# Tax Performance and Reform in the OECS

UNITED NATIONS
ECONOMIC COMMISSION
FOR LATIN AMERICA AND THE CARIBBEAN
Subregional Headquarters for the Caribbean
CARIBBEAN DEVELOPMENT
AND COOPERATION COMMITTEE

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## Contents


| | | Page |
|---|---|---|
| Introduction | | 1 |
| Section 1: | Economic Structure and Recent Economic Performance | 2 |
| Section 2: | Savings and Investment | 7 |
| Section 3 | The Tax Systems in the OECS | 18 |
| Section 4: | Concluding Remarks and Recommendations | 30 |
| Appendix | Graphs | 38 |
| Endnotes | | 42 |

**List of Tables**

Page

1. Selected Demographic and Economic Statistics ........ 3
2. Annual Growth Rate of Real GDP at Factor Cost, 1987-97 ........ 5
3. Composition of GDP (at Current Factor Cost) 1987 and 1997 ........ 6
4. Gross Domestic Savings as a % of GDP,[1] 1986-96 ........ 11
5. Gross Capital Formation as a % of GDP,[1] 1986-96 ........ 12
6. Central Government: Current Budgetary Savings (Deficit)as a % of GDP,[1] 1987-97 ........ 13
7. Growth of Nominal Revenue and Expenditure, 1987-97 ........ 15
8. Composition of Current Expenditure, 1987 and 1997... ........ 16
9. Growth of the Outstanding (Disbursed) External Debt, 1981-96 ........ 17
10. Tax Revenue as a % of GDP[1] 1982-97 ........ 19
11. Comparative Tax Data on Selected Countries, 1986 ........ 20
12. Composition of Tax Revenue, 1997 ........ 22
13. Composition of Indirect Taxes, 1997 ........ 23
14. Tax Receipts as a % of GDP,[1] 1987 and 1997 ........ 25
15. Buoyancy (Tax Elasticity) Coefficients, 1987-97 ........ 26
16 Taxes on International Trade as a % of Imports of Goods and Non-Factor Services, 1986-96 ........ 31
17 Targeted Public Sector Savings for Member Countries of the ECCB ........ 32

# TAX PERFORMANCE AND REFORM IN THE ORGANIZATION OF EASTERN CARIBBEAN STATES (OECS)

## Introduction

Based on the evidence of the last few decades, it is widely accepted that the State can be an obstacle to development. The corollary to this, of course, is that public policy can play a pivotal role in creating a growth-oriented environment and in promoting change. Not surprisingly, the major thrust of the structural reforms of recent years has been in creating a more effective State that can work in partnership with the private sector for the public good. An appropriate regulatory and institutional framework is critical to the functioning of both the financial and real sectors. In this context, one of the most powerful instruments at the disposal of the State is the tax system which not only provides the government with the resources needed to carry out its functions, but can also be used to achieve economic and social objectives, such as growth, employment and equity. The tax system, however, is a double-edged sword in that it can be used to create or destroy incentives. Taxes not only impact directly on saving and investment, but are also a tool to redistribute income, influence resource allocation and deal with pressures bearing on inflation and exchange rates. In situations where there is limited scope for the use of monetary policy, the tax system takes on particular significance in addressing internal and external imbalances.

In practice, the tax system has to straddle several different functions at the same time, and its structure is influenced not only by culture, social and economic conditions, but by politics and power. A tax regime can never remain fixed, since changing circumstances can make it irrelevant or ineffective. Inflation, growth and changes in the structure of output, changes in the distribution of income, trade liberalization, demographic changes, the emergence of new influential groups, increased levels of social services, and so on, can force changes in the tax structure. Political parties are associated with different ideologies and priorities and as governments change, the approach to taxation and welfare may also change. Governments everywhere are under constant pressure to provide more and better quality services with less taxation, and in a democratic setting where elections decide who holds power, the need to meet popular expectations requires a considerable amount of creativity and innovation, given the fact that there are limits to taxation in any economy. The effect on effort and investment has to remain a major consideration. The immediate need for revenue, however, can overwhelm concerns over the distortions caused by particular fiscal measures, and the effect could be felt in the long-term performance of the economy.

In the Organization of Eastern Caribbean States (OECS),[1] the need to become more self-reliant and developments in the domestic economy and the international economic environment are creating pressures for change across a wide spectrum of governmental functions and activities. With respect to the tax system, the tax structure not only has to be considered in the context of the conjunctural factors emanating from national, regional and global trends, but also has to take account of the resource potential for increasing the standard of living. The constraints

of size on economic development has received a great deal of attention in the literature. Small markets are not only associated with diseconomies of scale which act as a disincentive to investment, but small size also results in high unit costs of infrastructure and production. A narrow resource base underlines some of the structural challenges facing these countries. Exposure to the devastating effects of storms contributes to a very volatile and unpredictable economic environment where gains made in one period can quickly be lost in another. In one country, Montserrat, the recent volcanic eruptions have devastated the economy and the social fabric, leaving a gigantic challenge in their wake. With the decline of traditional activities associated with the colonial economy, the OECS has used its location, natural assets, legal system and tax regulations to create new sources of income and employment. In the context of the challenges facing the governments in these countries, the administrative and institutional structures have to remain sensitive not only to changes in the society and economy, but to the demands of an open economy and developments in an increasingly competitive regional and international environment.

This paper is focused largely on the tax systems of OECS[2] members, and is organized as follows. Following the introduction, the first section discusses the salient features of the OECS economies and recent economic performance in these island States. The second discusses some issues relating to saving and investment. In the third, the tax systems in the OECS are outlined and evaluated. This includes a discussion on tax revenue and trade policy reforms. And in the final section some concluding remarks and recommendations are presented.

### 1. Economic structure and recent economic performance

As can be seen in Table 1, the members of the OECS are very small States both in terms of physical size and population. Saint Lucia is the largest with a physical size of 442 $km^2$ and a population of almost 150,000 while Anguilla and Montserrat are at the other end of the spectrum with areas around 100 $km^2$ and populations of less than 12,000. Population growth rates have been falling and are now less than 1 per cent per per year in most cases. Total GNP (at current market prices) in 1997 ranged from US$40 million for Montserrat to US$584 million for Antigua and Barbuda. Per capita GDP (at current market prices) in the same year ranged between US$2,530 for Saint Vincent and the Grenadines to over US$8,000 for Anguilla and Antigua and Barbuda, respectively. Output in Montserrat which had attained a per capita GDP second only to Antigua and Barbuda's has fallen as a result of the recent volcanic eruptions. Another salient feature of these economies is the high level of openness with imports of goods and services as a proportion of GDP amounting to over 60 per cent in most cases while the export ratio is generally over 40 per cent.

**Table 1**

**Selected Demographic and Economic Statistics**

| Countries | Area $Km^2$ | Population '000 | Population Growth | | Total GDP (1997)[1] | Per Capita | Inflation Rate (per cent) | Import[2] | Export[3] Ratio | Life Ratio | Infant Expectancy | Human Mortality |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Development Index | (1996) | Rate (per cent) | | | US$ mn. | GDP (1997) | 1987-97 | (1996) | (1996) | at Birth | Rate[4] |
| | | | '80-'90 | '90-'96 | | US$ | Average | | | 1996 | | 1995 |
| Anguilla | 91 | 11 | 2.4 | 4.1 | 90 | 8,180 | 3.9 | 101.7 | 72.1 | .. | .. | .. |
| Antigua & Barbuda | 442 | 68 | 0.5 | 0.4 | 584 | 8,340 | 4.6 | 86.8 | 78.2 | 75 | 18 | .895 |
| Dominica | 750 | 74 | 1.2 | 0.3 | 243 | 3,240 | 3.6 | 62.1 | 48.6 | 74 | 16 | .879 |
| Grenada | 345 | 99 | 0.7 | 1.4 | 324 | 3,240 | 3.0 | 50.9 | 43.3 | .. | 14 | .851 |
| Montserrat | 102 | 5 | 0.3 | -12.0 | 40 | 8,000 | 4.6 | 126.8 | 77.9 | .. | .. | .. |
| Saint Saint Kitts-Nevis | 269 | 43 | -0.3 | -0.6 | 268 | 6,090 | 3.4 | 62.6 | 44.0 | 70 | 24 | .854 |
| Saint Lucia | 616 | 147 | 2.0 | 1.0 | 571 | 3,800 | 4.0 | 70.0 | 68.0 | 70 | 17 | .839 |
| Saint Vincent and The Grenadines | 388 | 112 | 1.0 | 0.7 | 284 | 2,530 | 3.0 | 66.9 | 53.4 | 73 | 18 | .845 |

.. not available
1. at current market prices
2. imports of goods and services as a per cent of GDP at current market prices
3. exports of good and services as a per cent of GDP at current market prices.
4. per 1000 live births 1986.

Source: Caribbean Development Bank; Eastern Caribbean Central Bank; UNDP, *Human Development Report*, 1998; Judy L. Baker, *Poverty Reduction and Human Development in the Caribbean*, The World Bank, Washington, D.C. 1997; World Bank *Atlas*, 1998.

In the first half of the 1990s developing countries as a group grew by almost 5 per cent per year, but performances varied widely from region to region. In Latin America the rate was just over 3 per cent per year as compared to 1.6per cent for Africa and 6.4per cent for Eastern and Southern Asia.[3] In a large number of countries in Latin America, Africa and Western Asia, real per capita GDP in 1996 was less than that in 1980.[4] In the OECS, despite fluctuations in total production, the growth of real GDP in recent years has exceeded 3 per cent per year in most cases, while real per capita GDP growth has generally been inreasing by over 2 per cent per year (See Table 2).

This performance has taken place against the background of a decline in the traditional sectors, such as bananas, sugar, nutmeg and cocoa. Value-added in the agricultural sector has been falling, and the highest contribution by the sector to total GDP is in Dominica where it is now around 20 per cent (See Table 3). Handicapped by small internal markets, the manufacturing sector has not taken off in these countries, and the contribution to total output is generally less than 10 per cent. Tourism has emerged as a major source of income and employment and has played a significant part in the recent economic performance. The growth of this sector has been assisted by tax incentives, the provision of infrastructure and the inflows of private foreign investment. Attempts are being made to encourage an offshore financial services sector, but at the moment this sector makes little contribution to income, employment or government revenue. The OECS economies have become highly service-oriented, with services accounting for over 75 per cent of GDP in most cases. Government services contribute less than 20 per cent of the total.

**Table 2**

**Annual Growth Rate of Real GDP at Factor Cost, 1987–97**

(Percentage)

| Countries | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | Average 1987–97 Total GDP | Average 1987–97 Per Capita GDP |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Anguilla | 10.6 | 15.6 | 8.6 | 7.1 | -3.6 | 7.1 | 7.5 | 7.1 | -4.2 | 3.3 | 9.5 | 5.6 | 1.3 |
| Antigua & Barbuda | 9.0 | 5.7 | 6.8 | 2.3 | 2.7 | 0.9 | 5.1 | 6.2 | -5.0 | 5.4 | 5.3 | 3.5 | 1.8 |
| Dominica | 6.8 | 7.3 | -1.2 | 6.3 | 2.2 | 2.6 | 1.8 | 2.2 | 1.5 | 3.2 | 1.9 | 2.8 | 2.3 |
| Grenada | 9.4 | 2.4 | 5.8 | 5.3 | 3.6 | 1.0 | -1.2 | 3.4 | 3.1 | 3.0 | 4.6 | 3.1 | 2.5 |
| Montserrat | 4.1 | 9.8 | 7.7 | 14.3 | -21.0 | 2.7 | 2.5 | 0.8 | -7.6 | -21.4 | -21.3 | -4.4 | 4.5 |
| Saint Kitts-Nevis | 8.3 | 10.4 | 5.7 | 3.1 | 2.2 | 3.3 | 5.3 | 5.5 | 3.6 | 5.7 | 6.5 | 5.1 | 3.9 |
| Saint Lucia | 1.8 | 13.3 | 8.4 | 4.0 | -0.1 | 6.1 | 0.5 | 2.6 | 1.0 | -0.1 | 2.2 | 3.6 | 2.0 |
| Saint Vincent & The Grenadines | 4.4 | 14.8 | 3.1 | 6.6 | 0.4 | 9.0 | -0.7 | -3.0 | 8.1 | 1.4 | 2.3 | 4.1 | 4.0 |

Source: ECCB.

