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TAX POLICY RECOMMENDATIONS OF TECHNICAL ASSISTANCE MISSIONS:
EVOLUTION, PATTERN, AND INTERPRETATION

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TAX POLICY RECOMMENDATIONS OF TECHNICAL ASSISTANCE MISSIONS:
EVOLUTION, PATTERN, AND INTERPRETATION*

1. The Fiscal Policy Conference sponsored by the Joint Tax Program of the Alliance for Progress offers a particularly timely occasion for a review and analysis of the tax policy recommendations of technical assistance missions. More than a decade has now passed since the last comprehensive examination was made of technical assistance recommendations in this field (The Technical Assistance Conference on Comparative Fiscal Administration, Geneva, 16-25 July 1951) [54] and it should be recognized that at the time this Geneva Conference was held there existed only three to five years of technical assistance experience in the area of taxation. The considerably greater body of reports now available provides a much firmer basis for determining the general pattern of recommendations with respect to a much larger number of economically less-developed countries, and the experience of an additional eleven years offers an opportunity for studying any evolution in thinking that may have taken place among technical assistance experts working in this field.^{1/}

2. In reviewing the reports submitted by various missions, special emphasis has been placed on selecting those policy issues and recommendations which are

* The author wishes to express his sincere appreciation to Mr. Martin R. Blyn; without his excellent summaries of a considerable number of reports by technical assistance missions, this study could not have been written.

^{1/} The numbers in brackets [] that are to be found in both the main text and the footnotes refer to the "List of Cited Technical Assistance Reports and Other References", which is appended to this report. This appeared to be the least cumbersome procedure in view of the considerable number of documents cited and of the many instances of multiple citation of the same document.

considered to be of particular interest to the Latin American countries.^{2/} In this connexion, however, the reader should keep an extremely vital point in mind -- namely, that no two technical assistance reports can ever be completely comparable. This is because the recommendations of any given mission necessarily evolve from the mutual interaction of three variables: A) the formal terms of reference specified by the host government (e.g., investigation of the impact or administration of an individual tax or group of taxes, qualitative review of the tax system as a whole, analysis of the optimum method for raising a specified amount of government revenue, determination of the level of taxable capacity with a view to discovering the optimum level of government expenditures, the relative priority assigned to economic development, social reform, and other objectives of government, etc.); B) the analytical frame of reference implicitly or explicitly assumed by the particular expert or experts involved (e.g., the nature of economic growth and of the relative roles of the government, industrial and agricultural sectors, the comparative importance of the effects of taxation on equity, incentives and resource mobilization, the degree to which tax policy is believed to be influenced by the stage of economic development or under-development, etc.); and C) the economic and political characteristics of the individual country at a particular

^{2/} With the exception of one or two very recent missions, it was originally planned to limit the technical assistance reports to be covered to those included in the list compiled and published by the United Nations Technical Assistance Administration. [54] [55] However, when it was discovered that limitations of time would preclude complete coverage of this lengthy official list, priority was given to those missions which served Western Hemisphere countries and dependencies, and what is considered to be a reasonably representative selection was made from the reports of missions to other areas.

It should be recognized, moreover, that all references are to be interpreted as illustrations of particular points of view and not as an exhaustive catalogue of recommendations; no attempt has been made either to refer to every report which was examined or to include the viewpoint of each mission on every policy issue. Furthermore, whenever direct reference has been made to a report which is still classified as "restricted", extreme care has been taken to ensure that the observations are of a general nature and not critical of the specific tax system of the particular country.

moment of time (e.g., receptivity of social blocs to tax reform, size and distribution of the national income, degree of industrialization and urbanization, importance of foreign trade, rate of inflation, etc.). In the light of the large number of individual possibilities inherent in each of these underlying variables, and given the vastly greater number of combinations and permutations that can exist among the three, the chances are exceedingly small that any two technical assistance reports will ever raise precisely the same issues in either an explicit or implicit fashion.

3. Any analysis of the kind undertaken here must, as a consequence, inevitably involve a considerable amount of personal interpretation on the part of the writer with respect to a) selection of and emphasis upon those questions and issues which are considered to be most important and revealing and b) judgment as to what answers to these questions are clearly implicit in the analysis of individual reports in cases where the experts do not themselves raise the particular issues explicitly. The present writer assigns the highest priority to the views of the missions on broad views of tax policy; not only is this the only way in which the various reports can be placed in common perspective and on a broadly commensurate basis, but an understanding of the differences which arise on the subject of overall tax policy also provides a useful explanation of most conflicts which exist in the case of more specific policy issues. On the other extreme, comparatively little weight is given to purely administrative considerations--except, of course, when these exercise a direct influence on tax policy recommendations; this procedure appeared sensible in the light of last year's Conference on Tax Administration which was also sponsored by the Joint Tax Program (Buenos Aires, 11-19 October, 1961) [52].

I. The Views of the Missions on Over-all Tax Policy

4. A convenient standard by which to begin an appraisal of the views of the missions on over-all tax policy is on the basis of their degree of agreement or disagreement on the question of tax differentiation with respect to source of income and kind of consumption expenditure. This point of departure assumes particular significance when it is recognized that such differentiation runs counter to the only two canons of taxation, namely neutrality and equity, that are universally accepted in the modern economic theory of public finance. A neutral tax system, it will be recalled, is usually defined as one in which there is no difference between the after-tax and pre-tax positions with respect to relative prices, relative rates of return on investment, or any other factor that influences the structure of production within either the capital goods sector or the consumers' goods sector of the economy. An equitable tax system, on the other hand, is taken to mean one under which similar persons (i.e., those with incomes of the same size) are treated similarly.^{3/}

A. General Attitudes Towards Tax Differentiation

5. For the most part the technical assistance reports under examination treat the general subject of tax differentiation in an implicit rather than explicit manner, but it is interesting to note that hardly any of the reports come out categorically against tax discrimination solely on the basis of the two principal canons of the

^{3/} According to this definition views which lead to differential tax treatment with respect to size of income, such as the familiar ability-to-pay principle, are considered to be based on value judgments rather than the findings of economic theory. That this distinction is both reasonable and justifiable becomes quite apparent when one considers (a) the inherent conflict which can exist between the ability-to-pay principle and the equally familiar benefit principle and (b) the fact that, even among those who argue for progressive taxation on the basis of the ability-to-pay principle, there exists a considerable difference of opinion as to the precise degree of progressivity which is desirable from a purely ethical point of view. See paragraphs 14 and 36 below.

economic theory of public finance.^{4/} This general consensus should not be considered too surprising, however, since it reflects the commonly-held judgment that economic under-development and stagnation are in themselves a result of the existing structure of production, comparative price relationships, and distribution of income in the countries concerned. What is astonishing, on the other hand, is the tremendous diversity of viewpoint which emerges in the reports once the analysis moves away from a purely theoretical frame of reference and considers more practical matters. The recommendations of the experts on this subject cover the entire gamut of possibilities, ranging from a point of view that favours tax concessions in all fields where they can reasonably be expected to encourage higher output and productivity [7] to one that appears to be against virtually all forms of tax differentiation with the possible exception of that between earned and unearned income [45].

6. There are four factors which appear to explain most of this tremendous diversity and range of viewpoint: A) differences in the relative weights assigned to qualitative and quantitative considerations and varying estimates of the actual benefits, in quantitative terms, that could be obtained through tax incentives and disincentives under ideal conditions; B) conflicting opinions as to whether the theoretical benefits of tax differentiation (irrespective of their actual size) would actually be realized or whether it is more probable that such a policy would, in practice, produce a decline rather than an improvement in economic welfare broadly defined; C) variations in the degree to which individual reports incorporate money, credit, balance-of-payments, and other types of government policy into their analytical frames of reference and to which individual

^{4/} It is difficult to interpret the viewpoints expressed in several of the reports. In the case of Venezuela, for example, the mission [45] sees no theoretical (as contrasted with practical) basis for not differentiating with respect to sources of income in the case of direct taxes, but at the same time one of the reasons that this mission gives for the inferiority of indirect taxes is the distortions which these produce in comparative price relationships. Similarly one report on Bolivia [3] does recommend quite strongly that the corporation income tax apply equally to the net income of all corporations, but the other writings of the technical assistance expert involved certainly indicate that his views on the subject of tax differentiation are not based on rigid theoretical dogma [5] [46].

experts believe that tax policy should act as a substitute for these other types of policy; and D) differences of opinion as to the chances of an "optimum" tax system being introduced and as to the nature of this optimum tax system.

