70-23,975

FUTAYYEH, Mohamed Amin Suleyman Khalid, 1930-
SALES TAX FOR ECONOMIC DEVELOPMENT: SYRIA AS A CASE STUDY.

The University of Oklahoma, Ph.D., 1970
Economics, general

University Microfilms, A XEROX Company, Ann Arbor, Michigan

THE UNIVERSITY OF OKLAHOMA

GRADUATE COLLEGE

# SALES TAX FOR ECONOMIC DEVELOPMENT: SYRIA AS A CASE STUDY

A DISSERTATION

SUBMITTED TO THE GRADUATE FACULTY

in partial fulfillment of the requirements for the

degree of

DOCTOR OF PHILOSOPHY

By

MOHAMED AMIN SULEYMAN KHALID FUTAYYEH

Norman, Oklahoma

1970

SALES TAX FOR ECONOMIC DEVELOPMENT:

SYRAI AS A CASE STUDY

APPROVED BY

Jack L. Robinson

A. V. Kardman

Paul A. Brinker

W N Peach

Gilman Blumon

To my wife

SABAH DALLO FUTAYYEH

# ACKNOWLEDGMENTS

The writer wishes to express his gratitude and sincere thanks to the chairman of his committee, Dr. Jack L. Robinson, for his guidance and encouragement during this research. Appreciation is also extended to all committee members, Dr. Alexander J. Kondonassis, Dr. W. Nelson Peach, Dr. Paul A. Brinker and Dr. Oliver E. Benson for their useful comments.

I am deeply indebted to the Syrian Government for its continued interest in my graduate studies program which has been evidenced by financial assistance. A debt of gratitude is also due to the Department of Economics, University of Oklahoma, for financial assistance the past two years which enabled me to continue my doctoral program.

Thanks are due to Dr. Preston M. Juvenal of Northeast Louisiana State College, Monroe, Louisiana, who reviewed the entire dissertation and accomplished the final editing.

Particular thanks are due to Dr. Eugene H. Fox, Chairman of the Department of Economics and Finance, Northeast Louisiana State College, Monroe, Louisiana, who provided me with encouragement and time to finish the dissertation.

TABLE OF CONTENTS

LIST OF TABLES

SALES TAX FOR ECONOMIC DEVELOPMENT:

SYRIA AS A CASE STUDY

# CHAPTER I

# INTRODUCTION

## Background

An important feature of the post-war era is the phenomenon of the poor countries of the world embarking on a more or less conscious effort at assessing and developing their total resources in the context of ambitious national development plans or programs. The preparation of a development plan is the easiest which an underdeveloped country makes in its quest for self-sustained economic growth. The techniques are standard and well-known.

Basically, a development plan aims to achieve both economic and social improvements. A plan requires that any assessment of the total inputs that can be made available in this effort must consist of an examination of the resources which can be generated domestically as well as the additional resources which can be provided through contacts with the rest of the world.[1]

---

[1]Gustave Ranis, "Trade, Aid and What," <u>Kyklos</u>, Vol. 17, 1964, p. 179.

Although the preparation of the plan may not be a problem, the employment and allocation of resources in promoting economic development is a complex process. The plan involves more than the programming or the establishment of a few enterprises. To be meaningful, economic development must be accompanied by new attitudes toward production, consumption, saving, and investment. Economic development requires the emergence of a new set of social values that reward enterprise, innovation, and stimulate expansion and growth.[2] A development policy impinges upon many disciplines of life--economic, political, sociological, religious, and similar factors. Obviously many of the difficulties encountered in development may not be economic but would involve other disciplines.

This study will concern itself primarily with one facet of development policy--fiscal--as a segment of economic planning. In the beginning, it should be emphasized that there are few applicable fiscal or other economic policies that may be generally applied without adjustment to the particular situation. Each nation has its own peculiar problems and institutional environment that would make broad generalization controvertible. With this qualification, most underdeveloped countries have resource constraints which limit the rate of development--

---

[2]E. M. Bernstein, "Financial Problems of Underdeveloped Countries," The Journal of Finance, Vol. XII (May, 1957), p. 167.

capital and/or other means to finance growth are primary.

Every nation is concerned with its governmental receipts and expenditures--that is, fiscal policy. The use of fiscal policy for economic development appears when the governmental budget is deliberately used to further certain developmental objectives.[3] The importance of the fiscal policy stems from the fact that governments have at their disposal a number of tools with which to influence economic activity. For example, the fiscal system is one of the most important and effective ways to influence the savings within an economy. A characteristic prevalent in poor nations is the inadequacy of saving and the difficulty of mobilizing any resources into investment--investment that is productive and investment that will also promote the development effort. Under such circumstances, fiscal policy would be primary in determining the total level of investment. Tax policy might be used to help direct the flow of induced savings into the desired investment projects. Accordingly, if government desires to redirect investment away from real estate, it might consider the use of various types of land and real estate taxes that would weigh heavier than comparable types of taxes on other investments more within

[3]Reuben E. Slesinger, "Fiscal Policy Considerations for Underdeveloped Economies," Kyklos, Vol. XV, 1962, p. 624.

the scope of the overall development program.[4]

Within the fiscal policy, expenditure policies are important, but if tax receipts are insufficient, governments cannot invest directly or lend to the private sector to facilitate development. A characteristic of the tax system in most of the underdeveloped countries is that it does not provide governments with adequate revenue--that is true not only of the absolute amounts but also with tax revenue in relation to national income.[5]

The problem that faces most of the underdeveloped countries is how to increase their financial resources to accelerate development. Many experts in economic planning agree that economically underdeveloped countries must depend primarily on themselves for financing their development effort. The emphasis on home finance does not mean that foreign capital is undesirable. Foreign capital is desirable, but at the present time the capital inflow is less than adequate to the needs of the poor countries--it may flow into sectors which have no connection with the development effort.

## Purpose

The present study--Sales Tax for Economic

---

[4]Ibid., pp. 627-628.

[5]Tun Wai, "Taxation Problems and Policies of Underdeveloped Countries," International Monetary Fund Staff Papers, Vol. IX (November, 1962), p. 430.

Development--is not a general study of economic planning in Syria. This study is limited to an analysis of the fiscal system in Syria in relation to economic development, and to devise a practical program for furthering the process of such development in Syria. The purpose is to determine whether the Syrian government should substitute a sales tax for an income tax in the development process.

## Preview

The study is presented in seven chapters including the introduction. Chapter II deals with the basic problems for development in an underdeveloped economy. The characteristics of the economy are discussed in order as: low income, low well-being, raw material producers, and foreign trade orientation. The chapter points out the obstacles to the development process and points out that these barriers must be overcome in order that the development process may be successful.

Chapter III provides the theoretical background of tax policy. It discusses the principles according to which tax burden should be distributed among the citizens of a nation. The government's revenues and the sources from which they are collected are discussed. It divides the government receipts into two parts--tax receipts and non-tax receipts. A comparison between government revenues of Syria and other Arab states of the Middle East is discussed briefly.

Chapter IV surveys the fiscal policy that exists in most of the underdeveloped countries. Fiscal policy is discussed in relation to the promotion of saving and investment--the role of foreign capital in facilitating economic development is examined as well as the sources through which the underdeveloped countries can acquire foreign capital to supplement their domestic resources. The relationship of the fiscal system in Syria with the process of economic development is also discussed. The efficiency, flexibility, and capacity of the fiscal system is analyzed to determine its potential to meet the requirements of government and its development plan.

Chapter V is an evaluation of sales taxes in selected countries from which representative samples have been taken. Four types of sales taxes are examined: the turnover tax in Germany; the manufacturing tax in Canada; the value-added tax in France; and the purchase tax in England. The rationale leading to the enactment of the tax in each country--the rates and exemptions in each--and how each tax has been assimilated into the tax structures are all discussed.

Chapter VI surveys the means of financing economic development in underdeveloped countries. The substitution of the sales tax for the income tax in Syria is recommended as a means of financing its development plan. The role of land taxes in economic development is discussed

--how these taxes can be used to divert resources, improve land, and increase incentives to work--and how these taxes have been effectively used in countries for accelerating development.

The role of inflation as an aid or restraint to development is examined. The question of a relationship between inflation and economic development is analyzed.

The use of sales tax in Syria is recommended. This pointed out that because of the peculiarity of the Syrian economy the tax should be imposed at the manufacturing level in case of finished products--and at the wholesale level for consumable perishable goods. The sales tax is analyzed in connection with the problem of economic development--and how it can divert resources, control inflation, and mobilize saving to accelerate development. The discussion embraces rates and exemptions, administration of the tax, and the advantages of the proposed sales tax.

Chapter VII concludes the study with a summary and recommendations. The statistical information used in this study was primarily obtained from official government sources; and some unpublished data were obtained from the Syrian Ministry of Planning. Other data used in the present study were those published by international agencies of the United Nations, as well as those published by the United States Government Printing Office in

Washington, D. C.

Throughout the study, an attempt is made to follow the method of quantitative analysis. Where this is not possible, the descriptive method is used.

## CHAPTER II

## BASIC PROBLEMS FOR DEVELOPMENT IN UNDERDEVELOPED COUNTRIES

### The Meaning of Underdeveloped Country

The underdeveloped countries are called by various names by different authors such as "backward," "underdeveloped," "less-developed," and so on. No precise definition can be made but attempts are made to define an underdeveloped economy. United Nations experts have defined an underdeveloped economy as one in which:

> . . . on the whole, production is carried on with a relatively small amount of real capital per head and with a relatively backward technique in the broadest sense of the word.[1]

Bernstein defined an underdeveloped economy as:

> The best test of an underdeveloped country is its level of real income and the rate at which per capita real income is increasing. In short, an underdeveloped country is one in which output per capita is relatively low and in which productive efficiency is increasing very slowly, if at all.[2]

---

[1]United Nations, Methods of Financing Economic Development (New York, 1949), p. 90.

[2]E. M. Bernstein, "Financing Economic Growth in Underdeveloped Economies," Savings in the Modern Economy, ed. By W. W. Heller, F. M. Boddy, and C. L. Nelson (Minneapolis: The University of Minnesota Press, 1953), p. 267.

Krause defined an underdeveloped country as:

> . . . one that, on the average, affords its inhabitants an end product of consumption and material well-being inferior to that provided in developed countries; conversely a developed country becomes one that affords an economic product superior to that of underdeveloped countries.[3]

The classification of economies into developed and underdeveloped is arbitrary since there is no absolute rule which precisely divides them. One rule of thumb is to regard as underdeveloped any country whose per capita income is no greater than one-fourth that of the highest income country.

Higgins chooses the figure of $500 per capita as the divisory line. This choice is designed to include all countries with announced goals and policies of economic development, and which are regarded as candidates for technical assistance by international agencies of the free world. After having given the figure, Higgins speaks of the problem of measurement, i.e., the difficulties in selecting a common figure to more clearly differentiate an average per capita income for underdeveloped countries.[4] A country with $400 per capita income may, in essence, be a developed country, whereas a country with $600 may be, in essence, underdeveloped.

---

[3]Walter Krause, Economic Development (San Francisco: Wadsworth Publishing Company, Inc., 1961), p. 6.

[4]Benjamin Higgins, Economic Development (New York: W. W. Norton and Company, Inc., 1961), pp. 6-8.

By use of this measurement, a country like Venezuela might be considered as developed or at least capable of financing its own development by expansion of its petroleum industry.

Higgins points out another difficulty--that of translating per capita incomes into United States dollars. For example, the Lybian figure of $25 does not necessarily mean that its average standard of living could be compared to what an American would suffer with an income of $25 per year.

Despite the numerous difficulties in comparing the two groups, it would be useful to describe briefly some of the salient characteristics of underdeveloped economies.

## Basic Characteristics

Several characteristics seem to be present in most of all underdeveloped countries. The underdeveloped countries do not form a homogeneous group, but differences exist among themselves. Some are richly endowed with natural resources, others are deficient in many respects, some may be wholly agricultural, other have an industrial structure of some sort, others are still in the tribal state, and so on. These characteristics are different in weight and importance in each country, but nevertheless such characteristics form a general picture that repeats itself more or less in all cases.[5]

Low Income

The basic characteristic which may be shared by all the underdeveloped countries is the presence of low per capita income compared to the developed countries of the world. An idea of the disparity between incomes in the developed and the underdeveloped countries is illustrated in Table 1.

TABLE 1

WORLD INCOME DISTRIBUTION IN 1949

| | World Income (Per Cent) | World Population (Per Cent) | Income (Per Head) |
|---|---|---|---|
| High Income Countries | 67 | 18 | $915 |
| Middle Income Countries | 18 | 15 | 310 |
| Low Income Countries | 15 | 67 | 54 |

Source: R. Nurkse, Problems of Capital Formation in Underdeveloped Countries, Patterns of Trade and Development (New York: Oxford University Press, 1967), p. 63.

Information in the table suggests that 82 percent of the world population could be considered underdeveloped--if Higgins' $500 per capita figure is used. It is further shown that two-thirds of the world income accrues to only 18 percent of the population with 67 percent of the

[5]Krause, Economic Development, pp. 7-23.

population receiving only 15 percent of the income.

The disparity of the world income distribution is magnified in Table 2--the estimates for selected countries, both underdeveloped and developed countries. An exmination reveals that in 1963, per capita gross domestic product at factor cost ranged from $4902 to $85. Most of the underdeveloped countries had a per capita product of less than $200 per year, less than one-tenth that of the United States. Table 2 shows also that the lowest per capita income is in India, one of the most populous countries in the world.

Low Well-Being

Evidence that underdeveloped countries are far behind the advanced countries is also found in various non-monetary measures of material well-being--the amounts and types of food intake, life expectancies, literacy rates, mortality rates and extensiveness of public facilities. These measures offer a somewhat more detailed picture of the poverty inherent in the environment of underdeveloped countries. Additionally, these measures provide an alternative to data on money income and tend to support the idea that the underdeveloped countries are far below the level of the advanced countries on every count. All the nonmonetary measures cited in Table 3 reveal wide variations among the countries, but the significant fact remains that countries categorized as low

TABLE 2

ESTIMATES OF PER CAPITA GROSS DOMESTIC PRODUCT AT FACTOR COST, SELECTED COUNTRIES, 1963

| Country | Per Capita (In U.S. Dollars) |
|---|---|
| Kuwait | 4902 |
| United States | 2857 |
| Lebanon | 295 |
| Iraq | 252 |
| Algeria | 229 |
| Iran | 212 |
| Tunsia | 200 |
| Jordan | 181 |
| Syria | 170 |
| Marocco | 168 |
| United Arab Republic | 143 |
| Sudan | 94 |
| Indonesia | 90 |
| Pakistan | 88 |
| India | 85 |

Source: United Nations, _Statistical Yearbook, 1967_ (New York, 1968), pp. 576-579.

TABLE 3

NON-MONETARY MEASURES OF MATERIAL WELFARE
IN SELECTED COUNTRIES

| | Year | Caloric Intake Per Person Per Day (Numbers) 1 | Protein Consumption Per Day (Grams) 2 | Infant Mortality (Number of Deaths Per 1000 Live Births) 3 | Literacy (Per Cent of Population 10 Years and Over) 4 | Inhabitants Per Physician (Number) 5 |
|---|---|---|---|---|---|---|
| Ceylon | 1965 | 2080 | 44 | 72 | 58 | 5820 |
| Denmark | 1965/66 | 3310 | 95 | 27 | 99 | 740 |
| France | 1965 | 3250 | 103 | 42 | 97 | 900 |
| India | 1964/65 | 2110 | 54 | 119 | 18 | 5780 |
| Iraq | 1960/62 | 2140 | 62 | 44 | 12 | 4760 |
| Pakistan | 1965/66 | 2280 | 52 | 125 | 14 | 6200 |
| Philippines | 1965 | 2070 | 50 | 109 | 62 | 1330 |
| Syria | 1963 | 2360 | 72 | 102 | 50 | 5110 |
| United Arab Republic | 1963/64 | 2930 | 84 | 127 | 25 | 2380 |
| United States | 1965 | 3140 | 92 | 27 | 98 | 670 |

For Column 1, 2, and 5 Source: United Nations, Statistical Yearbook, 1967 (New York, 1968), pp. 498-502, 696-698.

For Column 3 and 4 Source: U. S. Senate, Foreign Aid Program, Document No. 52 Washington, July, 1957, p. 242.

income countries are also deficient in terms of the various non-monetary measures of material well-being.

<u>Raw Material Producers</u>

Economists generally classify economic activity into three groups: industrial, primary and tertiary. The first group includes manufacturing, extending to construction and basic facilities. The second group includes agriculture and mining. The third includes commerce, trade and services. Accepting these classifications and comparing the developed countries with the underdeveloped countries, the underdeveloped countries have a lower proportion of industrial output than the advanced countries. However, the share of total output in the tertiary sector is not significantly lower than those of the advanced countries.

The share in the primary sector (agriculture) is the distinguishing factor between the advanced and underdeveloped countries. For example, the share in total output (or employment) is larger than in the advanced countries. The concentration of underdeveloped countries on the primary output, and especially agriculture, is to be expected in low-income countries. A major part of their efforts will be devoted to this occupation, since at low income level, the proportion of income spent on food is very high. One prevalent and common reason for this concentration can probably be focused on the industrial and tertiary sectors. These sectors have not been growing at a rate proportional with the increases in population because of a lack of sufficient investments outside agriculture. Leibenstein has said:

> The persistent lack of adequate non-agricultural employment opportunities lies at the very root of the economic development problem.[6]

Data indicating major productive sectors within which output arises in both developed and underdeveloped countries are shown in Table 4.

The heavy concentration of the labor force in raw materials production in underdeveloped countries can be attributed to three factors. First, output per worker tends to be low and thus the services of many are required to produce even the minimum of needed food supplies. Second, the production of many of these countries is geared to sales of raw materials in export markets. This tends to happen in countries in which plantation of agriculture plays a major role and in countries where important mining operations exist. Thirdly, absence of alternative employment opportunities which provides grounds for staying on the land further aggravates the situation.[7]

---

[6]Harvey Leiberstein, Economic Backwardness and Economic Growth (New York: John Wiley and Sons, Inc., 1957), p. 51.

[7]Krause, Economic Development, pp. 17-18.

TABLE 4

INDUSTRIAL ORIGIN OF GROSS DOMESTIC PRODUCT AT FACTOR COST, IN SELECTED COUNTRIES, 1964-66

| Country | Year | Agri- culture | Total Industrial Activity[a] | Manu- fac- turing | Con- struction | Trans- port | Wholesale and Retail Trade | Others[b] |
|---|---|---|---|---|---|---|---|---|
| | | PERCENTAGE DISTRIBUTION | | | | | | |
| Cambodia | 1964 | 41 | 12 | 10 | 5 | 3 | 20 | 20 |
| Canada | 1966 | 7 | 33 | 26 | 6 | 9 | 13 | 32 |
| Ceylon | 1966 | 41 | 8 | 7 | 7 | 10 | 11 | 24 |
| France | 1966 | 7 | 38 | 35 | 9 | 5 | 14 | 29 |
| India | 1966 | 48 | 16 | 14 | 4 | 5 | 10 | 17 |
| Iraq | 1965 | 21 | 45 | 9 | 2 | 6 | 6 | 20 |
| Pakistan | 1966 | 49 | 11 | 10 | 4 | 6 | 12 | 17 |
| Sudan | 1964 | 54 | 6 | 6 | 6 | 14 | 14 | 19 |
| Syria | 1966 | 28 | 15 | -- | 4 | 11 | 17 | 25 |
| U. A. R. | 1961 | 25 | 22 | 17 | 4 | 9 | 10 | 29 |
| United States | 1966 | 3 | 33 | 28 | 4 | 6 | 16 | 37 |

Source: United Nations, Statistical Yearbook, 1967 (New York, 1968), pp. 560-567.

[a]Total Industrial activity includes mining, quarrying, manufacturing, electricity, gas and water.

[b]Other comprises banking, insurance and real estate, ownership of dwellings, public administration and defense and personal and other services.

Foreign Trade Orientation

Most, if not all, underdeveloped countries are raw material producers and their economies are based upon the production of only one, or few, single items. Foreign trade should therefore be considered among the activities that are closest to the development of the economy and that economy is influenced by trade expansion or contraction.