**Table 3**

**Composition of GDP (at Current Factor Cost), 1987 and 1997 (Percentage)**

| Sectors | Anguilla 1987 | Anguilla 1997 | Antigua & Barbuda 1987 | Antigua & Barbuda 1997 | Dominica 1987 | Dominica 1997 | Grenada 1987 | Grenada 1997 | Montserrat 1987 | Montserrat 1997 | St Kitts/ Nevis 1987 | St Kitts/ Nevis 1997 | Saint Lucia 1987 | Saint Lucia 1997 | St Vincent / Grenadines 1987 | St Vincent / Grenadines 1997 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Agriculture | 5.7 | 3.8 | 4.5 | 4.1 | 29.8 | 20.5 | 21.7 | 8.3 | 4.9 | 1.0 | 10.6 | 5.2 | 13.2 | 8.0 | 17.0 | 10.4 |
| Manufacturing | 1.1 | 0.8 | 3.6 | 2.2 | 6.4 | 6.4 | 5.0 | 6.6 | 6.8 | 3.8 | 14.5 | 10.3 | 8.5 | 6.4 | 10.3 | 8.1 |
| Construction | 18.0 | 14.9 | 11.3 | 10.6 | 5.1 | 9.1 | 8.8 | 8.0 | 9.7 | 16.5 | 8.7 | 11.9 | 6.1 | 6.8 | 9.9 | 12.2 |
| Distribution | 7.2 | 7.8 | 9.3 | 10.6 | 10.6 | 11.7 | 13.1 | 11.7 | 13.7 | 7.7 | 13.6 | 15.2 | 16.1 | 14.2 | 11.2 | 15.1 |
| Hotels & Restaurants | 27.8 | 31.4 | 16.0 | 13.8 | 1.3 | 2.6 | 5.8 | 8.5 | 3.5 | 0.7 | 8.9 | 9.0 | 8.7 | 13.7 | 2.2 | 2.5 |
| Communications | 8.3 | 9.4 | 5.9 | 6.9 | 5.4 | 7.9 | 3.2 | 8.3 | 5.0 | 5.8 | 4.1 | 8.2 | 4.4 | 7.5 | 5.6 | 7.4 |
| Government Services | 14.2 | 14.4 | 14.0 | 17.4 | 20.3 | 18.7 | 18.8 | 18.1 | 16.6 | 34.8 | 18.3 | 17.9 | 15.2 | 15.5 | 17.4 | 18.4 |
| Other | 17.7 | 17.5 | 35.4 | 34.4 | 21.1 | 23.1 | 23.6 | 30.5 | 39.8 | 29.6 | 21.2 | 22.3 | 27.8 | 27.9 | 26.4 | 25.9 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: CDB, *Social and Economic Indicators, Various Issues*; Central Bank of Barbados, *Annual Statistical Digest*, Various Issues

The export trade is highly concentrated with bananas accounting for over 40 per cent of domestic exports in Dominica, Saint Lucia and Saint Vincent and the Grenadines and sugar for about 30 per cent of Saint Kitts-Nevis'. Bananas, cocoa and nutmegs dominate Grenada's merchandise trade. In the OECS over 50 per cent of foreign exchange earnings come from tourism. All these countries run deficits on the goods account of the balance of payments, but these deficits are covered by earnings from the service sectors and from capital inflows. This dependence on a narrow range of activities contributes significantly to the vulnerability of these islands, and diversification remains a major objective of government policy. Traditional export crops have been facing both production and marketing problems and there is increasing pressure to find new sources of income and employment. Foreign assistance has also been dwindling and an increasingly large share of capital programmes has to be financed from domestic savings and borrowed funds. A growing informal sector raises interesting fiscal challenges in these countries.

The present standard of living compares favourably with a large number of middle income developing countries[5] and maintaining this momentum will depend on more efficient use of land, labour, capital and other resources. Life expectancy at birth is generally over 70 years, while infant mortality rate is less than 20 per thousand live births. With one or two exceptions, the adult literacy rate is over 90 per cent, while population access to health services, safe water and sanitation is above the level enjoyed by most developing countries.[6]

Despite the progress that has been made in recent years, there are major challenges facing these island States and public policy has a critical role to play. Maintenance and development of the infrastructure are needed to encourage continuing expansion, and weak fiscal systems will not help. While reliable data on unemployment is not available, there is an employment and under-employment problem which has become more open with the decline of agriculture and the seasonal nature of some activities. The insufficiency of job opportunities encourages the emigration of persons, both unskilled and skilled, many trained at government expense. Though there is little information on the distribution of income, poverty is still a problem in these countries. According to a recent study[7] using a head count index, 25 per cent of the population of Saint Lucia was listed as poor, 33 per cent of Dominica's, 20 per cent of Grenada's, 15 per cent of Saint Kitts-Nevis' and 17 per cent of Saint Vincent and the Grenadines'. Dependence on public assistance varies from country to country. Poverty and unemployment has created an environment conducive to the use and transshipment of drugs, and this has put added strain on resources available for policing.

## 2. Savings and investment

It is a widely accepted proposition that a high level of savings and investment is essential for economic growth and development. Roger Smith has made the point in these terms:

> "The stock of capital will decline in a closed economy if consumption equals production; the existing capital stock will gradually be consumed if funds are not set aside for its replacement. Gross saving must be positive and equal to economic

> depreciation to maintain the existing level of capital. If population growth is positive, still more must be set aside if the amount of capital per worker is to be maintained. And still more savings is required if a country wishes to increase the per capita level of capital stock. Historical evidence indicates that an increase in per capita capital stock makes an important contribution to increased productivity and a rising standard of living."[8]

There is some controversy in the literature whether saving causes growth or growth causes saving. What has been noted, however, is that high-saving countries generally grow faster than do low-saving countries. "Fourteen of the world's fastest growing economies over the past ten years had a saving rate over 25 per cent, and none had a saving rate under 18 per cent."[9] The fast-growing economies in East Asia are now saving and investing over 35 per cent of GDP as compared to 20 per cent or less in Latin America. Writing in the mid-1950s, one noted economist observed that "communities in which national income per head is not increasing invest 4 or 5 per cent of their national incomes per annum or less, while progressive economies invest 12 per cent per annum or more. The central problem in the theory of economic growth is to understand the process by which a community is converted from being a five per cent to a twelve per cent saver with all the changes in attitudes, in institutions and in techniques which accompany this conversion."[10]

While one may quibble about what constitutes an acceptable rate of saving, it is widely accepted that capital formation is a major factor in economic growth and development. Increased capital per head of population is associated with increased productivity. In an open economy, investment is not constrained by the levels of domestic savings since external capital resources can be used to break the low-saving low-income low-saving circle. Following the debt crisis of the 1980s, developing countries are putting more emphasis on private sector development and this has intensified the competition for private foreign investment. Not all countries, however, have the same attraction to private foreign capital or enjoy the same access to the loans markets. In this context, fiscal policy has taken on a new significance, and the tax system is seen as much more than a tool for raising revenues for the government. Government tax and revenue policies have macro-economic effects which influence private behaviour and which, in turn, impacts on savings, growth and employment. In a development context, the proportion of resources government takes out of the system in the form of taxes has to be tempered by concerns over the effect on work, saving and investment. For example, in practice, there is great support (on equity grounds) for the principle that incomes at the higher levels should be subjected to a higher rate of taxation, even though it is sometimes argued that the people with higher incomes have a higher propensity to save.

In more recent times tax systems are paying more attention to the effect on incentives to work and invest This trend is bolstered by arguments that taxes pitched at 'reasonable' levels are associated with greater compliance, and the yield may well exceed those associated with high rate systems. This position has some basis in economic theory which argues that up to a certain point increasing marginal rates may not affect the work effort and the marginal benefits from work (more after – tax income) exceed those from leisure. After that point, however, a

substitution effect kicks in and the individual may choose to work less, preferring more leisure instead. The 'optimum tax rate' is one beyond which increases in the tax rate do not lead to increased revenues. In practice one finds a variety of taxes with different rates, reflecting trade-offs between efficiency (in terms of the allocation of resources) and equity. From a theoretical standpoint the optimal tax structure would be "the one that maximizes social welfare in which the choice between equity and inefficiency best reflects society's attitude toward these competing goals."[11]

Aggregate savings as a percentage of GDP (the Gross Domestic Savings ratio, GDS) reflects the saving effort of the economy as a whole and, therefore, incorporates a complex of motives which are not easy to disentangle and analyze. In the Eastern Caribbean Central Bank (ECCB) area, as a group, the Gross Domestic Savings (GDS) ratio averaged around 20 per cent between 1986 and 1996 while the Gross Capital Formation (GCF) ratio exceeded 30 per cent in the period (See Tables 4 and 5). Foreign savings as a per cent of GDP fluctuated between 8.3 per cent and 16.8 per cent in the period. With respect to the savings ratio, there is no clear upward trend with the figure fluctuating from year to year. Dominica, Grenada and Saint Kitts-Nevis not only display the weakest effort, but there seems to be some decline in recent years. In all the countries the investment ratio has exceeded the savings ratio and this has been made possible by inflows of foreign grants and private investment. In the OECS, foreign portfolio investment is not a significant source of funds given the under-developed state of the securities markets. Foreign direct investment, however, has averaged almost EC$500 million per year in the 1990s – the equivalent of almost 10 per cent of GDP.

Domestic savings are normally broken down into three components: government savings, corporate savings and household (individuals) savings. The factors affecting savings behaviour in each of the sectors are not the same, and the limited focus of this paper does not allow an indepth discussion of the various determinants which are explored in the voluminous literature on the subject. Governments' concerns are not strictly financial, and the broad range of social, economic and political factors affecting revenue and expenditure policies makes the study of governments' behaviour very complex.

In the case of the private sector, tax and interest rate policies and the level of per capita income are among the major determinants. In the case of corporations, the rate of profit and demands by shareholders for dividends help decide the level of corporate savings. Corporations are often taxed at a flat rate and this rate will feature in the investment decision which, in practice, may be influenced by tax exemptions and allowances of various kinds. Numerous studies on household savings have not surprisingly produced a variety of results, given the differences in institutional settings and social values. "There have been two fundamentally different theoretical views about the prime motivation for saving. In one view, saving is seen as resulting from a choice between present and future consumption. Individuals compare their rate of time preference to the interest rate, and smooth their consumption over time to maximize their utility. The interest rate is the key mechanism by which saving and investment are equilibrated. The other view sees a close link between current income and consumption with the residual being saving. In this view saving and investment are equilibrated mainly by movements in income, with the interest rate having a smaller effect. A hybrid view attempts to reconcile

consumption smoothing with the income determination of consumption, by seeing a concept of permanent income as driving the consumption process."[12]

The relationship between taxation and savings is associated with many unsettled issues. Besides the income and substitution effects already alluded to, tax policy can affect both the level and composition of savings. In many countries, including some among the OECS, mortgage interest up to a certain level is treated as a deductible expense. Insurance premiums are also allowed in some countries in arriving at chargeable income. In light of the difficulties being faced by pay-as-you-go pension schemes, an increasing number of governments (Saint Lucia, very recently) are encouraging Individual Retirement Plans by exempting payments (up to a certain level) from taxation. In some instances interest income from savings are exempted from tax or taxed at very low rates. There is some controversy, of course, about the effect of tax incentives on home ownership, pension saving or other forms of financial savings. There is a view which argues that the propensity to save for contingencies (the precautionary motive), saving for retirement or the desire to leave a bequest to offsprings represent more powerful reasons for saving than even the rate of return. Indeed, explorations of the relationship between the real interest rate and saving levels have produced mixed results. One study done on the OECS has shown no relationship[13]. Generally, the evidence that savings have a high interest elasticity is not overwhelming.[14] A major impediment to saving in developing countries might well be the absence of properly functioning capital and stock markets and a stable macroeconomic environment.

Regardless of the controversy surrounding the direction of causality between saving and growth, a high level of savings makes possible a high level of investment. In the case of governments where savings (i.e. the excess of current revenue over current expenditure) are not sufficient to finance the desired level of investment, resources can be obtained by increasing the public debt (i.e. by borrowing both locally and abroad). Local sources include the Central Bank, but Central Bank statutes tend to place limits on the extent to which these institutions can lend to their owners (governments).[15] Commitment to private sector development, the breadth and depth of local capital markets, existing levels of debt and debt service payments and credit rating place constraints on the extent to which governments can borrow. Borrowing from the Central Bank, particularly in small open economies, raises sensitive questions, since increases in money income can lead to an increase in the money supply, a higher level of domestic prices and pressure on the exchange rate. Increased demand in the absence of adequate domestic supplies generates higher levels of imports which can result in balance of payments problems in the absence of a concomitant growth in exports and capital inflows. Fiscal deficits often go hand in hand with external deficits. In the OECS the constraints placed on lending to member governments, has no doubt been a significant factor in the low inflation rates in these countries and in the strong foreign exchange position.[16] While the fixed exchange rate arrangement has no doubt contributed to the low rate of price increases in these countries, the traditionally low-inflation experience has also helped in maintaining the EC dollar to the US dollar at $2.70 for over 20 years.

**Table 4**

**Gross Domestic Savings as a per cent of GDP,[1] 1986-96**

| | Antigua & Barbuda | Dominica | Grenada | Saint Kitts-Nevis | Saint Lucia | Saint Vincent & the Grenadines | ECCB Area | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | GDS | GNS | Foreign Savings |
| 1986 | 14.0 | 16.4 | 2.3 | 10.6 | 16.2 | 23.4 | 15.3 | 16.0 | 12.4 |
| 87 | 22.0 | 15.1 | 8.4 | 12.0 | 12.9 | 42.4 | 15.7 | 17.3 | 15.0 |
| 88 | 28.3 | 17.0 | 14.8 | 30.0 | 20.3 | 23.4 | 22.8 | 23.8 | 11.0 |
| 89 | 31.5 | 9.9 | 12.7 | 29.2 | 12.9 | 11.5 | 19.5 | 21.3 | 16.8 |
| 90 | 34.4 | 14.7 | 16.2 | 22.3 | 16.0 | 20.0 | 22.5 | 21.5 | 14.5 |
| 91 | 37.0 | 13.1 | 15.0 | 22.9 | 11.8 | 20.4 | 19.8 | 17.8 | 15.8 |
| 92 | 37.6 | 18.0 | 10.9 | 27.4 | 15.2 | 15.6 | 21.9 | 19.9 | 10.3 |
| 93 | 37.1 | 18.6 | 12.1 | 20.7 | 18.8 | 11.4 | 23.0 | 20.8 | 9.9 |
| 94 | 33.9 | 15.4 | 24.7 | 14.0 | 18.0 | 10.7 | 23.0 | 21.2 | 8.3 |
| 95 | 28.1 | 14.0 | 17.6 | 16.7 | 17.3 | 21.4 | 21.4 | 20.7 | 12.1 |
| 96 | 30.8 | 13.0 | 10.8 | 5.5 | 17.0 | 20.5 | 18.4 | 16.7 | 16.9 |

1. at current market prices

Source: IMF, *International Financial Statistics, Various Issues.*

**Table 5**

**Gross Capital Formation as a per cent of GDP,[1] 1986–96**

| Year | Antigua & Barbuda | Dominica | Grenada | Saint Kitts-Nevis | Saint Lucia | Saint Vincent & the Grenadines | ECCB Area |
|---|---|---|---|---|---|---|---|
| 1986 | 35.7 | 22.3 | 33.4 | 27.1 | 20.6 | 29.5 | 28.4 |
| 87 | 45.7 | 23.2 | 35.0 | 33.6 | 20.1 | 32.5 | 32.3 |
| 88 | 39.8 | 31.1 | 32.1 | 55.8 | 24.3 | 30.4 | 34.8 |
| 89 | 41.3 | 41.3 | 31.9 | 58.1 | 28.2 | 28.8 | 38.0 |
| 90 | 32.4 | 40.7 | 35.2 | 55.3 | 24.7 | 31.0 | 36.0 |
| 91 | 37.6 | 31.6 | 34.7 | 42.8 | 24.4 | 30.9 | 33.6 |
| 92 | 34.8 | 29.5 | 27.6 | 40.2 | 23.2 | 26.6 | 30.2 |
| 93 | 31.7 | 26.9 | 29.3 | 45.4 | 24.6 | 30.5 | 30.7 |
| 94 | 32.3 | 27.1 | 33.9 | 38.0 | 24.3 | 32.6 | 30.9 |
| 95 | 36.9 | 32.6 | 30.4 | 36.5 | 24.2 | 33.3 | 32.8 |
| 96 | 39.5 | 26.3 | 32.0 | 24.1 | 25.5 | 34.1 | 33.6 |

1. at current market prices
Source: IMF, *International Financial Statistics*, Various Issues.

