too sweeping. In point 10, the suggestion that there should be a progressive tax on net wealth in addition to a progressive income tax should be represented as advocated by some, or a few, of the participants, rather than a general suggestion emanating from the Conference as a whole. The implication in point 12 that low rates of corporate income tax would favour foreign governments needed further clarification. Although he himself supported the idea of taxing income on a world-wide basis, as suggested in point 18, he was not sure that that view was widely supported by other participants.

His criticisms were based on the fact that he took a different view of what was the appropriate nature of the final report of the Conference, which should be more modest in scope than the present draft.

Mr. VEGA congratulated the Chairman and his colleagues on the draft report now being discussed. He proposed the following amendments:

The last paragraph of point 1 should read as follows: "In this connexion, it should be pointed out that fiscal policy includes all State action which influences the amount and composition of public expenditure, including the problems posed by the external and internal debt, international treaties and common markets and the operations of State agencies. Fiscal policy should, moreover, influence private consumption and investment, in order that these economic factors should contribute to the economic growth of the countries."

/The following

The following sub-clauses should be added to point 6: "(viii) The provision of suitable incentives to private investment with a view to securing a harmonious growth of the economies; (ix) Fiscal reform should include both the legal and administrative aspects."

The following sentence should be added to point 15: "This recommendation is, of course, valid only in those countries where it does not conflict with legal or constitutional provisions."

The following new point should be added to the report: "20. Since capacity to pay is the chief factor in taxation, the Conference believes that some government works and services should be self-financed, either on the basis of well-calculated rates or of taxes related to the principle of the benefit received."

As a general recommendation based on orderly arrangement, he proposed that all the points dealing with the same subject or the same tax should be brought together.

Mr. DESAI agreed with other speakers that the report should include some reference to incentives. There should also be a reference to Mr. Herschel's suggestion that more fiscal research was required. In point 7, a single sales tax with a broad tax base was recommended, in place of excise taxes, but Indian experience suggested that a sales tax was very difficult to administer compared with an excise tax; if the tax was to be broad-based, a value added tax would be preferable. He agreed with Mr. Goode that the reference at the end of point 7 to a universal value added tax was incorrect. In any case, the conference should be cautious in recommending a tax which was comparatively new in practice. He also agreed with Mr. Goode about the inadvisability of including specific rates and suggested that the reference in point 10 should be to a multiple of the per capita income rather than to the specific multiple of twenty. He would like to see in point 16 a reference to his suggestion that gift and inheritance taxes should be combined in a single accession tax. He would also like to see special emphasis on the fact that whatever the fiscal capacity of the

/Latin American

Latin American countries might be, it far exceeded the present revenue collected. There should also be more emphasis on the obligation of Governments to spend wisely. The second paragraph of point 1 seemed irrelevant, and if included in the final report should be redrafted to read: "In this connexion, fiscal policy must be broadly related to all State action which influences...."

Mr. HARBERGER said there appeared to be a difference of views as to the degree of strength appropriate to such a report. He thought that it was generally agreed that Governments needed to spend more on development. That did not imply any conclusion as to what should be the scope of the public sector, since it was recognized that even in accordance with any minimum concept of that scope, not enough was being achieved in Latin America, and he cited educational services as an outstanding example. With respect to the criticism that not enough data had been presented at the present Conference to warrant certain types of conclusion, he said that if statements made in the presence of acknowledged experts in the field from the countries concerned were not disputed, they could be regarded as accurate. As for the general tone of the report, he pointed out that the same tone had already been adopted in official agreements signed by all the Governments concerned, with the exception of Cuba, and that the Act of Bogota and the Charter of Punta del Este implied acceptance of the facts on which the draft report was based. It did not appear amiss to maintain a tradition already embodied in the official policies of the countries of the hemisphere.

Mr. HERSCHEL considered that the task of experts, far from being confined to an analysis of developments and of institutions, should also include making practical recommendations that Governments could use in working towards their economic development objectives. He explained the reasoning underlying certain parts of the report. He agreed with what Mr. Naharro had said about the last part of point 1, but not with what Mr. Naharro and Mr. Vega had said about incentives, since he himself

/considered that

considered that there had been general agreement at the Conference in condemning the abuses to which a policy of tax incentives could lead. He agreed with Mr. Pinto's suggestion for a systematic integration of the various taxes.

