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PROVISIONAL SUMMARY RECORD OF THE SIXTH MEETING

held at Santiago, Chile
on Saturday, 8 December 1962, at 9.55 a.m.

Chairman: Mr. MAGAÑA

later: Mr. LYNN

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

ISSUES OF TAX REFORM FOR LATIN AMERICA (CPF-DB-4) (continued)

Mr. PREST referred to section II of Mr. Harberger's paper, on progressive excise taxes. With respect to substitution effects, he wished to draw attention to the possibility of such an effect in relation to the demand for leisure, or the supply of work. Secondly, he said that on the basis of twenty years' experience of progressive excise taxes in the United Kingdom, they could not be regarded as very successful; it was difficult to ensure that comparable goods were taxed at comparable rates, and rates were now being consolidated in order to avoid irrational discrimination. Lastly, European experience with a common market had shown that the different structures of progressive excise taxes in different countries led to problems in establishing a common market; such problems were not insoluble, but they should be given careful consideration before establishing such taxes if they did not already exist.

Mrs. de NAVARRETE, referring specifically to the tax on income from capital, reminded the meeting that it already existed in many countries, including Mexico. After explaining in detail how the tax operated in that country, and pointing out that its rapidly progressive rates climbed to as much as 40 per cent, she said she was not in favour of ad rem taxation. What was urgently necessary, in her view, was a personal and progressive tax on capital. If applied to agriculture, the tax proposed by Mr. Harberger would have a discouraging effect inasmuch as it would hinder capital formation. The author of the panel paper, in estimating the probable income from the taxes he suggested, had not taken into account evasion in respect of capital as a factor reducing the tax base. On the other points raised in the panel paper she supported Mr. Harberger's views.

Mr. NAHARRO said he was in general agreement with Mr. Harberger's excellent paper, and endorsed the proposal respecting a tax on capital, however difficult it might be to apply. But he did not see how an equitable solution, avoiding double taxation, could be found for the problems arising in connexion with interest on capital where interest on bank loans or interest earned and distributed by holding companies was concerned, or in the case of subsidiary companies in relation to the head office.

/Mr. HART

Mr. HART referred to the question of whether corporations should be subject to a tax on income from capital at the same rate as unincorporated companies. Although a tax on the net activity of a corporation corresponded to the concept of a tax on capital income, the same was not true for unincorporated companies, where to some extent the profit represented the remuneration of the entrepreneur's labour, the labour element being proportionately larger in the smaller companies. He referred to experience in Chile in relation to the possibility of taxing the two categories of enterprise at different rates. Moreover, it was difficult to establish a net income consisting of interest if the current inflation rate was higher than the nominal interest rate.

Mr. RIOFRIO thought that all the papers presented to the Conference were of high quality, though he disagreed with them on a few points. What caused him most concern with regard to the work of experts was the lack of continuity and even the incompatibility of their ideas, since the outcome might be bewilderment and misgivings among those who were anxious to follow their advice. To support his contention, he cited several cases that had arisen in Ecuador.

With regard to the tax on income from capital, in his opinion income, by its very nature, was always net, and that he would be loth to tax gross income. He also saw difficulties in connexion with the multiplicity of taxes on the same source and the problem of determining where progressiveness in indirect taxation began. He thought the best thing was to avoid every kind of discrimination, by establishing a global tax on capital and a further supplementary tax which might play some part in the redistributive function proper to fiscal policy. He asked Mr. Harberger what level of progressivity he would recommend for the taxes on consumption suggested in his paper.

Mr. DESCARTES, referring to the assessment of agricultural and residential properties, said that he viewed with some misgiving a system of assessment of collection which appeared to be over-simplified. He felt that assessment of property raised numerous problems, and hoped that they would be discussed in connexion with the taxation of agriculture.

/Mr. GNAZZO

Mr. GNAZZO took it that what Mr. Harberger meant by a tax on corporate profits was a tax on the capital profits of an enterprise. He wondered whether a distinction could be made between the profits of an enterprise and those of a shareholder. Some enterprises were owned by a single shareholder. He would therefore ask Mr. Harberger whether it might not be better to consider corporate profits as the capital profits of shareholders and to tax them at the time the profits were distributed.