While there is no simple correlation between inflation and deficits, inflation can have a profound effect on tax revenues, particularly through direct taxes. With respect to indirect taxes, the tax take is likely to remain proportional to the value of goods and services with little change in the real spending power of tax receipts from this source. In the case of taxes with a progressive rate structure income earners are pushed into higher tax brackets leading to increases in both nominal and real income taxes. "Furthermore, inflation reduces the real value of depreciation allowances based on historical costs and raises the effective rate of tax on the return to savings."[17] Inflation, of course, can also adversely affect savings.

Fiscal discipline is widely regarded as an important step in creating an environment conducive to sustainable development. In the OECS the deficits, when they occur, have not been large, but public sector savings have not been sufficient to finance public sector development programmes, and with the decline of grants, there is increasing pressure to increase public sector savings. Current budgetary savings for most of the OECS countries have generally been small, rarely exceeding 3 per cent of GDP in recent years (See Table 6). The savings effort has been strongest in Saint Vincent and the Grenadines and Saint Lucia. The respective contribution of the public and private sectors have not been the same in all countries. In Antigua and Barbuda, for instance, public sector savings has been negative in the 1990s and capital formation has been dominated by private sector activities amounting on average to over 20 per cent of GDP. In

Saint Lucia, on the other hand, public sector savings have been relatively more significant, as has public investment.

**Table 6**

**Central Governments: Current Budgetary Savings (Deficit) as a per cent of GDP,[1] 1987–97**

| Year | Anguilla | Antigua/ Barbuda | Dominica | Grenada | Montserrat | Saint Kitts/ Nevis | Saint Lucia | Saint Vincent & the Grenadines |
|---|---|---|---|---|---|---|---|---|
| 1987 | 2.4 | 3.1 | 3.0 | -3.7 | 0.2 | 2.4 | 4.3 | 5.4 |
| 88 | 3.7 | 1.8 | 3.8 | 1.5 | -0.2 | 1.5 | 6.3 | 4.5 |
| 89 | 7.9 | -2.1 | 5.6 | -7.3 | 2.7 | 2.3 | 5.6 | 2.0 |
| 90 | 4.0 | -0.9 | 2.6 | 1.2 | 3.5 | 0.6 | 5.5 | 5.8 |
| 91 | -0.4 | -1.6 | 0.5 | -0.3 | 3.5 | -1.0 | 6.1 | 7.5 |
| 92 | 1.8 | -1.0 | 0.0 | -1.0 | 0.4 | 1.0 | 6.4 | 6.0 |
| 93 | 1.6 | 0.6 | -1.3 | 1.3 | 0.1 | 1.7 | 7.4 | 7.1 |
| 94 | 1.7 | 0.4 | -3.3 | 1.1 | 0.9 | 0.4 | 6.0 | 4.0 |
| 95 | 1.8 | -0.6 | -0.4 | 1.9 | 1.0 | -1.0 | 3.9 | 3.2 |
| 96 | 0.9 | 0.6 | 0.5 | 2.0 | -15.7 | --0.8 | 3.6 | 4.0 |
| 97 | 1.2 | -0.4 | 1.0 | 0.6 | -32.6 | -0.5 | 3.4 | 3.8 |

1. at current market prices.
Source: ECCB.

Over the period 1987-97 the growth of current expenditure has exceeded the growth of current revenue in almost every case (See Table 7). As a percentage of GDP current expenditure ranges between 20 and 30 per cent, and one option to increase savings is to control the growth of expenditure while increasing revenue. As can be seen in Table 8, while the share of goods and services in total current expenditure has been falling, the shares of personal emoluments and transfers have in almost all cases have been increasing. With two exceptions (Montserrat and Saint Kitts-Nevis) personal emoluments account for over half of current expenditure. The need to rationalize the public sector workforce and increase efficiency has long been recognized, but this requires a strong political will. The level and structure of government spending in the Caribbean is receiving increasing attention in the context of prevailing levels of poverty and the state of government services, including particularly the social sectors, such as education and

health. There is a widespread perception that public spending in these areas over the years has not produced the returns expected, and there is need for a serious review of the delivery systems and administrative structures.

Despite the existence of external payments arrears in some cases, the public sector debt in the OECS has been growing as a result of continued borrowing to finance public sector investment programmes. The largest creditor to the subregion is the Caribbean Development Bank (CDB). In absolute terms and as a percentage of GDP, the external debt is not large (as can be seen in Table 9), and this is reflected to some extent in debt service payments. In 1997, interest payments in no case exceeded 12 per cent of current expenditure, and the actual debt service ratio has generally been less than 5 per cent. In certain cases, however, the scheduled ratio may be much higher, and interest payments may not truly reflect contractual obligations.[18]

The issues of savings and the financing of development also revolve around the structure and performance of the tax system, and a detailed discussion follows.

**Table 7**
**Growth of Nominal Revenue and Expenditure, 1987-97**

| Countries | Average Annual Growth Rate (per cent)[1] | | As a per cent of GDP[2] | | | | As a per cent of GDP | |
|---|---|---|---|---|---|---|---|---|
| | Current Revenue | Current Expenditure | Current Expenditure 1987 | Current Expenditure 1997 | Capital Expenditure[3] 1987 | Capital Expenditure[3] 1997 | Current Revenue 1987 | Current Revenue 1997 |
| Anguilla | 10.1 | 10.6 | 23.1 | 22.0 | 5.6 | 4.3 | 25.5 | 23.2 |
| Antigua & Barbuda | 6.3 | 8.0 | 19.9 | 21.2 | 1.7 | 3.0 | 23.0 | 20.8 |
| Dominica | 7.9 | 8.8 | 23.2 | 28.2 | 12.8 | 4.2 | 26.2 | 29.2 |
| Grenada | 7.2 | 5.3 | 26.4 | 22.8 | 8.4 | 8.0 | 22.7 | 23.5 |
| Montserrat | 6.4 | 8.6 | 23.6 | 58.0 | 9.4 | 20.9 | 23.8 | 25.5 |
| Saint Kitts-Nevis | 9.0 | 10.4 | 22.2 | 24.2 | 0.3 | 3.9 | 24.6 | 23..6 |
| Saint Lucia | 7.0 | 7.5 | 19.9 | 21.3 | 6.3 | 4.4 | 24.2 | 24.6 |
| Saint Vincent & the Grenadines | 6.1 | 6.6 | 26.8 | 25.4 | 4.8 | 9.0 | 32.2 | 29.2 |

1. 1987-1997; for Montserrat, 1987-95
2. at current market prices
3. includes 'net lending'.

Source: Computed from official data.

**Table 8**

**Composition of Current Expenditure, 1987 and 1997**

(Percentages)

| Countries | Goods & Services | | Personal Emoluments | | Interest Payments | | Transfers | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1987 | 1997 | 1987 | 1997 | 1987 | 1997 | 1987 | 1997 | 1987 | 1997 |
| Anguilla | 56.5 | 40.8 | 40.8 | 55.2 | – | 0.2 | 2.7 | 3.8 | 100.0 | 100.0 |
| Antigua & Barbuda | 35.7 | 24.7 | 47.1 | 53.1 | 9.9 | 11.6 | 7.3 | 10.6 | 100.0 | 100.0 |
| Dominica | 22.0 | 15.9 | 62.3 | 57.2 | 5.7 | 8.9 | 10.0 | 18.0 | 100.0 | 100.0 |
| Grenada | 21.3 | 16.0 | 49.3 | 55.3 | 8.9 | 9.8 | 20.5 | 18.9 | 100.0 | 100.0 |
| Montserrat | 34.8 | 46.0 | 56.0 | 41.6 | 0.4 | 2.2 | 8.8 | 10.2 | 100.0 | 100.0 |
| Saint Kitts-Nevis | 41.2 | 29.6 | 45.7 | 48.3 | 13.1 | 10.8 | – | 11.3 | 100.0 | 100.0 |
| Saint Lucia | 22.4 | 19.8 | 51.8 | 52.1 | 7.6 | 5.6 | 18.2 | 22.5 | 100.0 | 100.0 |
| Saint Vincent & the Grenadines | 28.7 | 23.0 | 51.3 | 53.9 | 14.2 | 6.3 | 5.7 | 16.8 | 100.0 | 100.0 |

Source: ECCB.

**Table 9**

**Growth of the Outstanding (Disbursed) External Debt (end of period), 1981-96.**

| Countries | External Debt (US$) mn. | | | Debt as a per cent of GDP[1] | | | Actual Debt Service Ratio[2] | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1981 | 1991 | 1996 | 1981 | 1991 | 1996 | 1981 | 1991 | 1996 |
| Antigua & Barbuda | 57.2 | 260.0 | 224.4 | 46.0 | 61.6 | 42.1 | 8.2 | 2.2 | 1.7 |
| Dominica | 17.0 | 84.8 | 101.2 | 28.8 | 47.8 | 43.2 | 3.4 | 4.2 | 7.1 |
| Grenada | 17.1 | 85.9 | 85.7 | 17.6 | 40.9 | 29.0 | 3.7 | 4.3 | 5.0 |
| Montserrat | 2.0 | 3.4 | 10.0 | 9.9 | 5.7 | 20.0 | 2.4 | 2.0 | 1.3 |
| Saint Kitts-Nevis | 10.8 | 36.8 | 54.1 | 20.9 | 21.5 | 22.4 | 3.0 | 2.7 | 4.7 |
| Saint Lucia | 17.8 | 70.2 | 126.8 | 13.6 | 16.7 | 22.1 | 1.3 | 2.0 | 3.3 |
| Saint Vincent & the Grenadines | 15.6 | 58.7 | 87.4 | 21.2 | 26.2 | 32.5 | 1.6 | 3.5 | 5.5 |

1. at current market prices
2. debt service payments (interest and principal) as a per cent of exports of goods and services.

Source: CDB.

## The tax systems in the OECS

Taxes are compulsory instruments that transfer resources from the private to the public sector. Like government spending, taxes have macroeconomic effects, and can be used to attain particular objectives in economic management. There are four basic reasons for introducing taxes:[19]

1. The need to raise revenue to pay for government activities;

2. The desire to redistribute income, wealth, capital or manpower among persons, types of occupation or areas;

3. The desire to encourage or discourage the production or consumption of a particular good or activity;

4. The desire to stabilize the macroeconomy.

Tax revenue as a percentage of GDP (sometimes referred to as the tax burden or tax effort) varies widely among countries. In the ECCB area as a whole, the ratio has hardly changed since the early 1980s, remaining at around 20 per cent (See Table 10). If anything, there seems to have been a slight decline. As far as individual countries are concerned, the ratio for Antigua and Barbuda and Saint Kitts-Nevis has generally been less than 20 per cent and the figure has remained fairly unchanged in the 1980s and 1990s. Saint Vincent and the Greandines' ratio has come down from over 25 per cent in the early 1980s to around 23 per cent in recent years. The tax take in Grenada has also trended downwards. In the case of Montserrat the tax effort has remained fairly steady, while in Anguilla there has been a steady increase in the tax ratio from around 11 per cent in the mid-1980s to almost 20 per cent in recent years. Compared to a number of Latin American countries the tax effort in the OECS is impressive. A ratio of over 30 per cent in some developed countries reflects taxes associated with social security arrangements (See Table 11). Besides the national insurance schemes which provide limited pension, sickness disability and contingency benefits, and are funded by contributions from employers and employees, there is no elaborate social security arrangements in these countries. In some OECS members, fiscal pressures have made the governments the major delinquent as far as contributions to the schemes are concerned.

With respect to the share of non-tax revenue in total revenue, the ratio was lowest in Grenada, Montserrat and Saint Lucia (around 10 per cent) and highest in Saint Kitts-Nevis and Anguilla (over 18 per cent). As far as the composition of taxes is concerned, Anguilla is almost totally dependent on indirect taxes and in the case of the other countries the proportion ranged from around 90 per cent for Antigua and Barbuda to 60 per cent for Montserrat in 1997 (See Table 12). In the developed countries, indirect taxes generally contribute less than 70 per cent to the total tax take.