Mr. LEWIS suggested a number of drafting changes, which he said he would hand to the secretariat.

Mr. COSCIANI said that he agreed with the criticisms levelled by other speakers at the second paragraph of point 1, and he proposed that the very broad expression "all State action" should be replaced by the more precise expression "all action relating to the national budget". He did not consider that the reorganization of fiscal systems proposed in point 4 need be "comprehensive"; it would be sufficient if the reorganization were described as extensive. He asked what was meant by "heavier taxation" in sub-section (iv) of paragraph 6. He doubted that the list of purchases compiled as a basis for calculating the value added tax could be used as suggested in the third paragraph of point 7, and said that the system of records employed for that tax in France and Italy did not lend itself to such a use of the tax. He did not think that capital gains should be liable to income tax, as stated in point 8. He also thought the reference to suggested rates of personal income tax in point 9 inappropriate, and that a more general formula based on parameters would be preferable to listing percentages. He was also opposed to a register of transfers of assets, as proposed in the second paragraph of point 11, on the grounds that the system would be incomplete and should not be recommended for under-developed countries. Nor did he agree that personal income from agriculture should be imputed on the basis of the value of the properties concerned, as maintained in point 15.

He concluded by saying that he was not in complete agreement with the draft report as a whole, and consequently reserved the right to dis-associate himself from it, and to make public comments on the work of the Conference.

/Mr. PINTO

Mr. PINTO was generally in agreement with the character of the draft report, which contained recommendations and was not merely descriptive. While he intended to submit a number of suggestions to the executive officers which, in his view, would improve the report, he wished to make a general comment on certain taxes.

With respect to the personal income tax, dealt with in point 9, he asked whether the tax base was to be narrow or broad. That was an important consideration in taking a decision regarding the proposals contained in that point. The intention of the drafters was not clear from the present wording.

Mr. BACA agreed with the general tone of the report, particularly with the emphasis placed on the yield both from the income tax and from indirect taxes in so far as they were levied on the middle and high income groups.

In his view, the wording of point 6 of the draft report could be improved by amending sub-clauses (i) and (iii) and rearranging the order of sub-clauses (iv) and (vii).

He was opposed to the special taxation of articles of luxury consumption which was suggested in the second paragraph of point 7 as a means of augmenting yield.

With respect to points 17 and 18, he was skeptical as to the possibility of obtaining practical results from the information which foreign countries were expected to provide under the recommendation in the draft report.

Mr. DARDON said that he wished to refer only to two points in the draft report. The first was the definition of fiscal policy. He did not believe that it was or should be an essential aim of the experts participating in the Conference to seek a definition, in the strict sense, since that would seem to imply that they did not already have a full understanding of that concept, which was completely untrue. The problem was to analyse what was the scope and content of the concept of fiscal policy that would help in attaining the aims and objectives of the Conference. Consequently he considered that the second part of point 1 of the draft report should be so redrafted as to take account of that view.

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The second point related to the alternative set forth in point 15 of the draft report. As he had stated when the self-assessment procedure had been discussed earlier, it was already used in Guatemala but not in the form of forced sale of properties recommended in point 15. That alternative method conflicted with the right to dispose freely of private property which was enshrined in most of the constitutions of the Latin American countries. To include it in the report might therefore give rise to harsh criticism by the sectors concerned, not only of that particular point, but of the whole philosophy of the report. Consequently he suggested that the paragraph in question should be deleted altogether, in order to obviate criticism that might prejudice the aims of the Conference.

Mr. DESCARTES agreed with those who had suggested that emphasis should be placed in the report on the operating machinery of fiscal policy, in other words the application and administration of fiscal measures. He also supported those who favoured the inclusion of a paragraph on tax incentives, and shared the view of the participants who were opposed to the inclusion of specific rates of taxation. He felt that the reference to the value added tax in point 7 should be toned down somewhat since no agreement had been reached as to the applicability of such a tax.

On point 8, he agreed with Mr. Goode that the objection to exemptions on interest on government bonds or mortgages was not valid.