7. Ideally, of course, quantitative estimates of the effects of tax policy alternatives should form an integral part of any comprehensive technical assistance report. Actual attempts at measurement, however, are found in only a very small number of reports, and even in these cases actual estimates are limited to a few highly selected problems (e.g., revenue yields and the distribution of the tax burden among different income groups). In part differences in the degree to which quantitative techniques are utilized can be explained by differences in the tastes and training of individual experts, but to a much greater extent the failure to make measurements, and in particular the failure to make measurements in the critical case of the effects of taxation on private capital formation,^{5/} is a result of the way in which the study of public finance has evolved over time. Formal microeconomic tax theory placed its emphasis solely on the effects of taxation on incentives, and this tradition has continued strong even though macroeconomic theory, with its emphasis on resource mobilization, has been increasingly applied to other fiscal policy problems. No matter what view one takes of the quantitative importance of incentives, however, the fact remains that they are inherently unmeasurable. Moreover, there is a mounting volume of evidence that, when the problems of incentives and disincentives are translated to a particular institutional or social setting, they become infinitely more complex than is envisioned in pure economic theory.

^{5/} Specific quantitative judgment of the effects of taxation on private capital formation (which is discussed in Section II, below) is almost invariably of the rough verbal variety and considers the possibilities of a) attracting foreign capital, b) increasing the over-all rate of domestic private savings and investment, and c) redirecting private investment into what are believed to be more productive channels. From a strictly technical point of view, of course, only method (c) can be considered as a clear-cut departure from the neutrality principle of formal tax theory; since the concept of neutrality can be rigidly defined only in a microeconomic sense, it abstracts from the problem of capital formation.

8. Several technical assistance experts have in view of these difficulties, come out firmly in favour of the use of macroeconomic techniques by making resource mobilization, rather than incentives, the central criterion of tax policy [48], and significant support for this point of view can be found in the general literature on development economics and in informal discussions among tax economists. However, nearly all of the technical assistance reports under review continue to lay principal, if not exclusive, stress on incentives. This general reticence about using the criterion of resource mobilization may have some justification in the case of the vast majority of under-developed countries where there is no significant industrialized private sector, for under these conditions the neglect of incentives means the virtual abandonment of the traditional central problem of public finance (namely, the allocation of resources between the government and private sectors of the economy). However, in modern empirical work in the United States and other highly developed countries this difficulty has been minimized by placing both analysis and quantification on the useful middle ground of the financial capacity (rather than incentives) of the industrial sector to save and invest. The same type of analysis would appear to have definite relevance for those under-developed countries that are semi-industrialized, and it is somewhat surprising to find that the technical assistance reports dealing with these countries make such limited use of the concept of private industrial financial capacity.

9. Turning to the second factor which helps to explain basic differences in attitude towards tax differentiation, the most general statement with respect to the improbability of theoretical benefits being achieved in practice is found in a report on Venezuela, where at the time of the mission's visit the tax system contained only a relatively small number of instances of selective and specialized treatment [45]. Nevertheless, the mission came out very firmly in opposition to these devices; the introduction of any special exclusion or incentive, it was argued, would open the door to all types of pressure groups with the inevitable results a) that the income tax base would slowly shrink and b) that tax differentiation would gradually take on an increasingly non-rational basis that would ultimately produce unwanted distortions in the economy. That a

prediction of this kind can be fairly realistic is borne out by the experience of a number of Latin American countries, among them Chile and Mexico. Interestingly enough, however, the missions which analyzed these two countries gave diametrically opposed remedies for the existing situation. The mission to Chile, like the one to Venezuela, argued that special tax treatment is, in effect, merely a form of disguised subsidy and that direct subsidies are always preferable to such hidden subsidies [9]. On the other hand, the Mexican mission simply urged considerably greater selectivity in the granting of tax relief with a view to avoiding what had become a system of general subsidies for extended periods of time [33]. Clearly, if there can be said to be any consensus at all on this subject on the part of the missions, it is that tax discrimination with respect to source of income must, if employed at all, be limited to a few highly selective cases.

10. As is demonstrated by the different stands taken on the relative merits of direct and hidden subsidies, the attitudes of technical assistance experts towards tax differentiation are, in some instances, determined by their views on the desirability of using taxation as a substitute for other types of government policy. Similar differences of opinion, for example, arise in connexion with a) the suitability of employing taxes as a balance-of-payments corrective [29] [30] and b) the question of whether the tax system should be utilized to counteract basic inflationary pressures [9] [27] or merely be adapted to minimize the distortions which the existence of inflation creates in the tax system itself [31] [37]. What is of far more general significance, however, is the considerable number of reports which appear to exclude consideration of other types of government policy from their analytical frame of reference. Indeed, it is quite surprising to discover that some reports can speak of the incentive and disincentive effects of taxation without taking into account whether the exchange rate is undervalued or overvalued relative to what it would be in a foreign exchange market in which the rate were permitted to fluctuate freely. Given the critical relationship which exists in an under-developed country among the capacity to import investment goods, so-called protective effects, and the potential rate of economic growth, the delicate interaction between the balance of payments and the fiscal system cannot be ignored [51]. The need for income tax incentives to stimulate

domestic investment would, for instance, obviously be smaller (and the quantitative impact of such incentives would be larger) in an economy characterized by an overvalued currency, while the effects of taxation on the export sector could be expected to vary considerably in accordance with the direction and degree of departure from the true equilibrium exchange rate.^{6/}

11. A tax mission's attitudes towards tax differentiation may depend finally, as has been indicated above, on its relative degree of preference for either an "optimum" or a "second-best" tax system. On one level, judgements of this kind involve a mission's appraisal of the chances of all its recommendations being adopted and its interpretation of the interrelationship between de facto tax burdens and de jure tax codes and administrative regulations;^{7/} on another level, the differences in attitude simply reflect conflicting basic viewpoints as to what an optimum tax system really is. The most clear-cut example of attitudes towards tax differentiation being shaped by a government's reaction to over-all tax policy recommendations occurs in the case of Israel, where the same technical assistance expert visited the country on three separate missions over a period of several years. In his first two reports the expert repeatedly argued that, because the high level of individual income taxes coupled with a very steep rate of progression seriously hampered personal savings and incentives to undertake overtime work, both the average and marginal rates of income tax should be reduced [25] [26], but in his final report the expert, recognizing that this basic reform would probably not be forthcoming, endorsed the special tax treatment that had already been introduced in the case of overtime bonuses and even recommended selective incentives for some forms of personal savings [27].

^{6/} Although sliding-scale systems of export taxation (which are recommended in a number of reports) implicitly take account of cyclical departures from the normal exchange rate, they do not deal with the problem of longer-run changes in the true equilibrium rate of exchange. See paragraph 49 below.

^{7/} Even when a rational tax system is believed to exist or be forthcoming, it may be incumbent upon a technician to appraise the probability of subsequent changes being enacted that will bring a drastic move away from optimality. Many practicing tax attorneys and certified public accountants justify the retention of some so-called "loop-holes" on the basis of such risks.

12. Contrasting attitudes on the comparative importance of de facto and de jure considerations is illustrated by reports on Peru and Bolivia. In the first instance the expert argued that the fact that there was de facto discrimination against earned income was not a reason for introducing de jure discrimination in its favour but pointed, instead, to the need for improved income tax administration [37]. In the case of Bolivia, on the other hand, the expert (while apparently supporting discrimination in favour of earned income) argued that there was no need to introduce this in a de jure sense because the tax system already favoured earned income on a de facto basis [3].

13. Differences in judgment as to the true nature of an optimum tax system are, of course, more fundamental than considerations of "optimality" vs. "second-best". To some extent the explicit and implicit disagreement on this subject to be found in the mission reports can be explained by the different views that have always existed among public finance specialists concerning the relative priority which should be assigned to the four principal traditional criteria for evaluating taxes: economic effects, social justice, administrative suitability and convenience, and provision of revenue for the government. But the problem of defining the most rational tax system is, in fact, far more subtle and complex, for what is involved here -- as has already been demonstrated by our discussion of the interrelationships among incentives, resource mobilization, and the financial capacity of the industrial sector -- is not merely conflicts in priority taken in some abstract or generalized sense. The really basic questions involve a) judgment as to the degree, if any, to which the interaction of these four criteria does change with the stages of economic development and b) appraisal of the extent to which such differences in interaction should actually be taken into account in formulating tax policies.

B. Taxation and the Stages of Economic Development

14. There is, upon a superficial first reading, considerable disagreement to be found in the reports with respect to the subject of taxation and the stages of economic development. This is largely because there is a definite tendency upon the part of the technical assistance experts to treat one or more of the four tax

criteria in an implicit fashion.^{8/} The only criterion which appears to be handled explicitly in almost every instance is that of social justice, for virtually all of the reports pay homage to the notion of progressiveness embodied in the familiar ability-to-pay principle. Even here, however, there is a complete gamut of treatment, ranging from a simple classification of taxes in accordance with their progressiveness or regressiveness [14] [35] to a forthright statement that the criterion of social justice should be abandoned [11] in the short run because of the requirements of economic development.^{2/}

15. For the most part the reports have treated the problem of taxation and the stages of economic development almost exclusively in terms of the potential role of income taxation. This tendency has, from one standpoint, been unfortunate, for most of the discussion has been inevitably concerned primarily with the criterion of administration. From another point of view, however, this concentration on the role of the income tax is quite understandable since the technical assistance experts all agree that its functions are unique. A definite consensus exists that only this type of tax offers progression over the complete range of the income

^{8/} In this connexion, it is interesting to note that only one of the reports reviewed clearly and explicitly spelled out the implications of all four criteria [36]. However, the technical assistance expert involved carefully refrained from taking any stand on the central problem--namely, the relative priority to be assigned to each. Presumably his justification for not making any recommendations on this subject was the belief that the decision was so vital that only the government itself could make it. See paragraphs 52-54 below.