**Table 10**

**Tax Revenue as a per cent of GDP[1] 1982-97**

| Year | Anguilla | Antigua & Barbuda | Dominica | Grenada | Montserrat | Saint Kitts-Nevis | Saint Lucia | Saint Vincent & the Grenadines | ECCB Area |
|---|---|---|---|---|---|---|---|---|---|
| 1982 | .. | 17.3 | 24.2 | 25.6 | 20.6 | 20.0 | 20.5 | 27.7 | .. |
| 83 | .. | 16.2 | 21.9 | 25.6 | 22.0 | 17.2 | 20.1 | 25.6 | 21.7 |
| 84 | .. | 17.6 | 23.7 | 25.6 | 21.0 | 16.7 | 20.0 | 26.6 | 21.6 |
| 85 | .. | 18.9 | 23.7 | 26.4 | 20.7 | 15.8 | 21.9 | 27.9 | 21.9 |
| 86 | 11.0 | 20.5 | 24.2 | 19.7 | 22.2 | 16.4 | 20.8 | 26.6 | 21.0 |
| 87 | 11.5 | 19.6 | 24.1 | 20.3 | 21.8 | 18.6 | 22.3 | 26.4 | 18.0 |
| 88 | 12.1 | 18.7 | 23.1 | 21.4 | 20.7 | 17.5 | 23.1 | 26.0 | 20.4 |
| 89 | 11.3 | 17.7 | 24.6 | 20.6 | 22.5 | 18.0 | 23.3 | 23.0 | 20.8 |
| 90 | 11.4 | 18.4 | 24.1 | 22.3 | 21.3 | 16.6 | 22.0 | 24.1 | 20.8 |
| 91 | 12.7 | 17.4 | 23.2 | 22.5 | 27.7 | 15.5 | 22.7 | 23.0 | 20.8 |
| 92 | 12.1 | 17.5 | 23.4 | 21.3 | 21.9 | 15.5 | 22.6 | 21.7 | 20.3 |
| 93 | 13.1 | 17.2 | 22.9 | 22.8 | 20.4 | 16.4 | 23.1 | 22.1 | 20.6 |
| 94 | 16.7 | 17.5 | 20.9 | 21.8 | 21.3 | 16.3 | 22.8 | 23.2 | 20.4 |
| 95 | 18.4 | 17.8 | 22.4 | 22.3 | 22.4 | 16.6 | 22.3 | 22.6 | 20.4 |
| 96 | 17.6 | 18.4 | 23.7 | 22.7 | 22.7 | 17.2 | 21.5 | 23.6 | 21.2 |
| 97 | 18.9 | 17.8 | 24.6 | 21.2 | 22.9 | 18.1 | 22.0 | 24.2 | .. |

.. not available
1. at current market prices

Sources: Computed from official data.

**Table 11**
**Comparative Tax Data on Selected Countries, 1996.**

| Countries | Per Capita GNP US$ 1996 | Tax Revenue as a % of GDP 1996 | As a per cent of Current Revenue[1] | | | |
|---|---|---|---|---|---|---|
| | | | Income and Profit[2] | Social Security Taxes[3] | Taxes on Goods & Services | Taxes on International Trade |
| Argentina | 8,380 | 11.9 | 10 | 35 | 36 | 5 |
| Brazil | 4,400 | .. | 15 | 31 | 19 | 4 |
| Canada | 19,020 | 18.5 | 48 | 19 | 19 | 2 |
| Chile | 4,860 | 18.3 | 17 | 6 | 45 | 9 |
| Colombia | 2,140 | 13.6 | 34 | 0 | 41 | 9 |
| Costa Rica | 2,640 | 22.5 | 11 | 26 | 33 | 15 |
| Dominican Republic | 1,600 | 14.7 | 16 | 4 | 34 | 37 |
| Ecuador | 1,500 | 13.9 | 50 | 0 | 26 | 11 |
| El Salvador | 1,700 | 11.6 | 27 | 0 | 51 | 17 |
| France | 26,270 | 38.8 | 18 | 44 | 28 | 0 |
| Germany | 28,870 | 29.3 | 16 | 48 | 23 | 0 |
| Guatemala | 1,470 | 7.7 | 19 | 0 | 46 | 23 |
| Peru | 2,420 | 14.0 | 17 | 9 | 49 | 10 |
| Mexico | 3,670 | 12.8 | 27 | 14 | 54 | 4 |
| Malaysia | 4,370 | 20.1 | 37 | 1 | 26 | 12 |
| Mauritius | 3,710 | 16.3 | 13 | 6 | 24 | 35 |
| Singapore | 30,550 | 16.2 | 26 | 0 | 21 | 1 |
| South Korea | 10,610 | 18.6 | 31 | 8 | 323 | 7 |
| United Kingdom | 19,600 | 33.6 | 36 | 17 | 33 | 0 |
| United States | 28,020 | 19.4 | 52 | 33 | 4 | 1 |

1. 1995
2. includes capital gains
3. social security taxes include employer and employee social security contributions and those of self-employed and unemployed people.

Sources: World Bank, *World Development Indicators,* 1998; World Bank *Atlas*, 1998.

Because of the trade liberalization process, the contribution of taxes on international trade to tax revenue has been falling globally. The burden is being increasingly placed on domestic measures. In the OECS, revenue from trade taxes, however, still accounts for the largest share of tax revenue, accounting in most cases to over half of the total tax take. Table 13 gives some indication of the variety of tax devices applied in the OECS. Consumption taxes and import duties are the most important measures in the international trade sector. With respect to domestic goods and services consumption taxes, hotel levies and stamp duties are among the major sources of revenue.

In the category of direct tax measures the two most important instruments are property and income taxes. Anguilla has no income, profits, capital gains or withholding taxes. Antigua and Barbuda has a personal income tax but that is levied on non-residents of Antigua and Barbuda and has a progressive structure ranging from 2.5 per cent to 5 per cent on incomes below EC$1,000 to 65 per cent on incomes in excess of EC$30,000. There is however, an education levy ranging from 2.5 per cent on incomes between EC$6,500 and EC$60,000 to 5 per cent on incomes over EC$60,000. Dominica also has a progressive income tax with three brackets ranging from 20 per cent on chargeable incomes below EC$18,000 to 40 per cent on incomes above EC$48,000. Saint Kitts-Nevis, like Anguilla and Antigua and Barbuda, does not have a personal income tax, but has in its place a Social Service Levy of 6 per cent (3 per cent borne by the employer and 3 per cent by the employee). In a radical fiscal experiment Grenada abolished income taxes in 1986 and introduced a 20 per cent Value Added Tax (VAT) on goods and services imported or produced for sale in Grenada. Certain items were exempted or zero rated to add a degree of progressivity to the tax structure This experiment had a disastrous effect on revenue, and following the introduction of several *ad hoc* measures, income and corporation taxes were again introduced in 1994, but two years later the personal income tax was largely removed. A 30 per cent tax is payable on incomes over EC$60,000. In Montserrat the income tax exempts incomes below EC$15,000 and has three brackets with marginal rates ranging between 20 and 30 per cent. In Saint Vincent and the Grenadines chargeable incomes under EC$10,000 are exempt, and marginal rates rise progressively from 10 per cent to 45 per cent. In Saint Lucia the rate increases from 10 per cent on chargeable incomes under EC$10,000 to 30 per cent over EC$30,000. The level of personal and other allowances permitted in arriving at chargeable income varies from country to country.

With the exception of Anguilla, all countries have withholding taxes ranging between 10 and 30 per cent on rents, dividends, royalties, public entertainers, etc. Again with the exception of Anguilla, a corporation tax is part of the tax structure in all the countries, with rates varying from 30 per cent in Dominica, Grenada and Montserrat, to 33 1/3 per cent in Saint Lucia and to 40 per cent in Antigua and Barbuda, Saint Kitts-Nevis and Saint Vincent and the Grenadines.

# Table 12

**Composition of Tax Revenue, 1997**

(Percentages)

| Source of Revenue | Anguilla | Antigua & Barbuda | Dominica | Grenada | Montserrat | Saint Kitts-Nevis | Saint Lucia | Saint Vincent & The Grenadines |
|---|---|---|---|---|---|---|---|---|
| Current Revenue | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Tax Revenue | 81.2 | 85.9 | 83.9 | 90.2 | 90.0 | 76.8 | 89.1 | 83.1 |
| Non-Tax Revenue | 18.8 | 14.1 | 16.1 | 9.8 | 9.1 | 23.2 | 10.9 | 16.9 |
| Tax Revenue | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Taxes on Income and Profits | – | 9.1 | 29.2 | 11.8 | 36.3 | 26.5 | 29.1 | 32.7 |
| Taxes on Property | 0.4 | 1.7 | 1.3 | 2.6 | 3.6 | 2.3 | 0.6 | 1.0 |
| Taxes on Domestic Goods and Services | 33.7 | 22.5 | 15.5 | 21.0 | 12.9 | 15.7 | 12.4 | 15.5 |
| Taxes on International Trade | 65.9 | 66.7 | 53.7 | 64.6 | 47.2 | 55.5 | 57.9 | 50.8 |
| Tax Mix | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Direct | 0.4 | 10.8 | 30.5 | 14.4 | 39.9 | 28.8 | 29.7 | 33.7 |
| Indirect | 99.6 | 89.2 | 69.2 | 85.6 | 60.1 | 71.2 | 70.3 | 66.3 |

– nil

Source: ECCB, *Annual Report and Statements of Accounts*, Various Issues.

## Table 13

**Composition of Indirect Taxes, 1997**

(Percentage)

| Sources of Revenue | Anguilla | Antigua & Barbuda | Dominica | Grenada | Montserrat | Saint Kitts-Nevis | Saint Lucia | Saint Vincent & the Grenadines |
|---|---|---|---|---|---|---|---|---|
| Taxes on Domestic Goods and Services | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| of which | | | | | | | | |
| Accommodation Tax | 38.4 | 35.7 | 2.0 | | 3.1 | 11.1 | 33.6 | 13.1 |
| Bank Deposit Levy | 9.3 | | | | | | | |
| Stamp Duty & Licenses | | 18.6 | | 25.6 | 68.7 | 25.1 | | |
| Telecommunication Tax | | 15.7 | | | | | | |
| Consumption Duty | | | 2.0 | 48.2 | | | 25.5 | 22.8 |
| Value-added Tax | | | | 1.3 | | | | |
| Insurance Company Levy | | | | | 9.4 | | | |
| Taxes on International Trade & Transactions | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| of which | | | | | | | | |
| Import Duty | 86.8 | 30.6 | 26.7 | 22.8 | 17.9 | 39.7 | 33.9 | 25.0 |
| Foreign Exchange Tax | 3.7 | 3.9 | | | 7.7 | | | |
| Embarkation Tax | 6.1 | | | | | | | |
| Consumption Tax | | 44.8 | 64.4 | | 35.9 | 43.3 | 49.2 | 65.2 |
| Customs Service Charge | | 12.5 | 3.8 | 16.4 | 30.7 | | 15.4 | 9.8 |
| Value-added Tax | | | | 57.2 | | | | |

Note: The blank spaces indicate the unavailability of data or the absence of such a tax

Source: ECCB, *Annual Report and Statement of Accounts*, 1998.

The property tax is not a significant source of revenue for the islands. The land tax is based on rental value, market value or on the area of land. The house tax is based on the market or annual rental value. Because of the dislocation created by the recent volcanic eruptions, Montserrat has made significant reductions in the level of property taxes. There is also a transfer of property tax in the form of stamp duties and other taxes. In Antigua and Barbuda there is an undeveloped land tax of 5 per cent on undeveloped land owned by foreigners, while Montserrat imposes a surcharge of 1.65 per cent on a similar base. All the countries have adopted an Aliens Land Holding Tax ranging between 7.5 per cent in Saint Lucia to 17.5 per cent in Anguilla.

For the ECCB area as a whole, taxes on domestic goods and services accounted for less than 20 per cent of tax revenue. A variety of instruments is used to raise income for the government though not all the countries operate the same set of taxes. All impose a tax on hotel accommodation (less than 10 per cent) and this is supplemented by a hotel guest levy of 2 per cent in Antigua and Barbuda. Six of the eight countries considered in this paper also impose consumption taxes on domestic production ranging between 5 and 35 per cent. Other taxes used include a restaurant tax of 7 per cent (Antigua and Barbuda and Saint Kitts-Nevis), a telecommunications tax (all except Anguilla, Dominica and Montserrat), an excise tax (Dominica), an entertainment tax (all except Grenada and Montserrat), an insurance premium tax (all except Anguilla and Dominica), a casino tax (Antigua and Barbuda and Saint Kitts-Nevis) and a bank deposit levy (Anguilla, Montserrat and Saint Vincent and the Grenadines).

As indicated earlier, taxes on international trade and transactions make the largest contribution to government revenue in the ECCB area – around 60 per cent. The proportion varies from country to country. All the countries impose import duties, but these have been coming down as a result of concessions, exemptions and the implementation of the CARICOM Common External Tariff (CET) which has an eventual structure ranging between 5 and 20 per cent. The countries have made up some of the shortfalls in revenue from this source by imposing a customs service charge. A consumption tax on imports is also widely used with rates ranging between 2.5 per cent and 35 per cent. An embarkation tax exists in all the territories and this is supplemented by a travel (ticket) tax (Antigua and Barbuda, Grenada, Saint Kitts-Nevis, Saint Lucia, Saint Vincent and the Grenadines) and a security tax. Other measures include a Cruise Ship Passenger Tax (all except Anguilla and Montserrat) and a Foreign Exchange Levy (Anguilla, Antigua and Barbuda and Montserrat). Saint Kitts-Nevis levies a mercantile tax of 10per cent on the c.i.f. value of imported duty free goods.

**Tax performance**

Though there may be other objectives involved, the basic function of a tax system is to raise revenue for the government. Because of exemptions, allowances, evasion, collection and enforcement problems, etc. a tax may not perform in the way intended, and the yield may be far less than expected. A tax with the same nominal rates (and even with the same structure) may produce different results in different settings. Differences between the nominal rates and the effective rates may be only one reason for this situation. A tax system is normally comprised of different types of taxes with different structures, and even though some taxes may be progressive, the system as a whole may not be. A regressive tax may offset the effects of a

progressive tax, but the reverse can also hold. A progressive tax is one where the average rate of tax rises as income rises. In the case of a proportional tax the average rate of the tax remains constant as income rises, i.e. the marginal rate is equal to the average rate. In a regressive tax the average rate of tax falls as income rises. As indicated earlier, with the exception of Anguilla total tax revenue as a per cent of GDP in the OECS has remained fairly constant or even fallen slightly since the early 1980s. Table 14 shows the tax take from individual groups of taxes in relation to GDP in 1987 and 1997. With the exception of Antigua and Barbuda, the ratio relating to income and profit taxes increased in all cases between 1987 and 1997.With respect to taxes on domestic goods and services, the ratio increased in Anguilla, Dominica, Grenada and Saint Lucia, but fell in the others. The ratio relating to taxes on property increased only in Grenada and Saint Kitts-Nevis. The ratio relating to international trade and transactions increased in Anguilla and Montserrat, but declined in the others. This may be partly the result of the lowering of import duties resulting from implementation of the Common External Tariff.