On point 10, the word "agreed" was too strong. Something like "the view was expressed" was better.

The first sentence in point 15 was more applicable to the least developed countries than to Latin America as a whole. The references to self-assessment gave the wrong impression, since it was at best a short-term measure. That should be pointed out in the report.

With respect to taxation of agricultural land, the support expressed at the Conference for the proposals made in Mr. Wald's paper was not reflected in the report.

/He agreed

He agreed with the views expressed in point 18, but with respect to point 19 he felt that the report should point out that the price of public services in Latin America should not only cover costs but should also provide social benefits.

Mr. KALDOR said it was for the Latin American countries to decide whether or not they agreed with the basic message of the report as drafted, and were willing to face its implications. That message was that the weakness of the Latin American tax systems lay in their inability to get at the income from property, which represented such a large share of the national income. If the system was to be changed so that the propertied classes bore their fair share of the tax burden, radical action was required; capital gains must be treated as income, and there must be a full disclosure of individual wealth to enable the tax authorities to verify individual returns in relation to income from real property or shares, and the possession of capital assets. He did not agree with Mr. Cosciani that bearer shares were an essential requirement in under-developed countries. They should either be abolished, or information about their ownership should be made available through a system of deposit with registered banks that kept a record of owners that would be accessible to the tax authorities. The basic proposition before the conference was that it was wrong for the capitalist classes to escape taxation. The technical question followed of whether it was possible to introduce a system to tax those classes effectively, and if so, what the implications would be. Experience in India and Ceylon showed that it was not impossible to establish a net wealth tax in under-developed countries. The difficulties were political, not technical. Some Latin American participants had said that not enough stress had been placed on income redistribution, which amounted to the same as forcing the propertied classes to surrender to the State their due share of tax.

He agreed that the reference in the draft report to the value added tax should make it clear that the subject was merely aired, without any conclusions being reached. The fact that in France it was not used to

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provide a framework for the administration of other taxes did not mean that it could not be so used; there was no reason not to take advantage of the potential self-reinforcing features of that tax. He agreed with other speakers that the second paragraph of point 1 was not useful, and thought it could well be deleted.

Mr. RODRIGUEZ MOLINA felt that great care should be taken in the drafting of the report before it was published in order to avoid criticism which might deform and even vitiate it. While there might be agreement on the basic points, he felt that the final report should be limited to the necessary general appreciations and considerations. Several alternatives should be provided so that a choice could be made depending upon the different cases involved and the individual characteristics of each country.

With respect to point 2, he felt that emphasis should be placed not only on the need to increase revenue but also to programme public expenditure and to control it properly so that it might contribute effectively to the desired economic development. A recommendation that State agencies must be efficient should be made.

In connexion with point 3, the general comments made were not quite suitable. Each Latin American country had its own peculiar conditions, and it should therefore be left to each State to make use of tax incentives in the way best suited to its needs.

The meeting rose at 1.25 p.m.

PROVISIONAL SUMMARY RECORD OF THE FOURTEENTH MEETING

Held at Santiago, Chile
on Thursday, 13 December 1962, at 3.40 p.m.

Chairman: Mr. MAGAÑA

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General discussion: Provisional Report of the Conference on Fiscal Policy (continued)

GENERAL DISCUSSION: PROVISIONAL REPORT OF THE CONFERENCE ON FISCAL POLICY (Continued)

Mr. HART said that the value of a report from the Conference lay largely in that it gave the economist participating in a tax reform discussion an insight into the opinions of his colleagues in other countries. From that standpoint, the authors of the provisional report were right to discuss many types of taxes.

It would be desirable to recommend that a strong and well-integrated combination of the suggestions made in the report should be adopted, and to point out that each suggestion had its economic merits and deserved serious consideration in every country where it would be administratively feasible.

In view of those two suggestions, an effort should be made to keep intact the list of objectives in paragraph 6, since if the items were quoted separately they might be misinterpreted. For instance, it might be assumed that to enact a tax was to put it into effect. Defects in administration could so distort a good tax that its application might do more harm than good.

He wished to make a specific suggestion, i.e. that the following sub-paragraph be added to paragraph 6:

"6 (viii) Establishment of an objective and co-ordinated system of administration, using each tax to give more solidity to others, so as to guarantee that the benefits of substantive reforms will not be lost in administration."

