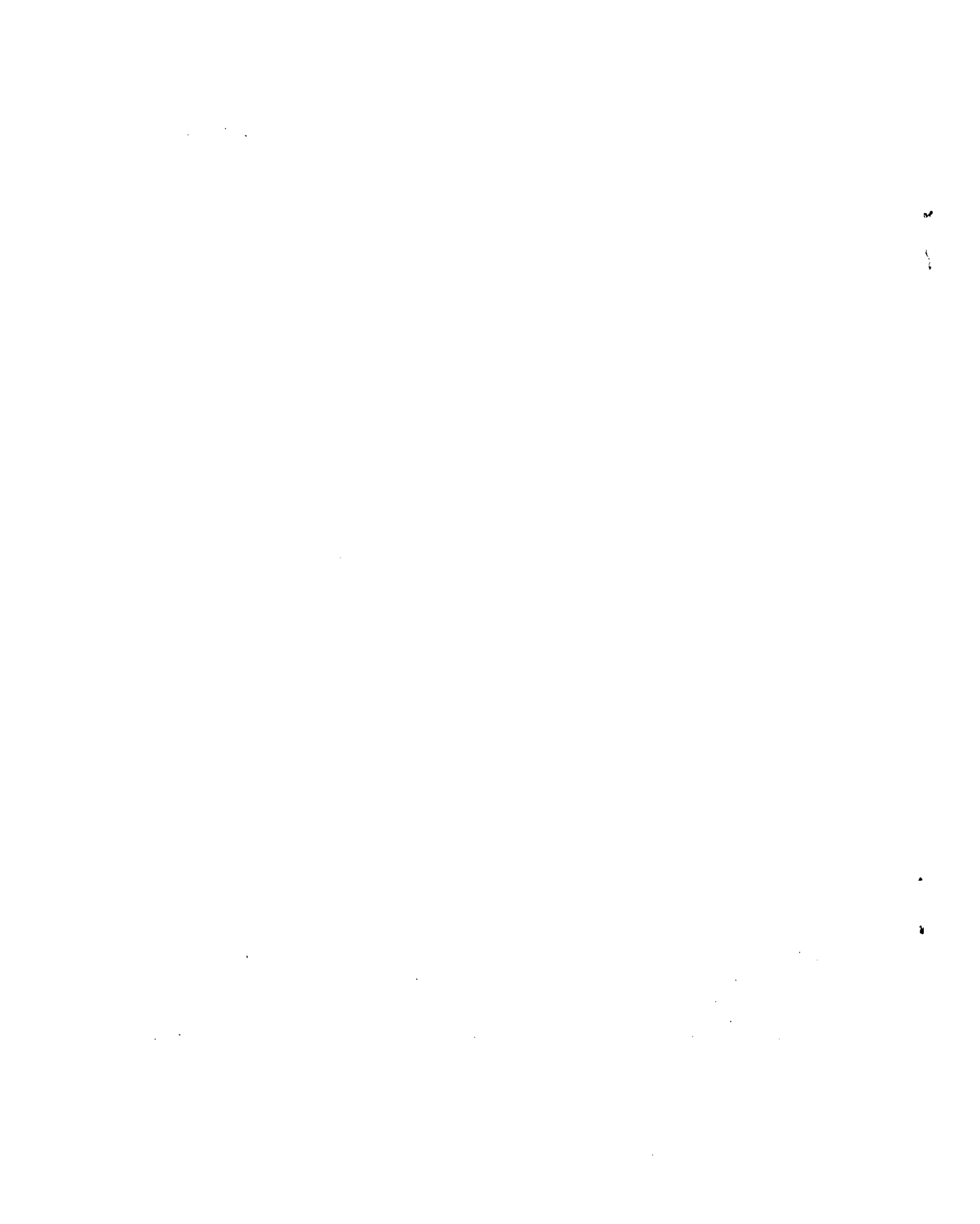


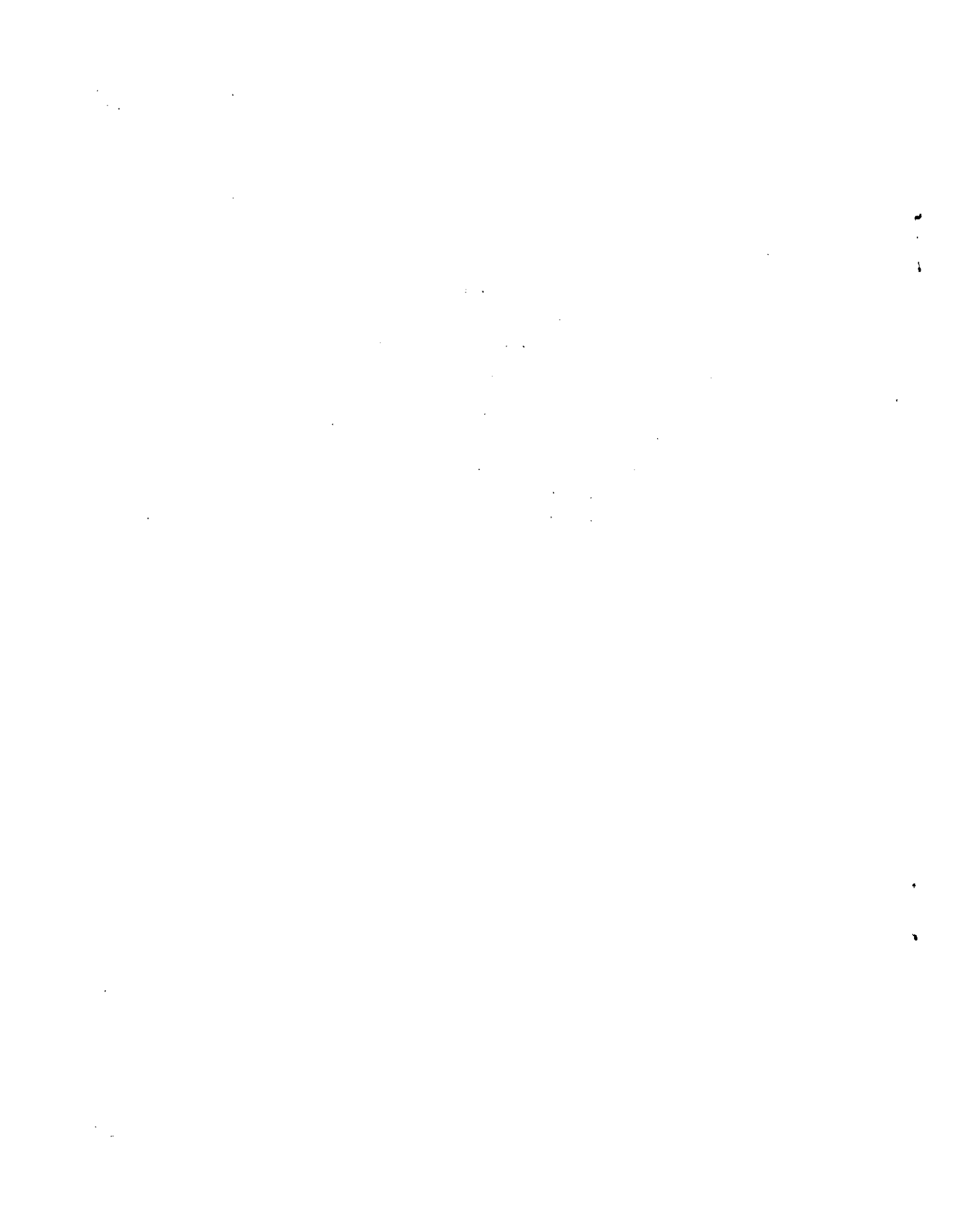
COMMENTS ON THE PAPER PRESENTED BY PROFESSOR MORRISSON:
"THE REDISTRIBUTIVE CONSEQUENCES OF PUBLIC CHOICES
ACCORDING TO THE DEVELOPMENT OF ECONOMIES"*

* Presented at the Congress of the International Institute of Public Finance, Hamburg, 4-8 September 1978. This paper was prepared by Mr. Federico J. Herschel, consultant of the OTC (UN) for Financing and Development at CEPAL's Mexico Office. The opinions expressed are of the sole responsibility of the author and do not compromise CEPAL.