Foreign trade occupies an important position in Syria because it is through that sector the government obtains most of its foreign exchange receipts that are so necessary in financing its economic development.

In Syria, as in other underdeveloped countries, the development of the trade sector, as well as the role it plays in the economy, depends on the structure of production within the economy.

An assumption is made that the Syrian economy is underdeveloped, and its production is unstable. It is also an economy which relies upon "the outside" for its consumption, its growth rate and its investment.

With these qualifications, the structure of the Syrian trade reveals: first, a limited diversity of exports since a very few commodities form the bulk of Syrian exports. These are chiefly agricultural products which are sold as raw materials. The share of these commodities--wheat, barley, and cotton--in total exports has ranged from 34.6 per cent to 66.5 per cent, during the period 1960-1965. Table 5 shows the value of these commodities and their share in total exports.

TABLE 5

MAJOR EXPORTS AS A PER CENT OF TOTAL EXPORTS
IN SYRIA, 1960-65
(IN THOUSANDS SYRIAN POUNDS)

| Year | Wheat | Barley | Cotton | Total | Per Cent of Total Exports |
|---|---|---|---|---|---|
| 1960 | -- | -- | 174,687 | 174,687 | 34.6 |
| 1961 | -- | 3,614 | 205,678 | 209,292 | 53.0 |
| 1962 | 74,207 | 75,315 | 260,676 | 410,198 | 66.5 |
| 1963 | 43,670 | 71,757 | 348,771 | 464,198 | 64.4 |
| 1964 | 47,009 | 41,324 | 338,985 | 427,318 | 63.6 |
| 1965 | 6,706 | 49,876 | 279,742 | 336,324 | 52.2 |

Source: Ministry of Planning, Statistical Abstract, 1965 (Damascus: Government Press, 1966), pp. 180-183.

On the other hand, imports are composed mostly of finished goods available for direct consumption. They are either in the form of foodstuffs essential for daily diet of the population, or as necessary durable consumption goods such as watches, cars, household equipment, and machinery. Additionally, various raw materials necessary for the operation of certain manufacturing industries are imported. Imports can thus be considered as essential to the economic life in Syria. They provide food for the population; play an important role in the industrial life of the country; and contribute to the formation of fixed capital. It has been estimated that more than 30 per cent of Syria's consumption, and 60 to 70 per cent of its investments depends on imports.[8]

There is an instability in Syrian trade--production is mainly agricultural and the vagaries of weather results in a fluctuating production. As the yield fluctuates, so does the exportable surplus of goods where production is at the mercy of variable natural elements.[9]

The scantiness of rain affects not only the volume and type of exports but also the volume and nature of imports in certain years. Thus, the government, in the event of a decline in the output of wheat, barley, and meat, is obliged to import these commodities from abroad in order to satisfy the needs of the population.

Foreign trade in its two components--exports and imports--is not only influenced by fluctuations in the national product, but largely by variations and trends in the markets of the world. As an exporter, Syria does not produce strategic or essential commodities where she can control the price and conditions of sale. Syria's primary production--cotton, wheat, barley--constitutes

---

[8]Youssef Helbaoui, "Major Trends in Syria's Foreign Trade, 1952-1962," Middle East Economic Papers, 1961, p. 2.

[9]Ibid., p. 3.

only a small percentage of world production and is therefore compelled to be a price follower. The heavy reliance on exports--the few commodities--makes Syria susceptible to trade cycles from abroad. A depression abroad reduces the demand for the country's primary products and a concurrent decline in price and volume of exports. Conversely, prosperity abroad increases the demand for Syrian products--along with an increased volume of exports and foreign claims.

Because of trade instability, Syria has had a permanent unfavorable balance of trade--the amount of the debit balance depending on the volume of exports. The period 1957-1965 is a case in point--in only 1957 and 1963 were exports able to cover as much as 80 per cent of imports--the other years, exports were about three-fourths the value of imports.

A trade deficit by itself is not a symptom of underdevelopment and economic difficulties. Many economically advanced countries have trade deficits. However, the danger in the Syrian trade balance is that Syria does not possess important invisible resources which could compensate for this deficit. Its principal invisible receipts are the expenditures and receipts from foreign companies which operate petroleum pipelines across Syria. Though these receipts have increased in recent years, they were not enough to cover the deficit and realize a surplus in favor of Syria.

Other invisible revenues may occur from tourism, transit trade and emigrants' remittances. However, these revenues fluctuate depending on political conditions at home and Syria's relations with the outside world. Even though invisible revenue may increase, these sources will not be enough to cover trade deficit. Table 6 shows the annual changes in imports, exports, and balance of trade. The information shows also the exports and imports as a per cent of national income. Table 7 reveals the transactions of goods and services with the rest of the world including the petroleum revenue, transit commissions and other services. It will reveal that even with the inclusion of all these sources, a balance of payments deficit existed in Syria except in two years--1962 where they were even, and in 1963 when for the first time Syria realized a surplus.

The foreign orientation is also revealed through foreign borrowings. The expansion in exports that has occurred in many underdeveloped countries is attributable largely to direct foreign investments in these countries. However, these investments have concentrated on development of primary products for export markets. The objective has been to expand production for overseas markets rather than for domestic markets. The reason for this concentration is that the domestic markets are limited

TABLE 6

ANNUAL CHANGES IN IMPORTS, EXPORTS AND
BALANCE OF TRADE, 1957-1965
(MILLIONS OF SYRIAN POUNDS)

| Year | Exports | Imports | Balance of Trade | Per cent of Exports to Imports | Exports as Per cent of National Income | Imports as a Per cent of National Income |
|---|---|---|---|---|---|---|
| 1957 | 587 | 665 | -78 | 88.4 | 22.6 | 25.6 |
| 1958 | 475 | 730 | -255 | 65.0 | 21.1 | 32.5 |
| 1959 | 468 | 709 | -241 | 66.0 | 20.5 | 31.6 |
| 1960 | 505 | 898 | -393 | 56.2 | 22.2 | 35.2 |
| 1961 | 395 | 711 | -316 | 55.5 | 15.8 | 28.4 |
| 1962 | 617 | 862 | -245 | 71.6 | 19.3 | 27.0 |
| 1963 | 721 | 896 | -175 | 80.4 | 21.7 | 27.0 |
| 1964 | 673 | 898 | -225 | 74.5 | 18.7 | 24.9 |
| 1965 | 644 | 812 | -168 | 79.3 | 17.9 | 22.6 |

Source: Ministry of Planning, Statistical Abstract, 1965 (Damascus: Government Press, 1966), p. 374.

TABLE 7

TRANSACTION OF GOODS AND SERVICES
WITH THE REST OF THE WORLD, 1957-1965
(IN MILLIONS OF SYRIAN POUNDS)

| Items | 1957 | 1958 | 1959 | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 |
|---|---|---|---|---|---|---|---|---|---|
| Exports of Goods | 587 | 475 | 468 | 505 | 395 | 617 | 721 | 673 | 644 |
| Transit Commissions | 18 | 15 | 28 | 20 | 15 | 20 | 12 | -- | -- |
| Tourism | 45 | 30 | 32 | 40 | 45 | 50 | 20 | 26 | 28 |
| Oil Royalties | 58 | 84 | 113 | 120 | 127 | 182 | 160 | 154 | 160 |
| Net Government Expenditure | 8 | 22 | 20 | 20 | 20 | 25 | 40 | 10 | 3 |
| Commission from Foreign Exchange | 3 | 3 | 5 | 4 | -- | 3 | -- | -- | -- |
| Other Services | -- | -- | -- | -- | -- | -- | -- | 20 | 18 |
| Total Exports of Goods and Services | 719 | 629 | 666 | 709 | 602 | 897 | 953 | 883 | 853 |
| Import of Goods | 665 | 730 | 709 | 898 | 711 | 862 | 896 | 898 | 812 |
| Transit Commissions | 4 | 3 | 3 | 3 | 5 | 5 | 8 | -- | -- |
| Tourism | 60 | 10 | 20 | 20 | 35 | 30 | 30 | 23 | 27 |
| Other Services | -- | -- | -- | -- | -- | -- | -- | 16 | 16 |
| Total Imports of Goods and Services | 729 | 743 | 732 | 921 | 751 | 897 | 934 | 937 | 855 |
| Balance of Transaction | -10 | -114 | -66 | -212 | -149 | -- | +19 | -54 | -2 |

Source: Ministry of Planning, Statistical Abstract, 1965 (Damascus: Government Press, 1966), p. 374.

while overseas there is a demand for these exports, and foreign investors are interested in foreign exchange receipts.[10]

Though there has been an inflow of foreign capital, the inflow is unstable and tends to fluctuate even more than earnings from the export proceeds. Years of declining capital inflow tend to coincide with years of decreasing export proceeds. The fluctuations in foreign investments tend to intensify the instability of the domestic economy. A more significant feature of the inflow of foreign capital is that it has brought absentee owned plantations, foreign owned mining enterprises, and foreign trading firms. These investments have created a certain degree of monopoly or high concentration of economic power in the hands of foreigners.[11] They are interested in quick return on their investment and have no interest in the development of the domestic economy.

## Population Pressures

Another major characteristic of some of the underdeveloped countries--a corollary of the pressure of population on land--is that a considerable part of the.

---

[10]G. M. Meir and R. E. Baldwin, Economic Development (New York: John Wiley and Sons, Inc., 1957), p. 312.

[11]Ibid., p. 313.

population now subsisting on land really is surplus to the needs of agriculture and can be said to be in a state of disguised unemployment.

From the standpoint of development the perplexity of population pressure is significant. In many of the underdeveloped countries there is a relatively abundant labor force compared to capital and natural resources. Too, the marginal productivity of labor is negligible, zero, or even negative. In such a situation, new industries can be created and old industries expanded by drawing on a pool of labor from the subsistence sector of the economy without raising the real wages--the hiring can be done at the existing wage level.[12]

The disguised unemployment is usually associated with the family system in the underdeveloped countries. The unit of production is the family--those who are working have to support themselves as well as other members of the family. If such underemployment exists in rural areas, labor can be withdrawn from agriculture without reducing agricultural output and without reorganization of production or the substitution of capital.

A striking difference between demographic patterns of rich and poor is that the percentage of population

---

[12] W. A. Lewis, "Economic Development with Unlimited Supplies of Labor," Readings in Economic Development, ed. by T. Morgan, G. W. Bertz and N. K. Coudhry (Belmont, California: Wadsworth Publishing Company, Inc., 1963), pp. 215-216.

below 15 years of age is greater in the poor countries than in the rich ones, but life expectancy is higher in rich than in poor countries. In poor countries the mortality rates in the younger age groups are appreciably higher than in rich countries and the productive years remaining for those who do not die in childhood are much fewer. Thus, if the economically productive age is between 15 to 64 years, the percentage of population in this category is considerably less in poor than in rich countries. The unfavorable age structure of the population is due primarily to high birth rates and high mortality rates which requires the economy to devote a considerable part of its resource to the maintenance of children who die before reaching the productive age.[13]

Although not all poor countries are densely populated, the rate of population gives indications of becoming a serious problem for most poor countries. As modern medicine becomes more widely applied in poor countries, the fall in death rates without any reduction in birth rates will result in population growth. "And, unlike during the nineteenth century, the possibilities for population outlets through international migration are now limited by economic, cultural, and political obstacles."[14]

---

[13]Meier and Baldwin, Economic Development, pp. 283-284.

[14]*Ibid.*, p. 285.

The rate of growth in population in several underdeveloped countries (India, Egypt and Pakistan to name a few) is one of the most serious problems to be met. The advancement in controlling diseases has made it possible to control and diminish death rates at a very low cost. Thus unless the fertility rates also decline, the expected decline in mortality rates will aggravate the problem for these countries. If the fertility rates do not decline, these countries will be concerned with accelerating their development at a faster rate than population increases.

The characteristics of poor countries thus far discussed are not the sole causes for a country being poor. They can be best considered as only associative with underdevelopment but not inhibiting the expansion. There are other characteristics which do inhibit development and which may be referred to as obstacles to the development process in poor countries. Meier and Baldwin list three such obstacles: (1) market imperfections, (2) vicious circles, and (3) international forces.[15]

Market imperfections. In underdeveloped nations as in developed countries, the perfect market does not exist--there are market imperfections. These imperfections are found in factor mobility, price rigidity, and an ignorance of market conditions. Too, a rigid social

---

[15] Ibid., pp. 316-333.

structure prevails as well as a lack of specialization, each of which have acted as hendrance and impediments that prevent an optimum allocation of resources. Efficiency of production has remained low, resources have been underemployed, and employment has been misdirected.

In advanced countries, factors of production move from one industry to another until a near equilibrium return is achieved. In poor countries, there is a large number of workers whose productivity is near zero. These near negative producers do not migrate to industries where their productivity could be increased. In poor countries, social habits and attitudes toward alternative employment are powerful deterrents to an easy flow of capital and labor. The worker's poverty acts as a constraint on any move to take advantage of alternative or better employment elsewhere. He cannot afford such a cost. Too, there is the lack of knowledge about employment opportunities elsewhere; and, even producers are ignorant of the domestic and international market situation.

Resources have remained underdeveloped in poor countries because of underutilization of those that are available. Efficient reallocation could bring the poor country nearer its productive potential, and a different combination of factors could increase real income.

Any country is faced with a production possibility curve. This curve denotes the various possibilities that a given production could be produced with given resources and technology. There are various factor combinations which are attainable but the outer boundary or the production possibility curve represents points that are optimal factor combinations which produce different levels of output. Characteristically the factor combinations of poor countries are represented by a point inside that outer boundary which indicates a less than full employment of resources, and a production level below potential. Added to the misallocation of resource combinations the poor country has its various forms of immobility--social, geographical, and occupational--all of which tend to contribute to a low elasticity of supply--and a failure of the price mechanism to follow the fluctuations of supply and demand. In addition, there is a lack of specialization in workers and an absence of entrepreneurs to undertake innovations, which results in a picture of friction and obstacles that will not permit the optimal allocation of resources.

*The vicious circle of poverty*. It is suggested that underdeveloped countries usually suffer from the vicious circle of poverty. This circle operates both on the demand and supply sides.[16] On the supply side, there

---

[16]Ragnar Nurkse, *Problems of Capital Formation in Underdeveloped Countries and Patterns of Trade and Development* (New York: Oxford University Press, 1967), p. 5.

is a low level of saving resulting from a low level of real income. The low level of real income is a reflection of low productivity, and that low productivity is due to the lack of capital. On the demand side, the low rate of investment lessens productivity and income. As such, the purchasing power of the people in real terms is low which in turn adds to the relatively low marginal productivity of investment. Since the inducement to invest is low, low incomes are perpetuated.

To be sure, the concept of the vicious circle of poverty only partly explains the perpetuation of low incomes. For instance, given the existing distribution of income and property in underdeveloped countries, the potential rate of savings cannot be related directly to the level of per capita income. A considerable part of investment, when used, is directed into unproductive channels--residential dwellings and buildings. If the vicious circle of poverty is to be broken, the causes of low investment have to be tackled.

International Forces. The classical theory of international trade would maintain that the orientation of poor countries to foreign trade is consistent with the comparative costs. The theory holds that the operation of free market forces at the international level tends to promote income maximization among all countries and the poor countries would be "better off" than they would without trade.

This theoretical proposition has been questioned recently by many writers in this field. They questioned whether the classical theory is relevant to poor countries under dynamic conditions.

As indicated earlier, poor countries are prone to experience serious economic instability by their dependence upon the international market in which they sell their raw materials. Some have suggested that, in addition to being victims of domestic instability induced through fluctuations in foreign trade, poor countries have also been experiencing long-run deterioration in their export-import relationships. Such deterioration is evidenced in a tendency for the terms of trade to worsen over time.[17] They argue that the plight of the poor countries is attributable to the poor bargaining position of raw materials in the process of exchange for manufactured goods.

Some of the leading critics of the exploitation argument are Prebish, Singer, and Myrdal. They do not charge deliberate exploitation, but they maintain that there were "disequalizing forces" operating in the world economy. They argue that these disequalizing forces resulted in the gains from trade going primarily to the more developed countries, even though foreign investors

---

[17]Krause, Economic Development, p. 38.

and foreign governments did not consciously exploit the poor areas.[18] The argument of these writers is about as follows:

First, it is maintained that the export industries in underdeveloped countries--metal mines, plantations, etc.--are often highly capital intensive industries supported by a great deal of imported foreign technology. However, production for domestic uses, particularly food and clothing, is often of a very primitive subsistence nature. As such the export sector which is a highly productive sector is surrounded by subsistence conditions and inferior methods of production. Thus the economy of the underdeveloped countries often presents the spectacle of a dualistic economic structure--a high-productivity sector producing for export coexisting with a low-productivity sector producing for the domestic market.[19]

Secondly, it is maintained that the effects of international factor movements have not been entirely beneficial. The previously mentioned higher productivity of the foreign trade sector in poor countries may be looked on as a healthy sign for those countries. For example, it should raise their general standards of productivity; it should move their economies in the direction of a

---

[18] Neier and Baldwin, Economic Development, p. 328.

[19] H. W. Singer, International Development: Growth and Change (New York: McGraw-Hill, Inc., 1964), pp. 161-162.

monetary economy; and it should contribute to spreading the knowledge of modern technology. But, foreign investment has only developed the natural resources for export, and not for the benefit of the domestic sector. Myrdal has observed:

> The governments of the metropolitan powers . . . were unable to undertake any great sacrifice in order to promote a general and balanced industrial development of their dependencies. However, they did conceive a clear interest in building up economic endeavors there, related to their own economies at home; in promoting and safeguarding their own settlers; and, more generally, in treating their dependencies as protected extensions of their home markets for their industries.[20]

The facilities for producing export goods in poor countries are often foreign owned. These facilities have never become a part of the internal economic structure of poor countries except in a geographical and physical sense. Economically speaking, they are really an outpost of the economies of the more advanced countries. If these foreign investments were to open up new sources of food for the people and industrialization of poor countries, then the people would benefit. However, the unfavorable differential in productivity between the export and domestic sectors is alone an indication that more productive export sectors have not become a real part of the economies of poor countries.[21]

---

[20] Gunnar Myrdal, An International Economy (New York: Harper and Brothers, 1956), p. 225.

[21] Singer, International Trade: Growth and Change, pp. 163-164.

Some may argue that poor countries have benefited from this foreign investment. This may be true, but the gains from foreign trade and investment have not been equally shared between the two groups of countries. The capital-exporting countries have received their repayment many times over in the following forms:

(1) possibility of building up exports of manufacturers and transferring their population from low-productivity to high-productivity occupation;

(2) enjoyment of internal economies of expanding manufacturing industries;

(3) enjoyment of the general dynamic impulse radiating from industries in a progressive society;

(4) enjoyment of the fruits of technical progress in primary production as main consumers of primary commodities;

(5) enjoyment of a contribution from foreign consumers of manufactured articles, representing as if it were their contribution to rising incomes of the producers of manufactured articles.[22]

The poor countries' bounties cannot be compared to this formidable list of benefits derived by industrialized countries. All that can be said about foreign investment of the traditional type is that the poor countries have the worst of both worlds--as consumers of

---

[22] Ibid., p. 168.

manufactured goods and as producers of raw materials. "This perhaps is the legitimate germ of truth in the charge that foreign investment of the traditional type formed part of a system of 'economic imperialism of exploitation.'"[23]

A third major argument involves the contention that there has been a secular deterioration in terms of trade for poor countries. It is argued that the benefits of technological progress have favored the advanced countries. The leading critic of the proposition that advantages accrue to an underdeveloped country is Paul Prebiseh who stated that:

> . . . the reasoning on the economic advantages of the international division of labor is theoretically sound . . . it is based upon the assumption which has been conclusively proved false by facts. According to this assumption, the benefits of technical progress tend to be distributed alike over the whole community. . . . If by the community only the great industrial countries are meant, it is indeed true that the benefits of technical progress are gradually distributed among all social groups and classes. If, however, the concept of the community is extended to include the periphery (i.e., underdeveloped countries) of the world economy, a serious error is implicit in the generalization. The enormous benefits that derive from increased productivity have not reached the periphery in a measure comparable to that obtained by the peoples of the great industrial countries.[24]

Thus the quest of most poor countries for industrialization can be viewed and understood against this factual

---

[23] Ibid., p. 167.