Mr. JARACH suggested that a preface should be added to the report in which it would be clearly stated that, although the conclusions reached by the Conference were based on a general consensus of opinion, reservations had been expressed by some of the participants.

With respect to paragraph 2 of the provisional report, the words "the overriding problem" in lines 1 and 2 should be replaced by "one of the overriding problems".

The list of points in paragraph 6 did not include any mention of the co-ordination of personal income tax with the net wealth tax. In point (iv) of

/the same

the same paragraph, the words "the imposition of heavier taxation" should be replaced by "the imposition of taxes with particular incidence on real property". Some indication should also be given that the tax on rural property ought to be applied as an alternative, when such co-ordination could not be achieved.

With respect to paragraph 10, he considered that a progressive tax on net wealth would be a little too severe, and that a proportional tax would be enough to serve its purpose. With further reference to the same paragraph, he thought that it was dangerous to give examples of low rates. It would be more desirable to define a moderate rate.

Paragraph 15 contained a conceptual error since it was the value of capital that was determined on the basis of potential income instead of vice versa.

Mr. MENDEZ said that it was necessary to amplify paragraph 5, bearing in mind the view put forward by various participants that stress should be laid on the need to rationalize and co-ordinate fiscal expenditure, in order to ensure that it played a useful part in economic and social development and provided an effective instrument for redistributing income.

It had been suggested that the systematic application of integrated development programming and the adoption of public investment plans would be particularly effective for achieving those aims, since they would enable a proper assessment to be made of how far public expenditure could and should be in co-ordination with the interests and requirements of the private sector in the process of development, and allow such expenditure to be distributed in the way that would most conduce to a progressive solution of social and economic problems. For the satisfactory implementation of public investment plans, he specifically stressed the value of the technique of programme budgeting, which was already being applied in some Latin American countries.

He also pointed out that, as part of the movement towards economic integration, which was already under way in Latin America, studies should be undertaken on the problems of fiscal co-ordination that might arise in the course of integration, in order to prevent certain fiscal practices from distorting trade transactions among the countries concerned.

/Mr. MOISES

Mr. MOISES suggested a new schema for the presentation of the report, going from the general to the particular and from points on which there was unanimous agreement to those with which only a minority concurred, since he had observed during the discussion on the report that the participants agreed on theoretical aspects but differed considerably when they came to deal with specific taxes.

The CHAIRMAN thanked Mr. Moisés for his suggestion but thought that it would be possible to take into account all the views expressed by the participants without changing the presentation of the report.

Mr. PORRAS said that successful achievement of the aims of fiscal policy depended on the instruments used. That was why it was important to improve financial techniques. Changes could be made in the legal structure at any time, but they should be accompanied by a reform of the financial administration. Such a reform would not be easy, but it was essential to break down administrative apathy, and time was needed to perfect the technique and even the hierarchy of administration.

With respect to paragraph 3, he pointed out that equity could be achieved not only through a revision of the tax laws but also through financial administration. It was essential for the tax laws to be codified.

He suggested that the following sentence be added at the end of paragraph 4, in order to make it quite clear that the purpose sought was redistribution of income: "in such a way as to enable highly regressive taxes to be abolished or at least substantially reduced in favour of the lower-income groups that form the bulk of the population".

In relation to paragraph 8, he pointed out that in countries where capital was scarce, incentives had to be created for the purchase of Government bonds by private persons. Accordingly, he thought that the interest on bonds or mortgages created for economic development purposes should be tax-free.

He also considered that the rent of owner-occupied property should be assessed and taxed.

The net wealth tax referred to in paragraph 10 would, in his opinion, be difficult to apply in the absence of an efficient tax administration.

/In connexion

In connexion with paragraph 14, it seemed to him that if the objectives of land reform were to be achieved, tax administration should be in the hands of the Central Government.

He was not in agreement with the view put forward in paragraph 14 that the author of a bid that had been rejected should share in the tax increment, because it would be difficult in such circumstances to ensure that the bids made for properties were bona fide.