**Table 14**

**Tax Receipts as a per cent of GDP[1], 1987 and 1997.**

| Countries | Taxes on Income and Profits | | Taxes on Domestic Goods & Services | | Taxes on Property Property | | Taxes on International Trade | |
|---|---|---|---|---|---|---|---|---|
| | 1987 | 1997 | 1987 | 1997 | 1987 | 1997 | 1987 | 1997 |
| Anguilla | – | – | 3.0 | 6.4 | 0.1 | 0.0 | 8.3 | 12.5 |
| Antigua & Barbuda | 2.6 | 1.6 | 4.2 | 4.0 | 0.3 | 0.3 | 12.6 | 11.9 |
| Dominica | 6.0 | 7.2 | 2.1 | 3.8 | 0.0 | 0.3 | 16.0 | 13.1 |
| Grenada | 1.8 | 2.5 | 3.9 | 4.4 | 0.3 | 0.5 | 14.2 | 13.7 |
| Montserrat | 6.3 | 8.3 | 8.0 | 2.9 | 1.0 | 0.8 | 6.4 | 10.8 |
| Saint Kitts-Nevis | 3.6 | 4.8 | 3.0 | 2.8 | 0.3 | 0.4 | 11.7 | 10.0 |
| Saint Lucia | 5.8 | 6.4 | 2.6 | 2.7 | 0.2 | 0.1 | 13.6 | 12.7 |
| Saint Vincent and the Grenadines | 7.4 | 7.9 | 3.8 | 3.7 | 0.2 | 0.2 | 15.0 | 12.3 |

1. at current market prices
Source: Computed from official data.

In the context of the need for revenue an elastic tax system is seen as a desirable feature of modern revenue structures. A tax system in which tax revenues rise proportionately faster than income rise has an elasticity greater than one, and is described as elastic. In such a system the marginal rate of tax exceeds the average rate. And the average rate would rise as income increased. An inelastic tax system is one where the elasticity is less than one, and indicates that revenues are rising proportionately slower than income. In this situation the marginal tax ratio is less than the average and the average tax rate on income falls as income rises. An elasticity of

revenue equal to one is associated with a proportional tax system. Here the marginal and average tax rates are equal.

In assessing the responsiveness of a tax or tax system to changes in income, it is useful to distinguish between two concepts: the 'elasticity coefficient' and the 'buoyancy coefficient'. The former measures the 'automatic' change in tax revenue for a given tax base in response to economic growth or an increase in income. It excludes the effects of discretionary tax changes, improvements in compliance, changes in laws, etc. This measure is difficult to compute in practice and the 'buoyancy coefficient' (the percentage change in realized tax revenue divided by the percentage change in GDP) is commonly used to gauge elasticity or responsiveness.

Table 15 shows that the buoyancy coefficient for total tax revenue in the period 1987 to 1997 was highest in Anguilla (almost 2). In Dominica, and Grenada the coefficient was just about one, and in the other countries less than one. It was lowest in Saint Kitts-Nevis. With the exception of Anguilla, the OECS tax systems are inelastic. When we look at the coefficients relating to taxes on income and profits, it was lowest in Antigua (0.27) and highest in Grenada (1.77). It was less than one in Saint Lucia. With respect to taxes on domestic goods and services, the coefficient ranged from over two in Anguilla and Dominica to less than 0.5 in Grenada. As indicated earlier, property taxes are not a major source of revenue for OECS countries, but with the exception of Anguilla, Saint Lucia and Antigua and Barbuda, the coefficients are well over one. With respect to taxes on international trade and transactions, only Anguilla and Montserrat had a coefficient greater than one. This is unexpected given the high dependence on imports, but may be explained by exemptions, liberalization and the decreasing level of import duties associated with the implementation of the CET.

**Table 15**

**Buoyancy (Tax Elasticity) Coefficients, 1987-97**

| Countries | Total Tax Revenue | Taxes on Income and Profits | Taxes on Domestic Goods and Services | Taxes on Property | Taxes on International Trade |
|---|---|---|---|---|---|
| Anguilla | 1.98 | – | 2.69 | 0.53 | 1.75 |
| Antigua & Barbuda | 0.82 | 0.27 | 0.92 | 0.92 | 0.89 |
| Dominica | 1.02 | 1.43 | 2.56 | 2.28 | 0.63 |
| Grenada | 1.09 | 1.77 | 0.47 | 1.95 | 0.93 |
| Montserrat[1] | 1.22 | 0.68 | (0.23) | 1.59 | 3.38 |
| Saint Kitts-Nevis | 0.74 | 1.54 | 0.93 | 1.57 | 0.76 |
| Saint Lucia | 0.97 | 0.82 | 1.06 | 0.11 | 0.86 |
| Saint Vincent and the Grenadines | 0.84 | 1.15 | 0.93 | 1.57 | 0.65 |

1. 1985-95.; - not applicable; Source:Computed from official data.

**An assessment of the tax system**

Though the basic function of a tax system is to raise revenue, it can be used in pursuit of other objectives, such as redistributing income, encouraging or discouraging certain activities, influencing aggregate demand with a view to reducing inflationary pressures or protecting the exchange rate and the balance of payments. What is an ideal level of taxation is an open question. The ratio of tax to GDP will vary over time and from country to country. As a country develops the tax capacity as reflected in the growth of income, wealth, consumption, etc., new tax bases emerge and not only is the tax structure likely to change but the tax ratio also tends to increase. Increases in per capita income and changes in the structure of the economy and in the occupational distribution of the labour force will expand the tax base and this should lead to a higher level of revenue. As a country develops it is expected that the tax ratio will increase as governments are called upon to provide a wide range of services and a higher level of social security. They also find it increasingly easier to impose direct taxes. There is some controversy in the literature over whether the level of revenue is determined by the level of expenditure or the level of revenue determines the level of expenditure. The level of revenue places a constraint on expenditure, but the tendency for expenditure to grow faster than national income creates a situation where revenue has to be responsive to social needs. Though a tax involves a compulsory payment to government without receipt of a specific benefit of equal value, the purposes for which revenue are used would have some impact on the willingness to pay and this should also have an effect on the tax ratio.

There are certain principles which are associated with a 'good tax or a 'good tax system'. One is 'fairness', though it is not always easy to operationalize this idea in practice. Two concepts commonly employed here are 'vertical equity' which is concerned with 'fairness' between people with different circumstances and 'horizontal equity' which requires that people in equivalent circumstances should be treated fairly. Both these concepts relate to the ability to pay, and in practice the notions of 'progressivity' and 'regressivity' are a major consideration in designing tax systems. Other criteria include administrative simplicity and transparency, minimum cost for compliance and administration, certainty and minimizing distortions on consumers' choices between goods and producers' choices between factors. In practice there tends to be a certain amount of trade-off between these principles since a tax that might be easy to administer may be judged to be 'regressive' from an equity standpoint, i.e. it may take a higher proportion of the income of the poor than of the rich. It is worth noting that even though some taxes in a tax system may be regressive the system as a whole might not be, as was pointed out earlier.

In the OECS the tax systems show results consistent with a proportional one. In 1997 the tax ratio ranged between 18 per cent in Antigua and Barbuda to almost 25 per cent in Dominica. This is low compared to several developed countries with ratios over 30 per cent (including social security contributions) but is higher than a number of developing countries, as was indicated earlier. Some of these are associated with lower per capita incomes. Earlier we made reference to the high dependence on indirect taxes which tend to be regressive, but this is partly the result of historical and economic factors rather than conscious policy-making. High dependence on trade and the existence of a limited number of entry ports made it

administratively easy to operate these taxes. In situations with large agricultural sectors, subsistence farming, large numbers of self-employed, too heavy a dependence on income tax would not have yielded the desired revenue levels.

The choice of taxes and tax bases is not strictly an economic one and may reflect political preferences informed by ideology, resource constraints and the characteristics of the economy. The Government of Anguilla which is a very tiny island of 11,000 people has opted to operate a tax haven environment with a heavy dependence on indirect taxes and licenses. Antigua and Barbuda and Saint Kitts-Nevis use an education levy and a Social Services Tax, respectively, in place of an income tax. The tax system may not be elastic, but revenues have grown in line with income, and in the case of Anguilla it has grown even faster. There is a considerable merit in a tax system with an elasticity greater than one, since the government can capture an increasing share of resources it has helped to create and would be able to provide a wider range of high quality services, as well as finance a larger share of the development programme. One result may be reduced dependence on borrowing.

**Tax revenue and trade policy reforms**

Against the background of the increasing trends towards trade liberalization both regionally and internationally, a major concern facing governments generally is the impact of trade reforms on public revenue. While the protective effect of quantitative restrictions is being transformed into tariffs, generally the trend is towards the lowering of tariffs and the simplification of the tariff structure to encourage greater freedom in the movement of goods and services. In the OECS, besides some skepticism over the limited gains to be derived from trade liberalization, the loss of revenue provides the major explanation for the unwillingness of OECS governments to meet scheduled deadlines with respect to the implementation of the CARICOM Common External Tariff (CET). This dilemma is complicated by another issue. Besides raising revenue for the governments, tariffs (like quantitative restrictions) are often used as a protective device and to balance the international accounts. Tariffs can serve as a powerful allocative mechanism, and, as such, the tariff system can be structured to discriminate more against some imports than others. By increasing the prices of imports relative to the prices of import competing domestic production, consumers are encouraged to substitute locally-produced goods for imports. Besides the distortion of consumption, the import substitution strategy has had limited income and employment effects in the subregion, and the policy framework has tended to encourage inefficiencies by creating monopolies and discouraging competition and export development. Industries identified as ‘infant’, ‘pioneer’ or ‘essential’ are often assisted in other forms, such as tax holidays, exemptions from duties on capital equipment and intermediate inputs, accelerated depreciation allowances, etc. There is a revenue cost to the governments as well.

The recent trends towards more open trade policy assumes that competition will not only benefit the consumer but will improve the allocation of resources and in time this will impact on growth and employment. The thinking is in the short term there may or may not be some adverse effect on revenue (depending on the quality of the tax reforms and the effect on imports), but in time, income and export growth would eventually have a positive impact on public

revenue. In the OECS, because of the small markets, import substitution has been limited and tariffs therefore seem to be more revenue than protection oriented. The major challenge is the restructuring of the tax system to obtain the desired revenue yields as import duties are lowered or removed. The volume and quality of services the government would like to provide hinges critically on the level of revenue, and this is not only an economic, but a political question as well, since particular revenue measures are featured in political agendas.

With respect to trade reforms, lower tariff rates would tend to reduce tariff revenues, but if the volume and value of imports increase as a result, fiscal revenue can also increase. By stimulating trade over time on the basis of comparative advantage, trade reform measures may increase income and imports. Lower tariff rates may also discourage smuggling and under-invoicing. Lower tariff rates may also remove the need for special exemptions, and this could impact positively on revenue. In a situation where trade reforms are accompanied by devaluation (or depreciation) of the currency, the domestic currency value of imports would also increase, and the effects should be felt on the level of revenue. Where a government collects some part of its revenue in foreign exchange, depreciation of the currency would also increase revenue in terms of local currency. Adherence to a fixed exchange regime limits the scope for revenue enhancement from currency depreciation.

The effect of lower import duties on revenue depends on a number of factors. Among these are the price elasticity of demand for importables and the price elasticity of supply of importables by domestic industries.[20] Lower tariffs may or may not lead to an increase in imports and can also result in lower domestic prices. While higher levels of imports may enhance tax revenue, unless these are offset by an increase in exports or capital flows the external balance can deteriorate, thus putting pressure on the exchange rate. With a fixed rate, a government will have to be very sensitive to increases in imports, particularly if the foreign reserves position is weak. Fiscal and monetary measures, of course, can be used to deepen demand and ease the pressure on the exchange rate. Not surprisingly, trade reform measures often encourage changes in the exchange regime since exchange controls also have allocative implications for the economy.

Table 16 provides some useful insights into the role and performance of international trade taxes in the OECS in the 1986-1996 period. In Dominica and Grenada revenue from taxes on international trade accounts for around 20 per cent of the value of the imports of goods and non-factor services. In Saint Lucia and Saint Vincent and the Grenadines, the proportion is a little under 20 per cent, and in Anguilla, Antigua and Barbuda, Montserrat and Saint Kitts-Nevis, it is less than 15 per cent. In Anguilla and Antigua and Barbuda, the proportion has increased since the mid-1980s, while in the others it has declined (e.g. Dominica), or remained fairly constant. In Anguilla, and Antigua and Barbuda and Grenada revenues from international trade taxes grew at a faster rate than the value of imports of goods and non-factor services between 1986 and 1996, while in the others the reverse was the case.

## Concluding remarks and recommendations

The fiscal systems in the OECS are being challenged by a number of developments both locally and at the regional and international levels. The rapid pace in the reduction or removal of barriers to the free movement of goods, services and capital in recent years has been astonishing, and is a trend no country can afford to ignore. Technology has revolutionized the organization of world production and trade, and in so doing has made obsolete many of the old trade theories based on restricted access to know-how, factor endowments and immobility of factors of production. The benefits of larger markets have stirred the imagination of even the small countries of the subregion, and some have expressed keen interest in the anticipated formation of the Free Trade Area of the Americas (FTAA) by the year 2005. In an increasingly competitive environment, public policy and a well-developed infrastructure are crucial requisites in increasing output and attracting investment.

The implementation of the CARICOM's Common External Tariff, which is behind schedule in some countries largely because of the revenue implications, has provided the occasion for a general review of the entire fiscal system in OECS countries. It is difficult to separate the issues of revenue from concerns on the expenditure side. Lack of proper controls and inefficient spending can increase the pressure to raise higher levels of revenue and this could impact on effort and growth. In a large number of instances departmental reorganizations, computerization of administrative procedures, use of modern equipment and systems and training can increase the returns on each dollar spent. The ongoing Fiscal Reform Programme (FRP) in member States of the ECCB emphasizes the following areas:[21]

1. The determination of a targeted public sector savings;
2. Developing efficient revenue and expenditure systems;
3. Ensuring consistency between fiscal policy and other economic policies; and
4. Addressing issues of fiscal harmonization.