^{9/} It is now almost universally recognized that the ability-to-pay principle should be applied, not to individual taxes, but to the tax system as a whole, and the established techniques for statistically allocating the over-all burden of the tax system among different income groups were clearly demonstrated at the Buenos Aires Conference on Tax Administration [50]. Furthermore, since what is really important, from a social welfare standpoint, is the redistribution of income through the fiscal system as a whole, the distribution of the benefits of government expenditures among different income groups should, to the extent that they can be measured, also be taken into account. This is particularly important in countries where social reform is given high priority. Although techniques for allocating expenditure benefits are not nearly so clearly defined as in the case of the tax burden, several of the mission reports did attempt to quantify the distribution of such benefits [17] [19].

distribution, provides (if it is so desired) that similar persons will be treated similarly, and ensures a high degree of yield elasticity in the revenue system, particularly under conditions of inflation.^{10/}

16. Agreement on the ultimate desirability of income taxation is, nevertheless, entirely consistent with different views on how fast such taxation can and should be introduced. The majority of the reports under review do, of course, favour rapid introduction of a global individual income tax, but there are a few reports which recommend that comprehensive modern income taxation should either be approached gradually after considerable experience with separate schedular taxes [31] or evolve through the slow adaptation of export and production taxes [34]. It is important, however, not to underestimate the significance of this minority view, for to the extent that the ability of a country to absorb an income tax system is a function of its stage of development, it should be recognized that the presently existing body of technical assistance reports covers for the most part the more economically advanced of the under-developed countries and, as such, may be unrepresentative of the world group as a whole. In order to avoid any possibility of such a bias, therefore, the reports of the missions must also be examined with regard to A) attitudes on the degree to which alternatives for the income tax are available, B) the nature of the evidence put forth in support of the "majority" view, and C) judgment as to whether the income tax or any viable alternatives to it are likely, either singly or in combination, to produce sufficient revenues to meet the basic requirements of a government in a rapidly developing country.

17. In view of the comparatively low level of the average standard of living and the relatively undiversified nature of the structure of production that are characteristics of under-developed countries, it is not surprising that almost

^{10/} A considerable number of the reports call attention to the distortions introduced into the individual income tax by past inflation (i.e., the lowering of the real value of exemptions and the change in the degree of progression), but suggestions that automatic provision for future inflation be introduced by linking the level of exemptions to some cost-of-living index are relatively rare [31]. The impact of inflation on other types of taxation (including business income taxation) is discussed in various places below.

all the experts appear to believe that consumption taxes, import duties, and (with a somewhat smaller degree of agreement) export taxes are likely to be more progressive over a significant range of the income distribution than they are in more developed and diversified economies. In fact, a considerable number of the reports recommend that the progressiveness and yield elasticity of import duties and consumption taxes be increased by placing all such imposts on an ad valorem rather than specific basis,^{11/} and a good number also support increasing the selectivity of the consumption tax base, one expert even going so far as to recommend the introduction of a graduated purchase tax [26]. On the other hand, it should be clearly recognized that the majority of the experts treat such improved methods of indirect taxation as a useful complement to income taxation rather than as a substitute for it; selective taxation of consumption and imports is viewed as a way of re-enforcing the income tax while, at the same time, perhaps inducing favourable or preventing unfavourable changes in the structure of production. The relatively few experts who seem to believe that there are really effective short-run substitutes available for income taxation in under-developed countries apparently base their case on the revenue potentialities of export taxation, but in interpreting these views, it should be remembered that the reports concerned were largely written in the early nineteen fifties when the relatively high level of primary commodity prices on world markets made the conflict between

^{11/} For the most part the reports appear to accept implicitly the assumption of national income accounting that there is complete forward shifting of indirect taxes in the ex-post sense of measuring the tax burden in terms of actual collections; this is, of course, entirely consistent with some of the ex-ante burden falling on the seller in the form of a reduced physical volume of sales. One of the few reports that questions the applicability of this assumption is one on Venezuela where the difference in shiftability among various firms in an industry is cited as one of the reasons for the inferiority of indirect taxes [45]. Surprisingly enough there is very little attention paid to possible differences in the degree of shiftability in developed and under-developed countries that can be created by the high mark-up and small volume policies so frequently found in the latter. One report on Guatemala does comment on the fact that even the substantial differentials in tax burdens associated with a graduated business income tax do not appear to inhibit competing firms from raising prices to an extent determined by their individual tax rates [19]. This is in marked contrast to experience in the United States where the much smaller differentials in tax burden associated with what is essentially a proportional business income tax do appear to reduce the degree of shiftability [52].

substantial export tax revenues and the balance of payments far less serious than it is under present conditions.^{12/}

18. The principal evidence in support of the rapid introduction of a global income tax is the well-documented fact that the only effective method of improving administration of and compliance with this tax is through actual experience; if an income tax is not introduced because of an existing lack of administrative capabilities, the majority of the reports imply, the capacity to administer the tax will always appear inadequate, thereby creating a vicious circle. However, the mere existence of an income tax does not by itself mean that its revenue yield will be reasonable. For this reason it should be recognized that the evidence in the reports on the relationship between income tax administrative capability and revenue yield is conflicting and points, to say the least, to the existence of a considerable range of differences among the under-developed countries. One factor which emerges, for example, is the importance for income tax administration of the presence in a country of relatively large-scale economic or industrial units,^{13/} which would indicate that significant yields can only be obtained in economies that are already semi-developed or semi-industrialized. Moreover, there is also evidence that some of the technical assistance experts involved may tend to exaggerate tax administrative capabilities in all under-developed countries in the sense that they recommend reforms (e.g., treatment of all corporations as partnerships [40], introduction of a graduated tax on global expenditures [6] [22] which the majority of technical opinion believes would be impracticable even under the best administrative practices possible in the highly developed countries.^{14/}

^{12/} The analysis of shifting tends to be somewhat more elaborate in the case of export taxes and includes such considerations as the relative share of the world market [21] and the possibility of backward shifting [17]. See paragraph 49 below.

^{13/} Sometimes this point is made directly [48] and sometimes by implication, as in the case of a report which accepts the existence of the capacity to administer the income tax but believes that the large number of small retailers in the country makes retail sales taxation impracticable [45].

^{14/} In the light of this, it might be quite instructive to follow the experience of India and Ceylon which have introduced limited versions of the expenditures tax. However, it should be recognized that the proponent of these measures has himself criticized the inadequacies of the Indian version of the tax [23].

Finally, one should bear in mind that experts in public finance have traditionally been influenced by the adage that "old taxes are good taxes"; in this connexion, it is interesting to note a) that reports dealing with countries where income taxes do not exist are far less optimistic about their potentialities [20] [34] than reports on countries which already have such taxes and b) that the one report [31] which recommends any significant change from the status quo definitely favours drastic simplification of the existing income tax.^{15/}

19. The effective yield of the income tax, it has long been recognized [47], depends not only on largely subjective factors such as administration and "tax consciousness", but also on the basic structural characteristics of a country. In this connexion, although many of the technical assistance reports recommend a lowering of personal exemptions under the income tax, there is no way of appraising from most of these reports how much additional revenue is to be expected in the absence of quantitative estimates of the impact of such factors as the degree of monetization of the economy and the proportion of the population living at or close to the subsistence level. However, one strategically important structural characteristic that is analyzed in some of the reports is quite susceptible of measurement -- namely, the relative importance of the profit, dividend, interest, and rent components of the total share of the national product accruing to property. Because the share of profits and dividends in total property income is relatively small, as compared to developed countries, in even the most industrialized among the under-developed nations,^{16/} and since actual and imputed rental income is

^{15/} There is conflicting evidence on countries which have introduced income taxes in recent years. The experience in Malaya, for example, has been quite encouraging [32], but a recent study of the experience in Afghanistan can only be interpreted as indicating disaster [1].