Mr. DARDON, referring to the question of the assessment of property for tax purposes, agreed with Mr. Harberger's proposal of self-assessment based on the declaration of the property owner. The question of a statutory provision, however, required further discussion. The solution must necessarily vary from country to country.

Mr. COSCIANI believed that the organic, progressive tax on consumption proposed by Mr. Harberger had several disadvantages. One of them was that, as the propensity to consume was less in the higher income-from-capital groups, the rate formally applicable to the tax would not correspond to the rate actually charged. An ordinary tax on net wealth seemed to him to be preferable and simpler.

Mr. NUÑEZ referred to Mr. Harberger's position that income from capital should be taxed at a higher rate than income from labour. He understood a capital profits tax to mean a progressive personal tax on capital profits. Such a tax would be easier to collect than a tax on wealth, particularly if based on a progressive rate. There would be some advantage to combining the progressive tax on capital profits with the income tax.

Mr. Harberger's proposed method of assessing property was interesting and he had recommended its adoption in Panama. However, the Panamanian Government had preferred to tax property on the basis of the size of the holdings.

Mr. GOODE supported the idea that there should be an effort to increase substantially the taxes paid in most Latin American countries on urban residential property, as well as on agricultural land. Referring to paragraph 29 of Mr. Harberger's paper, he said that he distrusted the proposal that property should be assessed on the basis of a simple assessment

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of the value of his property by the owner himself. Moreover the idea of obliging the owner to sell his property if offered 20 per cent above that assessed value would introduce the constitutional problem of forced sale. In addition, it might leave room for corruption, or sharp practice on the part of those who had easy access to information about, for example, the building of a road that would lead to an increase in the value of certain properties. Again, there might be no likely buyers for a property that was unusually large or valuable, or at least none outside the social circle in which the owner moved, where social restraints would operate to prevent an attempt to force a sale, whereas there would be a much larger market for small properties. With respect to the adjustment of established values, he doubted very much whether a general price-index would be appropriate for the purpose, especially for agricultural property, in view of the instability of agricultural prices. He sympathized with Mr. Harberger's aim, but could not agree with his views about achieving that aim. Property valuation was a technical problem that the Latin American countries would have to deal with by getting technical assistance and advice from the various public and private agencies that specialized in that field. It would be a lengthy and costly task, but it was urgent and important, and the only true solution of the problem of getting a correct assessment of taxes on property.

Mr. KALDOR suggested an amendment to Mr. Harberger's proposal regarding self-assessment of property values by the owner, which might meet some of Mr. Goode's objections. The scheme might be more acceptable if the owner always had the option of retaining his property if he revalued it above the offer made; for example, if an offer was made to buy the property at the owner's valuation plus 20 per cent, the owner could retain it if he raised his valuation by 25 per cent. That would lead to a correct valuation on the basis of a kind of auction, without involving forced sales. Mr. Harberger's original proposal might lead to certain difficulties; for an example an owner who was particularly attached to his property might over-value it through fear of losing it, which would lead to resentment of the system. As for Mr. Goode's suggestion about the difficulty of finding buyers for large properties, it was quite likely that a syndicate

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could be found to do so if there was the chance of a large profit. If no-one came forward, that would mean that the market value of the property was in fact lower than the valuation plus 20 per cent, and that the valuation was approximately correct. The question of self-assessment had been discussed in public finance circles in the United Kingdom for the past fifty years, and the view had long been held that expert valuation was to be preferred, but that view was now changing. However good the expert advice, there would be strong pressure for under-valuation unless the tax administration was entirely free of corruption. No country had found an ideal method of adjusting assessed values. In Latin America assessed values represented less than 1 per cent of current market values; but even in highly developed countries the situation was not satisfactory - in the United Kingdom assessed values represented about 10-30 per cent of market values, and in the United States, where there was no shortage of experts, assessed values in some States were entirely out of line with current values. Whatever expert system was used, values would be out of date within a few years, but if Mr. Harberger's system, amended as suggested, were adopted, assessed values would continue to rise as inflation, or other factors, led to a rise in market values.