[24] United Nations, Economic Development of Latin America and Its Principal Problems (New York: 1950), p. 1.

background of their very unbalanced economies as inherited from the era of colonialism and economic dependence.[25] A United Nations publication indicated:

> Thus there exists an obvious disequilibrium a fact which whatever its explanation or justification, destroys the basic premise underlying the scheme of the international division of labor. Hence, the fundamental significance of the industrialization of the new countries. Industrialization is not an end in itself, but the principal means at the disposal of these countries of obtaining a share of the benefits of technical progress and of progressively raising the standard of living of the masses.[26]

Myrdal expressed a somewhat similar view when he was writing about the effects of trade. He expressed the view that:

> . . . Trade does not by itself necessarily work for equality. It may, on the contrary, have strong backwash effects on the underdeveloped countries.
>
> A widening of markets often strengthens in the first instance the rich and progressive countries whose manufacturing industries have the lead and are already fortified by the surrounding external economies, while the underdeveloped countries are in continuous danger of seeing even what they have of industry . . . priced out by cheap imports from the industrial countries. . . . The main positive effect of international trade on the underdeveloped countries was in fact to promote the production of primary products. . . . The advice--and assistance--which the poorer countries receive from the richer is, even nowadays, often directed toward increasing their production of primary goods for export. . . . In a broader perspective and from a long-term point of view, what would be rational is above all to increase productivity, incomes and living standards in the larger agricultural subsistence sectors, so as to raise the supply price of labor, and in

---

[25] Myrdal, An International Economy, p. 226.

[26] United Nations, Economic Problems of Latin America and Its Principal Problems, p. 2.

> manufacturing industry. This would injure economic development and raise incomes. But trade by itself does not lead to such a development; it rather tends to have backwash effects and to strengthen the forces maintaining stagnation or regression.[27]

He sums up the argument by pointing out that the theory of international trade:

> . . . would, indeed, suggest that trade starts a movement toward income equalization, while, instead a quite normal result of unhampered trade between two countries, of which one is industrialized and the other underdeveloped, is the initiation of a cumulative process toward the improvershment and stagnation of the latter.[28]

A similar line of reasoning was sounded by Singer. He has said that the specialization of underdeveloped countries on export of food and raw materials to industrialized countries has been unfortunate for the underdeveloped countries for two reasons. First, most of the cumulative effects of specialization and foreign investment of the traditional type accrued to the benefit of the investor rather than the country in which investment occurred. Second, it caused the poor countries to divert their resources to types of activities offering lesser opportunities for technical progress.[29] In addition, there is a third factor of perhaps even greater importance--the terms of trade.

---

[27]Gunnar Myrdal, Rich Lands and Poor (New York: Harper and Brothers, 1957), pp. 51-53.

[28]*Ibid.*, p. 101.

[29]Singer, International Development: Growth and Change, p. 165.

The terms of trade refer to changes in price relationship between the imports of manufactured goods from industrialized countries relative to prices of primary exports of the underdeveloped countries. A United Nations report indicated that the general trend of prices from the 1870's to the last prewar year 1938, was heavily against sellers of food and in favor of the sellers of manufactured articles.

> In other words, average prices of primary commodities relative to manufactured goods have been declining over a period of more than half a century. By 1938, the relative prices of primary goods had deteriorated by about 50 points, or one-third, since the beginning of the period and about 40 points, somewhat less than 30 per cent, since 1913.[30]

There are some who support a thesis that a traditional trend toward deteriorating price relations for primary producers has been sharply reversed since the Second World War. The United Nations report does not substantiate this. The report showed that:

> Between 1950 and 1961, the terms of trade of primary commodities fell by 26 per cent in relation to those of manufacturers, mainly owing to the rise in the price of the latter. It should be noted, however, that the magnitude of the deterioration was less for some developing countries than this figure indicates, because those countries also import primary commodities and export manufactures, even on a small scale in the latter case. From the over-all standpoint, even if these circumstances are taken into account, the deterioration in terms of trade between

---

[30]United Nations, Relative Prices of Exports and Imports of Underdeveloped Countries (New York: 1949), p. 23.

developing and developed countries over the period in question was 17 per cent.[31]

Other writers in the field have debated the persistent tendency in the external imbalance of the poor countries by describing the imbalance as an "export lag." More specifically, the discussion has focused on the lag in exports from the primary-producing countries, other than oil countries, compared with those of the industrial countries.

A recent study of the United Nations points out that:

> . . . the trend towards external imbalance in the developing countries is mainly a manifestation of the disparity between the rate of growth of their primary exports and that of their imports of industrial goods. While primary exports, with certain exceptions, developed fairly slowly, demand for industrial imports tends to accelerate.[32]

If the "export lag" is accepted as a fact, what have been the influences at work? Various answers to this question have been given. These answers can be conveniently grouped according to whether the emphasis is placed on the world demand for the exports of the primary-producing countries or on a deficiency in the supply of those exports to the world market.

Demand deficiency. The most powerful advocate

---

[31] United Nations, Towards a New Trade Policy for Development (New York, 1964), pp. 18-19.

[32] Ibid., p. 11.

of the demand deficiency theory is Professor Nurkse. He argued that a lag in the exports of the poor countries was mainly a reflection of relative sluggishness in external demand emanating from the great industrial consumers.[33]

The causes of this sluggish growth in the demand by industrial countries for imports of primary products is due to several factors. The factors at work according to Maizels have been:

(1) a shift in the pattern of output in the industrial countries in favor of engineering, chemical and other industries and services, which have a low-import content, relative to textiles and other industries which have a high import-content;

(2) agricultural protectionism in the industrial countries, which has proved in practice more difficult to reduce than trade restrictions on manufacturers;

(3) a secular trend towards reduced usage of primary materials per unit of output of manufacturers; and

(4) a substantial substitution of synthetics for imported natural materials.[34]

---

[33]Ragnar Nurkse, Problems of Capital Formation in Underdeveloped Countries and Patterns of Trade and Development (New York: Oxford University Press, 1967), p. 186.

[34]M. Maizels, The Effects of Industrialization on Exports of Primary Producing Countries, Kylos, Vol. IV, 1961, p. 19.

Nurkse, however, did not deny that domestic policies causing limitations on the supply side in producing countries have been effective in certain cases. Nevertheless, he considered that such policies in certain cases were themselves reactions to unfavorable demand conditions in the export markets.[35]

Supply Deficiency. The opposing view holds that the failure of primary-producing countries to expand their exports more rapidly is due to the process of industrialization in these countries. It is argued that the industrial growth in these countries will involve the consumption of greater quantities of their own agricultural produce, thus restricting the supply for the export market.

Professor Cairncross has pointed out that the failure of industrial countries to expand their imports of primary products in proportion to their economic growth, or their consumption of manufactured goods, must have been due in part to a price factor. The prices of exports from non-industrial countries have, in fact, risen since pre-World War II by half as much again as the prices obtained by industrial countries for their exports of primary produce. The sharper rise in prices of exports from the non-industrial countries, Cairncross

[35] Nurkse, Capital Formation in Underdeveloped Countries, p. 186.

maintains that it:

> . . . reflected the acute pressure on supplies of primary goods produced in a fully-employed economy--a pressure that continued because of the low elasticity of supply of this produce. This low elasticity was aggravated by the concentration of effort in many underdeveloped countries on industrialization rather than agricultural development.[36]

Thus, all indications point to the fact--whether accepting either the deterioration or the export lag argument--that while primary commodity exports are, with a few exceptions, expanding relatively slowly, demand for exports of manufactured goods is tending to grow at a pace that increases with the rate of development. The result is an imbalance in trade which may create serious obstacles and makes the development process more difficult. This imbalance must be rectified if development is to be accelerated.

The United Nations report has pointed out that

> . . . there are many ways in which the external resources of the developing countries could be increased through additional exports of primary products, through more exports of manufacturers, or through greater external aid. To some extent, each of these possible solutions is a substitute for the others. To the extent that one fails in solving the problem under one heading, one increases the burden to be born under other headings.[37]

Governments Instead of Entrepreneurs. There is an

---

[36]A. K. Cairncross, "International Trade and Economic Development," Kyklos, Vol. XIII, 1960, p. 553.

[37]United Nations, Towards a New Trade Policy for Development, p. 4.

almost unanimity of opinion on the importance of the role of government in stimulating economic activity in underdeveloped countries; some writers argue that there are serious limitations that restrict the role of government as a major agent in development. Deyrup stresses four factors which limit the capacity of a government of an underdeveloped country to substantially aid in economic growth. These factors are:

> . . . those determining the strategic position of government vis-a-vis various political groups in the population; those determining the speed and severity of economic and concomitant political-social changes; those involving the special economic problems of the country; and those affecting the tools and techniques of development which a government may have at its disposal.[38]

These factors do not move in the same direction and their success will depend on external and internal factors that are beyond the control of government. The type of political life and sources of political control offer an important clue to the probable effectiveness of government activity in development. Economic development implies raising the real income of poorer groups faster than that of richer groups, and this alone may imply a heavier burden of taxes on those occupying the higher income brackets. The success of development effort depends on the willingness of the political groups

---

[38] Felicia J. Deyrup, "Limits of Government Activity in Underdeveloped Countries," Social Research, Vol. XXIV (Summer, 1957), pp. 191-192.

to assist the government in this effort. However, in certain underdeveloped countries their political structures threaten to reduce the effectiveness of government activity in development.[39]

The second group of limiting factors consists of those forces that determine the speed and severity of economic and concomitant political and social change. This may happen through a revolution and may destroy resisting political groups and allow rapid economic development under the sponsorship of government. However, it may be assumed that revolution is unlikely to happen in countries where there is a potential market ready to absorb their production; neither is a revolution likely to happen in those countries who are willing to remain in the orbit of an economically self-sufficient revolutionary state which acts as their major trading partner.[40]

The third limiting factor involves specific economic problems such as: (1) the extent and nature of a particular economy and its dependence on world markets; (2) the character of organized labor; and (3) the attitudes of the population as a whole.

As mentioned earlier, most underdeveloped countries are heavily dependent on the export of one or two

---

[39] *Ibid.*, p. 194.

[40] *Ibid.*, p. 196.

products into a world market--a market which is beyond their control--that seriously affects their processes of development.

Labor and the nature of its demand may have a limiting effect on government development activity. Although labor in most underdeveloped countries lacks economic strength, it has considerable political importance. Labor's demands in regard to wages, working conditions, and other programs may be considered justifiable in human terms but in many cases these demands are too excessive because of the restricted conditions under which most development takes place. Deyrup, in commenting on labor, also said:

> In particular, the fact cannot be ignored that organized labor, if it presses its demands too far, may seriously check both private and public domestic capital formation.[41]

As to the attitudes of the population--it depends on its present or future expectations. If the people are willing to wait and endure low living standards in the interest of increased investment and capital-goods production for future betterment, the delay will aid development. However, in most cases, the situation is quite the reverse. The population, by and large, is unwilling to forego present consumption for a promise of better things in the future. This attitude

---

[41] _Ibid._, p. 198.

may destroy the process of economic development.

Finally, the fourth group of factors limiting government's development role consists of those more or less tangible elements--personnel, technical knowledge, capital--constituting the developmental tools that a government has at its disposal.[42] The needs for trained and responsible civic service has multiplied as government activity has expanded. Generally, the underdeveloped countries lack such qualities in personnel despite the acceptance of technical assistance.

In the field of technical knowledge, the underdeveloped countries lag far behind the advanced countries. This knowledge could be transferred and incorporated into the recipient country, but the time lag between the introduction of improved techniques and their general adoption may be considerable. This lag could retard certain aspects of development.

Capital is subject to a host of complex problems. It is generally agreed that domestic capital is insufficient for development processes. Foreign capital is available, but only on its terms and conditions. Other foreign sources may be available, but usually in quantities inadequate to the needs. Until governments of underdeveloped countries have adequate and trained personnel, along with sufficient supplies of capital, government's

[42] Ibid., pp. 199-200.

assistance in development will fall short of its potentialities.

Singer believes the substitution of government action for private entrepreneurship is an obstacle to development. A lack of trained personnel and inadequate financial resources may prevent a government from accepting the dual burden--its normal duties plus the promotion of economic development. With its inherent weaknesses, the government would be compelled to discharge one duty at the expense of the other--it could not do both.[43]

The establishment of government as the primary agency for economic development will require a good administration--absent in most underdeveloped countries. If the administration is poor, economic development will be more difficult. As a precondition, administration in the underdeveloped countries must be strengthened if it is to act as the main agency for promoting desired development.

There is another very important barrier in the substitution of government action for the private entrepreneur. If government were the primary agent for economic development, those objectives could well be mixed with national assertion abroad--and with the distribution of political power at home.

---

[43]Singer, International Development: Growth and Change, pp. 56-64.

> But nationalism is ambivalent in regard to economic development. While it provides a driving force and a motivation, it contains within itself features that may be an obstacle . . . prevent the reform or adaptation of institutions which may be a pre-condition for economic development. . . . It may result in the allocation of a high proportion of natural resources to the maintenance of large armies or police forces . . . thus draining resources away from genuine economic development.[44]

This attitude towards government intervention in the economic life of the country should not be construed as defeatist. On the contrary, governments in poor countries have an essential role to play--to aid their respective countries in attaining a higher standard of living and sustained economic growth. All that is sounded is a word of caution to these countries. The private sector has its role to play. It should be encouraged to participate and not to be brushed aside and labeled with various slogans that are often heard in many of the underdeveloped countries.

> Syria is often regarded as a good example of an underdeveloped economy where private initiative has largely contributed to the post-war economic growth of the country. Perhaps no one would dispute the fact that the Syrian private entrepreneurship has in many respects proved itself capable of responding to the challenge of economic development.[45]

But, instead of rewarding the entrepreneur for his effort, the Syrian government nationalized all projects--it has

---

[44]Ibid., p. 57.

[45]Samir Makdisi, "Some Aspects of Syrian Economic Growth," Middle East Economic Papers, 1961, pp. 48-49.

paralyzed its most important agent of past economic development. Private capital began to flee the country and private initiative in all areas became inert.

## Summary

The preceding discussion has provided typical situations facing underdeveloped countries in their quest for development. The obstacles to be met by underdeveloped countries in their efforts to advance are multiple and complex.

Given these obstacles, the typical situation in any of the modern underdeveloped economies presents a very challenging problem for development. In this area the economy is confronted with economic stagnation characterized by: (1) the vicious circle of depressed income; (2) retarded capital formation; (3) the paucity of resources accelerated by the pressure of rapidly growing population; (4) the inequality of income distribution resulting in consumption of capital by the poor and its dissipation by the rich; (5) lack of indigenous growth of entrepreneurial skill and technology; (6) exposure to the fluctuations of world markets; and (7) a host of other bewildering problems.

In this setting and given all data on economic backwardness, an underdeveloped economy needs a creative impulse to trigger the initiation of the development process. The logical choice for the innovating agency would be the government which can use its budgetary policies as a major technique to accelerate the speed of development--provided the governmental machinery is reasonably stable and efficient. More precisely, policies concerned with governmental revenues and expenditures can be systematically applied to stimulate the development of new resources, new products, new processes, potential markets and better organization of production. Furthermore, through fiscal regulation and inducement, the government can guide the allocation of resources into desirable channels and step up the process of capital accumulation.

In light of this analysis, the attention in the coming two chapters will be focused on fiscal policy as an aid in overcoming the multitude of formidable problems that is plaguing the economy--as an aid--and toward accelerating the process of economic development by judicious use of that policy tool.

CHAPTER III

# TAX THEORY AND GOVERNMENT RECEIPTS

## Introduction

The fiscal system adopted by any government is the outcome of a long evolutionary process. Taxation as a part and parcel of fiscal policy has assumed more and more importance--and the concept of taxes and taxation has undergone an elaborate development.

In primitive times, the revenue of the sovereign was derived entirely from land, which was the source of wealth. The sovereign owned and administered the land, and rented it for a modest fee. As society developed and the system of private property and self government came into being; as population increased and the needs of the people and of government became more complex; the costs of government administration increased. Earlier methods of raising revenue had to be abandoned as being inadequate. The answer had to be taxation in its many forms. Taxation no longer takes the form of customary service of an arbitrary exaction by a superior authority, but is determined by popular will and sentiment, and professes to conform to certain principles of justice.[1]

A government may obtain its revenues in various ways:

> First, state-owned property may yield an income which can be used for public purpose, and many countries in the past have derived substantial revenue in this way.
>
> Second, a government may raise money by means of loans; this method is extensively used during wars.
>
> Third, a government may carry on commercial or industrial undertaking, selling its products at a price covering their cost, and possibly making an additional profit which can be used as a general revenue. The tobacco industry in France and the state railways in Prussia is an example of a state monopoly maintained for revenue.
>
> Fourth, but not the least important method of raising revenue, and the one which modern governments have come to rely on more and more as the means of raising the bulk of their ordinary revenue, is taxation.[2]

## Meaning of Taxation

The increasing importance of taxation as a way of supplying the public wants is a conspicuous feature in financial development. This importance is partly attributed to the decline of the earlier forms of revenue, but far more to the immense volume of public expenditures. The modern state is dependent on the taxation to an extent unknown in earlier times. Lutz used as a corollary:

---

[1] B. Armitage Smith, _Principles and Methods of Taxation_ (London: John Murray, 1924), p. 22.

[2] M. E. Robinson, _Public Finance_ (London: Cambridge University Press, 1928), p. 3.

> However, the state is not always able, like a tailor, to cut the garment according to cloth. Some way enough cloth must be found to make the garment. The present level of expenditure sets the style and the pattern of this garment. It is not of plain and simple design, it is full of frills. How to find cloth enough for such a garment has been the despair of the finance ministers.[3]

Below are some representative definitions of "tax." Professor Seligman said:

> . . . A tax is a compulsory contribution from the person to the government to defray the expense incurred in the common interest of all without reference to special benefits conferred.[4]

Adams suggested that a tax:

> . . . is a contribution from the citizens for the support of the state.[5]

Bastable said:

> A tax is a compulsory contribution of the wealth of a person or body of persons for the service of public powers.[6]

These statements of the tax concept agree on three points which may be regarded as essential to any satisfactory definition of a tax.[7]

The first of these is that a tax is a contribution

---

[3]H. L. Lutz, Public Finance (New York: D. Appleton and Company, 1924), p. 239.

[4]E. R. Seligman, Essays in Taxation (9th edition) (New York: The Macmillan Company, 1921), p. 432.

[5]H. C. Adams, The Science of Finance (New York: Henry Hoer and Company, 1898), p. 301.

[6]C. F. Bastable, Public Finance (London: Macmillan and Company, Ltd., 1917), p. 263.

[7]Lutz, Public Finance, pp. 240-244.

--it involved a sacrifice on the part of the contributor. Furthermore, this contribution is enforced without reference to any special benefit conferred. This places the tax in contrast with various other levies which the government may make--(1) the special assessment, which is compulsory but which is based on the benefit received; and (2) the fee, which is a noncoercive payment for administrative service.

The contributory element in the modern tax concept is also in contrast with the earlier view that was held concerning the tax. That view regarded the tax as payment for services or benefits received. (The benefit theory will be discussed later in the chapter.)

The contributory element in the modern tax concept emphasizes the greater social unity, and the stronger sense of common burdens and responsibilities which are a feature of modern life. The State is an all-embracing social organization. No one can be apart from it; no one can deny his obligations to the community; and neither can one deny his dependence upon the common life. Therefore, all should contribute to the effective supports of his State.

A second common characteristic of a modern definition of a tax is that it should be considered as a personal obligation. A personal obligation follows from the condition that the payment of taxation is a duty, and only persons are subject to duties. The State is an association of persons. Therefore, these persons, as such, are responsible for its support. The personal obligation to contribute to the State's support is universal to <u>all</u> persons subject to its jurisdiction.

A third characteristic is that the tax is a compulsory contribution. This does not mean that all tax revenue is paid unwillingly, but means that the levy is now fixed or estimated by government and the will of the payer is legally immaterial. The amount, the mode of levying, the time of payment and the persons affected are all determined by the government. These are all in accordance with legal procedure which is carefully prescribed, and are subject to constitutional regulation and central.

