PROVISIONAL

CPF/SR.5
7 December 1962

ORIGINAL: ENGLISH/SPANISH

JOINT TAX PROGRAM OAS-IDB-ECLA

CONFERENCE ON FISCAL POLICY

Santiago, Chile, 5-14 December 1962

PROVISIONAL SUMMARY RECORD OF THE FIFTH MEETING

held at Santiago, Chile
on Friday, 7 December 1962, at 3.15 p.m.

Chairman: Mr. MENDIVE
later: Mr. MAGAÑA

CONTENTS:

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

THE ROLE OF TAXATION IN ECONOMIC DEVELOPMENT (continued)

Mr. PIEDRABUENA, referring to Mr. Kaldor's views on incentives, believed that in Chile such incentives would have to be rationalized, established on a traditional basis, and applied in a manner which distinguished between business and personal income.

Mr. Prest's comments might be supplemented by Mr. Kaldor's alternative suggestion of partially replacing the corporation profits tax by a value added tax; the sales tax could thus be suppressed. The value added tax afforded sectoral control. The difference between the two types of tax was that the value added tax put a premium on efficiency and penalized inefficiency. Consequently, such a tax could take the place of the excess profits tax which actually penalized efficiency.

In his opinion, the transition from a sales tax to a value added tax should not be difficult; as an alternative, provision had been made in Chile to exempt industrial inputs, thus avoiding verticality, since the entrepreneur was allowed to deduct his purchases and taxes.

Referring to tax evasion, he observed that it existed in fact and could not be overlooked; but means should be devised to endeavour to reduce it to a minimum.

He thanked Mr. Kaldor for mentioning the tax reform act recently approved in Chile, and explained that assessments would be made on the basis of the potential value of the current use of land.

He did not believe that the tax on wealth was just; in his opinion, it had been established to compensate for administrative inefficiency; he could not only conceive of such a tax as a comparative test, i.e., it would serve as a minimum but could not be added to income tax, except in the case of inheritance.

Mr. LESSA said that while there was a consensus of opinion in the Conference that economic development was the final objective of fiscal policy, there were differences of approach as to the manner of applying tax revenue to achieve it. Mr. Urquidi favoured spending on infrastructure to change the productive functions of a community and establish its stock

/of capital,

of capital, while Mr. Kaldor assigned more importance to social needs - education, health, etc. - as improving a country's working capital. He personally agreed with the former, since it had often been seen in Latin America that, owing to deficiencies in the structure of production, labour left the country or had to be absorbed by the public administration, which, as a result, because excessively swollen.

With regard to agricultural taxes, a similar system to that favoured by Mr. Kaldor had been tied out in Brazil, but had failed owing to the difficulty of administering it. While taxation might be a help in agrarian reform, it could also be self-defeating, as when an entrepreneur, instead of selling his land, decided to capitalize his productive unit by adopting a more advanced technology, which was reflected in a lowering of the man-land ratio. In such cases, labour was ousted from the land and could not find work in the cities, thus aggravating unemployment, which was serious enough any way in Latin America owing to the rapid growth of the population. In Brazil, for instance, the industrial sector, which had a 9 per cent annual rate of growth, had not been able to absorb even half the population growth.

With regard to the suggestion of establishing a tax on value added, such a system had been established in Brazil in 1957 and had been yielding 30 per cent of the total tax collections for the Federal Government. It would be a good idea to introduce the system in Latin America to correct the regressive nature of the sales tax, which was particularly unfair when there were differences in the degree of development of different regions of the same country, as in Brazil.

Mr. COSCIANI said that taxes on sales, purchases, and value added were all of the same nature in that they were transferred to the final consumer. The value added tax offered certain advantages, and he found it curious that Mr. Naharro assigned to it the effect of encouraging monopolies, since it was a tax neutral in its effect. However, he agreed with Mr. Naharro that the application of such a tax implied that all business firms kept books recording all sales and purchases, and that small firms would be able to evade it.

/Referring to

Referring to taxes on capital gains, he asked Mr. Kaldor whether his suggestions referred to supplementing the income tax or whether they were inspired by the desire to punish speculation. In the latter case, it would be necessary to introduce an index of speculation in applying it in Latin America bearing in mind the period over which the capital gains had taken place and the percentage of the total capital they represented.

Mr. GOODE wished to make a few comments on Mr. Kaldor's suggestion of a value added tax. If it was to be levied on the value of an enterprise's sales or receipts minus its purchases of raw materials without any deduction for capital outlay he feared that it might have an unfortunate effect on investment, since the enterprise would have to pay tax twice over.

Regarded as a partial replacement for profits tax, he doubted whether it could be applied over a larger area than the latter since it was not suitable for agriculture, small enterprises or the professions.

He doubted whether the self-reinforcing features of the value added tax would be as effective as Mr. Kaldor claimed. Even with the aid of electronic computers, he thought that tax collection would remain a problem, and enforcement would undoubtedly entail much field work,

Mr. HART believed that attention should be paid to the possibility of integrating or supplementing the various taxes, and cited as an example the case of taxes on net wealth and income; if both existed an income tax could be applied without any discrimination. If only income tax were applied, a distinction would have to be made between income derived from work and income from property.