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1. Introduction

Professor Morrison's paper is of extreme interest and great value, because it deals with admirable knowledge with one of the crucial problems in Public Finance for developing countries, i.e., the possibility to use fiscal instruments for redistributive purpose. It has also to be emphasized that the author tried to apply his methodology to 43 countries in order to arrive at some general conclusions.

I shall concentrate my comments not on the statistical procedures applied to measure the effects of taxes and expenditure based on the Gini and Theil indexes, distinguishing their intensity and progressivity, but on the substantial implications, namely the final results of the instruments used which I think require also some comments on the steps previous to measurement.

2. Coverage of taxes and expenditures

There are usually considerable differences between items included in various studies made in different countries. There are for instance different ways of considering social contributions, fees and similar revenues (f.i. betterment levies and profits of state monopolies, e.g. liquor and lotteries.^{1/}

With regard to social contributions in the present case, there seems to be a justification to include them among taxes, as the social benefits (welfare) are apparently included and the contributions mentioned finance the total or a considerable part of the corresponding benefits.

The problem of taxes covered is by no means negligible and it could change intensity and progressivity of taxes and transfers and therefore G' (Gini index of income after transfers) and the resulting comparison among countries (in order to illustrate possible differences in table 1 we have indicated taxes/family income and taxes/GDP used by ECLA.

^{1/} Cf. Richard M. Bird and Luc Henry de Wulf, "Taxation and Income Distribution in Latin America: A Critical Review of Empirical Studies", Staff Papers, Vol. XX, No. 3, Nov. 1973.

Table 1

TAXES IN RELATION TO FAMILY INCOME AND TO GROSS DOMESTIC PRODUCT

	Family income ^{a/}	Gross domestic product (1969/1970) ^{b/}
Brasil	13.0	27.0
Costa Rica	17.2	14.1
El Salvador	14.9	10.4
Argentina	9.9	15.0
Colombia	8.0	13.4
México	19.9	10.0
Chile	26.9	21.8
Perú	19.0	17.0

a/ Professor Morrison estimates.

b/ CEPAL, Indicadores del desarrollo económico y social en América Latina (E/CEPAL/1021), Santiago, 1976.

Of course the first relation should be greater, but this assumption is not fulfilled in 3 of 8 cases; on the other hand, the difference in the case of Mexico seems very great.

3. The classification of taxes

Taxes are classified under the traditional headings of direct and indirect. This division is generally associated with the distinction between taxes which cannot be shifted (direct) and those which are assumed to be shifted generally to the consumer. Has this been the criterion used in Professor Morrison's paper?

As we shall see this problem has considerable weight taking into account the question of incidence.

4. The decomposition of direct and indirect taxes

Different from expenditures, where the main items are specified; in the case of taxes only direct and indirect ones are distinguished. This question is of course related to the problem of incidence, which we shall refer to later on, and to the coverage of taxes, but whatever taxes were included in each group, it would have been important to give a list of the main taxes included and specify the degree of progressivity and intensity in each case. If we think for instance in the possibility of tax reform, in order to increase tax progressivity it would not be sufficient just to recommend a higher proportion of direct taxes instead of indirect ones, but to make specific proposal for individual taxes.

In fact only the higher regressivity of indirect taxes in the case of the Philippines is mentioned, where the extreme value of $C - G$ of -0.136 is mainly attributed to the overall importance of taxes on tobacco and alcoholic beverages. Why f.i. is the value of C for indirect taxes so high in Colombia? According to the McLure's Study, taxes on alcohol, tobacco and beer seem to have the highest intensity and

/are highly

are highly regressive; then comes the Sales Tax which is also regressive, Import taxes are very significant but they are mainly paid by the middle classes (5th and 6th bracket on a total of 9) and only motor vehicle taxes are clearly progressive but have a very low intensity.^{2/} It would be particularly stimulating to know whether some part of the indirect taxes are progressive in view of the significance which is frequently attributed to the role of taxes on luxury or unessential goods.