The essential element in this coercion is not simply the relation of the sovereign and the subject--compulsion has always characterized this relationship. It is a legal control of all subjects so that all are compelled to share the burdens of government. The growth of social unity demands this universal contribution to the support of the government.

## Principles of Taxation

If a tax system were to be constructed that would be acceptable for the modern state, there would be many different approaches. Doubtless, each would have some favorable features, but eventually the resulting tax structure would have to pass certain tests. There are certain fundamental tests which should be satisfied in order that a tax system can be considered as "well-ordered." Some of these principles that will be enumerated can be supplemented by various other tests, but only the more important will be discussed. These principles can be generally accepted as the recognized rules for guidance in taxation. It should be emphasized that these standards or tests are relative rather than absolute.

Four principles through which we can judge the merit of a tax are: (1) its fiscal adequacy; (2) its economy; (3) its simplicity; and (4) its equity.

1. Fiscal Adequacy. The first requisite of a sound tax is its ability to produce revenue. In other words, is it fiscally adequate? To be sure, mere fiscal adequacy or productivity is not enough. A tax system to be thoroughly sound and enduring must be something more than productive of sufficient revenue to meet the needs of the State. Lutz said:

> Many beautiful scheme have been formulated, on paper, for the satisfaction of the State's financial needs, and some of these have attained to quite dizzy heights of idealism in the theoretical justice and equity of their provisions for the distribution.[8]

---

[8] *Ibid.*, p. 258.

In considering the fiscal productiveness of a particular source of income, the time element may become very important. A tax in the short run may be adequate as a revenue producer, but be inadequate in the long run. On the other hand, the tax may yield little revenue at first, but a sufficiency after it has become established. A tax may require certain periods of development, of administrative adjustment, and of familiarizing both taxpayers and officials with its provisions, before fruition can be achieved.

A case in point is the federal income tax in the United States. When it was first introduced, the problems of levy were so great and the yield so little that many predicted that taxes on income would soon disappear as a source of revenue.[9] Today, the individual income tax is the most important source of revenue at the federal level. One of the first questions to be asked is whether the tax system is capable of producing enough revenue for public purposes.

2. Economy. If a tax has successfully passed its test as a producer of revenue, the next test in the development of a sound tax system is "economy of collection." Adam Smith, in his fourth maxim of taxation, said:

---

[9]Orval Bennett and Isaac Lippincott, Public Finance (Dallas: Southwestern Publishing Company, 1949), p. 504.

> Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the State.[10]

However, the economics of a tax must not be judged merely by its relative cost of administration or collection. Some taxes, as income tax and certain excises, yield much revenue above the cost of collection. On the other hand, a few taxes are socially desirable such as those on narcotics which cost much more to collect than they yield. They are levied for protection and their cost of collection and administration is secondary.

Hence, the other test of the economy of a tax will be by its economic effect on the taxpayer and on the community. Every tax has its direct and indirect economic and social effects. If it should be proved that certain taxes unduly discourage production or consumption--lower the morale of the community--provoke discontent--or check the accumulation of wealth, they should be terminated or modified. A tax system must be flexible enough to not retard production yet to permit growth.

3. Simplicity. The third test of a sound tax is that it should be simple and easily understood by

---

[10] Adam Smith, Wealth of Nations (The Modern Library, New York: Random House, Incorporated, 1937), p. 778.

the taxpayer. However, it is often found that complexities are sometimes inferrent in order to preserve fiscal adequacy, as well as the equity of the tax.

To preserve simplicity, the Physiocrats of the 18th century advocated that a single tax be placed upon land. They assumed that agriculture was the only industry to yield a net product, which did not accrue to any other form of industry. Thus, they held that all taxation should be placed upon the net product of the land since taxes placed elsewhere would still gravitate to the landlord. The advocacy of the single tax led to their downfall--opponents said the program would burden the small landholder-farmer while letting the wealthy rentier class escape--they didn't produce a product since many only <u>owned</u> land.

In a complex and highly organized society, the revenue requirements of the modern state are so great that no single source of revenue is likely to fulfill the first requirement of fiscal adequacy. Incomes are derived from many sources, and it is only by means of a composite system of taxation that any approximation of equity can be secured.

4. <u>Equity</u>. A further test that must be met is that a sound tax system shall be equitable. The tax system must appeal to the bulk of the citizens as being based on certain fundamentals of justice and

equity, rather than on the basis of narrow favoritism for select classes or groups.

The satisfactory application of this test is very difficult, because it is nearly impossible to define "equity" in words that will satisfy all thinkers. The constitution of equity depends on one's point of view. The interest of different groups of taxpayers in a state may vary so widely that a policy which appeals to one group as possessing the heights of equity may appear to another as the extreme depths of injustice.

The actual application of the principles of equity and justice in the tax system leads to various methods by which the burden may be distributed. Some of the rules or theories which have been advanced at different times for the distribution of the tax burden are of such importance that they warrant a separate treatment. Great diversity both in the rules suggested and in the conception of what constitutes equitable distribution are present.

## The Distribution of the Tax Burden

The foregoing survey of the characteristics of a sound system of taxation has touched indirectly upon the problem of distributing the tax burden.

A number of theories concerning the apportionment of the tax burden have appeared at one time or another. Each theory has arisen from attempts to explain and justify a particular tax system. From these varieties, three alternative theories for the equitable distribution of its direct money burden have been suggested. These are: (1) the cost of service principle; (2) the benefit of service principle; and (3) the ability to pay principle.

1. The cost of service principle. The cost of public service has been proposed as the basis by which each individual should be taxed to pay the cost of the services rendered him by the government. These governmental functions would be conducted on the principle of public enterprises.

This theory implies that the State is something separate from the body of citizens. The theory does not fit the concept that the State is the body of the people organized for governmental purposes. It also implies that the citizen is at liberty to refuse the services offered by the government, and is thus able to escape the necessity of making payments. Finally, it implies that the relative duty of citizens to make payment (or pay taxes) for the support of government is in proportion to the expense that is incurred.[11]

This theory seems to ignore the fact that the duty to pay for the support of the state cannot be

---

[11] Adams, The Science of Finance, p. 299.

assigned to citizens according to the cost of governmental service rendered. Protection, for example, consists in creating and maintaining a condition of security in a society, and its costs cannot be divided up and parcelled out. The law undertakes to arrest and punish every criminal no matter what the cost may be. If it undertook to protect only those who contribute to its cost, it would thereby breed lawlessness and invite anarchy.[12]

The theory upon which the cost of service principle rests will not harmonize with the generally accepted ideas of equity and justice, e.g., between different classes of property, or property differently located. If we were to apply the cost of service principle literally, a higher charge--or tax--would be imposed upon a property that is insecure by its location--or type of business. Too, if the cost of service principle were in order, it would be highly likely that heavier payments would be exacted from those least able to pay--since those able to pay would likely be in a position of influence and make lesser payments. Adams concludes that since taxes are a forced payment, inequities in the cost of service principle cannot be regarded as a reasonable employment of public authority.[13]

In spite of limitations, the principle of cost

---

[12] Ibid., p. 324.

[13] Ibid., p. 325.

cannot be ignored. The cost of service principle can be applied to supply. For example, the price of postal services can be fixed by the public authorities to yield the "costs." The mere fact that the cost of service criterion is not perfect should not be justification to completely rule it out of a tax system.

2. The benefit of service principle. This theory suggests that a tax is a payment by citizens to the State in proportion to the benefit received. This theory was quite in harmony with the political doctrines of the seventeenth and eighteenth centuries. According to some, the principle service or benefit which was conferred was protection, and the tax was the price of this protection. Whatever the benefits rendered by the State may have been considered to be, the whole transaction of paying the taxes on the one side, and of administration by the government on the other, was looked upon as an exchange in which each side gave the other quid pro quo.[14]

This idea can be seen in the writings of Montesquieu and Proudhan, to name two examples. Bastable quotes Montesquieu as saying that:

> The revenues of the State are the portion of his property that each citizen gives in order to have security for the remainder, or to enjoy it in comfort.[15]

---

[14]Lutz, Public Finance, p. 241.

[15]Bastable, Public Finance, p. 266.

Proudhan asserted that:

> taxation is an exchange in which the State gives serivces and the contributor money.[16]

This benefit doctrine seems to ignore the indivisibility of social benefits. Too, it overlooks the fact that the services of the State are wholly incapable of exact measurement and exact apportionment to individuals. Security against aggression is, literally speaking, an incalculable good. Social order cannot be sold at a retail store like tea or sugar. If defense and justice could be readily bought and paid for, we might trust it to private enterprise for a sufficient supply.

However, contribution to the public expenditure is not a purchase or exchange, but a response to a national demand for a common good--it confers collective advantages which cannot be stated in quantitative terms. The expenditure is general, and the revenue is a joint necessity which must be subscribed to by individuals, not for their share as such, but for the collective benefits derived from their common existence in a State.

Nevertheless, the principle of benefit cannot be ignored. Many fees, special assessments and special charges are based chiefly upon the benefit conferred. The commercial services necessarily involve the benefit principle. Many of the most general public services,

---

[16] Ibid., p. 266.

such as the construction of highways, may be provided on the basis of the benefits principle--through use tax, vehicle tax, gasoline tax, etc.

3. Ability-to-pay principle. The ability-to-pay principle is accepted today as the principal criterion which should guide government, as far as possible, in raising tax revenue. Behind the "ability" doctrine of taxation is the principle that government costs are incurred for general social purposes and are an obligation of society rather than of particular individuals. This obligation must be distributed among the taxpayers in a manner which imposes the least hardship. Adam Smith employed the ability-to-pay doctrine as the first of his four canons of taxation. He contended that the subjects of the State should contribute to the support of the government,

> . . . as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoyed under the protection of the State.[17]

Further explanatory statements convey Smith's idea of the basis or measures of ability, and he continued by saying that by the observance of or the neglect of this maxim comprised what is termed the equality or the inequality of taxation. Modern analysis has shown, however, that the question of ability to pay cannot be as readily

---

[17] Adam Smith, Wealth of Nations, p. 777.

disposed of as it is set forth in Smith's first maxim.

The fact that taxation should be levied according to the principle of ability-to-pay does not settle the whole problem of justice. Today the ability-to-pay principle is generally accepted as a proper standard of tax distribution, but the measurement of that principle is difficult because of the vagueness of the term.

There have been various responses to the question of ability, which on the surface implies a simple solution. Generally, in discussions of the question, the term "sacrifice" is debated--sacrifice by the taxpayer in the payment of his taxes--then by deduction arrive at some scheme of distributing the burden by the sacrifice entailed. Mill said that:

> . . . equality of taxation as a maxim of politics means equality of sacrifice. It means apportioning the contribution of each person toward the expense of government so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his.[18]

The most common of these principles are: (1) equal absolute, (2) equal proportional, and (3) equal marginal. If these concepts are analyzed under the assumption of a "mutually" personal utility comparison plus the assumption of identical tests, results according to Musgrave would be:

---

[18]John Stuart Mill, Principle of Political Economy, ed. W. J. Ashley (London: Longman, Green, and Company, Ltd., 1915), p. 804.

> . . . under the concept of equal absolute, assuming marginal utility of income is constant over the relevant range, the equal absolute sacrifice doctrine requires equal amounts of tax at different levels of income. This means a regressive rate schedule.

Musgrave continues:

> Now suppose that the marginal utility of income schedule shifts from constancy to a downward sloping curve due to declining marginal utility as income rises--and the degree of tax regressivity declines until we reach a situation where the slope of the income utility schedule is such that the marginal income utility declines at the same percentage rate at which income increases. As a result, a proportional rate of tax is required. If marginal utility of income diminishes fairly rapidly as income increases, the principle of equal sacrifice leads to a progressive tax schedule.[19]

In the case of equal proportional concept, a proportional rate of tax is justified on the assumption that the marginal utility of income does not diminish at all, but remains constant. A regressive tax rate can be justified according to the principle of proportional sacrifice on the assumption that marginal utility of income diminishes fairly rapidly as income increases.

Dalton explains that the marginal sacrifice provides for progression if the marginal utility of income declines. The principle of equal marginal sacrifice leads to a relatively high level of exemption and a very steeply progressive taxation of those not exempt. (If the marginal utility of income is constant, any distribution of the tax will be equitably good. If the

[19]Richard A. Musgrave, The Theory of Public Finance (New York: McGraw-Hill Book Company, Inc., 1959), p. 99.

marginal utility of income is positively sloping, a regressive tax schedule will yield the necessary requirement.) Also, Dalton further explains that:

> Obviously, by employment of reasonable assumptions, each of the three alternative interpretations of the "ability-to-pay" principle will lead to some degree of progression in the tax system. This practical conclusion is now generally accepted by modern opinion, which responds readily to the suggestion that the heaviest burdens should be placed upon the broadest shoulders.[20]

## Classification of Taxes

In the discussion of ability-to-pay principle and equity, reference is made to the various tax structures which could be used in apportioning the tax burden among the individuals. These various taxes can be classified into three categories: progressive, proportional, and regressive.

*The Progressive Tax.* The progressive tax may be defined as one type of the graduated tax, in which the rate increases as the taxable base increases. The federal personal income tax in the United States is a good example of a progressive tax. The rate could be four per cent on the first thousand dollars of tax--five percent on the next and so on. Progression of the rate is not possible indefinitely--the rate would ultimately be more than one hundred per cent--confiscatory--and this amount would

---

[20]Hugh Dalton, Principles of Public Finance (New York: Alfred A. Knoph, 1923), pp. 77-79.

not be desirable.

*Proportional Tax.* The proportional tax is one that uses the same rate regardless of the base amount taxed. An example would be the property tax where a fixed mill rate is assessed on the value of the property.

*The Regressive Tax.* A tax system, the rates of which decrease as the amount taxed increases, is a regressive system. A rate of 6 per cent applied to a base of $1,000, 4 per cent applied to a base of $10,000, and 2 per cent applied to a base of $100,000 is an example. A tax may be regressive in effect, however, even when the rates are uniform. A sales tax, for example, although applied at a uniform rate, takes a larger percentage of the total income of low-income groups than it takes from the total income of higher income groups.

## The Rate Structure of the Syrian Tax System

Syrian Government revenues may be divided into two broad categories: tax receipts and non-tax receipts. In terms of income to the government, the first category may be called "derived income" and the second one "original income." Any government income that is not derived from taxation is an original income. Revenues from the sale of government goods, annual rental payments for government properties, rents on government land, forest revenue, and revenues from government monopolies, such as salt and tobacco, are illustrations of the source of original income of the government of Syria.

The derived income of the government, or tax receipts, may be divided, in turn, into different classes according to the specific nature of each of them. The method used by the fiscal authorities in Syria is to classify all tax receipts into three categories: (1) direct taxes and duties, (2) indirect taxes and duties, and (3) registration fees. This kind of classification is based upon the concept that when a tax is imposed upon a specific person it is termed a direct tax. When it is imposed upon a certain transaction, regardless of who pays the tax, it is termed an indirect tax. Registration fees are imposed as a price of rendering a certain governmental service--and it applies to any applicant for the service.

Tables 8 (pp. 73-74) and 9 (p. 75) show the 1965 Syrian budget estimates for tax receipts and non-tax receipts. The total of the two tables represented estimated government receipts for the year 1965. Tax receipts, according to these estimates, contributed 74.69 per cent of total government receipts, and non-tax receipts 25.31 per cent. Table 8 also indicates that within the category of tax receipts a heavy reliance is placed upon indirect taxes. These indirect

TABLE 8

TAX RECEIPTS ESTIMATES, SYRIA
1965

| Government tax receipts | S.P. 1,000 |
|---|---|
| 1. Direct taxes and duties................Total | 123,949 |
| Tax on non-agricultural real estate..... | 27,958 |
| Tax on income from trade, industry and professions........................ | 30,214 |
| Tax on salaries and wages............... | 11,579 |
| Tax on circulating capital.............. | 1,125 |
| Tax on inheritance and gift............. | 2,776 |
| Tamattul (License tax).................. | 7,633 |
| Livestock............................... | 14,040 |
| Motor vehicle registration.............. | 25,012 |
| Mineral concessions..................... | 225 |
| Others.................................. | 3,387 |
| 2. Indirect taxes and duties..............Total | 241,512 |
| Fuel.................................... | 17,666 |
| Alcoholic drinks........................ | 4,637 |
| Sugar................................... | 19,267 |
| Tobacco................................. | 40,219 |
| Cement.................................. | 12,402 |
| Agricultural production................. | 37,421 |
| Customs................................. | 81,260 |
| Exports................................. | 24,074 |
| Others.................................. | 4,566 |

TABLE 8 (continued)

| Government tax receipts | S.P. 1,000 |
|---|---|
| 3. Registration fees......................Total | 86,581 |
| Judicial fees.............................. | 5,976 |
| Property transfer fees..................... | 11,043 |
| Stamp duties............................... | 25,166 |
| Army stamp duty on electric consumption.............................. | 4,358 |
| Consular fees.............................. | 2,329 |
| Statistical fees........................... | 29,106 |
| Foreign trade fees......................... | 7,458 |
| Others..................................... | 1,145 |
| Grand Total................................ | 452,042 |

[1]Watchman Tax is included.

Source: Ministry of Planning, <u>Statistical Abstract</u> (Damascus: Government Press, 1966), pp. 326-327.

TABLE 9

NON-TAX RECEIPTS ESTIMATE, SYRIA
1965

| Government Non-tax Receipts | | S.P. 1,000 |
|---|---|---|
| 1. Income from government property........ | Total | 3,556 |
| Salt sale.............................. | | 2,597 |
| Others................................. | | 939 |
| 2. Income from investment.................. | Total | 1,451 |
| Printing office and official journal........................... | | 1,082 |
| Others................................. | | 369 |
| 3. Miscellaneous revenues and revenue from public service................ | Total | 142,228 |
| Contributions to pensions............ | | 6,204 |
| Oil transit royalties................ | | 125,675 |
| Receipts in lieu of military service.............................. | | 1,333 |
| Others................................. | | 10,016 |
| 4. Receipts recovered from previous expenditures....................... | Total | 4,755 |
| 5. Extraordinary receipts.................. | Total | 1,156 |
| Grand Total................................ | | 153,126 |

Source: Ministry of Planning, Statistical Abstract (Damascus: Government Press, 1967), pp. 327-328.

taxes constituted about 53.20 per cent of all estimated tax receipts in 1965, and 40 per cent of all government receipts for the same year.

## Receipts of the Central Government

The receipts of the central government may be divided into tax receipts and non-tax receipts. The sources of these two classes of receipts will be examined in the following paragraphs.

### Tax Receipts

These receipts are divided into three classes: direct taxes, indirect taxes, and registration fees.

#### Direct taxes

Income tax was first introduced into the fiscal system of Syria in 1942. It is at present regulated by Legislative Decree No. 85, May 31, 1949, as amended. Article 1 of this decree states that "the net income of industrial, commercial, and non-commercial professions and businesses as well as salaries and wages are subject to a tax called the income tax." It is noted that agriculture income and income derived from non-agricultural real estate are not subject to income taxation.

The concept on which income tax is based is the schedular tax concept as contrasted to the general income concept on which taxation in the United States and Britain is based. As Article 1 stated, the following are the

the different incomes subject to the schedular income taxes:

1. Income from industrial, commercial, and non-commercial trades and professions.

2. Salaries and wages.

3. Income from circulating capital.

Income from industrial, commercial, and non-commercial trades and professions is subject to a graduated tax as follows:

(Syrian Pounds) S.P.

| Annual Net Income | Tax rate (%) |
|---|---|
| Between 5,000 and 10,000 | 8.5 |
| Between 10,000 and 20,000 | 12.5 |
| Between 20,000 and 30,000 | 16.5 |
| Between 30,000 and 50,000 | 24.5 |
| Between 50,000 and 75,000 | 28.5 |
| Between 75,000 and 100,000 | 32.5 |
| Between 100,000 and 250,000 | 36.5 |
| Between 250,000 and 500,000 | 40.5 |
| Between 500,000 and 750,000 | 45.0 |
| Over 750,000 | 49.0 |

In addition to the first SP 1,500 that is exempt, each person is allowed a personal exemption of SP 480 for his wife, SP 480 for the first child, and SP 20 for each additional child.