He noticed that Mr. Kaldor had not mentioned net wealth taxes in regard to agriculture; possibly taxes on potential income combined both wealth and income aspects.

The value added tax offered possibilities of integrating or supplementing it with sales or production taxes. One of the advantages of such a tax was its simplicity, which was wiped out when expemptions were introduced, as in the case of foodstuffs. On the other hand, its introduction demanded a rather high minimum level of administration and

/there was

there was a danger of failure if it were applied before it reached that minimum stage. A strong point in its favour was that it implied a conflict of interests between taxpayers.

Mr. DESCARTES said that, in general, he agreed with Mr. Kaldor's opinion, but he had certain reservations. With reference to taxes on wealth, he was concerned about their effect on the use of development funds because, in his view, it was extremely difficult to choose between direct development purposes and government expenditure - on health and education, for example. Nevertheless, he did not believe that there was a clear-cut conflict, or that each particular would have to decide which country was the more suitable procedure. The ideal would be to finance both, but if there was a shortage of funds something had to be sacrificed. Education was vital to economic development and it would be difficult to sacrifice it for the sake of other ends.

Mr. PREST said that the main point he wished to make had already been made by Mr. Goode. There were three ways of applying the value added tax: without any deduction for depreciation of capital goods, with some allowance made for depreciation or with a deduction for purchases of capital goods.

In comparing the sales and the value added tax, Mr. Kaldor had stated that the sales tax was less neutral. That depended on the particular way in which each tax was used. There was no difference, for instance, between a sales tax applied at one stage only and a value added tax applied with deductions.

Mr. Kaldor's idea should be contrasted with the suggestion put forward by Professor Baumol of Princeton University in a recent book that firms should be given subsidies according to the value added from one year to the next.

In relation to Mr. Kaldor's comment that the taxation of foreign enterprises should be given separate treatment, Mr. Lewis drew the attention of the meeting to secretariat paper CPF-DS-4, which made a useful contribution to the subject.

/With respect

With respect to the question of incentives for private enterprises, he thought that some more definite and quantitative answers might be obtained if the subject were approached from the standpoint of the enterprises themselves rather than from that of fiscal policy. According to Mr. Kaldor, the crux of the matter was not whether incentives produced a surplus for the Government, but whether the development of national income and expenditure produced a surplus, which was the optimum condition for the encouragement of private enterprise. In practical political terms he himself thought that it was a country where the controlling social and economic classes were able to adapt themselves to economic development.

Mr. KALDOR wished to reply to the comments that had been made point by point rather than according to the order of speakers, as many of them had dealt with the same aspect.

It had been charged that he neglected the redistributive functions of taxation. On the contrary, he felt he held very strong views about them, as witnessed by his work in Mexico, Ceylon and British Guiana. He considered that progressive taxation was redistributive in a double sense; firstly, because if effective, it reduced available income for consumption, and secondly, because the compression of luxury consumption diminished any inequalities that existed before tax. Profits stimulated luxury spending and *vice versa*. If the share of national resources claimed by the wealthy classes was reduced by progressive taxation, their income before taxation would also be reduced.

With respect to the criticisms of his treatment of inflation by Mr. Herschel and other speakers, it was true that he did not oppose inflation in all cases but was nevertheless convinced that it was a clumsy and inefficient instrument for mobilizing resources, since when prices rose in relation to income more money was transferred to the profit-earning classes who used it for luxury spending instead of for investment. Inflation was also socially unjust in that it enhanced the regressive structure of taxation.

/With regard

With regard to Mr. Núñez' contention that land taxes were difficult to apply he referred him to the example of Chile. It had been said that he exaggerated the critical role of agricultural surpluses as a determinant of economic development but in under developed and predominantly agricultural countries the difficulty of developing new industries to the point where they could compete successfully with the manufacturing capacity of highly advanced countries had to be taken into account. The lack of an agricultural surplus could not be compensated for by imports. Doubt had also been cast on whether a progressive land tax could stimulate productivity. He would like to leave that point open for discussion at a later meeting.

With reference to the charge that his ideas were not practical he asked whether that meant that they were unrealizable from a technical point of view or whether they would be likely to arouse political opposition. If the latter, he felt very strongly that it was the duty of economists and indeed of experts in any field to consider the public interest and not to bow to political considerations.

As regards the concept of family taxation, i.e. the integration of the unearned income of husband, wife and minors, he referred Mr. Urquidi to his report on tax reform to the Mexican Government, where the idea had been developed in detail. There was no reason to doubt its efficacy since it was being successfully applied in many European countries, India and Ceylon.

It had been said that he had not made the order of priority for his plan for tax reform sufficiently clear. In his opinion measures to enhance the integrity and efficiency of the tax administration should take precedence over all other considerations, since they formed the cornerstone of successful tax reform.