Mr. HARBERGER, replying to the comments made on his paper, did not think there was any great discrepancy between Mr. Matus' views and his own, since both were in favour of recommending a progressive tax on consumption and felt that capital should be taxed more heavily than labour. The difference in their views would appear to stem rather from their basic outlook, since Mr. Matus had little use for market forces, while he himself had slightly more respect for them. Hence his favourable attitude towards a tax on all income derived from capital, whatever its origin, without prejudice to the possibility of levying higher taxes on the less productive sectors in order to channel capital towards higher productivity.

In view of the lack of flexibility of current tax systems, and so long as it subsisted, recourse should be had to establishing new taxes or increasing existing ones.

As to whether the budget should be balanced or not, he was inclined to say no, provided the size of the deficit - which depended upon a number of circumstances - was not unduly large, as unfortunately was the case in many Latin American countries.

/The fundamental

The fundamental difference which in his own position arose from the increasing respect he felt for the complicated economic organization.

With regard to Mr. Urquidi's observations, he recognized that every tax had inherent in it an unemployment effect, but efforts should be made to ensure that the tax system as a whole was designed to ensure maximum yield from taxes with the least possible unemployment. The tax on income from capital outlined in his paper was intended, precisely, as double taxation, as in the case of corporations. Regarding assessments, he recognized likewise that it was difficult to reach a consensus of opinion on the subject; however, it would always be preferable to have some system of assessment and to endeavour to ensure that assessments were in line with the real value of the property. With respect to cars owned by diplomats, while it might be said that the loss of tax revenue was not considerable, the capital gains derived therefrom should be considered. Moreover, the question of principle involved should be looked into. That remark was also valid for the observations made by Mr. Descartes and Mr. Dardone.

While it was true that the progressive tax could discourage the desire to work, as Mr. Prest had pointed out, he did not feel there was cause for concern provided the rates were moderate. The indirect progressive tax he personally recommended for Latin American countries was based on his attitude towards the future that lay before them during the next decade. With regard to the attempt being made to establish a common market and its influence on the tax system, he believed that tax rates on the same goods in the different countries of destination should be the same or equivalent.

Whatever Mrs. Navarrete's views, he believed that systematizing of taxes on income from capital was desirable. It was true that he had not taken tax evasion into account in his paper, in order not to complicate the issues too much.

It was not easy to reply to the doubts voiced by Mr. Naharro, because each of the cases to which he had referred was different. While he would like to think about them at greater length, and recognized that they still needed an answer, he could say at once that he did not feel it was wrong to levy taxes on the interest obtained by banks, in addition to their own

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income from capital, provided they did not merely act as tax collector intermediaries, since to do so would be unjust.

Mr. Hart's observation was not without some foundation. However, if it were possible to tax income from capital in the case of small firms with lower rates than larger enterprises, the unfavourable effects of the proposed tax would not be so great.

Although he agreed that Mr. Riofrio's scruples were laudable, the aim he had in mind in proposing in his paper that gross income should be taxed was precisely double taxation. To establish progressivity in taxes on consumption, he would recommend that surveys of families be made for different income levels, in order to identify the goods into different groups depending on their income-elasticity. Depending upon the degree to which they were luxury goods, they would be taxed at varying rates - 30, 20 or 10 per cent.

When Mr. Gnazzo made a distinction between corporation income and the income accruing to their shareholders, he was possibly thinking of a single income tax and not of double taxation. If so, they were in complete agreement.

He agreed with Mr. Cosciani that the propensity to consume declined proportionately with the rise in capital income, which would seem to be an argument against the progressive indirect taxes which he himself had proposed. However, the net wealth tax could quite easily be supplemented or replaced by the system he proposed.

Reverting to the system of self-assessment, he insisted that despite all its drawbacks it was fairer than the system based on area only as mentioned by Mr. Nuñez.

In reply to Mr. Goode and Mr. Kaldor, he feared that if the fines paid in order to enable owners to keep their property were included in the system of assessment that he proposed, they might invalidate the objectives pursued. But provided the fines in question were high enough to discourage those who were ready to run the risk of incurring them, he would have no objection to make, since in that case they would not affect the substance of his suggestion.