The law enumerates explicitly all corporations and person subject to the tax. They are the following:

a. Joint stock companies and companies of limited liabilities whatever the nature of their business may be.

b. Industrial and commercial corporations.

c. Banking houses, bankers and all other persons engaged in a banking or discounting activity.

d. Insurance and reinsurance companies plus saving and investment institutions.

e. Industrial and commercial institutions which have more than one office in Syria, or those which are affiliated to institutions abroad or to which those institutions abroad are affiliated.

f. Industrial factories which are mechanically operated, provided that their capacity exceeds 10 horsepower.

g. Wholesalers, exporters and importers, dealers, shippers, and transitaries.

h. Contractors for business and government when the amount of the contract exceeds SP 50,000.

i. First-class hotels whose gross receipts exceed SP 50,000, and movie theaters in towns of 20,000 inhabitants or more;

j. All persons and corporations not residing in the country but who make profit in it.

k. And, in general, all business enterprises whose annual gross receipts are below SP 25,000, and professional men whose gross compensation for services is SP 15,000 or below.

The persons and business enterprises mentioned here are not subject to the graduated rates described above, but are subject to an arbitrary rate of 50 per cent of the license tax (Tamattu) which they are required to pay. The 50 per cent rate, however, is considered an income tax rather than a surcharge on the license tax.

The second category of the schedular income tax is the tax on salaries and wages. All salaried persons and wage-earners, whether they are in the service of the government or business, are subject to a graduated income tax at the following rate:

| Monthly Net Salary or Wage (SP) | Tax Rate (%) |
|---|---|
| Between 100 and 1,000 | 5 |
| Between 1,000 and 2,000 | 7.5 |
| Between 2,000 and 3,000 | 10 |
| Between 3,000 and 4,000 | 12.5 |
| Between 4,000 and up | 15 |

The five per cent rate is also applicable to all additional payments received over and above the monthly salary or wage, regardless of its amount.

Personal exemptions are SP 100 a month. No exemption is allowed for any additional payments over the salaries or wages. An amount of SP 40 per month is allowed as an exemption for the third child, and SP 10 per month for each successive child after the third one.

The third category is the taxation of income derived from circulating capital. Income from stocks, bonds, notes, bank deposits, personal loans, lotteries and other items of circulating capital, whether of national or foreign origin, are subject to a flat rate of seven and a half per cent. No personal exemption is allowed in the law for this kind of income.

Tamattu (license) tax. Article 1 of Law No. 48, January 29, 1928, as amended, states that every individual or corporation carrying on industrial, commercial or professional activities in Syria is subject to a tax called the Tamattu Tax. The application of the tax, however, requires quite an intricate process of calculation in order to arrive at a tax liability. The structure of this particular tax is as follows:

a. All public utility companies are subject to the tax at a flat rate of five per cent of their gross receipts;

b. A profits tax of 12.5 per cent is applicable to certain forms of business, e.g., one who leases a property for the purpose of sub-leasing at a profit;

c. All other taxpayers are subject to the tax in its three forms: proportional, variable, and fixed. The proportional rate is collected on the basis of the rental value of a property designed for the practice of a business or profession. The variable rate applies to the employers on the basis of the number of their employees. The fixed rate applies to persons in business or professions who do not have a location for the practice of their trades or professions;

d. All cities and villages in the country are divided into five classes on the basis of population. Consequently, the tax rate may vary from one city to another depending on the population classification. Businesses and professions are also divided into six classes. The tax rate applicable to each business or profession depends upon their category. The tax liability is based on the rental value of the place in which the business is conducted. For example, the banks and recorders of deeds are subject to a 31 per cent rate of their rents while wholesalers, accounting firms, engineers, and doctors are subject only to a 23.5 per cent rate of their rents.

<u>Tax on non-agricultural real estate</u>. Article 6 of Law No. 178, May 26, 1945, states that the income derived from the building and its rental value form the base of taxation. The rental value includes the land on which the buildings are erected.

Persons who own one or more houses or buildings or have a share of ownership in one or more houses or buildings are subject to a tax levied on the basis of the annual rental value or values of buildings located in the urban areas as specified by law. According to Article 19 of Law No. 178, the tax rate is as follows:

ANNUAL GROSS RENTAL VALUE

| Actual or estimated (SP) | Tax rate (%) |
|---|---|
| Less than 2,000 | 10.5 |
| Between 2,000 and 6,000 | 13.5 |
| Between 6,000 and 10,000 | 17.5 |
| Between 10,000 and 20,000 | 22.0 |
| Over 20,000 | 29.0 |

Unimproved land located in urban centers is subject to taxation on the basis of capital value:

SP 5 per thousand on the fraction of the capital value not exceeding SP 20,000;

SP 7.5 per thousand on the fraction of the value between SP 20,000 and SP 100,000;

SP 10 per thousand on the fraction of the value exceeding SP 100,000.

Watchman tax (Hirase). According to Law No. 90 dated November 13, 1944, the "Hirase" tax is levied in all regions of the Syrian Republic where there are services of police and night watchman. The tax is collected from the owner of the building or house. The owner, however, has the right to claim the tax against the occupation in the amount of 2.5 per cent of the rent. The remainder of the "hirase" tax rests on the owner. Non-payment by the occupant of his share of the tax is the same as non-payment of a part of the rent.

The levying of this tax takes the form of a surcharge to the tax on non-agricultural real estate at a rate of 40 per cent.

Inheritance tax and gift taxes. On February 2, 1952, Legislative Decree No. 101 was issued instituting a tax on all rights, personal property and real estate being transferred to other parties by inheritance, will, gift, or any other means of transfer without involving compensation. The tax covers the following items:

> The inheritance when the deceased is Syrian, regardless of his place of residence.
> Immovable property located in Syria when the deceased is a foreigners, regardless of his place of residence.
> The movable property located in Syria when the deceased is a foreigner residing permanently in Syria.

The tax is levied on the net amount of the inheritance after deducting all debts and obligations. An heir whose share of the inheritance is less than SP 500 is exempted. Should the share exceed this amount, exemption will apply only to the first SP 500. If the share exceeds SP 5,000, the tax will be collected on the total without any exemption. If the heir is younger than fifteen years of age, or is a permanently disabled child of the deceased, the exemption will be raised to SP 15,000 in either instance.

Two schedules of tax rates are: one for inheritance and the other for gifts and bequests. The tax rates vary with the degree of kinship of the heirs to the deceased. A schedule of these rates follows:

| Gross Amount Received Per Person(SP) | Tax Rate (%) on Inheritance Per Person | | Tax Rate (%) on Gifts and Bequests Per Person | |
|---|---|---|---|---|
| | Lowest | Highest | Lowest | Highest |
| Less than 5,000 | 2.0 | 10.0 | 2.5 | 12.0 |
| 5,001 to 10,000 | 3.0 | 13.5 | 4.0 | 16.0 |
| 10,001 to 15,000 | 4.5 | 17.0 | 5.0 | 19.5 |
| 15,001 to 20,000 | 5.5 | 20.5 | 6.0 | 23.0 |
| 20,001 to 40,000 | 7.0 | 24.0 | 7.5 | 26.5 |
| 40,001 to 65,000 | 8.0 | 30.0 | 8.5 | 34.0 |
| 65,001 to 100,000 | 10.0 | 36.0 | 10.5 | 38.0 |
| Over 100,000 | 12.0 | 48.0 | 13.5 | 50.5 |

Livestock tax. This tax had its origin in the Ottoman Empire. The legal basis for the present tax is Decree No. 794 dated December 28, 1928, and its amendments. According to the Decree, the livestock tax may be considered a capital tax since the imposition of the tax is in the form of an annual flat sum per animal. The animals subject to the tax as specified by the Decree and the rates applicable are the following:

| | Annual rate per head SP |
|---|---|
| Sheep and goats over one year old | 1.65 |
| Camels over two years old | 2.45 |
| Water buffaloes | 5.75 |
| Hogs over one year old | 9.05 |

Other direct taxes. As indicated in Table 8, the other direct taxes are those collected from individuals on mineral and quarry concessions, and those levied on owners of automobiles. These taxes are actually fees, because they are paid as the price for a certain service or privilege.

The last item under the heading of direct taxes in Table 8, "others," amounts 3,387 million Syrian Pounds, represents revenues from television, pump fees, and delimitation and registration of property. These taxes are actually fees because they are paid as the price for a certain service or privilege. For example, if a person owns a television set, he pays an annual fixed sum of 50 SP for the privilege of ownership. In case of pump fees, the tax is levied on owners of land irrigated by Government networks. The amount of the tax varies with the area of land irrigated and the cost of construction of the area network.

## Indirect Taxes

Indirect taxes are derived from various sources. The most important are Foreign trade, Customs duties, Excise duties, and the Agricultural production tax.

Foreign trade duties. Receipts from this source are very important because of their abundant yield. As shown in Table 8, receipts from foreign trade duties in 1965 are estimated at SP 81,260,000 which is more than half the receipts from all direct taxes and more than one-third the receipts from all indirect taxes. If the export duties are included with the customs duties, the receipts from these sources will amount to nearly half the receipts from all indirect taxes.

The tariff rates are chiefly ad valorem. The ad valorem duties are valued at the official rate of exchange.[21] The spread between the official and free market rates results usually in an undervaluation of imports--and in the yield of import duties. Consequently, there is undervaluation of the trade balance which cuases an adjustment for balance of payments purposes.

Presently, export duties are levied on only one product--cotton. The export duty for cotton is set at SP 90 per unginned ton and SP 200 per ginned ton. Until May 18, 1954, export duties were also levied on cereal

---

[21]SP 3.82 = $1.00 in 1965. The free rate of exchange for the same period is SP 4.04 = $1.00.

grains. The duty on wheat was SP 25 per ton and SP 10 per ton of barley.

Agricultural production tax. The Agricultural production tax was introduced on an experimental basis in 1939, after the abolishment of the old Ottoman tax on land (Tithe). In 1942, the tax became permanent and formed a major source of budget receipts.

The Agricultural production tax is levied in the form of a flat rate of nine per cent on the wholesale price of marketed agricultural produce. The wholesale price is established by commissions set up in the various consumption centers and collections posts are: posts along the roads leading the consumption centers; ports of export when the agricultural produce is destined for exportation; and at processing factories.

Some agricultural produce is tax exempt--produce consumed by the farmer or produce used as feed for cattle or seed for crops--and produce consumed in the village where production occurs.

Excise taxes. Excise taxes are levied on a variety of domestic and foreign commodities. These commodities are: fuel and petrol, alcoholic drinks, sugar, cement, and tobacco. The rates applicable on these commodities are as follows:

| Commodities | Syrian Piasters |
|---|---|
| Fuel oil | 5.5 per liter |
| Petrol | 15.0 per liter |
| Sugar (refined) | 20.5 per liter |
| Sugar (unrefined) | 17.5 per liter |
| Beer | 22.5 per liter |
| Wine | 16.0 per liter |
| Cement | 2,000.0 per ton |

The tax rate on tobacco products cannot be determined because of the special status of tobacco production and processing. One independent company, The Syrian Tobacco Company, has a concession on the production and sale of tobacco. In return for this monopoly, the company pays the government 95 per cent of its net profits. The sum received by the government every year is entered in the budget as an excise tax on tobacco. The receipts from this source in 1965 was SP 40,219,000--second in importance to customs duties.

Registration Fees

As shown in Table 8, registration fees are collected on a variety of transactions. The most important of these fees are the stamp duties--estimated to have yielded about one-third of all registration fees in 1965. The stamp tax is levied on bills of exchange, deeds, and petitions. The law specifies two rates: proportional and fixed. The proportional rate applies to bills of exchange and deeds--the fixed rate applies to petitions.

## Non-tax Receipts

Non-tax receipts, or original income of the government, come from five sources as indicated by Table 9.

### Income from the salt monopoly

The production and sale of salt, as well as its exportation and importation, is a state monopoly. The yield from this source of income was estimated to be about seventy-three per cent of the total revenue from government property in 1965, as indicated in Table 9.

### The other revenues

Other sources of revenue are returns from government property such as timber, fisheries, and the sale of various items of public property.

### Income from investments

Income originating in the printing office and that derived from subscriptions to the *Official Journal* constitute the large part of this category of revenues. Other minor revenues are derived from the operations of government agricultural centers.

Miscellaneous revenue and revenues from public services

The major items of income in this category are indicated in Table 9, and an analysis follows.

Oil transit royalties. Oil companies owning pipe lines that traverse Syrian territory pay a fee for that privilege. Two companies are involved--Iraq Petroleum Company (IPC) and the Trans-Arabian Pipeline (TAP). The transit fees are computed at the rate of one shilling and four pence for each ton-mile. By a 1955 agreement, IPC also pays 250,000 sterling pounds for protection and services rendered by the Syrian Government. The agreement further stipulated that the minimum annual amount could not be less than 20,000 sterling pounds, regardless of any circumstance that might prevent the flow of oil. The agreement also provided that the Syrian government could obtain crude oil at reduced prices to supply a refinery that Syria is being planned. The agreement concluded between the Syrian Government and TAP is comparatively recent--1959--and provides for a payment of an annual transit fee at a rate of 1.5 sterling pounds for each thousand tons of oil passing through Syrian territory. TAP also pays a minimum of not less than 20,000 sterling pounds.

Receipts in lieu of military service. According to Legislative Decree No. 115 of October 1953, the length of military service may be reduced from the regular period of two years to a period of four months, provided that the draftee pays a sum of money depending upon the type college degree that he holds when he is called to the draft board. The law specifically states that doctors and engineers cannot buy their way out. The law can be suspended depending on the military needs. Thus, the revenue from this source has fluctuated over the years. The estimated amount of revenue from this source in 1965 was SP 1,333,000.

Receipts recovered from previous expenditures. The item is a minor one. It represents sums recovered during the fiscal year from previous expenditures. Deductions made from salaries of military men for their uniform is one example of this kind of revenue.

Extraordinary receipts. The items that are included in this section change from year to year. Sometimes there may be withdrawals from the reserve fund or the item may happen to be a settlement of old petroleum revenues.

## Middle East Comparison

The comparison will include five Arab countries in the Middle East: Egypt, Iraq, Jordan, Lebanon, and Syria. The comparison is limited to these five countries because they have similar tax structures and economic conditions.

The comparison is made in terms of U. S. dollars rather than the individual country's currency for the purpose of having a common denominator.

Table 10 shows government receipts derived from taxes and other receipts. Table 11 shows the percentage contribution of each source of revenue to total receipts. Syria derived 74.2 per cent of its total receipts in 1964 from taxes alone; whereas Egypt derived 54.5 per cent from the same source in the fiscal year 1963-64; Iraq, 24.6 per cent; Jordan, 67.4 per cent; and Lebanon, 78.8 per cent. As Table 11 indicates, Lebanon relies more on taxes than all other Arab states.

"Other receipts" are more important in Iraq where 75.4 per cent of total receipts in fiscal year 1963-64 were derived from the other sources. Egypt follows next in this category. This category contributed 45.5 per cent of the total receipts in the same fiscal year. In Syria and Lebanon, the contribution of this source to the central budget was 25.8 and 21.2 per cent respectively.

The comparison of the revenues from the different types of taxes, direct and indirect, points to the fact that in Syria, and even more so in Lebanon, indirect taxes contribute more to total budget receipts than in the other states. All the Arab states of the Middle

TABLE 10

CENTRAL GOVERNMENT RECEIPTS, 1956-1965
(thousands SP)

| Receipts | 1956 | 1957 | 1958-59[a] | 1959-60 | 1960-61 | 1961-62 | 1962-63[b] | 1964 | 1965 |
|---|---|---|---|---|---|---|---|---|---|
| Tax Receipts | | | | | | | | | |
| 1. Direct taxes and duties | | | | | | | | | |
| schedular income taxes industrial, commercial, trades, professions | 15,945 | 19,073 | 28,608 | 27,000 | 26,000 | 17,524 | 49,197 | 29,565 | 30,214 |
| Salaries and wages | 6,308 | 7,525 | 11,286 | 8,000 | 9,500 | 8,870 | 14,051 | 10,833 | 11,579 |
| Circulating capital | 450 | 457 | 684 | 700 | 850 | 1,043 | 1,590 | 1,145 | 1,125 |
| Tax on non-agricultural real estate | 9,046 | 11,263 | 16,893 | 14,000 | 18,000 | 15.579 | 29,206 | 17,766 | 27,958 |
| Tamattu (license) tax | 3,912 | 4,936 | 7,404 | 5,500 | 6,500 | 6,101 | 10,444 | 6,627 | 7,633 |
| Livestock tax | 11,300 | 11,846 | 24,000 | 12,000 | 9,000 | 8,615 | 17,078 | 12,725 | 14,040 |
| Miscellaneous direct tax | 13,138 | 18,855 | 42,881 | 27.925 | 24,300 | 23,727 | 41,761 | 34,473 | 31,400 |
| 2. Indirect taxes and duties | | | | | | | | | |
| petroleum products | 20,679 | 18,527 | 33,789 | 28,000 | 23,500 | 14,789 | 17,163 | 13,286 | 17,666 |
| Sugar | 7,887 | 8,571 | 13,658 | 10,500 | 13,000 | 14,252 | 14,944 | 4,901 | 19,267 |
| Tobacco | 21,058 | 27,841 | 41,760 | 30,000 | 32,000 | 35,790 | 53,413 | 37,584 | 40,219 |

TABLE 10--continued

| | 1956 | 1957 | 1958-59 | 1959-60 | 1960-61 | 1961-62 | 1962-63 | 1964 | 1965 |
|---|---|---|---|---|---|---|---|---|---|
| Agricultural production tax | 30,646 | 20,242 | 30,000 | 25,000 | 24,000 | 26,684 | 55,590 | 37,239 | 37,421 |
| Customs[c] | 74,760 | 87,716 | 141,019 | 104,000 | 91,000 | 73,679 | 90,198 | 111,842 | 105,334 |
| Other | 7,425 | 8,987 | 14,479 | 12,800 | 16,500 | 16,756 | 31,297 | 20,006 | 21,505 |
| 3. Registration fees | 28,054 | 30,883 | 44,792 | 38,000 | 44,000 | 64,745 | 150,173 | 83,292 | 86,581 |
| Non-tax receipts | | | | | | | | | |
| 1. Proceeds of state property | 6,470 | 6,032 | 9,006 | 3,180 | 3,455 | 5,028 | 4,170 | 5,991 | 3,536 |
| 2. Industry | 880 | 911 | 1,412 | 950 | 1,200 | 4,451 | 2,060 | 1,390 | 1,451 |
| 3. Miscellaneous oil transit revenue | 56,817 | 32,789 | 113,707 | 96,000 | 92,000 | 89,618 | 150,874 | 122,027 | 125,675 |
| Other | 16,324 | 19,029 | 22,095 | 28,620 | 10,115 | 24,883 | 24,258 | 15,351 | 16,553 |
| 4. All other | 37,043 | 51,819 | 75,064 | 21,200 | 67,305 | 41,651 | 5,184 | 2,280 | 5,911 |
| TOTAL | 369,759 | 387,302 | 677,537 | 493,375 | 512,225 | 493,775 | 762,651 | 568,333 | 605,168 |

Source: Ministry of planning, Statistical Abstract, figures for 1956, 1957 are taken from 1958, 1958 to 1960-61 from 1961, 1961-62 to 1965 from 1966.

[a]Year starting January 1, 1958 and ending in June 30, 1959.

[b]Year starting July 11, 1962 and ending in December 31, 1963.

[c]Export duties included.

TABLE 11

MIDDLE EAST COMPARISON OF GOVERNMENT RECEIPTS
(Thousands $)

| Central Government Receipts | Egypt[d] | Iraq[e] | Jordan[e] | Lebanon[f] | Syria[f] |
|---|---|---|---|---|---|
| Direct taxes[a] | 156,883 | 30,016 | 4,906 | 22,614 | 19,246 |
| Indirect taxes[b] | 472,052 | 98,756 | 27,592 | 91,480 | 91,039 |
| Other receipts[c] | 523,388 | 395,724 | 15,778 | 30,572 | 38,492 |
| TOTAL | 1,152,323 | 524,496 | 48,276 | 144,666 | 148,777 |

Source: United Nations, _Statistical Yearbook_ (New York: 1966).

