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held at Santiago, Chile
on Wednesday, 12 December 1962, at 4.50 p.m.

Chairman: Mr. MENDIVE

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NOTE: Participants wishing to make corrections in the provisional summary record of their statements, for inclusion in the final printed report, should submit them in writing to the Editorial Section, either through the Conference Officer (Miss Eyzaguirre) during the Conference, or subsequently, by post, before 31 December, addressed to The Editorial Section, ECLA, Avenida Providencia 871, Santiago, Chile.

FISCAL PROBLEMS IN RELATION TO A COMMON MARKET (CPF-DB-7T, and Add.1 and 2)

Mr. COSCIANI explained that his paper had been based mainly on European experience in the field of economic integration, and that possibly, therefore, some of the lines of approach adopted might not be applicable to the Latin American situation. He would have liked to expand the part relating to Latin America, but had not had at his disposal sufficient statistical and legislative documentation on the fiscal systems of the region. He was therefore glad that Mr. Baca and Mr. Cazal would be giving additional information on the Latin American Free-Trade Area and the Central American integration system.

He suggested that it would be a mistake to attach too much importance to fiscal problems bearing on the establishment of a common market, and especially to take for granted that they might be a cause of distortions without sufficient evidence that the latter really existed.

In his paper he had defined two extreme cases of economic integration, namely, the customs union and the common market. The former was essentially a commercial union among several countries which retained their sovereign independence with respect to their economic policy. A common market, on the other hand, implied closer economic ties and the unification of the monetary, credit, economic and social policies of the member countries, as well as the establishment of a juridical structure capable of exerting a more direct influence on production and trade. The basic principles of a customs union could be summed up as follows: (a) the prohibition of fiscal discrimination; (b) a ban on the formation of tax havens; (c) the co-ordination of fiscal policy for development; and (d) the problem of dual taxation. In the last connexion, he indicated the desirability of multilateral conventions like those formulated in Mexico City and London, or the treaty currently being perfected by the Organization for European Co-operation and Development.

/The limitations

The limitations affecting fiscal legislation within a customs union related to the principle of taxation in the country of destination, in which context various methods had to be considered, such as exemption at the time of exportation, export drawbacks and compensatory import duties. A customs union implied the abolition of economic frontiers - those whose purpose was economic protection - and the maintenance of tax frontiers. The first of the limiting factors to be noted in connexion with the principle of taxation in the country of destination was the question of indirect taxes. The usual method of calculating the drawbacks and compensatory duties corresponding to the legal incidence of taxation on imported goods, was based on approximate averages implying discrepancies that were often impossible to eliminate and difficult to identify. The simplest solution would be to convert all multiple-stage taxes into a single tax on final consumption; or a tax on value added might even be introduced. The greatest difficulty lay in the dissimilarities between the fiscal systems concerned.

In its final form, a common market was analogous to an internal market, and should therefore be characterized by complete freedom of movement not only of goods and services but also of the factors of production. In that case the principle of taxation in the country of origin was applied, since the tendency was to do away with tax frontiers. To that end, some degree of harmonization of the fiscal systems of the various countries was essential, and its ultimate expression would be the establishment of a federal fund.

He thought that the fiscal problem was not yet very important for the Latin American Free-Trade Area, but that it was so in relation to Central American economic integration, owing to the fact that integration was rapidly being intensified. It would be desirable to set up a group of experts to study the problem.

/The CHAIRMAN

The CHAIRMAN explained that Mr. Cazal and Mr. Baca, who were commenting on Mr. Cosciani's paper, had been chosen not in their personal capacity but as representatives of the Latin American Free-Trade Area and the General Treaty on Central American Economic Integration, respectively.

Mr. CAZAL said he did not oppose Mr. Cosciani's view that a customs union and a common market constituted extreme cases, but in his opinion Mr. Cosciani's definitions of a customs union and a common market were relevant to Europe and differed from those applicable to other parts of the world (see CPF-DB-7/Add.2).

Although it might very well be that in other regions problems of fiscal policy did not arise, they did arise in Latin America, because there were many countries whose revenue depended upon customs duties, and when the various countries agreed to include a revenue-producing good in the common schedule of exemptions, the countries affected had to replace that source of revenue by another. Consequently, in Latin America a genuine problem of fiscal policy came to the fore even in the initial stage of product-by-product negotiations.

The basic objectives of the Montevideo Treaty establishing the Free-Trade Area were the progressive liberalization of existing trade through the gradual elimination of tax berriers, and an increase in the number of goods in which intra-Area trade was carried on.

As Latin America had no previous experience in the field of integration study had been devoted to the problems that might arise and solutions had been sought before any measure was adopted. In that connexion, he thought Mr. Cosciani's remarks on some of the fiscal problems that had presented themselves in Europe, where considerable previous experience of integration had existed, were of great interest inasmuch as Latin America could profit by such object lessons and avoid stumbling into the same pitfalls. With reference to Mr. Cosciani's suggestions as to the establishment of a federal fund, he concluded that political integration would be needed to solve most of the difficulties.