Mr. RAPOPORT agreed that greater significance should be attached in the report to the management of public funds, particularly since the only way to enlist the co-operation of the private sector was to convince it that the government authorities were make effective use of their funds for useful purposes and were not wasting them through superfluous expenses such as adding unnecessarily to the number of civil servants.

The guidelines laid down by Mr. Pinto regarding the distribution of national and fiscal income served a useful purpose, although he did not think that specific figures should be included. In Argentina the structure was similar to the one presented, although it might be different in other countries.

With respect to the description of rates, he thought that the term "moderate" was inadequate and should be replaced by "equitable, reasonable or fair".

He felt that the tax on net wealth would have a progressive effect even though the rates might be proportional. There was no need to mention specific rates.

Mr. MATUS said that he knew a great many people who were sceptical of the objectives of the Alliance for Progress because they considered them to represent a long-overdue reaction, but until the present Conference he had not encountered conservatives who looked upon the principles of the Alliance as too progressive and opposed income redistribution and planning.

The statement made by Mr. Prest at the previous meeting had led him to doubt the interpretation, since Mr. Prest had seemed to him to be asking for proof of things that were self-evident to everyone. No one present could doubt that tax evasion was practised by the propertied classes

/or that

or that they should make a fundamental contribution to economic development. He fully agreed with Mr. Harberger's replies to Mr. Prest during the same meeting.

There were several gaps in the provisional report that should be filled . No criticism of market forces had been made nor had any definite statement been made with respect to the general framework of a tax system. In that connexion, Mr. Pinto's should be taken into account and an analysis included of the intercontrol mechanisms that operated among the different taxes. Lastly, the use of taxes to promote development had not been explored. In paragraph 2, reference was made to fiscal deficits in relation to stability. He assumed that the authors of the report were not attempting to suggest that if deficits were eliminated stability would be achieved. If so, the paragraph should be redrafted. Moreover, frequent references were made to the distorting effects of indirect taxes which was absurd since a great deal of distortion already existed. Arguments of that kind should be suppressed or the report would have an old-fashioned flavour. He regretted that more attention had not been paid to the taxation of foreign enterprises.

With respect to public expenditure, he fully supported the remarks made by Mr. Mendez, and added that greater details should be given on the budget as a short-term plan of action. The examination of incentives in the report was sketchy. The fact that their importance had been exaggerated in the past did not mean that they should be entirely overlooked in the present.

He also pointed out that the report failed to deal with the fiscal aspects of a common market.

He fully agreed with the political tone of the draft report, which was in line with contemporary thought, but he thought that it smacked too much of the tax expert.

The CHAIRMAN explained that the question of programme budgeting had not been dealt with in detailed for fear of making the report too lengthy. He said that point 7 dealt with the subject of foreign enterprises. An attempt would be made to minimize the tax expert approach criticized by Mr. Matus.

/Mr. CASAS

Mr. CASAS agreed with Mr. Jarach that a paragraph should be introduced into the report explaining that the ideas included did not necessarily represent unanimous views. He suggested that the first sentence of point 2 should read "The participants of the Conference were in agreement that from the standpoint of the aims of fiscal policy the overriding problem of Latin American countries is to increase public revenue both by means of taxation and through an increase in the income of private enterprises". In point 3 he thought that the phrase after "the tax system" should be replaced by the phrase "impose effective levies lower than the the capacity to pay". He considered the idea of compulsory registration of transfers of assets to be naïve. Lastly, he suggested that the report should include a reference to the need for every country to make a careful study of the distribution of the tax burden, and of the methods resorted to by taxpayers to evade income tax.

Mr. GNAZZO thought that the draft report adopted the correct approach, but he agreed with Mr. Jarach as to the desirability of indicating that in some cases there might be basic objections by certain participants. He agreed with Mr. Mendez on the need to expand the reference to public expenditure. He thought that the scheme suggested by Mr. Pinto might be included as an item of general economic policy, but that it would not be useful to include his figures, since those would have to vary according to circumstances. He suggested that a sub-item (vii) should be added to point 6, referring to incentives, the co-ordination of taxes on wealth and income, the ideas on tax administration put forward by Mr. Hart, and the need to codify and simplify tax legislation.