[a]Direct taxes: including income tax, inheritance, real estate, etc.

[b]Indirect taxes: including export tax, customs, excise taxes, etc.

[c]Other receipts: including oil revenue, receipts of public enterprises and monopolies, etc.

[d]Year ending June 30.

[e]Year ending March 31.

[f]Calendar Year.

Exchange rate:

1 Egyptian pound = $2.30.

1 Iraqui and Jordanian dinar = $2.80.

3.08 Lebanese pounds = $1.00.

3.82 Syrian pounds = $1.00.

TABLE 12

COMPARISON OF GOVERNMENT RECEIPTS IN SELECTED MIDDLE EASTERN COUNTRIES, 1964
(In per cent of total)

| Source of Revenue | Egypt | Iraq | Jordan | Lebanon | Syria |
|---|---|---|---|---|---|
| Direct taxes | 13.6 | 5.7 | 10.2 | 15.6 | 13.1 |
| Indirect taxes | 40.9 | 18.9 | 57.2 | 63.2 | 61.1 |
| SUBTOTAL | 54.5 | 24.6 | 67.4 | 78.8 | 74.2 |
| Other receipts | 45.5 | 75.4 | 32.6 | 21.2 | 25.8 |
| TOTAL | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Based on Table 11.

East, however, rely more on indirect taxes in their tax revenue than on direct taxes. Table 12 indicates that in 1964 Syria collected about 61.1 per cent of its total government receipts in the form of indirect taxes. Egypt collected only 40.9 per cent in fiscal year 1963-64, Iraq 18.9 per cent in the same fiscal year, Jordan 57.2 per cent, and Lebanon 63.2 per cent.

Since economic development is so very important in current economic thinking, an analysis of fiscal policies in support and/or contrary to that theory will follow.

## CHAPTER IV

## FISCAL POLICY IN UNDERDEVELOPED COUNTRIES

### Introduction

Economic development is becoming the central theme of economic thought. This trend has increased tremendously since the end of World War II.

The interest in economic development was brought about by two events.

> One was the development of the socialist countries which started with the Russian Revolution after World War I, the emergence of a number of socialist economies in Eastern Europe, and finally the embarkment of the largest nation in the world, China, on a road of socialist development. These were, in any case most of them, countries which were formerly to a lesser or greater degree underdeveloped, and which after the social revolutions had taken place began to develop in a very rapid way. The most important of them, the Soviet Union, became in a brief period of forty years the second industrial power in the world.[1]

The other factor was the result of the national revolutionary movements in the countries which were formerly colonial, semi-colonial, or dependent on the leading capitalist powers. These national revolutions led to the

---

[1]Oskar Lange, Economic Development, Planning and International Cooperation (New York: Monthly Review Press, 1963), p. 5.

establishment of new independent states, and these states considered economic development and progress to be their chief goals.

> The international importance of the national revolutions became so great that the whole problem of underdeveloped countries, of their economic progress, became a major, I may say the major, international problem. Thus again attention of economists was drawn to problems of economic development.[2]

As a result of these events, the developed countries of the Western World became interested in the development process of these underdeveloped countries. A whole battery of institutions were created to help the disadvantaged countries in their development programs. Some of the institutions created were under the auspices of the United Nations, and some were sponsored by the United States.

The focus on the problem of economic development has shown itself in making economic planning a popular issue in the underdeveloped countries. This popularity of economic planning can be found in the trend by which most of the governments in underdeveloped countries have begun to commit themselves to economic progress by the formulations of some long range plans.

> Planning is a relatively new form of economic policy. It originated with the socialist economies and is an essential part of socialist economy. Under conditions where the major part of the means of production become publicly owned, it is only natural that the utilization of these means and the process of

---

[2] Ibid., p. 6.

> production be subject to a general national economic plan. However, planning as a method or promoting economic development has not remained limited to the socialist countries. It has spread first to the countries which follow the national revolutionary pattern of economic development. In those countries it has become the main instrument of promoting economic development.[3]

Underdeveloped countries pursuing the supreme objectives of planned economic development may not fulfill their goals. Mere planning of their economies is not a sufficient condition for the promotion of economic development. This is so, because the process of the economic development of a country is highly complex phenomenon. It is profoundly influenced by political, social, and cultural factors, so economic analysis can provide only a partial explanation of this process. The supply of natural resources, the state of development of social, political, and economic institutions, cultural patterns, social values and attitudes of the population and the scientific and technological knowledge have a strong bearing on the process of the growth of economics. As Professor Nurkse puts it:

> Economic development has much to do with human endowments, social attitudes, political conditions, and historical accident. Capital is a necessary but not a sufficient condition of progress.[4]

In economic analysis, the most important factors

---

[3] Ibid., p. 15.

[4] Ragnar Nurkse, Problems of Capital Formation in Underdeveloped Countries (Oxford: Basil Blackwell, 1957), p. 1.

determining the process of economic growth would appear to be the proportion of a community's income devoted to saving and capital formation. Thus the crux of the problem of economic development in an underdeveloped country lies in a significant expansion of the rate of its capital investment. It must attain a rate of growth of output which exceeds the rate of growth of its population by a significant margin--only then will it begin to improve its standard of living.

## Saving and Investment

The rate of capital formation in an economy depends on the amount saving that it can achieve since there is a direct relationship. By saving, factors of production are diverted from the production of consumption goods to those of capital goods, which increases the productivity of the economy. The word "saving" will be used to mean that part of income not spent on consumption or used to pay taxes.

There is an almost complete unanimity among the experts on economic development about the shortages of domestic savings available for investment in underdeveloped countries. The United Nations experts in their report stated that:

> There is a general agreement in the reports that domestic savings in most underdeveloped countries are very low and are unequally distributed, that domestic finance will, nevertheless, be required to

> cover the bulk of total investment needs and that there is a dearth of mature projects actually ready for financing.[5]

Professor Belshaw observed that:

> The United Nations experts estimated that domestic savings in underdeveloped countries throughout the world were $5,240 million in 1949, . . . in Asia, including Egypt, but excluding Japan, the savings are put at $2,530 million . . . about 4.3 per cent of national income.[6]

To accomplish economic growth in underdeveloped countries, it is necessary to have an increased portion of national income saved and invested in ways which are conducive to economic development. However, the increase of per capita income that may result from the development process does not necessarily imply that the percentage of income saved will increase as income increases.

> Observation of historical series for advancing countries has shown, indeed, that the ratio of saving to income does not necessarily respond to a rising trend in per capita income. For example, in the United States since 1870, the proportion of national income saved has not shown a rising trend, despite the fact that per capita real income has grown rapidly.[7]

A reason for this is that over an extended period of time people's consumption standards are flexible and

---

[5]United Nations, Methods of Financing Economic Development in Underdeveloped Countries (New York, 1949), p. 60.

[6]Horace Belshaw, Population Growth and Levels of Consumption (London: George Allen and Unwin, Ltd., 1956), p. 113.

[7]Ansley J. Coale and Edgar M. Hoover, Population Growth and Economic Development in Low-income Countries (Princeton, New Jersey: Princeton University Press, 1958), p. 154.

tend to respond to changes in income. These consumption standards are more powerfully influenced by forces of social imitation of other consumers--the so-called "demonstration effect"--than they are by retention of their past levels of consumption. The "demonstration effect" arises out of the tendency to emulate the higher levels of consumption both on the part of the low income groups within the domestic economy and on the part of the low income countries at the international level. Thus the "demonstration effect" operates both on the national level and international level.

The phenomenon of the "demonstration effect" according to Dusenberry has been derived from the theory of regarding the preferences of the individual's consumption function as being interdependent, instead of independent. The preferences of individuals are interdependent because of strong psychological and sociological reasons. As a result, the percentage saved by individuals is independent of the absolute level of income.

> In given circumstances, the individuals in question come into contact with goods superior to the ones they used with a certain frequency. Each such contact is a demonstration of the superiority of these goods and is a threat to the existence of the current consumption . . . we can maintain then that the frequency and strength of impulses to increase expenditure depends on the frequency of contact with goods superior to those habitually consumed.[8]

---

[8]James S. Duesenberry, Income, Saving and the Theory of Consumer Behavior (New York): Oxford University Press, 1967), pp. 26-27.

Because of the discontinuity in preference functions, the aggregate saving ratio tends to be insensitive to change in the interest rates and expectations parameters. As a result, the propensity to emulate the higher consumption standards of higher income groups tend to strengthen the propensity to consume of the lower income groups and this reacts adversely on the propensity to save. This demonstration effect operates on the international level as well, leading to the emulation of the higher consumption standards of advanced countries in the underdeveloped areas and reacting adversely on their propensity to save.

The possibility that the "demonstration effect" may inhibit saving in poor countries cannot be denied. However, the importance of the "demonstration effect" acting internationally can be exaggerated. Bauer and Yamey have maintained that the usual analysis of the international "demonstration effect" seems to leave out certain major considerations which are relevant to the economic problems of underdeveloped countries.

> . . . Information about a wider range of objects of expenditure and the accessibility of these objects have almost unvariably provided strong inducements to productive effort, the transformation of a traditional subsistence economy into a money and exchange economy, and the exercise of initiative and enterprise. The prospect of a higher and more varied level of consumption serves to induce agricultural producers to produce for the market, whether in addition to subsistence production or in replacement of subsistence production. . . . By widening markets

> and promoting specialization it conduces both to the growth of capital and to its more productive employment, which in turn facilitates further capital formation. . . .
>
> In these circumstances consumption and investment are complementary; the higher level of consumption induces additional and more productive effort, which serves to generate incomes, and which, in turn, renders possible both increased consumption and increase accumulation of capital. . . .
>
> Indeed, in the private sector the prospects of a higher level of consumption is more likely to promote than to hinder capital formation and economic development generally.[9]

The chances of raising the proportion of national income invested in any country depends not simply on the rise in per capita income, but also on increase in the proportion of income going to those who have a high propensity to save and invest. In the words of Professor W. Arthur Lewis:

> . . . the correct explanation of why poor countries save so little is not because they are poor, but because their capitalistic sectors are small. . . . No nation is so poor that it could not save 12 per cent of its national income if it wanted to; poverty has never prevented nations from launching wars, or from wasting their substance in other ways. Least of all can those nations plead poverty as an excuse for not saving, in which 40 per cent or so of the national income is squandered by the top 10 per cent of income receivers living luxuriously on rents. In such countries productive investment is not small because there is no surplus; it is small because the surplus is used to maintain unproductive hordes of retainers, and to build pyramids, temples, and other durable

---

[9]Peter T. Bauer and Basil S. Yamey, The Economics of Underdeveloped Countries (Chicago: The University of Chicago Press, 1957), pp. 139-141.

consumer goods, instead of to create productive capital.[10]

As indicated earlier, saving is income in a given period not spent for consumption. The wider the gap between income and consumption, the more the saving; thus saving is a function of income in the economy.

Saving in the economy could be increased by reducing consumption or vice versa. Saving and consumption are not fixed quantities in an economy and they could be increased or decreased by increasing other variables. As F. W. Parish stated:

> The resources available for investment are not immutably fixed, but depend in the short run largely, and in the long run wholly, upon the proportion of our total resources which we are prepared to spare from the provision of consumption of goods and services.[11]

The critical question, then, is not so much how to save a bigger proportion of growing income but how to bring about more savings to start the process. The present situation has been described by Belshaw as follows:

> Savings among large sections of the people are not primarily determined by the investment motive, in the sense of a desire for more current income from the investment, but express themselves a great deal in bunched ceremonial expenditure which is high in relation to income, in hoarding as a security reserve, and in land which is the main economic foundation for the perpetuation of the family. As a corollary,

---

[10]W. Arthur Lewis, The Theory of Economic Growth (Homewood, Illinois: Richard D. Irwin, Inc., 1955), p. 236.

[11]F. W. Paish, The Post-War Financial Problem (London: Macmillan and Company, Ltd., 1950), p. 52.

> investment is not so markedly affected by judgments on the financial rate of return. Much of the additional income of wealthier groups escapes through high ostentatious consumptions, or is invested in buildings or land, or in foreign currencies. In using funds to earn more income there is a preference for trade or finance rather than investment in concrete capital for industrial or agricultural production. So a great deal of saving is not used in such a way as to generate real national income. . . . The problem is both to increase the means to save and change cultural environment, and improve the institutional arrangements so that the aggregate of savings is increased and investment has a better balance. . . . An important aspect in any approach is to demonstrate that the possibility of income-earning investments for purposes in which the people are interested. . . . Another aspect is to bring home the possibility of achieving something worthwhile by aggregating the small units of savings of individuals into a larger sum which can be applied effectively.[12]

The paucity or the low level of investment in the underdeveloped countries has also been explained by various other theoretical explanations. Ragnar Nurkse has explained it in terms of the dichotomy of demand and supply. According to him the level of capital formation in underdeveloped countries is low due to both the low demand for investment goods and low supply of savings. In such an economy, the low level of per capita productivity limits the magnitude of real demand for output, which, as the result of the working of the acceleration effect, tend to react unfavorably on the marginal efficiency of capital resulting in a dampening of the inducement to invest.

---

[12]Belshaw, <u>Population Growth and Levels of Consumption</u>, pp. 116-117.

> It is a matter of common observation that in poor countries the use of capital equipment in the production of goods and services for the domestic market is inhibited by the small size of that market, by the lack of domestic purchasing power, not in monetary but in real terms. . . . If it were merely a deficiency of monetary demand, it could easily be remedied through monetary expansion. . . . Monetary expansion alone does not remove it, but produces merely an inflation of prices.[13]

Obviously, a crucial determinent of the size of the market would be productivity and the capacity to produce. In an underdeveloped country the accelerator is either weak or non-existent because of the low level of productivity of the economy.

There is a vast opportunity for the expansion of investment in underdeveloped countries, therefore the marginal inducement to invest should be fairly high. However, viewed from the standpoint of the individual entrepreneur, the marginal inducement to invest in the underdeveloped countries is weak--due to the low real demand for his product. Nurkse observed:

> The technical contribution which capital can bring about in backward countries is not in dispute. The possible increase in physical output with modern machinery, plus efficient management, may be tremendous. . . . The economic side is concerned, not simply with physical productivity, but with value productivity and is limited for any individual business by the poverty of potential consumers. . . . The technical opportunities may be great; the physical increase in the output may be spectacular compared with existing output, but value productivity is limited by the low purchasing power of the people.[14]

---

[13] Nurkse, <u>Problems of Capital Formation in Underdeveloped Countries</u>, p. 6.

[14] <u>Ibid.</u>, p. 14.

In order to remove the drag imposed on investment caused by the small size of the market in underdeveloped countries, Nurkse has suggested a program of "balanced growth" which involves a dynamic expansion of the market though a synchronized application of capital to a wide range of industries. Such a program of balanced growth will result in creating external economies. In Nurkse's words:

> Balanced growth may be a good thing for its own sake, but here it interests us mainly for the sake of its effects on the demand for capital. It appears in the present context as an essential means of enlarging the size of the market and of creating inducement to invest.[15]

In the underdeveloped countries, a marked inequality in the distribution of income exists. This inequality should have resulted in a greater volume of savings available for capital formation. But the sector with the greatest concentration of incomes is a sector which derives its income primarily from non-entrepreneurial sources such as rents and interest. The attitudes and social values of this sector are such that it is inclined to use its income for conspicuous consumption--investment in land and real estate, speculative transaction, and holdings of gold and foreign exchange.[16] If these

---

[15] Ibid., p. 12.

[16] Ram Niramjan Tripathy, Public Finance in Underdeveloped Countries (Calcutta: The World Press, Ltd., 1964), p. 10.

surpluses were channeled into development investment, the level of capital formation would be substantially increased. The tendency for a part of the available surplus to be invested unproductively explains the disparity in the level of potential savings and actual productive capital formation in an underdeveloped country.

The ratio of saving to national income is a function not just of inequality, but more precisely of the ratio of profits to national income.[17] In the underdeveloped countries, the capitalist sector, either private or state, constitutes a very small sector in the economy. Industrial profits in an underdeveloped nation constitute a much smaller proportion of national income than do such profits in an advanced country. It was the increasing volume of profits arising in the private sector in England in the nineteenth century that increased capital accumulation. The increasing volume of profits arising in the State Capitalist sector in the Soviet Union in recent years played an important part in the accumulation of capital in that country.

> In England, the inflation of profits through the lag of wages behind prices facilitated the accumulation of funds for investment in new enterprises, and widened the margin of savings to be ploughed back.[18]

---

[17] Ibid., p. 11.

[18] Earl J. Hamilton, "Profit Inflation and the Industrial Revolution, 1751-1800," The Quarterly Journal of Economics, Vol. 56 (February, 1942), p. 256.

Professor Hirschman's diagnosis of the economic ills of the underdeveloped countries is that they have failed to take advantage of their development potential--they have found it difficult to make decisions needed for development in the required number and at the required speed. If economic backwardness is due to an insufficient number of, and the speed of development decisions, then the fundamental problem according to him, is to generate and energize human action to make development decisions in sufficient number and at the required speed.

In the making of development decisions in the required number and at the required speed, Hirschman has assigned importance to the inducement mechanisms. He regards autonomous investment as uncertain because it depends on more uncertain factors such as new inventions and innovations. On the other hand, induced investment is more reliable and predictable than autonomous investment, because induced investment decisions are made due to the extra pressures as a result of pacing, routine response, threatened penalties, certain and high profitability, or other forces.[19]

In advanced countries, savings and investment decisions are independent of one another to a substantial extent--income per capita is an important determinant

---

[19] Albert O. Hirschman, The Strategy of Economic Development (New Haven: Yale University Press, 1961), p. 27.

of the supply of savings. However in an underdeveloped country, investment and savings decisions are largely interdependent and additions to savings depend far more on the opening up of investment opportunities and on the removal of the various obstacles to investment activity than on increased income.[20] In the economic growth of the advanced countries, the generation of savings and the availability of investment opportunity and their productivity are both important and thus economic growth will automatically take place provided the two opportunities are available.

> In the underdeveloped countries, such telescoping of the process would be highly unrealistic: the factors limiting growth are here most generally connected, not with the two terminal points themselves, but with the difficulties of connecting them. In other words, development is held back primarily by the difficulties of channeling existing or potentially existing savings into available productive investment opportunities, i.e., by a shortage of the ability to make and carry out development decisions.[21]

Thus Professor Hirschman does not regard the <u>shortage</u> of savings as a factor limiting the economic development of underdeveloped countries, but rather the difficulty in properly channeling the existing potential. His emphasis is on the inadequacy of investment decisions as against the views of Ragnar Nurkse who regards the weakness of both the saving and investment

---

[20] *Ibid.*, p. 32.

[21] *Ibid.*, p. 36.

decisions as responsible for economic underdevelopment.

An acceleration in the rate of capital formation is of central importance to the economic development of the underdeveloped countries. Continuous and lasting improvements in levels of living can be secured only through the progressive expansion of productive capacity; and, in the growth of the latter, a major determinent is the pace of capital formation.

> It is therefore encouraging that, in the nineteen fifties, there occurred a marked rise in the volume of investment within the underdeveloped areas as a whole. For many of these countries in these areas, the higher rate of investment attained in last decade marks a significant break with the stagnant economic conditions of the past and it has already borne fruit in the acceleration of economic growth.[22]

In the period before 1950, the annual rate of growth of total output in the underdeveloped areas was probably not more than one per cent. However a marked rise in the volume of investment during the 1950's is illustrated for thirteen countries in Table 13. Undoubtedly, the period under review has marked the inception of a new and more vigorous phase in the economic development of most underdeveloped areas especially in those countries where governments have embarked upon large scale programs of economic development.[23]

Although there was a marked increase in the

---

[22]United Nations, World Economic Survey, 1959 (New York: 1960), p. 63.

[23]Ibid., p. 63.