The meeting was suspended at 11.55 a.m. and resumed at 12.10 p.m.

Mr. LYNN took the Chair

PUBLIC EXPENDITURES AND ECONOMIC DEVELOPMENT (CPF-DB-10)

Mr. VAN DER MEL introduced Mr. Adler's paper (CPF-DB-10) on public expenditures and economic development. The first part of the paper dealt with the need for a rational expenditure policy, since appropriate expenditures were the whole justification for the levying of taxes, and there was a close connexion between the effective use of government funds and the willingness to pay taxes. The structure of revenue should be determined in close relation to the structure of expenditure, since the fiscal machinery, in the wider sense, aimed at redistributing income. The need for redistribution of income was more strongly felt in a stagnant economy than in a country where there was a considerable growth rate shared by the low income brackets, but such redistribution might be better achieved through expenditure policies than revenue policies, to guard against too great a reduction of incentives to saving and investment in the private sector.

The paper went on to deal with the budgetary process, touching on the drawbacks of the conventional administrative budget, and the advantages of the functional budget, and of performance budgeting, which made it possible to relate benefits to costs incurred. A related point was the need to have consolidated data and co-ordination of spending policies for the public sector as a whole, especially when expenditure was spread over many ministries, autonomous agencies, public enterprises, etc.

The comments on the level of public expenditures had to be somewhat tentative because of the lack of comparability of the data available. Table 1 seemed to show that there was no simple relation between the rate of economic growth and the rate of public expenditures expressed as a percentage of the gross national product. It could not be established

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whether the growth rate would have been higher if public expenditures had been higher. The decisive point seemed to be the quality of government expenditure.

The second half of the paper dealt with certain important categories of public expenditure, and touched on public sector formation, the need for full cost pricing of public services, and public enterprises, education, defense, and general administration. The World Bank had considerable experience in the pricing of public enterprises and had been able to exercise some influence for the good. In general the situation appeared somewhat better, although not with respect to railways. Subsidies, where unavoidable, should be regarded as exceptions requiring special justification. The proportion of total public expenditure allocated to education appeared to have increased in recent years, but the additional facilities provided were to a considerable extent absorbed by the population increase. Literacy ratios for the fifties were shown, but were not yet available for 1960. There appeared to be some relation between the literacy rate and the proportion of the gross national product spent on education. Expenditure on such social services as education and health seemed directly related to the willingness to pay taxes; that could be exploited by increasing local taxes, little used in Latin America as a means of financing government services. Although defense expenditure was an area where experts must tread warily, they had a duty to draw attention to the element of waste involved from the standpoint of economic development in some expenditure under that head in Latin America. Although data on general administration were not susceptible to detailed analysis on a comparative basis, it seemed clear that Latin American government services included a large number of superfluous posts, that efficiency at the low and middle levels was poor, and that there was an urgent need for better pay scales and status for government employees in general.

Mr. MENDEZ said he would confine himself for the time being to making some general comments on Mr. Adler's paper, which he would enlarge upon in a written paper that he intended to present later to the Conference.

/As Mr. Adler

As Mr. Adler had stressed, too little attention had been paid in the past to analysing the structure of public expenditure as a function of development, particularly from the practical standpoint. In his opinion, that was the salient point in Mr. Adler's paper.

He considered that prior over-all development planning was essential whether fiscal expenditure for investment purposes was regarded as a complementary function of the private sector, whether such expenditure was expected to have a redistributive effect or whether the end pursued was to secure the backing of public opinion for economic development plans.

From that standpoint, the basic questions posed by fiscal expenditure were to what extent the State could act in pursuance of over-all development aims without prejudicing the private sector, and how public expenditure could be systematically distributed. The development programme itself would answer those queries and would set the limits for State intervention.

Admittedly it was impossible for the criteria that determined the order of priority for expenditure to be altogether perfect, and it was not always easy to carry out the necessary structural reforms. It was equally true that an intensive investment plan would inevitably lead to higher recurrent expenditure than had been envisaged and that investment outlays that had already begun to be made could not always be abruptly broken off when the plan was initiated. All those considerations would act as so many further obstacles to investment policy. Despite the difficulties, however, it was always desirable to establish a plan and endeavour to keep to it.