Mr. VIDAL supported the idea of including a paragraph explaining that there were differences of opinion, to be found in the summary records and in other conference documents. He also pointed out that there was no reference whatever to tax incentives. Referring to point 4, he said that there should not be any reference to the introduction of new taxes, since the question was rather that of reorganizing the taxation system.

Mr. JATAR agreed that the paragraph on public expenditure should be expanded, and thought it was important to distinguish between incentives, more liberal depreciation allowances and deferred compensation for losses.

/Mr. FERNANDEZ

Mr. FERNANDEZ considered that the report should have referred more directly to the aims and methods of economic development.

Mr. LESSA agreed with Mr. Matus' remarks on price distortion, since the purpose of indirect taxation was precisely to change relative prices. As regards taxes on luxury goods, he thought that the meaning of the term should be clarified. It should be explained that it referred to superfluous consumption over and above that of the mass of the population. With reference to paragraph 12, taxes on corporate income should be based on the rate of return, irrespective of the amount involved.

Mr. PIEDRABUENA said that a special paragraph on inflation should be included. He believed that the net wealth tax should not be a special tax but a complement to income tax. The references to corporations should include some mention of the incorporation of the masses into the capital formation process, as being one of the aims sought. With respect to paragraph 15, he did not agree with the idea of self-assessment or the punitive measures suggested. Other omissions in the report that should be repaired concerned tax policy in relation to ALALC and the question of planning.

Mr. MARTINEZ was of the opinion that the second paragraph of point 2 should not refer to the expansion of revenue to provide more funds for current expenditure, since the phrase was open to misinterpretation. Paragraph 6 should outline a general framework for tax reform, with due regard for the suggestions made by Mr. Matus and Mr. Pinto.

With respect to the mention made in paragraph 3 of the need to tax the propertied classes, some indication should be given that, apart from reasons of equity, such taxes represented the price they should pay for maintaining their privileged position.

Mr. HARBERGER remarked that Mr. Lessa's statement was not incompatible with his own views. The important thing was simply not to lose too much fiscal revenue through the application of the systems in question.

With reference to point 6 (iii) of the provisional report, he suggested that it be recast as follows: "The collection of more revenue from taxes on urban and rural property, which are additional to personal income taxes on the income derived from such property and which should also be co-ordinated with other forms of special taxation of income from property".

/He further

He further suggested that sub-paragraphs (iv) and (vii) be combined and replaced by the following: "Tax incentives are a powerful instrument for channelling the resources of an economy toward the desired ends and preventing their diversion to less important uses. They should nevertheless be carefully studied with a view to ascertaining whether they can obtain results without unduly reducing fiscal revenue. It should also be pointed out that tax incentives are more effective in changing the distribution of investment than in increasing its total amount, owing to the fact that an increment in the said amount can be obtained only if a country's total savings increase".

Mr. KALDOR had two comments to make. Firstly, he agreed with Mr. Harberger's remarks on incentives, but thought they should be rephrased so as to stress the point that true incentives did not imply a loss of revenue but were actually a stimimulus to production.

Secondly, he thought that if the report was to be prefaced by an introduction of the kind proposed by Mr. Jarach, he did not think that the inclusion of the net wealth tax would commit its opponents too deeply. It should not be included as a kind of tax on real property, however, since it was a new idea, which, as some speakers had emphasized, should be integrated with progressive income tax if introduced at all. The need for integration, which would considerably increase the efficacy of income tax, should be underlined in the relevant paragraph of the report.

Mr. GOODE thought that a strong case could be made for the net wealth tax on grounds of economic expediency and justice, but wondered whether it would be possible to apply it in Latin America at the present stage of its tax administration. The tax was not widely used, being most successfully applied in Sweden and the Netherlands where the tax administration was particularly good.

Mr. KALDOR stated, with reference to Mr. Goode's remarks, that he knew of eighteen countries where the tax was being applied in a progressive way and always at a low rate of about 2 per cent. He agreed that it was not an easy tax to apply since it required a full disclosure of property on the part of the taxpayer, but did not consider that it was any more difficult than either income tax or the tax on capital gains. It was necessary to draw attention to the difficulties of application in the report, but no distinction should be made between one tax and another.

The meeting rose at 6.50 p.m.