With respect to his suggestion of a value added tax, Mr. Urquidi had said that it would not serve for small enterprises which did not keep proper accounts. He himself thought that if enterprises could be taxed in other ways, there was no reason why a value added tax should not

/be equally

be equally successful, particularly as it was simpler and more practical than sales taxes. He disagreed with Mr. Naharro that it would tend to distort the price system and resource allocation, as it was a completely neutral tax being simply a sales tax with the element of duplication removed. As Mr. Prest had said it was comparable to a comprehensive single stage sales tax. He further disagreed with Mr. Naharro that the tax tended to stimulate the formation of monopolies, but where economies of scale were present it did promote the development of larger and more efficient enterprises and eliminated inefficient units with little competitive power.

With reference to some remarks by Mr. Piedrabuena and Mr. Hart, he agreed that the value added tax had to be judged in relation to the tax it supplanted or complemented. It was best to look upon it as a substitute for the sales tax and partial replacement for the corporate profits tax. In answer to Mr. Goode, he thought that the value added tax was as applicable to retail trade as the sales tax. He agreed that the self-reinforcing features of the tax could be effective only if its coverage was comprehensive.

Mr. Urquidi and other speakers had criticized his neglect of the question of incentives in taxation. He was fully aware of their importance particularly when the objectives aimed at had been made clear beforehand, but did not consider that they were a salient factor in economic development and deplored their haphazard application which often left loopholes for tax evasion.

What he did disagree with was the idea that heavier taxation acted as a disincentive. On the contrary, its stimulating effects were apt to outweigh its potentiality as a deterrent. It was also likely to produce more revenue for investment instead of for consumption.

In answer to a point raised by Mr. Naharro, he agreed that direct taxes were more equitable than indirect taxes in that they were leveid on a person's actual capacity to pay. But since indirect taxes were primarily intended as instruments for collecting revenue, and the criterion that should be applied was one of economic efficiency, the question of equity was less valid in relation to enterprises than to persons.

/Since the

Since the value added tax was intended to produce revenue rather than equity, he thought that it should be universal without excluding foodstuffs as had been suggested. Any adverse effects it might have on distribution could be counteracted by the introduction of subsidies at one stage or another. He insisted on the importance of a single uniform rate for the value added tax.

The meeting was suspended at 5.25 p.m.
and
resumed at 5.35 p.m.

ISSUES OF TAX REFORM FOR LATIN AMERICA

Mr. Magaña in the Chair

Mr. HARBERGER said that his paper (Doc. CPF-DB-4) could be summed up in five main points: (1) Latin American countries faced strong tax increases because the development programmes they had undertaken demanded heavy fiscal expenditures; (2) Latin American countries should have the means to face unforeseen contingencies, such as the fluctuation of international prices of export products which affected government revenues and the sudden rises in wages and salaries; (3) however important reducing evasion might be, it would not produce all the funds required by those countries in the next decade; (4) to obtain a fair distribution of the tax burden it would be necessary to have recourse to several taxes. Although the income tax had been much improved, there were different possibilities of evasion for different community groups and it would be necessary to have recourse to other taxes in order to strengthen the progressive effect of income tax; (5) one way of achieving greater progressivity in the over-all tax system was to apply taxes to groups of luxury or semi-luxury goods. In Latin America a start had been made in that direction through import duties, but as the countries began to

/produce such

produce such goods, thought would have to be given to taxing them, even when they were locally manufactured. In this connexion, and as a matter of secondary importance, he mentioned the fiscal possibilities that the suppression of dimplomatic privileges would open up for automobile imports.

Mr. Harberger next referred to taxes on capital income, which should not be applied solely to corporations but should be extended to all enterprises, interest, agricultural activities, and income derived from urban property, without prejudice to applying the personal income tax concurrently. The difficulties in taxing unincorporated enterprises could be solved by means of schedular taxes such as those already existing in many Latin American countries. The taxing of interest, in so far as it represents capital, would not be very difficult because banks and financial institutions use efficient accounting methods and are not in a position to evade taxes. In taxing urban and rural property, recourse might be had to a system of self-assessment, whereby the owners would be obliged to sell to anyone ready to pay, for instance, 20 per cent above the value declared.

Mr. ROSS read the comments made by Mr. Matus (see Doc. CPF-DB-4/Add.1).

Mr. URQUIDI said that many of the points made by Mr. Harberger were excellent, especially with reference to the need for planning taxes to meet contingencies. However, he disagreed with the restriction on consumption of domestically-produced luxury goods, since it might have adverse effects oh employment and industrial activity, and consequently on fiscal revenue.

In his view, Mr. Harberger's reference to duty-free imports of automobiles by diplomatic missions was hardly correct, as the yield obtained from a tax on such transactions would not justify the difficulties that would arise.

With regard to taxation of income from capital, he believed that the idea of levying property taxes should be more generally adopted; that was no novelty in Latin America since they were in use in a number of countries in the region.

/Referring to

CPF/SR.5

Referring to the suggestion made by Mr. Harberger of instituting the compulsory sale of property when the owner received an offer of purchase at a certain percentage above the value of his assessement, he believed it would not be feasible. There were other means of establishing gradually a system of honest assessment which were far more practicable than the method proposed by Mr. Harberger. For example, in Mexico assessment by a bank, duly certified by a notary public, was required.

The meeting rose at 6.30 p.m.