^{16/} Those countries in which all components of property income account for only a small proportion of national product constitute a special, although important, case [31]. This economic characteristic would undoubtedly be an important determinant in any system of classifying countries into stages of economic under-development that are specifically defined for tax purposes (see paragraph 23 below) as would the specialized tax problems facing completely new nations [29] [30]. However, neither of these considerations has particular relevance for the Latin American nations.

everywhere far less susceptible to effective taxation than is profit income, there is a definite tendency for a given amount of income taxation to fall more heavily on the industrial sector in under-developed countries. As a result, such nations are faced with a dilemma unless they can find efficient alternative direct or indirect ways of reaching rentier income. Under these conditions a government can either, as some reports recommend, accept the existence of a lower level of taxable capacity and thereby hope to encourage the growth or emergence of the industrial sector ^[4] or, as other technical assistance experts suggest ^[48], give priority to the revenue needs of the government and accept thereby the attendant risks involved in terms of unfavourable effects on private incentives and financial capacity.^{17/}

20. The government of a developing country can, of course, also raise revenues through the use of the income tax complements described above, through taxes on the mass of the population, and through a combination of both of these.^{18/}

However, the consensus of opinion in the mission reports is that selective indirect taxes and mass taxes should be treated as alternatives rather than as compatible supplementary devices; not only, as has already been noted, does the majority view favour the former, but it also tends to oppose mass taxation on the grounds of social justice.^{19/} It must be recognized, nevertheless, that estimates of prospective revenue yield from the pattern of selective indirect taxes recommended in the mission reports are, for a number of reasons, somewhat hazy. First, since there is only limited analysis of the price-elasticity of

^{17/} Some choice among policy alternatives exists, in terms of the personal income tax, even when there is no significant industrial sector. But in terms of taxes on business income, the policy dilemma is far more acute in the case of semi-developed countries which have already experienced some significant degree of industrialization. The sharpness of any conflict in priorities can, of course, be ameliorated by appropriate business tax incentives. (See paragraphs 28-34 below.)

^{18/} Land and property taxation is discussed in paragraphs 45-47 below.

^{19/} See, however, footnote 9 above.

demand for luxury items to be found in the reports, one cannot be certain to what extent highly selective consumption taxes would work to improve progressiveness of the system and to what extent they would tend to reduce consumption of the taxed items; although many of the experts, naturally enough, point to the benefits from a development standpoint that could stem from the resulting changes in the existing or potential structure of production, the fact remains that government revenues would be correspondingly smaller. Secondly, most of the reports do not appear to pay sufficient attention to the fact that a considerable proportion of luxury consumption in under-developed countries is for personal services of a kind that is not particularly susceptible to selective forms of indirect taxation; the interesting suggestion has, however, been made that some study be given to the possibility of imposing old-fashioned types of direct taxes on some key items of luxury personal services [46]. Thirdly, the very frequent recommendation made in the reports that equipment imports be exempted from import duties or taxed at low rates would, although undoubtedly working to stimulate investment, act also to reduce the revenues of the tariff; moreover, the understandable policy, not uncommon in a large number of developing countries, of attempting to alleviate chronic balance-of-payments difficulties by favouring capital imports at the expense of luxury items would, given a policy of tariff exemption for such equipment imports, aggravate greatly the loss of revenue from import duties.

21. On the other hand, a policy of mass taxation would, as several reports point out, tend to inhibit the growth of investment in industry by limiting the size of the existing or potential market [4] [45]. However, in comparing the quantitative impact of this kind of disincentive with the disincentives created for industry by high taxes on net business income, other mission reports emphasize the fact that, all other things remaining the same, the industrial sector is usually better off with heavy indirect taxes than with heavy direct taxes [19]. For a rapidly developing country, moreover, all other things do not usually remain the same. For instance, the existence of inflationary pressures which are usually taken as an index of an adequate development effort tends to alleviate the effective impact of any decline in potential market demand that may result

from the imposition of indirect taxes [46]. In the case of direct taxes on net business income, on the other hand, inflation tends to have a different sort of effect and, in the absence of incentive depreciation policies, intensifies significantly the burden of taxation in the industrial sector. As a number of mission reports point out, this has been the actual experience in a number of Latin American countries where heavy rates of inflation have turned net business income taxes partially or wholly into taxes on capital [2] [9] [36].

22. Irrespective, therefore, of any superficial lack of consensus which the technical assistance reports may initially appear to exhibit on the subject of taxation and the stages of economic development, several conclusions definitely do emerge from the reports when they are read and collated as a group. First, proper perspective on the general problem cannot be obtained unless full and commensurate weight is assigned to each of the four traditional criteria for evaluating taxes; in the particular case of income taxation, extreme care must, in some instances, be exercised not to confuse the normative goal of continuously improving administration and compliance with the positive reality of limited administrative absorptive capacity, while the proven fact of administrative capability should not, in other instances, be permitted to camouflage the equally important reality of low yield potential. Secondly, as the preceding conclusion already implies, the structural and institutional differences which exist among the various under-developed countries themselves are probably more significant, from the standpoint of tax policy, than those which exist between the most economically advanced and industrialized of these nations and the so-called developed countries. Finally, the not inconsiderable differences which also exist between these semi-developed countries and the developed nations involve some quantitatively minor, but economically critical, variation in the limits of taxable capacity that should not be ignored.

23. No matter what attitude one takes towards the validity of some of the multiphase taxonomic schemes which have been elaborated for classifying the stages of general economic development, it seems clear that a highly specialized taxonomic

system based on the constraints which comparative economic structure and institutions place on the tax-policy mix would have real significance and relevance. Even if there were to be unanimous agreement that there is one unique kind of efficient modern tax system which is the ultimate long-run goal of all countries, the fact remains that, for the vast majority of the under-developed countries of the world (including a good number in the Western Hemisphere), the effective time-dimension of the particular "long run" involved in this case is, for reasons which vary for groups of countries, far too lengthy to have very much significance for government decision-making based on any reasonable planning horizon. Moreover, even for those countries where the potential realization of a comparatively modern tax system does not fall outside the limits of a reasonable planning horizon, the reconciliation of the conflicts which always exist among the major tax criteria point to a somewhat different policy-mix than would be found in highly industrialized countries. Given the delicate gradations of influence which the degree of industrialization, monetization, literacy, and level of average living standards exercise on the determinants of taxable capacity, it would appear -- on the basis of the reports of technical assistance missions interpreted as a group -- that the most rational tax system for countries at several different stages of under-development and several different phases of development can and should vary significantly.

II. The Views of the Missions on Selected Problems in Income Taxation

24. Turning from the ideas of the missions on over-all tax policy to a consideration of their views on problems of a more limited scope, it seems appropriate to begin with individual issues in the area of income taxation where the treatment in the reports has been quite exhaustive. To some extent, of course, many of the numerous issues involved here have already been touched upon in the discussion of the preceding section, but it should be recognized that, even when technical assistance experts differ on the general subject of tax differentiation, they can agree on whether one form of discriminatory device is more beneficial (or less harmful) than another. The particular problems to be analyzed are grouped under five topics: A) tax treatment of foreign capital; B) specific methods of stimulating business investment; C) miscellaneous problems in individual income taxation; D) the relationship between individual income taxation and corporate income taxation; and E) the taxation of capital gains. However, in view of the intimate relationship which the incentives and financial capacity of the industrial sector bear to some of the central problems of over-all tax policy raised above, approximately half of the discussion is devoted to the second of these.

A. Tax Treatment of Foreign Capital

25. With respect to the taxation of foreign capital, the mission reports are in virtually complete agreement on one essential point: Favourable tax treatment is considered to be only a marginal factor in the decisions of foreign investors because the prospective tax burden is believed to be only one (and by no means one of the most important) of the factors influencing such investment decisions. Despite the near unanimity which exists on this point, however, there is a considerable difference of opinion in the area of actual policy recommendations. Much of the explanation for this seeming paradox lies in the fact that, while some experts treat tax considerations in a direct narrow sense, others lay stress on the possibility that tax policy can exert a broad indirect influence on attitudes towards the other factors which enter into investment decisions.^{20/} Indeed, of the missions favouring low rates of taxation for foreign investment, only one appears to emphasize

^{20/} There is considerably less controversy about granting favourable income tax treatment to foreign technicians; the few reports which raise this issue strongly endorse such a policy.

the particular value, in money terms, of the tax savings or deferral [18]. The others lay stress on such broad qualitative factors as A) the publicity^{21/} involved in directing attention to the investment opportunities available in the country [4] [37], B) the sense of security against expropriation that such action may create on the part of foreign investors [21] [34], and C) a clear demonstration, in the case of prospective investors interested in the local market, of the government's desire to create an environment favourable to private economic growth [4].

26. All the technical assistance missions recognize either implicitly or explicitly that, for very obvious political reasons, it is unsound policy to grant foreign capital preferential tax treatment over domestic capital.^{22/} For this reason, the really critical factor in shaping a mission's attitude concerning the level of taxation to be levied on foreign investment is its judgment as to the relative extent to which the domestic level of business income taxation should be based on the expectation of attracting additional foreign investment or be determined by purely domestic considerations and requirements. Such judgment is, in turn, influenced largely by a mission's general views on the relative importance that should be assigned in over-all tax policy to the criteria of revenue requirements and economic effects.

27. Some of the reports also stress the primary importance of taking into account the tax policies of other countries. There is, for example, the necessity, in the short run, of adjusting tax policies to take full advantage of the tax laws in the countries of legal domicile of foreign firms which have already established operations [18] [20] and the desirability, in the longer run, of entering into treaties to avoid double taxation with countries which are likely to provide potential sources of investment capital [18]. At the same time a country should not ignore the tax policies of neighbouring countries which may offer similar investment opportunities for the location of foreign capital [18] and should preferably try to sign

^{21/} In view of the location of Puerto Rico in the Caribbean Area and the considerable interest that has been aroused by "operation bootstrap", it is important to note that expert opinion attributes the "success" of this program to such publicity effects [41] and to the island's unique position in having free access to the North American market [37].