Turning to some specific points made by Mr. Adler in his paper, he said he did not agree that the redistributive function of fiscal policy should be applied chiefly in the less developed countries with a stagnant economy; it might tend to aggravate the situation of those countries in some cases, whereas the opposite might occur in others.

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It was likewise possible that the redistributive effects of fiscal policy were more urgently needed in developing countries where the economy was not stagnant. He did not think that a general formula could be advocated which failed to take into account the individual features of each case.

With respect to the prices of public services, he thought all price policies should be an integral part of the respective expenditure policy. Only in that way would it be possible to avert the dangerous distortions from which development programmes were apt to suffer.

In conclusion he wished to stress again that the chief merit of Mr. Adler's paper was that it opened up a fundamentally important avenue of economic development which had hitherto been insufficiently explored.

Mr. NAHARRO wished to stress one point with respect to expenditure on education. The output of high-level technicians in Latin America was very low because expenditure on university education was inadequate, particularly with respect to university teachers. That fact should be borne in mind when determining the amount of public expenditure to be allocated to education.

Mr. LEWIS felt that one aspect of the question of public expenditure should be emphasized. In discussing such matters as reforms in the tax structure and tax administration, participants had thought in terms of timing, of what was actually being done at the Government level and in legislative bodies. The same realistic approach might well be taken to the question of public expenditure and budgetary procedures by thinking in terms of what was currently being done, of how many civil servants were needed and of how long it would take to train them, what budgetary procedures should be introduced and what political decisions were needed to enable the necessary legislation to be passed.

/Mr. MONTERROSO

Mr. MONTERROSO, referring to Mr. Adler's example of Peru as a country offering an unfortunate combination of low gasoline taxes and wholly inadequate road facilities, observed that road facilities were also inadequate in some countries which imposed a high tax on gasoline. That was due to the fact that the income from gasoline taxes was not specifically used to improve the highway network but went into a general fund. He wondered whether it might not be desirable in Latin America to apply income from certain taxes to specific purposes, perhaps on a percentage basis.

Mr. DARDON, speaking to the question of the price of public services, observed that prices were not always directly related to costs and that costs were usually inflated because of top-heavy bureaucratic administration. The problem might partly be solved by providing for the participation of the private sector, e.g. by transferring some public services to the private sector.

Mr. DESAI felt that Mr. Adler's paper had failed to tackle the real issues. The question of public expenditure could not be viewed on the same basis as tax policy. The functional distribution of expenditure was not a matter for bureaucrats but for legislators. Decisions on national priorities were the prerogative of the legislature and of Ministers of Finance but certainly not of technicians.

He thought that there was still a considerable misunderstanding of the development process itself. In that connexion, budget estimates and long-term forecasts were subject to major errors and the problems of imputations were serious. He had some experience with analysis of the processes of economic development. In connexion with his work with ECAFE and on European countries, one conclusion reached was that the process of economic growth depended upon many things of which capital investment was not always the major factor. The real approach, he thought, was the multi-variable system adopted by ECE, which selected three variables: 1. capital input; 2. labour input; 3. other inputs excluding capital and labour. The surprising discovery in using those

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variables had been that the factor with which growth was most closely related was the balance between those variables. Economic growth was a complex process which could not be viewed in terms either of investment activity alone or of any other single area. The human factor must be taken into account, especially in Latin America, and in Asia there was now considerable scepticism about the old type of analysis based on national accounts.

Expenditure policy could not be applied in terms of Mr. Adler's paper where such questions as education were treated as a side issue. Priorities in public expenditure depended upon conditions in each country. The major question was what could be done to make expenditure effective in terms of the objectives sought and in that field very little had been done in the way of fiscal research.

Mr. URQUIDI was in general agreement with the points made by Mr. Adler, particularly the emphasis he had placed on the redistributive effects of expenditure. He supported Mr. Desai's views on the question of public expenditure priorities. The Latin American countries had to undertake considerable social expenditure which also had economic consequences. Lastly, he supported Mr. Adler's view that programme budgeting techniques should be extended.

