PROVISIONAL
CPF/SR.10
11 December 1962
ORIGINAL: ENGLISH/SPANISH

JOINT TAX PROGRAM OAS-BID-ECLA

CONFERENCE ON FISCAL POLICY
Santiago, Chile, 5-14 December 1962

PROVISIONAL SUMMARY RECORD OF THE TENTH MEETING

held at Santiago, Chile

on Tuesday, 11 December 1962, at 3.50 p.m.

Chairman: Mr. MAGAÑA

CONTENTS:

Note: Participants wishing to submit corrigenda to their statements in this summary record for inclusion in the final printed version are requested to do so in writing to the Editorial Section through the Conference Officer (Miss Eyzaguirre) during the Conference. Subsequent corrigenda should be sent to the Editorial Section, ECLA, Providencia 871, Santiago, not later than 31 December 1962.

CORPORATE INCOME TAXATION IN LATIN AMERICA (continued)

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

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

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

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

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

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

/efficiency, more

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

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

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

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

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

/another. In

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

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

In the same field, there was the question of exemptions for invested retained earnings of corporations. Two possibilities were involved: differentiation in the taxation of undistributed and distributed profits and tax relief for capital investment. He did not agree that either should be applied arbitrarily. What was necessary was to determine the objective to be achieved and then to decide on the appropriate mechanism which would probably be blend of the two. An interesting suggestion had been put forward that companies making retentions should issue corresponding bonus shares which could then be taxed. That was tantamount to the partnership principle that undistributed profits should be allocated to shareholders and taxed accordingly. The case for that was a long-standing one, and seemed to him to have a number of advantages in theory but he thought it would be difficult to apply in practice.

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

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

/PRODUCTION AND

PRODUCTION AND CONSUMPTION TAXES AND ECONOMIC DEVELOPMENT
(Documents CPF-DB-6 and Add. 1)

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

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

The efficacy of indirect taxes as incentives could not be defined with the same precision as the effect of direct taxes.

Although import duties, for example, unquestionably exerted an encouraging influence on certain productive activities, as a general rule their repercussions were more marked in relation to some of the variables of economic development, such as distribution of resources, savings and investment and the labour supply. He was not concerned with their probable effect on income redistribution, since that had only a relative incidence on economic development.

In connexion with production and consumption taxes applied to the external sector, he drew a distinction between export duties, which were direct taxes, and import duties. In Latin America there was a trend towards protectionism, and he confessed that he was in favour of a moderate degree of protectionism or a moderate policy of free exchange rates. There were

/undoubtedly instances

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

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

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

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

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

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

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

/He agreed

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

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

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

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

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

/The former

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

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

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

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

/Argentina's experience

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

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

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

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

/He did

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

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

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

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

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

/They might

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

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

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

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

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

Mr. LEWIS stressed that the basic consideration before the meeting, with which he hoped Mr. Naharro would deal fully in his summing-up, was the question of indirect taxes, which produced from 30 to 90 per cent of total revenue in the different countries. The meeting should concentrate its future discussions on that question, with particular reference to practical aspects of application in a given country. Since the problems were quantitative the answers should be quantitative as well. His suggestion for a new approach should be linked up with Mr. Porras's statement on the previous day regarding the context of the net wealth tax. The property tax might be less efficacious than the net wealth tax, but from the practical point of view he supported Mr. Porras' contention that for the Latin American countries in the immediate future the property tax was best suited to deal with their revenue problems.

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

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

Mr. NAHARRO congratulated Mr. Vega on his excellent paper, which expanded and elucidated many of the ideas in the background document. He acknowledged that he had devoted little attention to development problems and that he had shelved the benefit principle, since he thought it was more properly applicable in relation to prices and tariffs for public utilities.

He dissented from Mr. Vega's opinion that production taxes fell on inventories and taxes on consumption did not. As an example he cited the tax on tobacco consumption in Spain. In his paper he had not gone into technical and administrative details on the application of such taxes because he thought that aspect had been sufficiently discussed at the previous Conference in Buenos Aires. As far as using national income

/or the

or the gross national product for purposes of comparison was concerned, he regarded that as a terminological rather than a substantive issue. He agreed that he had not taken tax collection by local authorities into account, but he did not think the omission affected the validity of his conclusions. Nor did he consider that taxes on consumption could reduce the level of savings; on the contrary, they were reflected in compulsory savings which passed into the hands of the Government.

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

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

He shared Mr. Herschel's ideas on the possibilities of channelling aggregate demand by means of indirect taxation. He explained that he had included Musgrave's table in his paper as background information, but its validity was no doubt limited.

In reply to the comments formulated by Mr. Pinto and Mr. Urquidi, he confessed that he was a conservative liberal, but he thought that however old-fashioned the terminology he employed, it expressed his ideas clearly enough. He fully understood the situation of Latin America and the need for developing the region beyond the traditional patterns.

He could not accept Mr. Urquidi's views on the private sector, since without its co-operation economic development would be impossible. He was surprised that Mr. Urquidi dismissed as absurd the paragraph he had quoted on the pressure which indirect taxation might exert on the labour supply, especially as Mr. Kaldor, without using exactly the same words, had expressed identical ideas, and Mr. Urquidi had raised no objection. He thought Mr. Urquidi's suggestion of a combined system of general and specific taxes was greatly preferable to the proposal of a tax on value added which had been discussed at other meetings.

The meeting rose at 7.10 p.m.