In the case of the direct taxes what taxes are included? Here we do not only have the Social Security taxes in mind, but also the Corporate Income Tax or income tax on firms as it exists in many Latin American countries, as well as net wealth, property and inheritance taxes. At some instance - commenting low progressivity in Iran - one gets the impression that only the Income Tax has been taken into account.

5. The hypotheses on tax incidence and the progressivity of the system

Unfortunately in Public Finance there is no general agreement with regard to the final incidence of each tax, i.e., who are in fact the groups who pay it.

One of the taxes whose incidence has been subject of considerable controversy is the Corporation Tax. As already mentioned, in many developing countries there are progressive income taxes on firms, whatever their legal form of organization, although in some cases the progression is different for each type. Again, there is no general agreement on its final incidence. Therefore the question arises whether they are included under direct taxes, i.e., not shifted or at the contrary, are treated as indirect?

In the case of social security taxes - in case they are considered at all - the same question arises as some authors think that they are

^{2/}Richard E. Musgrave and Malcolm Gillis, The Incidence of Taxation in Colombia, Fiscal Reform for Colombia, The Law School of Harvard University, Cambridge 1971, especially pages 258 and 259.

borne by the employee in the part legally imposed on them and shifted to the consumer in the part legally imposed on the employer. At the contrary some economists support the thesis that the total of the social contributions falls on wages or on the consumer. In case of considering a partial or total incidence on wages we would have a direct tax which would be clearly regressive.

Export taxes are usually considered as indirect taxes. Nevertheless if prices of the taxed products are fixed by the world market shifting to the foregoing importer is not possible and the corresponding taxes have to be borne by the producer.

How were these cases treated in professor Morrison's paper?

In a study prepared in Costa Rica, which refers to tax incidence in that country, social security contributions were considered supported by the employee in the part paid legally by him and shifted to consumer in the part paid legally by the employer; in that way those tributes became the most regressive element in the tax structure. An alternative estimate considering social security contributions borne totally by the employer accentuated even more its regresiveness.^{3/}

As a result of considering the tax on firms - excluding the agricultural sector - shifted to the consumer, tax incidence of the total of income tax was only moderately progressive.

In a study realized on tax burden distribution in Argentine Social Security contributions also were an important element of overall regressivity.^{4/}

6. Distributive series used for allocation of taxes and expenditures

Once criteria for incidence are established there still remains the problem of determining the distributive series used to allocate each tax.

^{3/} Incendencia fiscal y distribución del ingreso en Costa Rica, Ministerio de Hacienda de Costa Rica (CEPAL/SDE/77/C4) agosto de 1977, Vol. I.

^{4/} Cf. F. J. Herschel, Ensayos sobre política fiscal, Edersa, Madrid, 1975., p. 433.

/For instance,

For instance, taxes on consumption of alcohol may be distributed in accordance with the significance of that item in the consumption of different income groups, but sometimes finding an adequate basis is not so easy.^{5/}

How are import duties on manufactured goods distributed, as some of them may be raw materials or capital goods? Although sometimes general rules must be used (f.i. distribution according to general consumption for each income level) as there may be different criteria for allocation, its application may also influence the degree of progressivity of the system.

7. The progressivity of expenditures

The classification of expenditures according to their progressivity seem to prove that "specific expenditures may constitute the most important fiscal method of redistributing income^{6/} and within this group, as Professor Morrison determines, education, health and social welfare are the most progressive." In the Study on Costa Rica in fact the 3 belong to the most progressive type of expenditures, and prove in one case more Professor Morrison's statements. Land distribution was very progressive, meanwhile tourism, transport, culture and sport is erratic and energy regressive.^{7/}

In spite of our general agreement with Prof. Morrison, it would be interesting - perhaps in some future research - to determine the results in some extremely underdeveloped country, in which high rates of analphabetism and/or low levels of health indicators create the a priori impression that households in the first deciles do not receive

^{5/} Government on the Distribution of Personal Income in Canada, The Review of Income and Wealth, series 21, No. 1, March 1975.

^{6/} Cf. Luc de Wulf, "Fiscal Incidence Studies in Developing Countries: Survey and Critique", Staff Papers, Vol. XXI, No. 4, March 1975.