^{22/} Naturally enough, a number of reports point out the economic dangers inherent in overdiscriminating against foreign capital. See, for example, [10].

treaties with such countries standardizing the tax treatment of foreign capital and avoiding thereby mutually harmful tax competition [4].

B. Specific Methods of Stimulating Business Investment

28. A useful way of approaching the technical assistance experts' recommendations on specific methods of stimulating business investment is to compare their attitudes towards tax exemption with their views on such other techniques as accelerated amortization, loss carry-forwards, and special investment credits or development bonuses.^{23/} Specific criticisms which the reports make of tax-exemption programs may be grouped into three broad categories, which are interrelated rather than mutually exclusive. First there is a group of problems which are associated with the loss of government revenues that such policies usually entail, both in an absolute sense and when compared to some of the other types of tax incentive that can be utilized to stimulate industrial investment. Secondly, there is a set of problems which is created by differences in the degree of profitability or lack of profitability among the firms receiving the benefits. And finally there are the difficulties which arise in connexion with the possibilities of discriminating, on the one hand, between new enterprises and existing firms and, on the other, between expanding business and stagnant enterprises; among the chief problems here is the competitive advantage which firms obtaining tax exemption may gain over other firms in the same industry. In interpreting the attitude of individual reports towards these three categories of problems, it should be recognized that they are not always present to the same degree, with their comparative severity being dependent not only on the specific type of exemption program involved but also on the characteristics of a particular country's structural and institutional economic environment. Moreover care should be exercised not to distinguish too sharply, as some of the reports do, between tax exemptions and other methods of stimulating investment; the policy choice for a country need not be of the "all or nothing" variety since several devices can be combined into a package that can work to mitigate the disadvantages of tax exemption alone.

^{23/} Favourable tax treatment for reinvested profits and unfavourable treatment for distributed profits are best treated in connexion with the relationship between individual income taxation and corporate income taxation. See paragraphs 36-38 below.

29. An excellent example of the kind of benefit that can be obtained from a tax-package of this sort emerges in connexion with the first category of criticism (revenue loss). It is frequently pointed out in the reports that one of the major reasons for the inferiority of tax exemptions as compared to accelerated depreciation is that the former entails a permanent loss of revenues for the government while a policy of rapid tax write-offs involves only a temporary postponement or deferral of taxes (unless the firm continues to expand indefinitely). In the light of this, it is interesting to note that a policy recommendation originally made in the case of Ghana [18] and subsequently suggested as a device for joint adoption by the Central American countries [4] consists, to a considerable degree, of a combination of tax exemption and accelerated depreciation. Under this plan profits would be exempted from taxes for an indeterminate period sufficiently long enough in duration for a firm to recoup its entire original investment out of net income. Presumably the temporary exemption from taxes would apply to all investments and not merely to investments in depreciable capital assets, but since capital allowances on the initial capital investment would not be permitted after the termination of the initial "holiday" period, the treatment of depreciable assets would be virtually identical to that envisioned under accelerated amortization. As a consequence the largest part of the impact on government receipts under this type of arrangement would take the form of tax deferrals rather than of a permanent loss of revenue. Moreover, a country which adopted this policy would avoid having to face another of the vexing problems which is inherent in the standard variety of tax-exemption programs, namely, that of having to determine the optimum number of years for a tax-holiday.

30. Although a policy which combines the advantages of tax exemption and accelerated amortization does appear to offer more benefits than a simple tax-exemption policy, the question also arises as to whether these benefits are sufficiently greater than those of simple accelerated depreciation to justify the additional administrative complexities involved in such a combination. Since an announced policy of deferring taxes until the initial investment is recovered would be more dramatic and novel, it would certainly seem to be more effective from the standpoint of publicity since it would be more likely to capture the attention of prospective investors than would the staid and prosaic device of accelerated depreciation schedules.

Moreover, a policy of this kind (a) reduces somewhat further the risk inherent even in accelerated amortization that the distribution of a firm's profits over time may be such that the enterprise may not be able to utilize the tax benefits in any given year^{24/} and (b) also enables the taxing authority to avoid the problems involved in determining what rate of acceleration is the proper one. On the other hand, it should be clearly recognized that the original proponent [18] of the policy of allowing recoupment of investment out of profits over an indefinite time-span based his recommendation on an extremely narrow view of the nature of investment decisions by arguing that the most effective tax incentive that can be offered is a reduction in the period of time in which investment capital is exposed to risk.^{25/} This view of the investment decision-making process appears, from a strictly a priori standpoint, to have far more relevance for foreign investors than for domestic investors, but the technical assistance expert in question apparently also believes it to be a key factor for domestic investors since he advocates very strongly that the dividends paid out of such tax-holiday profits be made exempt from the individual income tax. In either event, it seems evident that the rationale behind the policy of tax-free recoupment of initial investment is more likely to lead to the mere establishment of new firms or the one-time expansion of existing firms than to encourage the continuous expansion of firms which is the true goal of tax incentive policy.

31. Another kind of revenue loss under a tax-exemption program, it is frequently pointed out in the mission reports, arises because many of the firms which avail themselves of the benefits would have commenced or expanded operations even in the absence of the tax incentives. The number of companies in this category tends to be greater if the general level of tax rates is low [10] [33], but in those cases, where a high level of business income taxation prevails, the unnecessary revenue loss to the government may actually be greater [49]. Closely related to this weakness of tax exemptions is the fact that a tax-holiday period tends to favour the

^{24/} This risk is, of course, considerably smaller in the case of accelerated depreciation than in that of normal depreciation. See, below, paragraph 34.

^{25/} The other report which advocates this policy [4] bases its recommendation, instead, on the argument that one of the strongest tax incentives which can be offered is that of assuring the investor that the government will only share in "true" profits.

more profitable companies when business income taxes are graduated and always discriminates against companies which obtain losses, even under proportional rates [42]. It has been occasionally argued that any discrimination against firms which make losses is consistent with a sound development policy since such companies are obviously inefficient [39]. But as a number of the technical assistance reports point out, this argument does not take into account the tendency for most companies to lose money in their early years; adequate provision for the carry-forward of losses [37] [40] actually offers greater incentives than tax exemptions^{26/} and, if combined with a loss carry-back, would provide some means of averaging business income over time and introduce an additional element of fairness into the tax treatment of all companies [45]. One technical assistance expert, moreover, carries the argument one step further: Contending that even a loss carry-forward would not be enough to neutralize the effects of a business income tax (since the government still shares in net gains but not in net losses), his report makes the interesting recommendation that, in a list of designated industries, those firms showing no profits be entitled to a full fifty per cent return of any net loss.^{27/}

32. Problems involved in the comparative treatment to be given to different kinds of firms within an industry constitute the third type of criticism which, as mentioned above, the technical assistance reports make of temporary tax-exemption policies. Special issues arise in this connexion with respect to, first, the differential tax burden on growing and stagnant firms and, secondly, the relative treatment of new and old firms. If, on the one hand, the exemption privilege is not granted to all firms in an industry, some companies are placed at a competitive disadvantage; on the other hand, if the program is extended to all firms regardless

^{26/} As one of the reports notes, however, the loss carry-forward and the tax exemption need not be treated as mutually exclusive alternatives since a tax exemption program can provide that losses be carried forward to the period beyond the initial tax-holiday [18].

^{27/} The government's potential liability in this case would, in view of the prevailing level of tax rates, have been greater than its potential gains; however, the expert argued that the subsidy inherent in such excessive sharing of losses would be justified by the need to provide adequate incentives for investing in particularly risky industries and by the fact that the subsidy, under these circumstances, would not enrich the beneficiary.

of whether they are expanding, the revenue losses to the government are considerable, and the program degenerates into a general subsidy instead of a method of encouraging new investment [33]. At the same time, however, it would appear unwise, on the one hand, to limit the program to new firms because the objective should be to stimulate all new investment in the designated industries [18], and in some under-developed countries the scarcity of managerial talent [42] might actually make it sounder policy to favour the expansion of existing firms;^{28/} yet, on the other hand, there are serious difficulties, from an administrative point of view, in allocating profits between the old and new parts of a business [42].

33. It is interesting to note, in the light of all this, that those few technical assistance experts who recommend some form of a tax-holiday period are dealing with countries where very little industrialization has already taken place [4] [18]. There are, moreover, other reports which advise that, if a tax-exemption policy is adopted at all, its use should be limited to new industries [37]. Nevertheless, the opinion expressed in the majority of the reports is that accelerated amortization of productive facilities, with its emphasis on new investment, is superior to tax exemption. Liberal depreciation allowances can provide many of the advantages of tax exemption without that policy's economic and fiscal disadvantages and administrative complexities. In the limiting case of a very rapidly growing firm such allowances may offset taxable income entirely, and the benefits of rapid write-offs are automatically cancelled if a firm ceases to expand.