Since all the Latin American countries were currently overhauling their fiscal policy, and in addition were striving after economic integration, it would be highly advisable to take future fiscal problems into consideration especially as many of them stemmed from the diversity of fiscal structures - and solve them in advance by endeavouring to introduce uniformity into the structures in question.

/Mr. BACA

Mr. BACA described the events leading up to the General Treaty on Central American Economic Integration and the principles by which it was inspired (see CPF-DB-7/Add.1).

With reference to tax havens, he said the problem had been bypassed in Central America, as had that of dual taxation, because the tax on bearer securities, which offered most opportunities for evasion, was collected at the corporate level and at the same rate as personal income tax. The solution was not altogether satisfactory, since it discriminated against the large-scale business enterprise, which was precisely the type that should be encouraged.

In Central America the principle of taxation in the country of destination was always applied, since it was considered to be more equitable, especially as there were countries at a less advanced level of development than others, and it would not be fair for a less developed country to derive no revenue from the services rendered by the State for the protection of property and the development of enterprises belonging to foreigners.

Broadly speaking, fiscal problems did not seem very difficult to solve in Central America because the systems of the countries concerned closely resembled one another.

In reply to Mr. Cosciani's concluding remarks, he said that it had already been decided in Latin America to set up a group of experts to study the problems in question, and the assistance of the Joint Tax Program would undoubtedly be requested.

Mr. PIEDRABUENA drew the attention of the meeting to the Treaty of Montevideo. From the preamble it appeared that integration would soon be approached but the Articles themselves were often too unspecific in their phraseology and made no provision for some aspects of fiscal policy that were liable to cause difficulties in future, and which, as Mr. Cazal had pointed out, were extremely important.

One of the first gaps in the Treaty was the lack of measures to rationalize or limit the use of incentives in Latin American countries to entice foreign capital. No mention had been made of the problems of double taxation, or there was no explicit statement as to whether countries had a unilateral right to exempt exports from payment of duty. The question of

/fiscal subsidies

fiscal subsidies had been left unclear, and no attempt had been made to solve problems of monetary devaluation. Lastly, insufficient attention had been paid to the burden that social security contributions represented for enterprises and individual taxpayers, which was a high proportion of the gross national product.

Mr. JARACH considered that the matter of tax havens was highly important in relation to a customs union or common market. The achievement of economic integration at the cost of fiscal disintegration would defeat its own ends. Mr. Baca's view was that in Latin America the repercussions of the problem on corporations were inconsiderable. Clearly, however, even if dividends were taxed at the corporate level, there was still a loophole for evasion, as holdings might be falsified and a shareholder might thus evade personal income tax. Systems of corporate income tax would have to be brought into line with those applied to natural persons. A possible solution would be to maintain a relatively high level of taxation on corporations, but to give the shareholder the option of having his share of the profits taxed as personal income, a corresponding credit being allowed for the tax paid by the corporation.

Mr. MENDEZ seconded Mr. Cazal's points of view, particularly with respect to the gaps in the treatment of fiscal problems in the Treaty of Montevideo which had just been pointed out by Mr. Piedrabuena.

The Free-Trade Area created by the Treaty of Montrvideo should be regarded as the first step towards a more complete type of integration. Since it had already begun to advance towards that goal, the problems that would arise on the way should be studied without delay in order not to impede the realization of the stages that lay ahead. Unless immediate consideration were given to those problems and their solution, the results would be as serious as those of railing to devise a system of payments which would ensure multilateral equilibrium in the Free-Trade Area.

Since the Free-Trade Area was already being beset by fiscal problems at its present stage of development, it was clearly recessary for the signatory States to take steps to remedy the lacunae in the Treaty of

/Montrvideo, either

Montevideo, either through the Standing Committee or by means of resolutions taken at the annual conferences which could subsequently be incorporated into the Treaty. Otherwise there was a danger that discriminatory practices or exchange, fiscal and monetary manipulations would invalidate the concessions negotiated under the Treaty.

Mr. MATUS considered that there were two major aspects of the analysis of fiscal problems in relation to the common market, and alghough it was true that one of them - the question of how to perfect fiscal mechanisms for economic integration - had been sufficiently elucidated, it was equally undeniable that the other, which concerned the reconciliation of the use of fiscal mechanisms for economic integration purposes with their application in favour of planning aims, had not received enough attention. The operation of a common market or customs union entailed the rejection of certain instruments that had been applied by planners, because they might have discriminatory effects on trade.

Moreover, there was good reason to fear that in the early stages the Free-Trade Area might aggravate the inequity of income distribution, since there would be a tendency to invest in the introduction of technological improvements in existing industries; and at the same time, a price policy designed to create better competitive conditions would be pursued. If political and social structures were taken into account, such competition in Latin America would probably not be reflected in a reduction of entrepreneurs' profits, but would affect wage policies. Such a situation would be counteracted if the common market encouraged the establishment of new industries, but that would not happen during the early years.

He agreed with Mr. Piedrabuena that social security contributions raised a serious problem in that context; a common market might possibly restrict the scope of such systems, and that would also help to perpetuate the existing inequitable distribution of income.