^{7/} Incidencia fiscal y distribución del ingreso en Costa Rica, Ministerio de Hacienda de Costa Rica, op. cit., Vol. II.

a larger share of the transfers, unless of course its intensity is extremely low. It would also be important to know the absolute per capita amount corresponding to each group.

Of course the incidence of public expenditures does not measure total inequality with regard to health and education as rich people may pay for it. In this connection it is interesting to keep in mind that in many Latin American countries private schools receive subsidies from the government.

With regard to land reform in the case of Costa Rica it is an extremely progressive type of expenditure.

The regressivity of university education seems also quite convincing in the general Latin American experience, according to which even if there are no fees, member of the lower income groups do not have the means to reach the university level (with the exception of a few countries where special assistance is provided).

Although it would not be fair to make such a demand with regard to the very elaborate and laborious paper by Prof. Morrison, I think that some type of evaluation of results would be necessary (f. i., retention rates in primary education, as drop-outs almost certainly concentrate in the lower deciles.^{8/}

A question which seems worrisome is the treatment given to pure public goods (or general benefit expenditures) as their different allocation formula may change considerably the overall progressivity as can be seen in Table 2.

8. Incidence of taxes and expenditures compared

In spite of greater initial inequality of income distribution in LDC's compared to developed countries, their fiscal action is less effective, so that differences between G and G' are lower than in DC's and not very significant.

8/ Cf. Vito Tanzi, Redistributing Income through the Budget in Latin America.

Table 2
BRASIL: EXPENDITURE INCIDENCE
(Percentage of total income)

	Income classes (in thousand of cruzeiros)								
	Less than 99	100-149	150-240	250-349	350-499	500-799	800-1 299	1 200-2 399	2 400 y más
<u>Total expenditure allocation</u>									
General expenditure on an equal per capita basis	63.58	41.22	31.00	25.34	17.65	15.43	12.69	9.51	9.13
Proportional to income	22.83	21.04	18.92	19.44	15.18	15.55	14.58	12.93	13.76
Assuming U = 1 -1/Y	17.52	15.92	14.21	15.15	11.35	12.52	12.76	13.81	24.17
Specific benefit expenditure allocated only	16.93	14.53	15.10	15.85	11.39	11.82	7.59	6.20	7.73

Source: Luc de Wulf, "Fiscal incidence Studies in Developing Countries: Survey and Critique", Staff Papers, Vol. XXII, No. 1, March, 1975.

How would the final results be affected if general government expenditures were included and not considered neutral and how would the change be if tax financing were not taken into account?

Considering that $G - G'$ is already near zero, could it not happen that the initial statement: "in every country, income distribution is less concentrated after taxes and public expenditures" would not always be valid?

9. Redistribution and Development

The fact that there are more countries in classes 3, 4 and 5 with GNP/capita ≤ 300 , and on the other hand the stronger redistribution in developed countries could show some evolution in accordance with the Kutzets hypothesis (the U shaped curve) but referred not to the initial income distribution, but to the action of Public Finance.^{9/}

If development is not a determining factor, others should be tried, f.i., initial distribution. Of course the effect could act both ways if governments consider actual needs or are forced by economic power. Again it seems sometimes to be useful to make geographical divisions as in each continent, f.i., differences could be sensible due to cultural heritage, recency of political independence, etc.)

I wholeheartedly support the author's statement that denying the priority of satisfying basic needs would come from a political choice.

It has also to be kept in mind that these needs are much more urgent in developing countries, as they could imply starvation, analphabetism and what not.

Concerning the possible availability of funds I do not see why there are some limits according to the level of development (f.i., GNP/capita > 1000), as according to table 9 of Prof. Morrison's papers, there is no relationship between total tax burden and degree of development. In this connection I think one cannot accept so easily that for one reason or another the state does not have the necessary funds. There again I think that the reasons are due to political choices but I also consider that one would not leave it just there but try to investigate what are these reasons or determinants of such choice.

^{9/} Cf. Montek S. Ahluwalia Inequality, Poverty and Development, World Bankk Reprint Series, number 36.