34. The reports under review tend to treat the subject of accelerated depreciation in a general fashion and do not, with very few exceptions, give detailed recommendations on such technical issues as a) the degree of acceleration to be granted, b) schedules for various individual industries, and c) whether the benefits should

^{28/} The same sort of consideration could, of course, apply to the question of whether the reinvestment of profits should be encouraged by the tax system. See paragraph 37 below.

be provided by rapid write-offs, special investment credits, or a combination of both.^{29/} What is stressed primarily is the general suitability of the device and its flexibility in the face of conditions which may vary from country to country and period to period. Naturally enough the strongest support for rapid amortization comes in the case of reports dealing with countries which are experiencing or have experienced substantial inflation.^{30/} Many reports, however, mention the incentives that are provided in the form of "interest-free loans" even in the absence of inflation,^{31/} and there are a very few which put emphasis on the fact that, when there is an already established industrial sector, a policy of rapid write-offs can exert as much, or more, influence through its impact on financial capacity as through its effects on incentives.

29/ A system recently introduced in Ceylon [8] which seems to merit study by other under-developed countries consists of A) lump-sum depreciation of an asset in the year of acquisition equal to the discounted value of the total depreciation that would be allowed under the declining-balance method over the life of the asset; B) carry-forward over an indefinite number of years of the amount of any unabsorbed depreciation, increased by 5 per cent each year to reverse the effects of the initial discounting; and C) a system of development rebates (or special investment credits) equal to 20 per cent in the case of a new business or the expansion of an old business and equal to 40 per cent in the case of an approved project. The first two features go a long way to eliminating the deterrent effect of an income tax on investment by "reducing the risk that the firm may not be able to take account of all allowable deductions for depreciation" and by "wholly avoiding the risk that allowances will become inadequate in the future because of rising prices" [5]. Moreover, the third feature offers positive incentives (rather than the mere neutralization of disincentives) and tends therefore to make investment in the industrial sector more attractive relative to other investment possibilities.

30/ See paragraph 21 above.

31/ One mission intimates that these incentives are likely to be more pronounced in a country with very high interest rates [37], but it should also be recognized that the existence of high interest rates implies that the attractiveness of alternative investment opportunities is commensurately greater.

C. Miscellaneous Problems in Individual Income Taxation

35. The views of the tax missions with respect to the optimum degree of progression in individual income taxation (including interrelationships among exemption levels, bracket sizes, and maximum rates) directly reflect their opinions on over-all tax policy and have already been discussed. But in the case of their attitudes towards tax differentiation under the individual income tax,^{32/} there are few additional points which merit elaboration. From the standpoint of social justice alone, most of the missions appear to favour tax differentiation in favour of earned income, apparently believing that the income from property (or the past accumulation of income) provides an additional basis for the ability to pay; however, the fact that so few of these missions actually recommend such differentiation probably reflects their belief that selective treatment of this kind runs counter to an over-all policy of furthering economic development [37]. Similarly only a very small number of reports suggest that individual income tax differentiation be used to encourage private savings,^{33/} and those which do limit any favourable treatment to highly selective forms of savings such as government bonds [27] or the securities of a development institute [34]. There are serious political difficulties involved in almost all countries in introducing differentiation which favours personal savings into the individual income tax structure directly, and most missions apparently prefer to achieve such effects indirectly by favourable treatment under the business income tax (as discussed above) or through the preferential treatment of capital gains.

^{32/} With respect to the respective merits of schedular and unitary income taxes, the views of the more recent missions tend to confirm the conclusion reached at the 1951 Geneva Conference that differentiation can be obtained under either system [54]. There has, moreover, been an increasing concern with the irrational form of differentiation under some patterns of schedular rates [45] and a growing awareness of the psychological and administrative advantages inherent in building a global income tax on the basis of some adaptation of the existing schedular pattern [31]. The tendency has been, however, to recommend reduction of the number of schedules to the bare minimum consistent with the essential requirements of effective administration [10].

^{33/} Those reports which favour replacement of the individual income tax by a graduated expenditure tax constitute, of course, a special case [6] [22].

D. The Relationship Between Individual Income Taxation and Corporate Income Taxation

36. Individual missions approach the question of the relationship between individual income taxation and corporate income taxation from the standpoints of a) social justice and equity, b) effects on capital formation, and/or c) possible impact on the form of business organization. With respect to the first of these, the conflicts in viewpoint reflect, in part, the usual differences to be found in developed countries between those who feel [40] that the individual is the only ultimate base for all taxation and those who believe [3] that the special privileges and powers granted to the corporation by the government offer a separate and distinct basis for legitimate taxation;^{34/} sometimes, moreover, it is argued that the substantial benefits provided to business enterprise in developing countries by government expenditures for necessary infrastructure actually make the case for separate taxation of business firms far stronger than in an industrialized nation [30]. As a result, the attitudes expressed in the reports range all the way from the virtual disregarding of "double taxation" of dividends to favouring complete integration of the individual-income and corporate-income taxes by treating all corporations like partnerships [38]. Some missions recommend partial integration in the form of either permitting a corporation to deduct dividend distributions from its tax-base or allowing the individual taxpayer a credit for income taxes paid by the corporation [45]; others, however, point to the danger that a crude method of integration, given limitations on administrative capabilities, may have unfortunate economic and equity consequences [3].

37. There seems to be significantly more agreement on the subject of the effects of "double taxation" on capital formation. Although a few technical assistance experts argue that such taxation is in itself a serious deterrent to investment [40], the majority of the reports appear to believe, either implicitly or explicitly, that the full taxation of dividends tends to promote the retention and reinvestment

^{34/} Even where missions take the point of view that corporations have a legitimate taxable capacity which is separate and distinct from that of their shareholders, they do not favour graduated tax rates for the corporate income tax; such progression, it is argued, tends to penalize the more efficient firms and has no real ethical justification [3]. See, however, the discussion on granting favourable treatment to small corporations in paragraph 38 below.

of dividends. In fact, some reports recommend that specific tax measures be introduced to encourage such reinvestment even further by placing a special tax on distributed earnings [3] or non-reinvested profits [25] or granting special allowances to reinvested profits^{35/} [4]. It has been pointed out, however, that the use of selective taxation of this nature assumes either that dividend distributions will largely be devoted to consumption expenditures or that the reinvestment of earnings within an individual enterprise is preferable to their investment in other areas [37]. Moreover, when the basis of differential treatment is the reinvestment or non-reinvestment of profits, there exists the thorny administrative problem of distinguishing between genuine reinvestment and unnecessary additions to reserves [3].

38. Concern about the impact of the tax system on the form of business organization is expressed primarily in those reports dealing with countries which tax corporations under the same rate schedule as individuals, but there is also some discussion of this problem in the case of countries with separate rate schedules. Although the practice of taxing individuals and corporations under identical schedules may not be too undesirable in a society where virtually all corporations are family owned and managed, it is not considered appropriate in a more economically developed country where a considerable number of large non-family corporations exist [45] and may even act as a potential deterrent to the development of large-scale corporations which are so essential for bringing together the capital of a great number of individuals [4]. On the other hand, where separate rate schedules do exist, some reports express concern about the possibility that the tax system may prevent the emergence and development of small corporations. For this reason, it is sometimes recommended that reduced rates be levied on corporations below a certain size so that the corporate rate is definitely below the rates which are

^{35/} For the most part the reports which favour differential treatment for reinvested profits appear to recommend that the granting of benefits be limited to investment in physical capital; occasionally, however, a report may recommend the inclusion of intangible investment in research and development [13].

likely to apply to the stockholders as individuals [18], or it is suggested that corporations with fewer than a given number of stockholders be granted the option of being taxed as either a corporation or a partnership [10]. Under either form of recommendation the advantages of the corporate form of organization are retained, and the emergence of new corporations is not impeded by unduly severe taxation.^{36/}

B. The Taxation of Capital Gains

39. The views of the missions on the taxation of capital gains, like their attitudes on the integration of individual income taxation and corporate income taxation, reflect a difference of opinion between those who believe that the proper treatment of such gains is independent of the stage of economic development and those who argue that capital gains taxation should be adapted to the particular characteristics of under-developed economies. This latter group, in turn, divides into reports which emphasize the need in under-developed countries for particularly heavy taxation of some sources of gains and reports which stress the desirability of giving favourable treatment (or exemption) to other sources of gains. It should be recognized, however, that the missions which approach the problem from the standpoint of the similarity of capital gains in developed and under-developed countries are in a minority. Moreover, they are concerned with what are essentially semi-industrialized and semi-developed economies; emphasis in these cases is given either to the role of capital gains taxation in achieving partial integration of individual income taxation and corporate income taxation [45] or to the fact that capital gains are like any other kind of income differing only in that they are obtained over a period of years and should therefore be handled by some method of averaging [25].