Table 16

Taxes on International Trade as a per cent of Imports of Goods and Non-Factor Services, 1986-96

EC$ mn.

| Year | Anguilla | | | Antigua & Barbuda | | | Dominica | | | Grenada | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | (1) | (2) | (3( | (1) | (2) | (3) | (1) | (2) | (3) | (1) | (2) | (3) |
| Year | Taxes on | Imports | (1) as a per cent | Taxes on | Imports | (1) as a per cent of | Taxes on | Imports | (1)As a per cent of | Taxes on | Imports | (1) as a per cent of |
| | Int'l Trade | | (2) | Int'l Trade | | (2) | Int'l Trade | | (2) | Int'l Trade | | (2) |
| 1986 | 5.4 | 52.8 | 10.2 | 85.7 | 702.2 | 12.2 | 43.6 | 179.2 | 24.3 | 53.7 | 285.7 | 18.8 |
| 87 | 6.9 | 67.2 | 10.3 | 97.2 | 799.9 | 12.1 | 54.1 | 209.3 | 26.0 | 64.1 | 310.7 | 20.6 |
| 88 | 9.4 | 91.8 | 10.2 | 112.1 | 825.7 | 13.6 | 57.1 | 267.0 | 21.4 | 71.4 | 323.7 | 22.0 |
| 89 | 12.3 | 112.0 | 11.0 | 113.6 | 915.1 | 12.4 | 68.4 | 324.7 | 21.0 | 75.4 | 347.3 | 21.7 |
| 90 | 13.5 | 117.2 | 11.5 | 122.7 | 915.5 | 13.3 | 65.6 | 361.6 | 18.1 | 100.4 | 374.8 | 26.8 |
| 91 | 14.3 | 121.0 | 11.9 | 126.7 | 1,004.7 | 12.6 | 66.5 | 341.0 | 19.5 | 93.6 | 402.6 | 23.2 |
| 92 | 15.6 | 150.6 | 10.3 | 132.7 | 1,067.5 | 12.4 | 67.4 | 338.1 | 19.9 | 86.5 | 373.6 | 23.2 |
| 93 | 18.0 | 162.1 | 11.1 | 140.5 | 1,118.2 | 12.6 | 72.1 | 301.5 | 23.9 | 90.1 | 429.6 | 21.0 |
| 94 | 22.0 | 172.4 | 12.7 | 156.2 | 1,169.2 | 13.3 | 64.7 | 331.6 | 19.5 | 89.4 | 423.4 | 21.1 |
| 95 | 23.9 | 201.9 | 11.8 | 160.6 | 1,201.3 | 13.4 | 73.5 | 388.6 | 19.7 | 90.0 | 445.3 | 20.2 |
| 96 | 25.3 | 217.2 | 11.6 | 181.6 | 1,272.0 | 14.3 | 81.2 | 392.4 | 20.7 | 110.9 | 521.6 | 21.3 |

Table 16 Continued

Taxes on International Trade as a per cent of Imports of Goods and Non-Factor Services, 1986-96

EC$ mn

| Year | Montserrat | | | SaintKitts-Nevis | | | Saint Lucia | | | Saint Vincent & the Grenadines | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (1) | (2) | (3) | (1) | (2) | (3) | (1) | (2) | (3) |
| Year | Taxes on | Imports | (1) as a per cent | Taxes on | Imports | (1) as a per cent of | Taxes on | Imports | (1)As a per cent of | Taxes on | Imports | (1) as a per cent of |
| | Int'l Trade | | (2) | Int'l Trade | | (2) | Int'l Trade | | (2) | Int'l Trade | | (2) |
| 1986 | 6.4 | 68.1 | 9.4 | 26.6 | 195.8 | 13.6 | 87.4 | 484.8 | 18.0 | 53.4 | 276.4 | 19.3 |
| 87 | 7.4 | 81.3 | 9.1 | 34.2 | 246.6 | 13.9 | 109.1 | 548.7 | 19.9 | 57.5 | 307.3 | 18.7 |
| 88 | 8.4 | 86.3 | 9.7 | 39.1 | 288.5 | 13.5 | 128.9 | 686.1 | 18.8 | 67.8 | 368.0 | 18.4 |
| 89 | 17.6 | 114.9 | 15.3 | 43.3 | 322.4 | 13.4 | 145.8 | 842.9 | 17.3 | 61.6 | 395.8 | 15.6 |
| 90 | 22.2 | 147.5 | 15.0 | 41.5 | 357.4 | 11.6 | 149.3 | 864.0 | 17.3 | 67.3 | 411.0 | 16.4 |
| 91 | 23.4 | 122.9 | 19.0 | 38.7 | 357.5 | 10.8 | 160.7 | 923.2 | 17.4 | 68.0 | 413.7 | 16.4 |
| 92 | 18.7 | 113.7 | 16.4 | 41.4 | 338.6 | 12.2 | 179.1 | 964.4 | 18.6 | 69.3 | 410.0 | 16.9 |
| 93 | 16.5 | 95.9 | 17.2 | 49.1 | 380.8 | 12.9 | 187.3 | 953.1 | 19.6 | 75.9 | 407.9 | 18.6 |
| 94 | 19.1 | 119.7 | 15.9 | 53.8 | 386.4 | 13.9 | 184.8 | 997.4 | 18.5 | 76.7 | 413.6 | 18.5 |
| 95 | 18.2 | 134.2 | 13.6 | 56.9 | 458.3 | 12.4 | 191.5 | 1,049.0 | 18.2 | 84.8 | 428.4 | 19.8 |
| 96 | 15.3 | 171.0 | 8.9 | 63.8 | 520.4 | 12.2 | 191.4 | 1,115.9 | 17.1 | 86.3 | 495.8 | 17.4 |

Source: ECCB

The progress on Fiscal Reform Report advances some powerful reasons for increasing public sector savings to around 4 to 5 per cent of GDP. Some of these include the use of such savings to eliminate loan arrears or to repay debt, for financing capital programmes, for providing counterpart funds for externally funded projects and for building up contingency reserves. These targets are not unreasonable, but there may be need for a number of reforms on both the revenue and expenditure sides. With respect to the Central Government, tinkering with the tax system has to give way to comprehensive rationalization of the fiscal measures necessary to meet revenue targets and encourage effort and investment. A tax revenue target equivalent to 25per cent of GDP is within the capability of most OECS members. It is difficult to plan expenditure on the basis of uncertain revenue yields and poorly performing tax systems that change with political whims and fancies. With the pressures being placed on Central Governments, the privatization or reform of the State enterprises must assume greater urgency to reduce the need for Central Government support. On the expenditure side greater transparency, accounting controls, better targetting and greater attention to productivity and performance can lead to a more manageable growth of public spending.

## Table 17

**Targeted Public Sector Savings for Member Countries of the ECCB**

| | Anguilla | Antigua & Barbuda | Dominica | Grenada | Montserrat | St. Kitts | St. Lucia | St. Vincent & The Grenadines |
|---|---|---|---|---|---|---|---|---|
| Central Government | 4.2 | 5.3 | 5.3 | 5.3 | 4.0 | 4.7 | 4.7 | 4.7 |
| Public Enterprises | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Total | 6.2 | 7.3 | 7.3 | 7.3 | 6.0 | 6.7 | 6.7 | 6.7 |

Source: Eastern Caribbean Central Bank.

The FRP is aimed at developing fiscal regimes that are conducive to economic growth and development, and promotes social equity and fiscal stability over the medium term.[22] These are very broad objectives, but they have to be supported by a consistent set of policies and actions that are credible and promote confidence. The experience of other countries can provide useful guidelines, but domestic tax structures must reflect local economic, social and political realities. The thrust and orientation of the tax structure must be in sync with government policies. Expenditure growth must be in line with fiscal realities.

As indicated earlier, a tax system cannot remain static. Inflation, increases in per capita income, changes in economic structure and the performance of taxes would always create pressures for review. Very often tinkering takes the place of well-considered incremental reforms, and the result is a more complicated tax system and the introduction of a range of measures of nuisance value or of no relationship to their avowed purpose.

**The tax system**

A tax system incorporates a variety of devices which do not always meet the ideal criteria stipulated in textbooks. What is administratively feasible may not be equitable. The evading and shifting of taxes are always forcing tax authorities to rethink their strategies. Even though it is argued that indirect taxes are regressive, the authorities in developing countries favour them because of their broad base and because they can catch some of those who are able to escape direct taxes or are in a position to exploit loopholes. Legal avoidance can have the same effect on revenue as illegal evasion. While there should be some balance between direct and indirect taxes, the Report is right in stating that there is no "standard acceptable ratio of direct tax and indirect taxes to total tax revenue."[23] Indeed the line between a direct tax and an indirect tax can often be blurred. Anguilla, Antigua and Barbuda and Grenada currently have direct tax ratios (defined in terms of total tax revenue) of under 15 per cent which is less than those associated with most developing countries.

Income and profit taxes are a favoured group of taxes because they can more easily be structured to conform with the principle of equity and to deal with increases in incomes and the enhancement of incentives. As was seen in Table 12 their share in current revenue varies widely from country to country. In some countries of the world, social security contributions exceed the tax take from income and profits, and this should be taken into account in making comparisons. In the OECS a unitary or global system is used (i.e. income from all sources are generally taxed at the same rate), but the effective rates may differ from the nominal rates. Collection from income and profit taxes as a percentage of total tax revenue varies from zero in Anguilla to over 30per cent in Montserrat. Low tax rates do not guarantee compliance, and problems of evasion point to the need for well-equipped tax intelligence units and for administrative machinery which can enforce the tax laws. With respect to the countries with an income tax on residents, the top marginal rate varies from 30 per cent in Grenada, Montserrat and Saint Lucia to 40 per cent in Dominica and 45 per cent in Saint Vincent and the Grenadines. While there are some countries with higher rates than these, a rate of 30 per cent to 35 per cent is becoming increasingly common in order to discourage the 'brain drain' and capital flight. The Fiscal Reform Report recommends a top marginal rate of 35 per cent with approximately three tax brackets and also a corporate profits tax rate no higher than 35 per cent.[24] Two countries (Dominica and Saint Vincent and the Grenadines) have marginal rates above 35 per cent and in three (Antigua and Barbuda, Saint Vincent and the Grenadines, Saint Kitts-Nevis) the corporate tax rate exceeds 35 per cent. In Saint Vincent and the Grenadines and Saint Lucia the personal income tax bands exceed three. In moving towards further simplicity the experience of Trinidad and Tobago offers some guidelines. Tax monitoring and collection involve costs. The adoption of a reasonable tax threshold (i.e. the lowest level of income at which income tax is paid) can free-up tax personnel for use elsewhere. The use of a flat personal allowance with additional deductions for a few selected expenses (e.g. mortgage interest, national insurance, contributions to pension schemes etc.) can also lead to a simpler tax form and easier computation of tax liability without necessarily violating the neutrality principle.

Over the years the corporation tax base has been eroded by the granting of *ad hoc* concessions and exemptions which are not only costly to monitor, but their usefulness in terms of

stimulating investment is often questioned.[25] It is sometimes argued that an inadequate infra-structure and bureaucratic procedures are a greater disincentive to investment than tax arrangements which compare favourably with other countries. As far as duty concessions on imports are concerned, the Fiscal Reform Report recommends that these be confined to capital equipment imported by government, profitable quasi-government organizations, schools, churches, sporting and cultural organizations, other non-profitable organizations and Cable and Wireless. Total duty exemptions relate largely to capital equipment required for upgrading or expansion. Why such a concession should be accorded to a private company like Cable and Wireless which enjoys a monopoly position in these islands raises an interesting question.

With respect to property taxes, these could be made more productive by updating the valuation of property and improving the assessment and collection systems. The case for enhancing and keeping the property tax was made very eloquently by the Saint Lucian Prime Minister in his 1998 Budget Statement. "Most property owners have benefitted from increases in property value that have taken place in Saint Lucia in recent decades. As a means to fund public services, property taxation is a useful addition to the array of other taxes because public services are capitalized into the value of the property and the tax is a way to capture back some of those benefits to help pay for public services."

There are essentially three bases on which taxes can be levied – income, expenditure (consumption) and wealth, property or capital. The choice of a tax base (or bases) is often a political one, but the effect on collection and the economy also has to be taken into account. As we saw earlier, in relation to the growth in income the various taxes performed differently in the different countries. In three, taxes on income and profit were associated with a lower buoyancy coefficient than those of taxes on domestic goods and services. Increasingly this latter group of taxes is being relied upon to meet revenue objectives. The main attraction is the broader base they offer. A major one of these taxes in the OECS is the consumption tax which varies from 5 per cent at one end to 35 per cent at the other. The Fiscal Reform Report recommends a General Consumption Tax (GCT) or a VAT with a rate of 10 per cent or 15 per cent and this should replace the hotel accommodation tax and other taxes on domestic goods and services. It recommends that the financial sector should be exempt from consumption taxes. In the OECS the consumption tax is generally limited to the taxation of goods, and the growing services sector in the subregion need to be brought within the tax purview. The Report argues that a VAT can correct such inefficiencies but it is an 'administratively demanding' tax to implement and requires a great deal of work to set it in motion.[26] One drawback of the present system is that "an efficient system for the rebate on taxes paid on inputs into production for exports is not in effect"[27] and this places those countries at a competitive disadvantage. This is an administrative shortcoming that can be corrected quickly.