TABLE 13

ANNUAL RATE OF GROWTH IN GROSS DOMESTIC FIXED CAPITAL FORMATION AND ITS SHARE IN GROSS DOMESTIC PRODUCT SELECTED COUNTRIES, 1950-51 to 1957-58

| Country | Annual Rate of Growth | Gross Domestic Fixed Capital Formation as Percentage of Gross Domestic Product | |
|---|---|---|---|
| | | 1950-51 | 1957-58 |
| Iraq | 29 | 9 | 19 |
| Turkey | 16 | 9 | 14 |
| India | 13 | 6 | 10 |
| UAR (Egypt) | -4 | 16 | 11 |
| Marocco | -9 | 24 | 14 |
| Burma | 15 | 11 | 20 |
| Thailand | 7 | 13 | 14 |
| Mexico | 6 | 15 | 15 |
| Ceylon | 5 | 9 | 10 |
| Union of South Africa | 4 | 22 | 20 |
| Chile | 3 | 9 | 9 |
| Brazil | 2 | 15 | 13 |
| Argentina | 2 | 23 | 24 |

Source: United Nations World Economic Survey (New York: 1960), p. 64.

volume of investment in the underdeveloped countries, the annual rate of increase in domestic fixed capital formation varies from country to country. In India and Turkey, for example, the annual rates of increase in domestic capital formation between 1950-51 and 1957-58 amounted to 16 and 13 per cent respectively; while in Iraq, it was 29 per cent. In other countries, the rates of increase, though not so high, were generally substantial and only in a few countries, such as Argentina, Brazil, and Chile, were annual rates of increase as low as 2 and 3 per cent.

## Private Saving in the Economy

In the economic development of many countries, private savings have been of primary importance. Various motives induce the individual to save a portion of his income--possibly future security or political and economic power. But a large part of private savings, however, are automatically made by the top income brackets in the country. On the whole, the volume of private saving is determined by the level of national income, the distribution of that income, and the willingness of the people to save.

In underdeveloped countries, possibilities for private savings are very limited due to the low level of income and the high percentage of income spent on consumption. In recent years, due to the rapid system of international communication and associations, the people of underdeveloped countries have been attracted by the consumption standards of the West. People of these countries are no longer satisfied with their present standard of living. They want to enjoy the consumption standards of the West, and they will not allow interference on the part of the government to restrict their pattern of consumption. Nurkse best described the situation:

> The basic trouble is that the presence or the mere knowledge of new goods and new methods of consumption tends to raise the general propensity to consume. New goods, whether home-made or imported, become part of the standard of living.[24]

Besides consumption, a great factor propagating low saving is a lack of savings institutions in these countries. In a large part of a country, there are no savings institutions of any kind. Even if the people desire to save, they do not have the institutions. Illiteracy, questionable administrative techniques and unqualified personnel are further hindrances to saving.

In the absence of facilities for saving, whatever savings take place will be in the form of gold, silver and investments in real estate and thus a substantial part of savings will not be available for capital formation in the country.

A large part of savings in many countries is made by institutions and business. Insurance companies, building associations and investment trusts receive a large part of the savings in the developed countries; but such institutions are few in backward countries. Savings

---

[24]Nurkse, Problems of Capital Formation in Underdeveloped Countries, p. 62.

through insurance could be increased only if the public has complete confidence--such confidence is lacking in underdeveloped countries.

More important than institutional savings are corporate savings in developed economies. In many countries, corporate savings form a substantial part of the total savings. In underdeveloped countries, corporate business is minor; therefore, they would not be a significant source of savings.

> There are numerous impediments to private saving and investment in many underdeveloped countries. These include the imperfect maintenance of law and order, political instability, unsettled monetary conditions, lack of continuity in economic life, the extended family system with its drain on resources and its stifling of personal initiative, and certain systems of land tenure which inhibit saving and investment.[25]

Despite the traditional obstacles, some measure of private capital formation has taken place whenever the usual barriers have been removed or weakened. In favorable circumstances, many individuals have contributed to the fund of savings. Some examples may be in point. In nineteenth-century Japan, Lockwood observed that:

> The great bulk of new investment resources came not from the coffers of the State, but increasingly from personal and business savings. The critical function of the new-post-1868 government was to establish and maintain the framework of political order and

---

[25]Bauer and Yamey, <u>The Economies of Underdeveloped Countries</u>, p. 132.

legal security essential for this purpose.[26] Professor Lockwood further emphasizes that the contributions to capital formation came from numerous individuals, rich and poor, and that the process of accumulation was spurred only to a widening of the market and the presence of inducements to save and invest. In his further comment on Japan, Lockwood concluded that:

> The decisive difference between Japan and most of her Asiatic neighbors was not so much a greater disposition to save on the part of Japanese as it was the more effective inducements to a high rate of investment in productive enterprise.

In postwar Syria, to take another example, the rate of private saving and investment has been high, in spite of political uncertainty and frequent changes of government.

> A substantial part of the profits earned in the post-war expansion of agriculture, industry and commerce was evidently reinvested. . . . Once the profitability of industry was demonstrated, additional capital was attracted . . . the fact that at least some of the stock ownership became rather widely dispersed testifies to the appeal which industrial investment has made to growing number of people.[27]

Table 14 presents information for gross domestic savings, total gross investment, net inflow of foreign capital and net imports of non-monetary gold in Syria for the

---

[26]William W. Lockwood, <u>The Economic Development of Japan: Growth and Structural Change, 1868-1939</u> (Princeton: Princeton University Press, 1954), pp. 268-269.

[27]International Bank for Reconstruction and Development, <u>The Economic Development of Syria</u> (Baltimore: The John Hopkins Press, 1955), pp. 22, 104-105.

period 1950-1956 and 1961-1965.

TABLE 14

ESTIMATE OF DOMESTIC SAVINGS IN SYRIA
1950-1956 and 1961-1965
(Millions of Syrian Pounds)

| Year | Total Gross Investment (1) | Net Inflow of Foreign Capital (2) | Net Imports of Non-Monetary Gold (3) | Gross Domestic Savings (1)-(2)+(3) |
|---|---|---|---|---|
| 1950 | 180 | 40 | na | 140 |
| 1951 | 197 | 42 | na | 155 |
| 1952 | 180 | 51 | 5 | 134 |
| 1953 | 232 | 20 | 25 | 237 |
| 1954 | 304 | 75 | 19 | 248 |
| 1955 | 345 | 106 | 34 | 273 |
| 1956 | 338 | 104 | 37 | 271 |
| 1961 | 438 | na | na | 310 |
| 1962 | | na | na | 345 |
| 1963 | 622 | na | na | 385 |
| 1964 | 562 | na | na | 430 |
| 1965 | 404 | na | na | 480 |

Source: Edmund Y. Asfour, Syria: Development and Monetary Policy (Cambridge, Massachusetts: Harvard University Press, 1959), p. 74 (1950-1956); and Ministry of Planning, Statistical Abstract (Damascus: Government Press, 1966), p. 325 (1961-1965).

As the table indicates, investment is financed by domestic savings, as well as by the net inflow of capital.

These estimated indicate that genuine domestic savings financed a substantial part of gross investment and the average rate of savings generally exceeds ten per cent of national income.

However, the distribution of investment funds among the various economic sectors does not indicate that the capital requirement in relation to output was of primary importance in determining the pattern of investment. Table 15 shows the composition of gross domestic fixed capital formation in Syria.

TABLE 15

COMPOSITION OF GROSS DOMESTIC FIXED CAPITAL FORMATION BY TYPE OF CAPITAL GOODS AT MARKET PRICES OF 1956 (Million of Syria Pounds)

| | 1961 | 1962 | 1963 | 1964 | 1965 |
|---|---|---|---|---|---|
| Dwellings | 85 | 179 | 133 | 131 | 104 |
| Non-Residential Buildings | 71 | 69 | 61 | 67 | |
| Other Construction and Work | 136 | 128 | 114 | 118 | 187 |
| Transport Equipment | 37 | 40 | 75 | 58 | 44 |
| Machinery and Other Equipment | 137 | 213 | 229 | 151 | 150 |
| TOTAL | 466 | 629 | 612 | 525 | 485 |

Source: United Nations, Yearbook of National Accounts Statistics, 1966 (New York, 1967), p. 555.

Thus, as the table indicates, construction, including dwellings and non-residential buildings, absorbs the greater part of the total annual investment. This fact supports the view that, at this stage of development in Syria, factors other than the relation of output to capital are predominant in determining the pattern of investment and capital formation. The tendency to invest in housing may be one aspect of a more general social characteristic. As Professor Asfour puts it:

> Houses, like trading shops and small industries, which are also favored form of investment, need relatively little capital per unit. They thus have the advantage of being adaptable to the amount of capital under the immediate control of the investor. Houses certainly add to the social prestige, sense of security and stable income of the owner.[28]

In some fields, Syrian entrepreneurs have shown readiness to pool resources in order to invest in a big, indivisible projects. However, ownership in most cases has been limited to a few rich stockholders who control the industry. Both their political power and the semi-monopolistic position of the big industry in a small market insures commercial survival or profitability. Small investors have shown readiness to buy industrial shares but only in a well-established business. Thus although industry has proven its profitability in many fields, it is the narrowness of the market (or low demand in general) as well as the retarded development of skills that check further expansion rather than capital shortage

---

[28] Edmung Y. Asfour, Syria: Development and Monetary Policy (Cambridge, Massachusetts: Harvard University Press, 1959), p. 76.

or indivisibility of investment.[29]

Private capital in Syria has also whon a preference for investment in other types of non-productive capital, particularly trading stocks and gold. The impact of changes in stocks of goods and gold hoards on the economy's capacity to build up its productive capital goods is probably as important as that of the heavy investment in housing. Its full significance is hidden by the lack of any reliable estimate of magnitudes involved. The need to accumulate stocks and gold arose from a need to insure their wealth against violent political or financial threats which have been accentuated in recent years. The recent rubulence and the frequent changes in government have been an added factor. The problem now is not just the accumulation of wealth in gold but also the outflow of private capital from Syria. This action acts as another drainage on the availability of capital and thus retards the process of economic development of the country.

In order to progress and cross the threshhold into selfsustained growth, the underdeveloped countries must have an adequate volume of saving to allow the required level of capital formation. In the underdeveloped countries, although their need for high rates of economic growth is greater, the total supply of saving

---

[29]<u>Ibid.</u>, p. 77.

available for domestic investment as a percentage of gross domestic product has often not been as large as in most industrial countries.[30]

The growth gap between the two groups of countries is reflected in their different levels of saving and also in their pattern of saving. A number of industrial countries are major sources of saving for the rest of the world, but most underdeveloped countries rely upon foreign saving to augment domestic supplies. This is illustrated in Table 16. In the underdeveloped countries, depreciation charges are generally a much smaller proportion of gross domestic product; therefore these charges contribute less to gross saving. It may be quite possible that this may partially denote differences in accounting practices between the two groups of countries. However, it may primarily reflect the fairly obvious structure of production and accordingly, the composition of the stock of depreciable assets. However, since agriculture accounts for a larger part of total output, a much smaller proportion of the capital stock in underdeveloped countries is made up of depreciable assets such as machinery. A much larger share consists of slowly depreciating assets, such as buildings, roads, railways or dams.

As the table indicates, there has been a considerable

[30]United Nations, World Economic Survey, 1960 (New York: 1961), p. 60.

TABLE 16

LEVELS OF FOREIGN AND DOMESTIC SAVING, SELECTED COUNTRIES--AVERAGE 1962-64 (PERCENTAGE OF GROSS DOMESTIC PRODUCT)

| Country | 1 Total Supply of Saving 3+5+6 | 2 Total Net Saving 3+6 | 3 Foreign Saving | 4 Total Gross Domestic Saving 5+6 | 5 Depre-ciation | 6 Net Domestic Saving 4-5 |
|---|---|---|---|---|---|---|
| Tunisa | 22 | 20 | 12 | 10 | 2 | 8 |
| Thailand | 20 | 15 | 2 | 18 | 5 | 13 |
| UAR (Egypt) | 18 | 16 | 4 | 14 | 2 | 12 |
| India | -- | 13 | 3 | --- | - | 10 |
| Sudan | 16 | 14 | 3 | 12 | 2 | 10 |
| Iraq | 14 | 8 | -1 | 15 | 5 | 10 |
| Ceylon | 14 | 9 | 2 | 12 | 5 | 7 |
| Philippines | 14 | 8 | -1 | 15 | 6 | 9 |
| Jordan | 14 | -- | 21 | -6 | - | -- |
| Morocco | 12 | 8 | 1 | 10 | 3 | 7 |

Source: United Nations, World Economic Survey, 1965 (New York: 1966), p. 57.

diversity of expansion in both the level and the pattern of saving. Moreover the volume of savings available for financing investment in underdeveloped countries is characterized by marked country-to-country differences, a high, though widely varying dependence on foreign sources. Foreign saving has generally contributed significantly to the total supply of saving and this is also pictured in Table 16.

## Foreign Capital

When domestic savings have not been adequate, foreign capital has played a vital role in the economic development of many countries, and is an important supplement to the meager resources of underdeveloped countries. As Professor Higgins pointed out:

> It is doubtful whether many of them can raise the additional capital resources they need without some foreign aid of foreign investment.[31]

The need for external capital arises not only because of inadequate resources but also because of balance of payment difficulties and exchange shortages. In the initial stages of development, underdeveloped nations need a large volume of imports to pay for all the imports necessary for their development. Until their industries producing export goods are expanded or capital goods industries are developed at home to meet a significant portion of their requirements, foreign capital is necessary to hasten economic progress. Foreign capital may also ease social pressures in speeding up the rate of development.

In the nineteenth century, international investment

---

[31] Benjamin Higgins, Economic Development: Principles, Problems, and Policies (New York: W. W. Norton and Company, Inc., 1959), p. 569.

played a large part in the development of the economies of the United States, Canada, Australia, and New Zealand.

> The development of the new countries required large capital expenditure on the building of railways, the sinking of mines, the draining of marshes, the erection of towns, and the pace of the development would necessarily have been greatly retarded if these countries had to depend upon their own resources for the savings and the capital equipment requisite for these purposes. . . . It enabled them, in other words, to share the gains of the industrial revolution.[32]

The United States depended very largely on foreign investment in the nineteenth century and one can observe a certain co-relationship between its increase in foreign investment with the rise in national wealth. Lewis has stated:

> By 1803 the country's foreign obligations of all kinds had increased to approximately 75 million dollars, and by 1843 were no less than 225 millions . . . by the end of the century, and at the outbreak of the World War they had reached the peak figure of 7.2 billions . . . reaching an all-time high of almost 9 billion dollars in 1929. . . . The national wealth for 1790 was estimated at 750 million dollars, and for 1840 was "officially" estimated at 3,764 millions. . . . In 1850 was 7.1 billion dollars. . . . At the outbreak of the World War the wealth of the country had increased to about 212 billion dollars. For 1929 it was estimated at about 460 billion.[33]

The need for foreign capital has been realized not only by the underdeveloped countries themselves but

---

[32]Royal Institute of International Affairs, The Problem of International Investment (London: Oxford University Press, 1937), p. 3.

[33]Cleona Lewis, America's Stake in International Investments (Washington, D.C.: The Brookings Institution, 1938), pp. 152-153.

also by many developed countries in the world. The developed countries have initiated programs to help the underdeveloped countries not only for political reasons but also for the promotion and progress of the underdeveloped economies. As an example, the United States during President Truman's administration started the Point Four Program. This program envisaged governmentally financed assistance in public health, education, and agriculture, but for other activites it relied on private capital as a complement to public assistance.[34] The Colombo planners asserted that:

> The strengthening of their economies through the resumption of a large scale of flow of capital is essential to any permanent increase in productivity and living standards of the people. . . . It is because this is a world problem of the first magnitude and not purely a regional or national one, that the Commonwealth Governments have framed this report for the World's Consideration.[35]

At present time, there are several different sources from which external capital could be available--private foreign investment, intergovernmental lending, foreign aid and loans and aids from international agencies.

By far the largest source of foreign capital in the past has been through private investment. These were

---

[34]"The Contribution of Private Foreign Capital-Note," Leading Issues in Development Economies, Gerald M. Meier, Editor (New York: Oxford University Press, 1964), p. 149.

[35]Frederic Benham, "Colombo Plan," Economica, Volume 21 (May, 1954), p. 95.

largely undertaken through profit motives of foreign investors and they largely went into agricultural pursuits and exploitation of mineral resources--with the production primarily exported to advanced nations. This can be illustrated by American foreign investment:

> Investment in the three years 1947 to 1949 . . . we see, first, that 92 per cent of it took the form of direct business investment and, secondly, that 78 per cent of this direct investment went to underdeveloped countries. This seems very good, but we must notice, thirdly, that over 90 per cent of the direct investment in underdeveloped countries went into petroleum production.[36]

Table 17 is a preliminary estimate of United States private direct investments abroad by region and industries.

The direct investment in 1967 was $59,267 million and of this total over 40 per cent was in manufacturing. The petroleum industry and the rest of the investment industries had less than 30 per cent each. This shift coupled with "the pattern of economic development and the technical proficiencies of American business have made Europe the favorite area and manufacturing the favorite type of investments."[37]

The total investment is not distributed evenly among the areas. The largest share of this total was

---

[36]Nurkse, Problems of Capital Formation in Underdeveloped Countries, pp. 82-83.

[37]United States Department of Commerce, "Survey of Current Business," Vol. 48 (October, 1968) (Washington, D.C.: Government Printing Press, 1968), p. 21.

TABLE 17

DIRECT INVESTMENTS ABROAD BY
REGION AND INDUSTRIES FOR 1967
(MILLIONS OF DOLLARS)

| Region | Total | Mining and Smelting | Petroleum | Manufacturing | Public Utilities | Trade | Other |
|---|---|---|---|---|---|---|---|
| Canada | 18,069 | 2,337 | 3,819 | 8,083 | 506 | 1,032 | 2,292 |
| Latin America | 11,921 | 1,649 | 3,502 | 3,572 | 665 | 1,299 | 1,234 |
| Europe | 17,882 | 61 | 4,404 | 9,781 | 78 | 2,055 | 1,504 |
| Africa | 2,277 | 398 | 1,232 | 369 | 3 | 148 | 128 |
| Asia | 4,282 | 43 | 2,599 | 986 | 76 | 321 | 257 |
| Oceania | 2,515 | 322 | 591 | 1,332 | 2 | 139 | 127 |
| International Shipping | 2,321 | --- | 1,264 | --- | 1,058 | --- | --- |
| TOTAL | 59,267 | 4,810 | 17,410 | 24,124 | 2,387 | 4,995 | 5,541 |

Source: United States, Department of Commerce, "Survey of Current Business," Vol. 48 (October, 1968), (Washington, D. C.: Government Printing Office, 1968), p. 24.

invested in Canada, then Europe and Latin America. The total investment in these three areas in 1967 amounted to $47,872 million--over 80 per cent of the total. The rest went to the other areas. The Middle East received $1,748 million and out of this amount $1,607 million (90 per cent) was invested in the petroleum industry.[38]

Even if the required amounts of private foreign investments were available, the type of present United States investments would not effectively achieve the form of development contemplated by the underdeveloped countries. Investment in agriculture and minerals are helpful in stimulating development but a re-channeling of investments to different areas would be more helpful.

The main problem is that even those investments are not available on a large scale. Foreign investments are influenced by non-economic considerations such as racial and political affinities, and the geographical situation of the borrowing countries. Some obstacles may include lack of political stability, the existence of discriminatory practices against foreign investment, and the possibility of nationalization. Among other reasons, as Professor Benham says:

> The foreign investor is still rather wary of tying his capital in the East. There is a risk of war or revolution or other disturbances or his property may be damaged or confiscated. There is the risk

---

[38] Ibid., p. 24.

> that the government may depreciate the currency, or impose special taxes on foreign capital or block his profit or control his prices or compel him to employ a number of their nationals in managerial posts and so forth.[39]

Since private foreign capital will not fill the gap between the capital requirements and the potential domestic investment in the underdeveloped countries, Higgins maintains that some role--probably a substantial one--will remain for foreign aid.[40]

A source through which the underdeveloped countries can secure a loan is the International Development Association (IDA). This agency grants loans in dollars and other hard currencies that can be paid back in the currencies of the developing nations themselves. Table 18 shows the credit that was extended by IDA for by mid-1967.