Mr. JATAR regretted that the important question of public expenditure and economic development was being disposed of at a single meeting. The point he wished to make was that the contribution of the public sector in stimulating economic development could not be measured solely in terms of the coefficient of real investment. It should be measured by the increase in economic efficiency determined by public expenditure. The question was rather what the participation of the public sector was in capital formation. If a Government purchased a piece of land, it would contribute to economic development only if that land was made available to a large number of people who would thus be given employment.

Mr. VEGA agreed in general with the views expressed by Mr. Adler and, in particular, with the points made by Mr. Desai and Mr. Jatar. With respect to Mr. Mendez' comments, he hoped that recommendations on

/the planning

the planning of public expenditure would ensure that budgetary provision was made for the completion of long-range programmes. The division of the budget into functions did not ensure efficiency even if allocations were made on a percentage basis. For example, if the construction of a highway cost \$10 million and budgetary expenditures was spread over fifty years, with an annual allocation of \$200,000, that did not constitute efficient public expenditure.

Mr. NÚÑEZ felt that the discussion so far had shown that very little was known about the effects of public expenditure. He recommended that an appraisal of those effects should be made.

Mr. VAN DER MEL considered Mr. Mendez' comments an amplification of what Mr. Adler had stated in his paper rather than a criticism of the recommendations made. He fully subscribed to Mr. Mendez' view that planning was desirable, that it raised a number of difficulties, and that it should be adaptable to changing circumstances. He further agreed on the desirability of income redistribution through fiscal machinery and the difference between countries with high and low growth rates. With respect to pricing policies, it was an important factor with regard to public enterprises and the aim should be full cost pricing, allowing for certain exceptions. While the difficulties were clear, the point was worth restating.

On the question raised by Mr. Naharro, he felt that the nature of expenditure on education was important. There will still be much to learn in the field of the economics of education. The International Bank recognized the increasing importance of education in the context of economic development and believed that in the present circumstances more could now be attempted in that field. Lack of data made it difficult to come forward with tangible suggestions. More study and research were needed as to the type of education which gave the best results in terms of economic development.

Replying to Mr. Lewis, he agreed that it would be desirable, in the context of the efforts being made to improve fiscal policy in Latin America, to devote attention to expenditure policies.

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On the point raised by Mr. Monterroso, the question whether it was preferable to have a unitary budget or to allocate specific taxes to specific uses was being studied by the International Bank. He felt that the problem should be viewed realistically and that a flexible approach should be adopted.

The problems raised by Mr. Dardon could be attributed to inefficient administration. However, there were some public services which could not be transferred to the private sector.

He felt that some of the misgivings expressed by Mr. Desai were the result of misunderstanding due to the rather general nature of Mr. Adler's paper.

With respect to the functional distribution of expenditure, he agreed that the ultimate decision rested with the legislature. However, sensible recommendations would have to be submitted to the legislators. On that point, all that Mr. Adler's paper sought to emphasize was the usefulness of a functional classification of expenditure.

On the question of the economic development process itself, he agreed that statistical data might be inaccurate. However, a paper on public expenditure had to provide some figures, however limited, rather than none at all. After all, statistical data did provide some order of magnitude.

The question of the forces behind economic development raised many problems and he agreed that over-simplification should be avoided. It should nevertheless be borne in mind that capital output ratios drew attention to other underlying factors.

He did not agree with Mr. Desai that the question of education had been minimized in Mr. Adler's paper. He could assure Mr. Desai that the author was fully aware of the importance of education.

With respect to the role of technicians in establishing public expenditure priorities, he agreed that it was limited but thought that the views of experts should be made available.

/He fully

He fully supported Mr. Desai's plea for further research on fiscal problems.

Replying to Mr. Urquidi, he felt that public expenditure on specific items must necessarily vary from country to country. Some countries in Latin America, as Mr. Urquidi had pointed out, were committed to substantial expenditure in certain fields.

He agreed with Mr. Jatar that high investment figures did not automatically lead to a high growth rate.

In conclusion, he shared the views expressed by Mr. Vega and Mr. Nuñez.

The meeting rose at 2 p.m.