One reason why an increasing number of countries are adopting a VAT tax is that it avoids the cascading effect of some consumption and sales taxes. A basic principle of VAT is that it is a sales tax chargeable to the sellers of all output, with the proviso that in computing their liability firms may deduct any VAT which has been levied on imports into their products.[28] A VAT can take a number of different forms ranging from a broad-based tax designed to reach a substantial part of domestic consumption expenditure – touching all stages of the production and

distribution of goods and services – to more limited forms that exclude retailing services and farming.[29] It differs from the retail sales tax which is collected from the retailer on the retail sales price. A VAT can be a single rate or a multi-rate tax and can be structured to exempt certain items and transactions to meet equity concerns. In an increasing number of countries the VAT is being used to replace a range of other taxes, including import duties, but generally the income tax is also retained. When the VAT was introduced in Grenada in the mid-1980s the income tax was abolished and the difficulties in implementing the VAT resulted in a significant drop in revenue. The main reason for its failure, however, appears to be inadequate preparation and education. The implementation of a VAT requires not only a properly trained set of administrators but also demands more stringent book-keeping practices by business concerns and a compilation of a comprehensive list of tax payers. A General Consumption Tax, as the one used in Jamaica, is less administratively demanding but can incorporate a value-added feature by allowing a credit for taxes paid on inputs and zero-rating exporters. In the interest of equity, certain items can be exempted. The inclusion of services in the base of a GCT or VAT is likely to increase the elasticity of the tax system. The introduction of a VAT or General Consumption Tax in Grenada, Saint Kitts-Nevis and Antigua will undoubtedly require a redesigned personal income tax system to allow the governments in these countries to deal with issues of equity and income growth.

The VAT should not be seen as a panacea for all the fiscal problems facing OECS countries. But there are certain advantages which should not be ignored. Firstly, it can simplify increasingly complex tax systems with eroding bases which are costly to administer. With its broad base it would catch some of those who are able to avoid or evade direct taxes, and thus enhance the tax take. Though the tax is regressive, it can be structured to exclude small entrepreneurs and essential goods consumed by the poor. As far as administrative capacity is concerned, the experience acquired by other countries in the subregion can be drawn upon to put the necessary structure in place and educate the population on the workings of the tax.

With respect to taxes on international trade and services, their share in total tax revenue has been falling and is likely to fall further given the trends toward greater trade liberalization. Over time, exemptions dictated by import substitution and other considerations have also weakened the base of import taxes. Customs Service Charges and increases in consumption taxes have been used to recoup some of the losses from implementation of the CET. The Fiscal Reform Report recommends the removal of the foreign exchange tax which has been adopted in three countries (Anguilla, Antigua and Barbuda and Montserrat) because it encourages hoarding of foreign currency. The travel, embarkation and security taxes have been retained in countries that have adopted a VAT. Even in the context of declining import duties, total tax revenue should not fall with a properly structured VAT or General Consumption Tax.

In the past, import tariffs and quantitative restrictions have served to protect local producers from foreign competition with the understanding that over time they would become more efficient and even export part of their production. This strategy has generally not worked and consumers have often been forced to put up with poor quality, high priced goods that are unable to compete in foreign markets. In a liberalized economy greater attention has to be paid to the training of managers and workers, the transfer of technology, organization and the use of modern equipment, and public policy can help target these objectives, particularly in areas which

offer scope for efficient import substitution. Trade liberalization is not only exposing domestic producers to greater competition but is also opening up external markets and removing some of the constraints associated with small size.

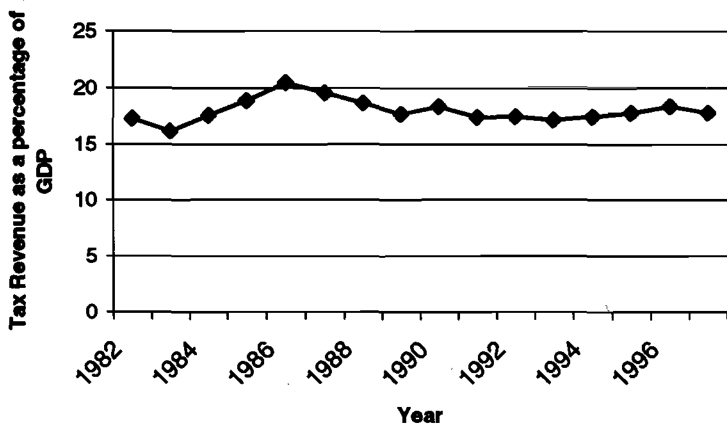
Basically, tax yield is the product of the tax base and the tax rate, so that changes in either one can affect the total take. What is an acceptable tax rate or degree of progressivity varies from country to country. Even though comparisons are often made by looking at what obtains in another country at a similar level of development, economic and political realities inform each particular situation. Political will and effective tax administration can affect yield. To gain an acceptable level of compliance, there has to be a continuous effort to share the tax burden by reducing legal loopholes that encourage avoidance and evasion. Some sectors in the economy are more difficult to tax than others, and this often calls for strong political action and imaginative approaches. The need for greater development is a powerful emotion in poor countries, and this often leads to adoption of incentives and subsidies of dubious worth. These should be brought under greater Parliamentary control. Given the scarcity of resources in the OECS, the effectiveness of such devices needs to be properly evaluated in any tax reform exercise.

With the increasing emphasis being placed on the private sector as the engine of growth, governments in the Caribbean are being forced to rethink the wide scope of their activities and to concentrate their efforts in those areas which enhance the development of the private sector or where a public role is needed. The retreat from directly productive activities to paying greater attention to public order, the regulatory environment and the infrastructural services carries with it the need for an efficient public service that could meet the challenge of providing better quality services now demanded by alert populations and an increasingly competitive world economy. In this context, government expenditure has to come under greater scrutiny and control and take on a greater measure of transparency. It may be necessary to privatize some services and put others under autonomous government agencies. Subsidies and incentives have to be better monitored and targeted and appropriate user fees may have to play an increasingly large role in the system. Governments cannot afford to employ for employment sake, and greater attention has to be paid to performance and productivity. Dissatisfaction with the present pay-as-you-go pension schemes in the public sector should encourage the adoption of fully funded programmes to relieve some of the pressures on public revenue. With respect to expenditure controls and the execution of the Public Sector Investment Programme (PSIP), the Fiscal Reform Project has made a number of very detailed proposals which are summarized in the interim report. Basically the Report calls for the institution of measures which would lead to greater accountability and better management. The need for greater training and changes in the administrative structure is emphasized in the recommendation for new budgeting systems which envisage a more consultative process and improved reporting and information systems. With respect to the PSIP the Report advises that the programmes should be realistic and manageable and advances suggestions for a more transparent approach to capital expenditure.

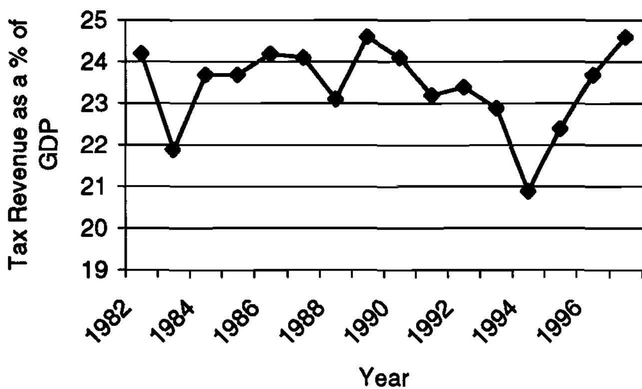
Reforms in both the revenue and expenditure systems in the OECS are a prerequisite for a more efficient government and a more competitive economy. With declining levels of grants and the constraints associated with borrowing, greater attention needs to be given to the buoyancy of

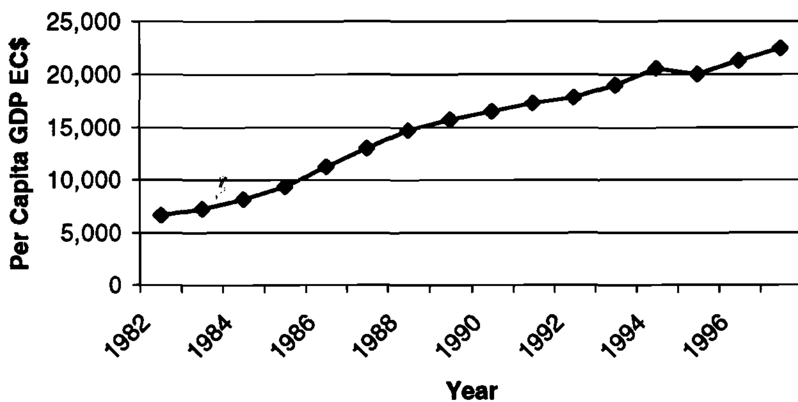
the tax system and the efficiency of public spending. Low rates of inflation have been beneficial to these countries, and the limits placed on borrowing from the Central Bank has no doubt contributed immensely to this situation. Borrowing domestically has to take account of the needs of the private sector, while growth of the external debt would tend to put greater pressure on the volatile foreign exchange earnings capacity. There is no question about governments in the OECS being involved in the provision of welfare services and looking after the poorest and disadvantaged in the society. In fact the government's responsibility in developing the human resources in these islands holds the key to development. Expenditure, however, both in dealing with market defects and in providing social services must be better targeted and greater attention must be paid to efficiency and performance.

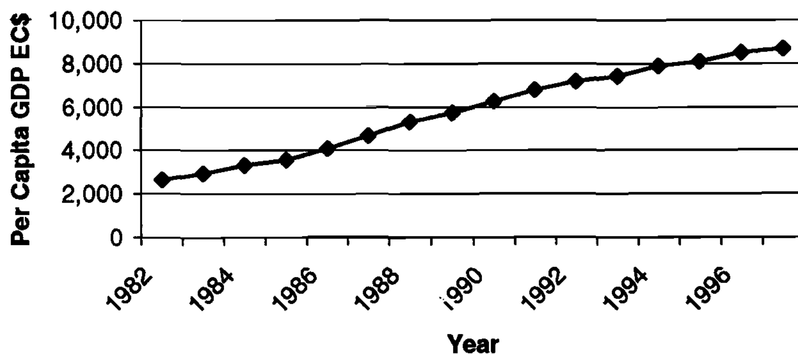
**Antigua/Barbuda**
**Tax Revenue as a % of GDP (TR)**

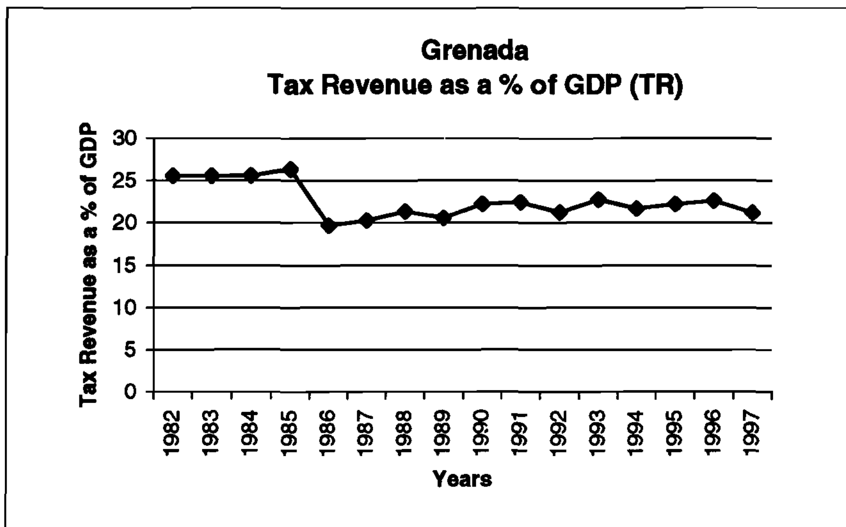


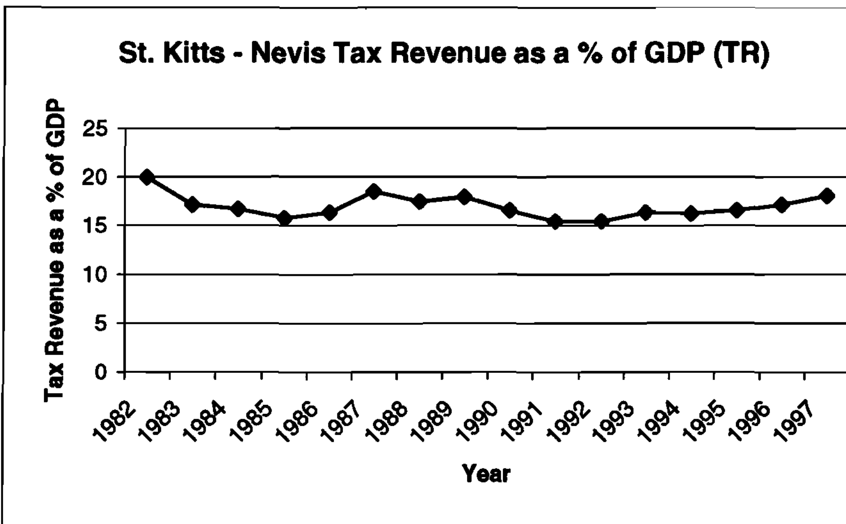

**Dominica**
**Tax Revenue as a % of GDP (TR)**

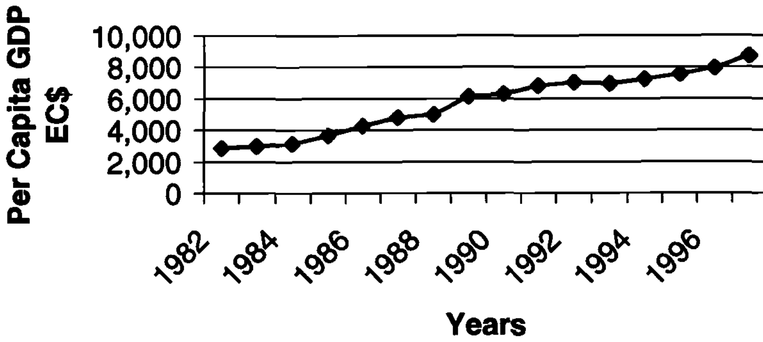


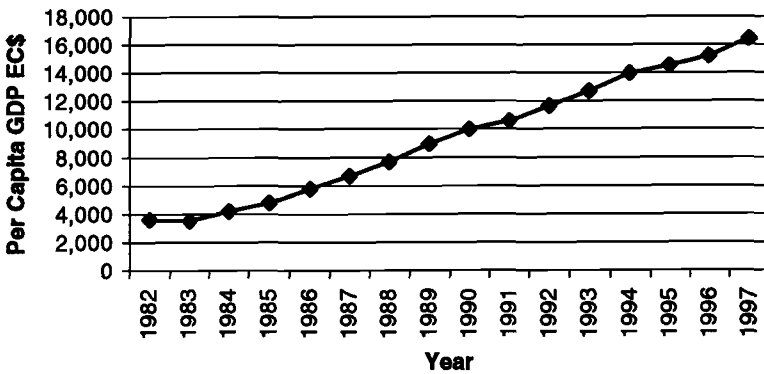

Antigua/Barbuda
Per Capita GDP EC$ (PC)
Per Capita GDP EC$
25,000
20,000
15,000
10,000
5,000
0
1982
1984
1986
1988
1990
1992
1994
1996
Year