Mr. CAZAL explained that the reason why he had not touched upon the points raised by Mr. Piedrabuena and Mr. Matus was because he had wished to confine himself strictly to the agenda item under discussion, and he felt that the topics in question could not properly be regarded as fiscal issues. He concurred with Mr. Piedrabuena's opinion that though the preamble to the Montevideo Treaty spoke of final objectives, the operative part was much

/more cautious

more cautious and vague. It should not be forgotten that the Montevideo Treaty was not describing a fait accompli but sketching a programme of future achievements. As its objectives were gradually attained, solutions would be found for the different problems. Thus, for example, the Montevideo Treaty said nothing of the maintenance of concessions and the problems of discrimination that might arise therefrom. But at the most recent meeting of the Latin American Free-Trade Association (ALALC), a specific decision had already been adopted in that connexion. By degrees, all the gaps in the Treaty would be filled.

With reference to Mr. Matus' comments, he did not see what limitations on the use of fiscal instruments for planning purposes were implicit in the establishment of a free-trade area. On the contrary, ALALC too was concerned, inter alia, with planning, and a meeting of planning experts to discuss such matters had already been convened for the first quarter of 1963. In Latin America the problem was not so much lack of co-ordination in the use of fiscal instruments for economic integration and planning as the lack of planning itself, even in countries of great importance in the region.

Mr. MOISES asked Mr. Cosciani how the Treaty of the European Economic Community had dealt with the difficulties that might be caused by the existence of State monopolies. For instance, a State monopoly in a given country might try to eliminate competition by levying an indirect tax on the particular item it produced whether its origin was domestic or foreign and then undercut its competitors in price.

Mr. NAHARRO referred to the harmonization of indirect taxation for purposes of economic integration, which he regarded as a serious problem that was likely to cause great difficulties in Europe in the near future and should be given immediate consideration by the Latin American countries. The theoretical drawbacks and advantages of harmonization had been fully dealt with by Mr. Cosciani, but he was anxious for him to give the participants his personal opinion on the practical problems faced by the European Economic Community in that respect and their possibilities of solving them in future.

Mr. MONTERROSO referred to the question of monetary planning in the Central American market. One institution set up for that purpose was the Central American Integration Bank of which the five countries that had signed the Treaty were members. The Bank took an active part in the work of planning since, before granting credit for new industries, roads, etc. determined whether the use to which the funds were to be put would aid the process of integration.

Another institution was the Central American Cámara de Compensación Centroamericana in Tegucigalpa, which had created a unit of account that was equivalent to the dollar at a given time, thus averting the dangers of monetary devaluation.

The Central American system was therefore more advanced than ALALC in that it was already making definite provision for the future.

Mr. COSCIANI, referring to Mr. Cazal's remark that the definitions of a common market and a customs union applied in Europe were different from those current in Latin America, said that he had put two extreme cases merely for simplicity's sake and that each treaty adopted brought into being unions which might resemble others in greater or in lesser degree.

With regard to the problem of the reform of fiscal structure, he thought that both short-term and long-term reforms would have to be applied. The former related to changes conducive to the creation of a customs union. With respect to the latter, which would pave the way for the establishment of a common market, it was advisable to proceed with caution to avert the risk of failure.

He agreed with Mr. Cazal that when a higher degree of integration was attained, it became easier to solve the fiscal problem and that it would ultimately be possible to move onward from economic to political integration.

He then referred to Mr. Baca's remarks to the effect that it was more equitable to tax goods in the country of origin than in the country of destination, because the taxes concerned could be regarded as payment for the public services by which an enterprise benefited, and ought therefore to be collected by the State providing the services in question. In his opinion, the tax ought to be applied in the country of origin of the good - as he had pointed out in his paper - subject to the necessary compensation because in that way uniform taxation on the consumer market could be

/achieved. The

achieved. The principle was not valid, however, in the case of trade between industrial and agricultural countries.

With regard to what Mr. Piedrabuena had said of the gaps in the Montevideo Treaty, he expressed the view that it was a trade treaty rather than anything else. He also agreed that there should be a higher regulating agency.

He did not think that drawbacks could be established in respect of social security contributions, which were a form of taxation impossible to compute. In Europe no such drawbacks were made, but it was a problem that would have to be taken into consideration if the United Kingdom joined the Common Market, since social security costs were a charge against the national budget.

In his opinion, the problem of specific taxes on consumption was insoluble, because the economic structure of the various countries differed, and if an attempt were made to tax similar goods and apply similar rates in all of them the financing of their budgets would be jeopardized.

With regard to the difficulties indicated by Mr. Naharro in the context of the harmonization of indirect taxes, he thought that the so-called "cascade" or multiple-stage taxes could be abolished, and that each country might establish whatever over-all tax it deemed most appropriate (a tax on value added or any other), with a system of exemptions.

In reply to Mr. Monterroso's question as to how the problem of monopolies might be tackled within a common market, he said that once such a market was established the creation of new monopolies would be prohibited, and that as far as fiscal monopolies were concerned, a distinction was drawn between fiscal revenue and business income.

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