^{36/} Where the corporate form of organization is already widespread, the principal problem with closely-held corporations is avoidance of the individual income tax; when stockholders have effective control over both salaries and dividend policy, they can, of course, allocate profits in such a way as to minimize over-all taxes. The one technical assistance report which goes into this problem extensively recommends that closely-held corporations be taxed as partnerships on a mandatory (rather than an optional) basis [25].

40. The majority of the reports recommend selective tax treatment of capital gains based on categories differentiated with respect to the source of gains. As would be expected, however, there are differences in the emphasis given to particular categories. Some reports, for example, favour relatively high rates on gains from unimproved land and relatively low rates on the sale of industrial plant [12] [13]. Other missions strongly recommend that gains originating in the sale of securities be exempt in order to promote the creation and development of a local capital market [16], and one technical assistance expert goes so far as to state that all gains except those arising from the sale of land be granted tax-free status so as to promote industrialization, capital formation, and general development [10]. There is even a rather ingenious device recommended for achieving differential treatment within the industrial sector itself: Capital losses realized in a list of designated preferred industries would be permitted to be deducted in full from total income, while losses realized in other industries could be offset only against capital gains [40].

41. The one type of capital gain in an under-developed economy that is singled out most frequently for particularly heavy taxation is, of course, that originating in the sale of land. Many of the mission reports suggest that the imposition of a schedule of rates which varies inversely with the period of time the land is held will A) act to discourage the frequent speculative buying and selling of land that is characteristic of so many under-developed countries and, at the same time, B) give the government a reasonable share in the social values created by population growth, public improvements, and other factors which are not the result of individual foresight and initiative [9]. However, the essential incompatibility of these two objectives is recognized in one report [10] which points out that, if the rates are to be set high enough to be effective in discouraging speculation, the period of time covered in the tax-base would have to be limited to no more than five years -- with the result that the so-called "unearned increment" would substantially escape the capital gains tax.

42. A different sort of conflict sometimes arises in the case of gains realized through the sale of the capital assets of a business. During an inflationary period

it frequently may become more profitable to sell such assets than to continue to employ them in business operations.^{37/} It has been suggested, however, that waiver of the capital gains tax in cases where the asset is replaced within a given period of time is an excellent way of avoiding excessive taxation of the normal turnover of capital assets and, at the same time, of discouraging purely speculative transactions [25].

^{37/} There is, with few exceptions [37], very little discussion to be found in the reports of the impact of inflation on capital gains taxation in general. Presumably this is because the missions are, in this particular instance, more concerned with curbing speculation than with abstract questions of equity.

III. The Views of the Missions on Selected Problems in Other Kinds of Taxation

43. The views of the technical assistance missions on selected problems in other kinds of taxation can be usefully analyzed under five headings: A) the taxation of land and property; B) the taxation of consumption and domestic trade; C) the taxation of foreign trade; D) inheritance and gift taxation; and E) municipal and departmental taxation. It should be recognized at the outset, however, that the treatment which the reports give to these topics is far less exhaustive than in the case of income taxation and tends, at the same time, to show a significantly greater consensus of agreement. Moreover, much of the discussion deals with problems which are essentially administrative in character and which fall, as such, outside the scope of the present report.

A. The Taxation of Land and Property

44. All of the missions, for example, recognize the extremely vital role of land and property taxation in under-developed economies, but only a very small part of their analysis is concerned with purely policy issues. The emphasis is for the most part on such factors as better trained assessors and improved assessment procedures, adequate land surveys and property censuses, and the need for periodic reassessments to take account of higher values resulting from economic expansion, population growth, and (most especially) inflation. Much of the treatment of these problems is, moreover, of only limited general interest, for although each of them has some relevance for all countries, the degrees of their severity and interrelationship vary considerably.

45. Collation of the policy recommendations of the reports on the subject of land and property taxation is also made difficult by these variations, and within the particular area of rural land taxation these are additional complexities created by different patterns of land use, different systems of land tenure and ownership, and different distribution of land holdings. Nevertheless, the great majority of the missions stress, in one way or another, the importance of employing the tax system to improve the economic utilization of agricultural land. Some reports apparently

believe that a combination of a realistic level of assessments and a reasonable scale of proportional rates would in itself be sufficient to discourage the holding of idle farm land [3/34], while others argue that this result could be achieved more effectively through progressive rates levied on either individual parcels [40] or cumulative holdings [28]. Frequently, however, a report will go further and recommend either a flat percentage penalty tax on unused cultivable land [10] [13] or the introduction of a more complicated system in which there is a progressive increase in the basic tax rate to the extent that net income falls below a certain percentage return on market value [12]. In some instances, furthermore, missions are concerned more with the encouragement of the full development of agricultural land than with its mere utilization. Although some of the foregoing recommendations would also tend to serve this purpose, it is also possible to introduce more direct measures to further this aim in the form of differential taxation for non-developed or under-developed land [7] or favourable income tax treatment [18] [34] for land development expenditures.^{38/} One mission even recommends [31] an elaborate system of land tax exemptions for farmers who agree to a specified list of land improvements.^{39/}

46. Another question which is raised frequently by the missions is that of exemption of small rural land holdings. This is, in part, a purely administrative consideration since the costs of assessment and collection may easily exceed revenue yields in the case of parcels below a certain size.^{40/} However, basic social and economic issues

^{41/} Surprisingly, very little discussion is to be found in the reports of the subject of special assessments or benefit taxes. There are, however, certain exceptions as in the case of a mission which strongly recommends that such charges be imposed for land that is improved through state irrigation.^{43/}

^{39/} Just how applicable this procedure would be to most under-developed countries is questionable, however, because the major incentive in the case of Libya was not so much a lower tax burden as the possibility of obtaining full legal title to the land.

^{40/} It has been pointed out, however, that even if such parcels are exempted, they should be included on the registration rolls so as to prevent fragmentation of holdings. [28]

are also involved. Some missions, for example, recommend exclusion or exemption of small parcels to prevent hardships to subsistence farmers [45], while others either contend that poverty does not justify exemption because taxes are levied for all the people [31] or believe that, if a piece of land cannot bear a minimum tax, it is probably unsuitable for private ownership [3]. In general, however, the reports tend to confirm the view reached at the Geneva Conference on Comparative Fiscal Administration [54] that, if the small farmer is to be taxed at all, land taxation is the most suitable vehicle.^{41/} The taxation of land, it is believed, is clearly superior to the available alternatives since production taxes tend to be notoriously perverse in their effects and marketing taxes act to prevent the emergence of the much-desired market economy.^{42/}

47. The treatment in the reports of urban real estate taxation and general property taxation is rather sporadic and inconclusive. There does, however, appear to be some agreement that urban land should be taxed more heavily than buildings either through basing assessments on capital values rather than rental values [45] or through taxing land at progressive rates and other real property at proportional rates [28].⁴ On the other hand, there seems to be definite disagreement as to a) the inclusion [10]/[16] or exclusion [3] of "movables" in the property-tax base and b) the deduction [40] or non-deduction [25] of such business assets as inventories, office furniture, and goodwill from that base.

^{41/} The missions also tend to agree that land taxation is the best method for taxing middle-size farmers — the consensus being that such farmers should not be made subject to income taxation (although it is occasionally argued that only the exemption of non-monetary income is necessary [44]). The case of the large farmer, however, involves the over-all policy disagreement referred to in paragraph 16, above; the majority view favors income taxation, but some reports recommend that land taxation be used as a temporary substitute [9] [31].

^{42/} The precise nature of the perverse effects of production taxes will vary with the nature of the base (for example, livestock, trees or cereals) and of the individual conditions of the country [31] [42].

^{43/} The interesting program of comprehensive land taxation recommended for Jamaica does, in fact, extend this principle to rural land as well [28].

B. The Taxation of Consumption and Domestic Trade

48. The views of the missions on the taxation of consumption and domestic trade exhibit a very high degree of agreement, and the consensus to be found in the reports on this subject is probably greater than in any other major area of taxation. Such frequently made recommendations as the need for selectivity in the consumption-tax base and the desirability of substituting ad valorem for specific taxes have already been mentioned (paragraph 17). There are, however, other recommendations which have been made so repeatedly that they can be summarized briefly:^{44/}

A) the preferability of excise and sales taxes to turnover taxes, gross receipt taxes, and stamp taxes; B) the need to avoid imposing indirect taxes on the manufacturer's level so as to prevent excessive pyramiding; C) the desirability in economically less developed countries of levying sales and excise taxes on the wholesale (rather than retail) level so as to facilitate collection and administration; D) the need to eliminate the practice of earmarking and to consolidate the many other different individual taxes which are frequently imposed on the same item as a result of historical accident; and E) the desirability of eliminating the very large number of patentes, licenses, and nuisance taxes which raise very little, if any, revenue and merely interfere with the efficient conduct of business operations.