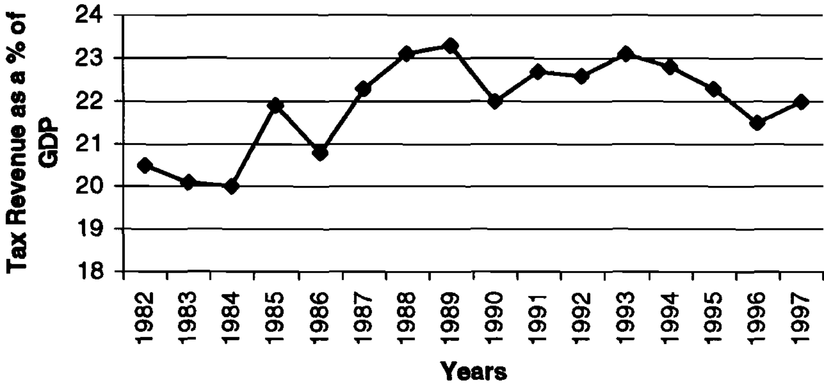

Dominica
Per Capita GDP EC$ (PC)
Per Capita GDP EC$
10,000
8,000
6,000
4,000
2,000
0
1982
1984
1986
1988
1990
1992
1994
1996
Year


Grenada
Tax Revenue as a % of GDP (TR)
Tax Revenue as a % of GDP
30
25
20
15
10
5
0
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Years

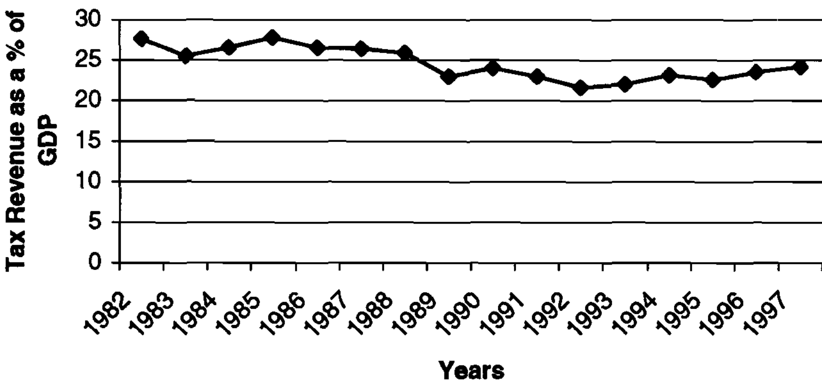

St. Kitts - Nevis Tax Revenue as a % of GDP (TR)
Tax Revenue as a % of GDP
25
20
15
10
5
0
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Year


Grenada
Per Capita GDP EC$ (PC)
Per Capita GDP EC$
10,000
8,000
6,000
4,000
2,000
0
1982
1984
1986
1988
1990
1992
1994
1996
Years

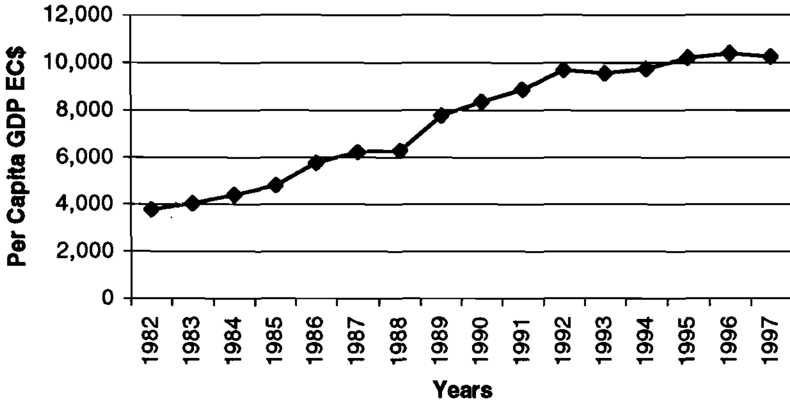

St. Kitts-Nevis Per Capita GDP EC$ (PC)
Per Capita GDP EC$
18,000
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Year

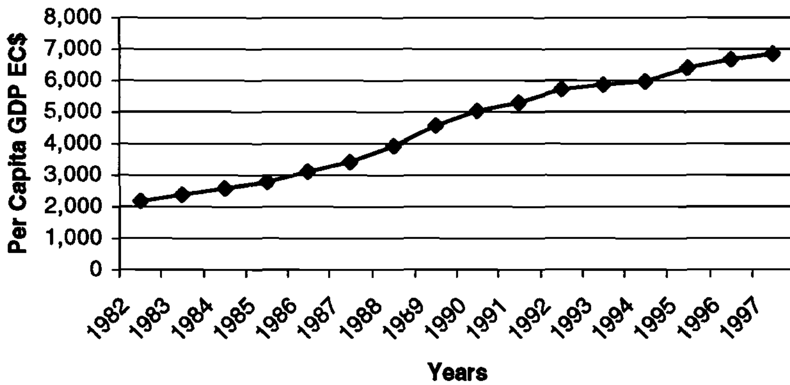


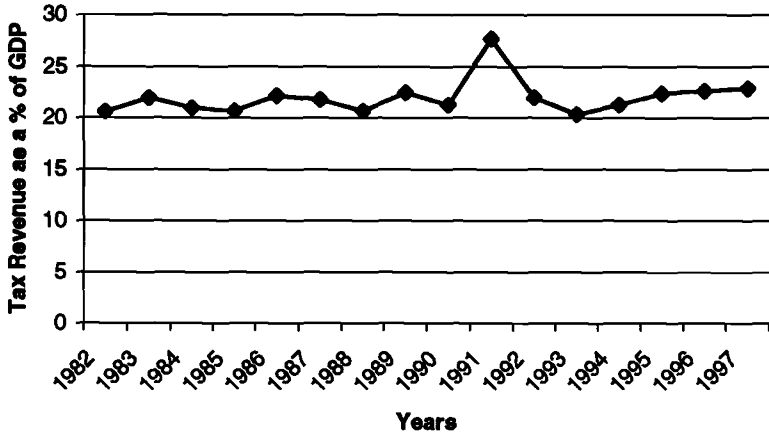
St. Lucia
Tax Revenue as a % of GDP (TR)
Tax Revenue as a % of GDP
24
23
22
21
20
19
18
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Years

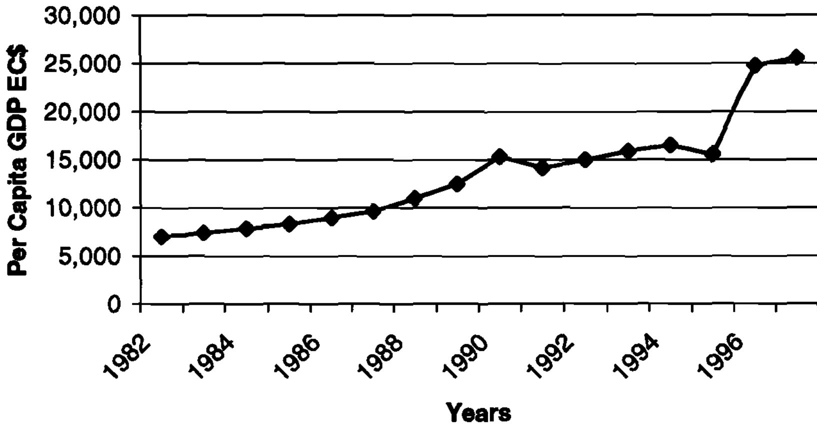
St. Vincent & the Grenadines
Tax Revenue as a % of GDP
Tax Revenue as a % of GDP
30
25
20
15
10
5
0
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Years


St. Lucia
Per Capita GDP EC$ (PC)
Per Capita GDP EC$
12,000
10,000
8,000
6,000
4,000
2,000
0
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Years


St. Vincent & the Grenadines
Per Capita GDP EC$ (PC)
Per Capita GDP EC$
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Years



Montserrat
Tax Revenue as a % of GDP (TR)
Tax Revenue as a % of GDP
30
25
20
15
10
5
0
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
Years


Montserrat
Per Capita GDP EC$ (PC)
Per Capita GDP EC$
30,000
25,000
20,000
15,000
10,000
5,000
0
1982
1984
1986
1988
1990
1992
1994
1996
Years

## Endnotes

[1] The Organization of Eastern Caribbean States (OECS) was established in 1981 "to strengthen links between themselves by uniting their efforts and resources and establishing and strengthening common institutions which could serve to increase their bargaining power as regards third countries." Members of the OECS are: Antigua and Barbuda, British Virgin Islands, Dominica, Grenada, Montserrat, Saint Lucia and Saint Vincent and the Grenadines. Montserrat and the British Virgin Islands are still British dependencies. The Eastern Caribbean Common Market (ECCM) which was established in 1968 to promote deeper economic integration among members of the group functions as a sub-grouping within CARICOM.

[2] Because of the unavailability of data for the British Virgin Islands, (BVI), the discussion in this paper is confined to members of the Eastern Caribbean Central Bank (ECCB) which include all the members of the OECS (except the BVI) and Anguilla.

[3] See the U.N. *World Economic and Social Survey, 1997*, U.N., New York, 1997, p. 233.

[4] Ibid.

5. Based on its 1995 Human Development Index, the UNDP listed the OECS countries among the first 60 of the 174 countries examined in its 1998 Human Development Report.

[6]. For greater details on critical social and economic indicators, see CDB,. *Social and Economic Indicators, 1996* and Judy L. Baker, *Poverty Reduction and Human Development in the Caribbean*, The World Bank, Washington, D.C. 1997.

[7] Judy L. Baker, op. cit., p. 162.

[8] R.J.Smith "Factors Affecting Saving, Policy Tools and Tax Reform", *IMF Staff Papers*, March 1990.

[9] IMF, *World Economic Outlook*, May, 1995, pp. 69-70.

[10] W. Arthur Lewis, *The Theory of Economic Growth*, Harper & Row, New York, 1970, pp. 224-25.

[11] J.E. Stiglitz, *Economics of the Public Sector*, W.W. Norton & Co., New York, 1986, p. 389.

[12] IMF op. cit. pp. 72-73.

[13] See P.K. Watson, "Estimation of Savings Functions for the Organization of Eastern Caribbean States" in R. Ramsaran (ed.) *The Savings/Investment Environment in the Caribbean*, The Caribbean Centre for Monetary Studies, U.W.I., Saint Augustine, 1995.

[14] See A. Hossain and A. Chowdhury, *Monetary and Financial Policies in Developing Countries*, Routledge, London, 1996, p. 133.

[15] With respect to the Eastern Caribbean Central Bank, credit to member governments is subject to the following limits:

1. Holding of treasury bills may not exceed 10 per cent of the government current revenue for the current year;

2. Holdings of government securities other than treasury bills may not exceed 15 per cent of currency in circulation, and other demand liabilities.
3. Temporary advances in the year may not exceed 5 per cent of the government's average annual revenue in the preceding three years;
4. Holdings of bonds issued by development finance corporations may not exceed 2.5 per cent of the average annual government current revenue over the preceding three years.

In addition to the restrictions on credit to member governments the Bank is required to maintain a foreign exchange cover of at least 60 per cent of currency in circulation and other demand liabilities.

16 At the end of March 1998, external assets amounted to more than 100% of total demand liabilities, including currency in circulation.

17 N.V. Gianaris, *Contemporary Public Finance*, Praeger, New York, 1989, p. 173.

18. For the ECCB as a whole total arrears and late payments (principal and interest) increased from US$179 million at the end of 1990 to US$344 million at the end of 1996. See ECCB, *Annual Statistical Digest* 1998, p. 22.

19 See T. Westaway, "The British Tax System and the Effect of Inflation" in P. Mander (ed.) *Case Studies in Public Sector Economics*, Heinemann Education Books, London, 1982.

20. See. R. Hood, "Fiscal implications of Trade Reform" in J. Nash, and W. Tackacs (eds.) *Trade Policy Reform*, the World Bank, Washington, D.C., 1998.

21 See Fiscal Reform Programme Report, ECCB, Nov., 1998, p. i.

22 Ibid., p. 1.

23 Ibid., p. 7.

24 Ibid, p. 8.

25 In the case of Saint Lucia, for instance, the 1974 Fiscal Incentives Act grants tax holidays to specified enterprises for [periods ranging from 10 to 15 years. The Act is part of the CARICOM Agreement , and as such , it cannot be amended unilaterally. The 1996 Tourism Incentives Act provides incentives in the form of hotel tax holidays (up to 15 years) and import duty exemptions for construction materials and furnishings.

26 Fiscal Reform Report, p. 9

27 Ibid.

28 J.A. Kay and M.A. *The British Tax System,* Oxford University Press, London, 1978, pp. 136-137.

29 See G.E. Lent and others, "Administrative Aspects of Value-added Taxes" in R.M. Bird and O. Oldman, *Readings on Taxation in Developing Countries*, The Johns Hopkins University Press, Baltimore, 1975.

UNITED NATIONS
ECONOMIC COMMISSION FOR
LATIN AMERICA AND THE CARIBBEAN
Subregional Headquarters for the Caribbean
CARIBBEAN DEVELOPMENT
AND COOPERATION COMMITTEE