C. The Taxation of Foreign Trade

49. The views of the missions on import taxes tend to exhibit almost as much consensus as in the case of taxes on consumption and domestic trade. A majority of the reports, as has already been pointed out, recommend exemption or low rates of duty for imports of equipment and also advocate that tariffs on consumption items be highly selective and levied on an ad valorem basis. It is, on the other hand, somewhat difficult to determine just what the consensus of opinion is with respect to export taxation. Many of the reports recognize the ease of collecting such taxes and the desirability of imposing sliding-scale rates based on price, but at the same time they emphasize that export duties discriminate against the export sector as a whole and among high-cost and low-cost producers within that sector. There has also been, as noted in paragraph 17, a growing disenchantment with the possibilities of utilizing export taxes as a major long-run source of government revenues; the tendency among the technical assistance experts is to treat export taxation as being A) either a stand-by supplementary device for

^{44/} One interesting example of a comprehensive suggested redrafting of a revenue code is to be found in the report of a special mission appointed by the Government of Ecuador, which included representatives of a number of different technical assistance agencies ^{15/}.

curbing inflation and taxing excessive profits during periods of cyclically high export prices or B) an evolutionary method, involving both credits and refunds, for effectively bringing the net profits of the export industries under the scope of general income taxation.^{45/}

D. Inheritance and Gift Taxation

50. The missions for the most part favour fairly heavy death taxes believing that such duties have far less detrimental effects on savings and investment than do taxes which are more closely related to the production of incomes.^{46/} In addition, the introduction of gift taxes is strongly advocated in cases where they do not already exist [43], and it is also recommended, almost without exception, that gift taxes and estate (and/or inheritance) taxes be levied on a common cumulative base. Some reports show no relative preference for inheritance or estate taxation believing that either type can be made to serve the purposes of raising revenue and checking the undue accumulation of wealth [45]; others, however, definitely favour the use of an estate tax because of administrative convenience, greater yield, and the fact that progressive rates can be more easily applied [34] [40], while a third group appears to favour, for reasons of social justice, the inclusion of both types of death duties in the tax system [9].

E. Municipal and Departmental Taxation

51. Quite a few of the reports are keenly aware of the critical responsibilities which fall on lower levels of government in developing countries and emphasize the need for such governments to provide a satisfactory amount of social and

^{45/} Even if there is full or partial integration of export taxation and income taxation, there still tends to be some discrimination against the export industries as compared with other industries because of time-lags in payments and refunds [36].

^{46/} Only one of the reports surveyed recommends introducing incentives or exclusions in connexion with death taxation and advocates that private corporate securities of all types and the value of partnership interests in certain designated areas be included at only 50 per cent of full value [40].

educational services and to carry out such economic activities as the construction and maintenance of secondary and feeder roads. As a result, the desirability of greater independent taxing powers for local governments is frequently stressed,^{47/} but while some reports seem unclear on the question of whether the taxable capacity of municipalities would be sufficient to meet local needs adequately ^[44], others appear definitely convinced that the answer to this question is either affirmative ^[40] or negative ^[24]. Sometimes the emphasis is placed on the need for more elastic revenue sources ^[33], and occasionally missions recommend the use of income taxation either through the direct implementation of local income taxes ^[7] or the introduction of a supplementary nationally administered tax the proceeds of which would be returned to the state governments ^[45]. Attitudes on the relative suitability of grants-in-aid and shared taxes differ in the reports which raise this issue at all -- some missions apparently favouring the latter ^[24] ^[45] but one mission definitely preferring grants-in-aid because of their greater flexibility and sensitivity to varying local needs ^[40].

^{47/} There is not very much discussion of whether there should be two or three levels of taxation within a country. Of those missions which go into this subject, reports dealing with Venezuela and Mexico strongly advocate giving the states independent taxing power ^[45] or more elastic revenue sources ^[33], while another report covering Bolivia recommends that the departments be deprived of their existing powers because the three-tier system is too elaborate for a country of her size ^[3].

IV. Taxation and Technical Assistance: The "State of the Art"
as Reflected in the Mission Reports

52. The main justification, as stated at the beginning of this report, for making a comprehensive survey of the policy recommendations of tax missions was to obtain useful perspective on the pattern and evolution of thinking in this field as reflected in approximately sixteen years of technical assistance experience. Unfortunately, however, our review and interpretation of the existing body of reports has not yielded completely unambiguous answers to either of these questions. With respect to the pattern of recommendations, for example, although the section on over-all tax policy clearly demonstrated that, when the reports are read and collated as a group, the consensus of opinion is very definitely that optimum tax policy can and should vary with the stage of economic development or under-development, it is extremely sobering to recognize that the following two sections showed just as clearly that the recommendations of the typical individual expert writing about different developed, semi-developed, and under-developed countries tend to bear much closer resemblance to one another than do the views of different experts dealing with the same country. On the other hand, the reports -- it is true -- do exhibit a definite evolutionary trend over time towards increasing recognition of the interdependence of recommendations on individual issues. But the majority of them have not carried this development to its logical conclusion; there is a growing consensus among experts in the field of public finance in general that the only effective method of creating a truly useful package of interrelated recommendations that takes full account of all tax policy criteria is by making estimates of the revenue yields of alternative policy combinations.^{48/}

53. The field of taxation has, however, always embraced more than purely technical issues, and this is particularly true in the specific area of technical assistance to developing countries. Since political economy is involved in

^{48/} According to the theory of public finance, not only do the marginal social costs of different kinds of taxation have to be balanced off against one another, but these in turn have to be assessed against the marginal social benefits of government expenditures. Ideally, therefore, a package of tax policy recommendations for a developing country could not be intelligently framed unless government expenditure policies were also taken fully into account. From a realistic point of view, however, it is probably asking too much of missions operating in the area of tax policy to do more than make rough implicit estimates of the probable amount and direction of government spending. See, on the other hand, paragraph 54 below.

addition to economics and public administration, the work of technical assistance missions must inevitably become as much, or more, of an art as a science. The growing intellectual awareness of the interdependence of individual taxes mentioned above and the increasing tendency to recommend over-all policy packages creates a definite dilemma for the politically-minded technician even when working in his own country, for it is quite politically unrealistic to expect any government to accept a complete package of recommendations. This basic dilemma becomes far more serious, however, when dealing with a foreign government -- especially in a developing country where there is probably a much greater degree of subtle interdependence involved among individual tax recommendations than in a highly industrialized country. Under these circumstances the chances are considerable that partial adoption of an expert's recommendations may actually produce detrimental rather than beneficial results, and in order to reduce this risk it would probably be both more realistic and safer for a technician A) to break down his over-all list of recommendations into groups of flexible interrelated sub-packages and B) to make sure, if given sufficient time to work with the government concerned, that the essential elements of each such sub-package are handled in an integrated manner.

54. From the standpoint of the governments of developing countries this survey of the recommendations of past technical assistance missions has revealed a number of interesting ideas and suggestions which merit their consideration and points also to the existence of a large number of potential laboratories in other countries for studying the effects of certain tax-policy alternatives.^{49/} But the major usefulness of previous reports for prospective government recipients of future technical assistance probably lies less in the realm of specific policies and ideas than in the broad terms of learning what formal specifications to give

^{49/} Apart from the major need for undertaking more work on the relationship between comparative economic structure and taxation, two other lines of inquiry for future research emerge from this preliminary review of the recommendations of technical assistance missions: A detailed study of the degree to which the suggestions contained in individual reports have been implemented, to be followed by an empirical investigation of the practical economic and fiscal effects of those recommendations which have actually been introduced.

to missions and how to interpret their reports. Given the considerable interdependence which exists among individual tax policies in developing countries, governments should become more aware of the need for missions with fairly broad frames of reference and of the potential dangers involved in adopting only some of a group of recommendations. They should, moreover, recognize that their expenditure policies have considerably more critical significance for economic development than their tax policies and that the latter cannot be realistically framed independently of the former.

55. For the organizations which sponsor technical assistance missions, a review of the reports of past missions in the field of taxation raises definite questions with regard to the kind of expert to be utilized and the type of mission to be sent. In the light of the many delicate economic interrelationships involved in developing a meaningful package of policy recommendations, it is not, on the one hand, at all surprising that -- from the strict standpoint of tax policy alone -- the reports prepared by economists seem, on balance, to exhibit a better over-all perspective than those written by specialists with other functional specialties and that, among the economists, those who also possess broad general economic backgrounds appear to do a more effective job in bringing in the co-ordination of tax policies with other kinds of government policies than do men who are exclusively specialists in taxation or public finance. On the other hand, too much reliance on economic generalists also appears, on the basis of past reports, to produce less than optimum results, for it is equally clear that even the best policy recommendations can have little or no effectiveness unless they can be implemented through practical legislation or reasonably efficient administrative procedures.

56. What is probably needed most in the area of technical assistance in taxation, therefore, is much greater co-ordination of the work of administrative specialists and policy generalists than has been possible within the confines of formal one-shot visiting missions, and in view of the conclusion reached above as to the real need for developing flexible sub-packages of alternative recommendations,

it would appear that the usefulness of missions which merely submit a formal report and then depart is even more limited. For these reasons it is reassuring indeed to see the degree to which the various organizations sponsoring technical assistance programmes in taxation are moving increasingly in the direction of stationing continuing advisory missions in countries for extended periods of time.

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