The underdeveloped countries may secure foreign aid from other international agencies such as the World Bank; the International Monetary Fund; and the International Finance Corporation. The International Bank for Reconstruction and Development (World Bank) was established in 1944 and was supposed to lend funds for development projects on the basis of strict banking principles. Loans were supposed to be more or less self-liquidating, and they were offered at relatively high rates of

---

[39]Benham, Colombo Plan, p. 107.

[40]Higgins, Economic Development: Problems, Principles, and Policies, p. 595.

TABLE 18

INTERNATIONAL DEVELOPMENT ASSOCIATION CREDIT
BY PURPOSE AND AREA, JUNE 30, 1967
(MILLIONS OF U.S. DOLLARS)

| Purpose | Total | Africa | Asia and Middle East | Europe | Western Hemisphere |
|---|---|---|---|---|---|
| Grand Total | 1,694.2 | 235.7 | 1,269.2 | 80.6 | 108.7 |
| Electric Power | 108.2 | -- | 67.5 | 25.7 | 15.0 |
| Transportation | 567.8 | 108.8 | 381.4 | -- | 77.6 |
| Tele Communications | 74.8 | -- | 74.8 | -- | -- |
| Agriculture, Forestry, and Fishing | 283.4 | 41.4 | 208.9 | 20.0 | 13.1 |
| Industry | 501.3 | -- | 466.4 | 34.9 | -- |
| Water Supply | 43.8 | 1.1 | 39.7 | -- | 3.0 |
| Educational Projects | 113.5 | 84.0 | 29.5 | -- | -- |
| Engineering Loans | 1.5 | 0.5 | 1.0 | -- | -- |
| General Development | -- | -- | -- | -- | -- |

Source: World Bank and IDA, Annual Report 1966-67 (Washington, D.C., 1967), p. 66.

interest.[41] Enke points out that the World Bank's operations have been limited by:

> First, it can lend only to or with the approval of a member government. . . . Secondly, its loans are for particular projects. . . . Third, its loans are normally limited to the so-called foreign exchange component of the project.[42]

With all those limitations on it, the overall impact of

---

[41]Robert J. Alexander, A Primer of Economic Development (New York: The Macmillan Company, 1962), p. 127.

[42]Stephen Enke, Economics for Development (Englewood Cliffs, N.J.: Prentice Hall, Inc., 1963), pp. 493-494.

the Bank as a means of channeling capital has been significant. By mid-1967 it had made loans aggregating to $10,442.1 million to various countries and projects as is shown in Table 19.

The International Finance Corporation (IFC) is another source for helping the underdeveloped countries. The IFC assists the underdeveloped countries in helping to promote the growth of the private sector in their economies. The IFC works exclusively in the private sector. It makes loans to private borrowers with government guarantee in which the concern resides and operates. The commitment of IFC during 1966-67 was $49.1 million.[43]

Besides these agencies, the underdeveloped countries have received aid from various developed countries. In this section, the stress will be only on United States aid and Soviet aid.

The United States has been for many years by far the most important contributor to the economic development of the underdeveloped countries. The current United States foreign aid includes the following:

> Long-term development loans (Payable in dollars; "Food for Peace" (disposal of agricultural surpluses abroad on easy terms); Export-Import Bank (assists exports with loans and political risk coverage); Private Investment opportunity surveys

---

[43]World Bank and IDA, <u>Annual Report 1966-67</u> (Washington, D.C., 1967), p. 5.

TABLE 19

WORLD BANK LOANS BY PURPOSE AND AREA, JUNE 30, 1967
(MILLIONS OF U.S. DOLLARS)

| Purpose | Total | Africa | Asia and Middle East | Austraila-Asia | Europe | Western Hemisphere | IFC |
|---|---|---|---|---|---|---|---|
| Electric Power | 3,588.9 | 428.3 | 766.7 | 182.3 | 592.3 | 1,619.3 | -- |
| Transportation | 3,446.0 | 566.7 | 1,552.7 | 181.4 | 404.9 | 740.2 | -- |
| Te Le Communications | 128.2 | 22.2 | -- | -- | .2 | 105.8 | -- |
| Agriculture, Forestry and Fishing | 802.4 | 95.1 | 282.4 | 103.4 | 87.8 | 233.6 | -- |
| Industry | 1,596.7 | 193.0 | 799.5 | 52.7 | 441.2 | 110.2 | -- |
| Water Supply | 52.2 | -- | 27.0 | -- | 3.9 | 21.3 | -- |
| Education Projects | 24.3 | -- | 12.0 | -- | -- | 12.3 | -- |
| Engineering Loans | 1.7 | 1.7 | -- | -- | -- | -- | -- |
| General Development | 205.0 | 40.0 | 75.0 | -- | 90.0 | -- | -- |
| Post-War Reconstruction | 496.8 | -- | -- | -- | 496.8 | -- | -- |
| Financing Loan (IFC) | 100.0 | -- | -- | -- | -- | -- | 100.0 |
| Grand Total | 10,442.1 | 1,347.0 | 3.515.4 | 519.8 | 2,117.2 | 2,842.7 | 100.0 |

Source: World Bank and IDA, Annual Report 1966-67 (Washington, D. C.: 1967), p. 66.

(to encourage the flow of private funds into backward countries); Development grants for technical assistance (mostly to improve human quality, make resource surveys, and to establish necessary institutions); Peace Corps (an attempt to apply American Youth and Idealism usefully in service abroad); Development research (learning how to spend money profitably and avoid past mistakes).[44]

Since 1961, all these activities except the Export-Import Bank and the Peace Corps have been administered by the Agency for International Development (AID).

No doubt every country that was given aid has desired objectives for the channeling of its funds and the United States is no exception. It has been stated that U.S. aid programs are designed to promote world conditions which will permit this nation (the United States) to survive, to progress, and to prosper, in a setting of peace and its fundamental human values, safely secured. However, these objectives have varied often in response to international conditions which prevailed at a particular time. In pursuit of the goals stated, the U.S. aid program has become a major instrument of its foreign policy directed toward furthering the U.S. national interest.[45]

The U.S. AID funds to developing countries for fiscal year 1966, 1967, and 1968 is shown in Table 20.

---

[44]Enke, Economics for Development, p. 508.

[45]Leo Tansky, U.S. and U.S.S.R. Aid to Developing Countries (New York: Frederick A. Praeger, Inc., 1967), p. 1.

There is a concentration on development loans and technical assistance. Therefore, military and supporting assistance programs are excluded.

TABLE 20

DEVELOPMENT ASSISTANCE BY REGION
(MILLIONS OF U.S. DOLLARS)

| Region | Fiscal Year 1966 Actual | Fiscal Year 1967 Estimated | Fiscal Year 1968 Proposed |
|---|---|---|---|
| Grand Total | 1482 | 1345 | 1747 |
| Development Loan Total | 1232 | 1089 | 1440 |
| Near East and South Asia | 576 | 444 | 686 |
| Africa | 70 | 90 | 90 |
| Latin America | 506 | 470 | 578 |
| East Asia (Excl. Vietnam) | 80 | 85 | 86 |
| Technical Assistance Total | 250 | 256 | 308 |
| Near East and South Asia | 44 | 42 | 47 |
| Africa | 81 | 85 | 91 |
| Latin America | 89 | 95 | 115 |
| East Asia (excl. Vietnam) | 36 | 44 | 55 |

Source: AID, Proposed Foreign Aid Program, 1968 (Washington, D.C.: Government Printing Office, 1968), p. 245.

As was indicated earlier, AID does not deal exclusively with providing development loans and technical assistance. It handles other programs--Alliance for Progress, supporting assistance, sales of surplus agricultural products and even the appropriation of military assistance is included in its budget. All of these programs are designed to help the underdeveloped countries build a better life and are central to the U.S. foreign policy objective of helping to establish a stable and peaceful world.[46]

The development loans enable recipients to import U.S. goods and services essential to development which they cannot afford to buy with their own scarce foreign exchange. AID loans finance such essential needs as irrigation works, private industrial facilities, fertilizer imports and plants, power plants, raw materials, equipment and spare parts.[47]

Another important component of AID's program is a provision for technical assistance. This is essentially a program for the exchange of technical knowledge and skills. The agency sends specialists abroad to help train local technicians, and it brings individuals from developing countries to the U.S. for advanced study or observation of agricultural, industrial, and administrative techniques. This is provided without charge to the recipient country. The cost of technical services and project equipment is provided as a grant-in-aid.[48]

The supporting assistance program has varied from year to year and the appropriation for this program

---

[46] AID, Proposed Foreign Aid Program FY 1968 (Washington, D.C.: Government Printing Office, 1968), p. 243.

[47] Ibid., p. 245.

[48] Tansky, U.S. and U.S.S.R. Aid to Developing Countries, p. 22.

depends on the world situation. The appropriation request for this program in the fiscal year of 1968 was $720.0 million. Out of the total, AID proposed to commit 141 million dollars for long-range development purposes.[49]

Yet another program provides for the sale of agricultural surplus--authorized under the Agricultural Trade Development and Assistance Act of 1954 (P.L. 480)--it permits the sale of surplus commodities for local currencies and the lending or granting of these currencies for military and economic aid purposes. P.L. 480 provides for the disposal of agricultural surplus commodities in several ways.[50]

> Under Title I, they can be sold for foreign currencies. Under Title II, they can be used to furnish famine relief and other emergency assistance. Under Title III, they can be denoted to nonprofit voluntary bodies for assistance to individuals outside the U.S. Under Title IV, they can be sold for dollars under long-term credit agreement between foreign governments and U.S. and foreign private trade entities.

The foreign currencies obtained from the sale can be used for three major purposes.

> Loans and grants for economic development and grants for military purposes; loans to private Americans and, in certain cases, foreign enterprises; and administrative expenses of U.S. Government posts in recipient countries, marketing programs, exchange programs, and other similar purposes.[51]

---

[49] AID, _Proposed Foreign Aid Program FY 1968_, p. 242, 245.

[50] Tansky, _U.S. and U.S.S.R. Aid to Developing Countries_, pp. 23-24.

[51] _Ibid._, p. 24.

Besides these, the Export-Import Bank provides another source of lending to underdeveloped countries. It is an important source of medium-and-long term loans to purchase capital goods, raw materials, and technical services. During the fiscal year which ended on June 30, 1968, the bank's authorization of loans during the year amounted to $3,534.1 million. The distribution of these loans by area is shown in Table 21. An important function of the Bank is to guarantee U.S. exporters against losses from political risks in friendly countries.

The U.S.S.R. has entered the field of economic aid to the underdeveloped countries. The U.S.S.R. started its aid in 1954 and since then has increased its programs tremendously. The U.S.S.R. has extended credits with favorable terms and does not require that the loans be repaid in foreign currency. This relieves the currencies difficulties of the economically underdeveloped countries. Usually a financial aid agreement provides a line of credit for specific projects subsequently agreed upon. Occasionally, a major agreement is concluded for a specific project, as for example, the Aswan Dam in the United Arab Republic. The total aid extended by the U.S.S.R. by the end of 1966, amounted to $4,867 million. Of this amount $867 million was extended in 1966.

Having discussed the aid of the two major powers, Table 22 presents the net official flow of external

TABLE 21

EXPORT-IMPORT BANK AUTHORIZATION BY AREA
JULY 1, 1967 THROUGH JUNE 30, 1968
(IN U.S. DOLLARS)

| | Credits | Guarantees | Medium Term Insurance | Short Term Insurance (Shipments) | Total |
|---|---|---|---|---|---|
| Africa | 53,081,345 | 28,005,593 | 3,220,293 | 34,321,943 | 118,629,174 |
| Asia | 373,315,361 | 47,623,876 | 16,866,259 | 62,761,472 | 500,566,968 |
| Canada | 500,175,000 | 3,001,863 | 181,700 | 5,604,641 | 538,963,204 |
| Europe | 604,435,950 | 16,563,478 | 4,475,949 | 197,131,637 | 822,607,014 |
| Latin America | 312,599,046 | 173,475,413 | 70,959,430 | 205,287,078 | 762,320,967 |
| Oceania | 255,118,129 | 21,394,629 | 1,127,691 | 24,927,478 | 302,567,927 |
| Miscellaneous | 397,570,774 | -- | -- | -- | 397,570,774 |
| Sub Total | 2,526,295,605 | 290,064,852 | 96,831,322 | 530,034,249 | 3,443,226,028 |
| Short Term Insurance (Authorized but unshipped) | -- | -- | -- | 90,896,324 | 90,896,324 |
| Total Authorization | 2,526,295,605 | 290,064,852 | 96,831,322 | 620,930,573 | 3,534,122,352 |

Source: Export-Import Bank, _34th Fiscal Year-End Report, 1968_ (Washington, D. C.: Government Printing Office, 1968), p. 37.

TABLE 22

INTERNATIONAL AID FROM THE DEVELOPED ECONOMIES
TO UNDERDEVELOPED REGIONS, FOR 1961-65
(MILLIONS OF U.S. DOLLARS)

| | (1) 1961 Bilateral Grants | Loans | 1961 Multi-lateral | (2) 1962 Bilateral Grants | Loans | 1962 Multi-lateral | (2) 1963 Bilateral Grants | Loans | 1963 Multi-lateral |
|---|---|---|---|---|---|---|---|---|---|
| Latin America | 338 | 479 | -49 | 338 | 449 | 69 | 428 | 382 | 287 |
| Africa | 1243 | 289 | 122 | 1335 | 297 | 146 | 1200 | 351 | 116 |
| Asia and Pacific Island | 1777 | 336 | 125 | 1790 | 436 | 194 | 1790 | 783 | 211 |
| Total Above | 3358 | 1104 | 198 | 3463 | 1182 | 409 | 3418 | 1517 | 614 |
| Net Inter-Regional Disbursements | 164 | 4 | 26 | 220 | 40 | 6 | 231 | 25 | 30 |
| Unallocated | 64 | 1 | -- | 71 | -- | -- | 86 | -- | -- |
| Total, all Developing Countries | 3584 | 1109 | 224 | 3755 | 1220 | 45 | 3734 | 1542 | 644 |

TABLE 22 (continued)

| Region | (2) 1964 Bilateral Grants | Loans | 1964 Multilateral | (2) 1965 Bilateral Grants | Loans | 1965 Multilateral |
|---|---|---|---|---|---|---|
| Latin America | 539 | 142 | 316 | 488 | 350 | 160 |
| Africa | 1221 | 359 | 189 | 1120 | 364 | 230 |
| Asia and Pacific Island | 1818 | 853 | 217 | 1839 | 965 | 424 |
| Total Above | 3577 | 1354 | 722 | 7447 | 1678 | 815 |
| Net Inter-Regional Disbursements | 108 | 39 | 12 | 168 | 11 | 11 |
| Unallocated | 100 | 4 | -- | 118 | 7 | -- |
| Total, all developing Countries | 3786 | 1397 | 734 | 3732 | 1696 | 826 |

(1) Source: United Nations, Statistical Year Book, 1965 (New York, 1966), pp. 686-689.

(2) Source: United Nations, Statistical Year Book, 1967 (New York, 1968), pp. 695-696.

resources to the underdeveloped regions from the developed market economies and from multilateral agencies, for 1961-1965.

However, the foreign capital needs for any country will depend on many factors such as the balance of payments, requirements of foreign exchange, provision of domestic capital and the rate of development contemplated. Syria's need for foreign capital has been put at SP 2,579 million for the next ten years (1960-1970).

The above statement expresses only the demand side of foreign capital. The important point is whether this amount will be forthcoming from foreign countries. It may well depend on the international situation and the attitude of lending countries. This may be the case--the West has not pledged itself toward the fulfilling of the desired goal for each individual country. The West has not committed itself as the United States did to Western Europe when it instituted the Marshall Plan. Barbara Ward sums this argument by comparing the U.S. Marshall Plan for the reconstruction of Europe and the pledges of Western powers to India which may well be applicable to almost all underdeveloped countries. In her comparison she said:

> When United States pledged itself to the Marshall Plan, it did not undertake a provisional program of half-measure designed to get Europe round the next series of awkward corners. It undertook a full recovery program with the specific aim of restoring

> Europe's productive mechanism to working order. The financing of the plan--overwhelmingly by direct grants--was geared to this final purpose. It was not a minimum sum for an operation of bailing out but a considered estimate of the full resources needed to finish the job. This is the element that is wholly lacking Western reactions to the Indian plans. The Western powers have not committed themselves to the aim of seeing that India's plan succeeds. They have done no more than half-guarantee that it will not be allowed wholly to fail. . . . There are no conditions in which a half-effort is the equivalent of no effort.[52]

## Fiscal Policy and Economic Development

### The Role of the State

Taking the previous discussion into account, it appears that under existing conditions that the primary initiative for development has to be taken by the state. A function of government is that it endeavors to arrange its affairs so that its citizens are encouraged to cooperate for the good of the country. The choice of economic development has compelling factors--economic, political and social, which are present in their economies. It is not only one thing that the state has more than one correction--a whole set of institutional and educational re-orientation has to be undertaken. Individuals left to themselves will not save enough--too, they fail to recognize the meaning of development, and the future which it promises.

---

[52]Barbara Ward, India and the West (London: Hamish Hamilton, 1961), p. 205.

In the past, private enterprise has played the most important part in the development processes in the capitalist countries. The favorable results were obtained through experimentation, and trial and error, and their successes were not overnight.

> In an underdeveloped country the problem is largely one of utilizing the experience of other countries. Thus Russia, between the two wars, was able to move ahead rapidly because she started far behind the established levels of the more advanced countries and could take over, without the costs of trial and error, the advanced technology of the Western World.[53]

Russian development required comprehensive planning for resource allocation--and this was largely achieved by the State. Left to private initiative, it might have taken much longer.

History teaches many things concerning the development process. In Japan between 1868 and 1879, the government took the lead in erecting all sorts of facilities to spur industrialization. The Japanese government began building the social overhead capital utilizing existing techniques and by doing so the Japanese government reduced the time required to industrialize by several decades. The State had taken the initiative and dominated the development process, because necessary development was of such a nature that unless the State had taken the initiative, it would have been almost

---

[53] W. L. Thorp, "Some Basic Policy Issues in Economic Development," American Economic Review, Vol. 41 (May, 1951), p. 412.

impossible for private capital to have accomplished the desired result.

The process of economic development in the underdeveloped countries largely depends on the creation of basic utilities (social overhead) such as irrigation, power, flood control, transport and communications, health, education and technical training for the people. The existence of these social necessities in an economy provides the basic conditions for economic development. Professor Adler has pointed out that these facilities create external economies which are an essential prerequisite for private initiative. He further observes:

> It seems to me that the currently fashionable comparisons between the process of development of the now mature countries of Europe and North America with that of the still underdeveloped countries neglect a key issue if they fail to take explicit account of the extent to which external economies have determined the rate of economic growth in various economies. . . . If the rate of economic growth of underdeveloped countries is to be accelerated, main reliance has to be placed on the creation of external economies through the availability of social overhead capital.[54]

Investment in social overhead capital is of such a nature that it cannot be undertaken by private enterprise. Even if the people in a village realize that better irrigation will improve the productivity of agriculture, they do not have the necessary capital. These

---

[54] J. H. Adler, "The Fiscal and Monetary Implementation of Development Programs," American Economic Review, Vol. 42 (May, 1952), pp. 587-590.

works require a hugh amount of capital; there is a time lag between investment and profit; and there may be no tangible profit at all. Too, the private sector may feel that the risk involved in these projects is not worthwhile, especially if there is no foreseeable profit. The state could enforce such a decision and only the state could manage such a project. Taking into consideration the existing social, political and economic factors, Jha said:

> Only the state can borrow, only the State can organize, only the State can set in motion the machinery of development. It must be set in motion and given momentum to the original processes of promotion, financing and operations.[55]

The role of the State in the development of Syria as enunciated in the First Five-Year Plan has stated in part:

> . . . the main aim of the development plan in the Syrian Arab Republic is to start with the development process, which aims at raising the standard of living and widening the horizons for greater opportunities and better life. . . . The fulfillment of the national plan requires the utmost governmental attention and the cooperation of all public, regional and local or otherwise. . . . The aim of economic development is to increase the productive capacity of the community in such a way that it creates the appropriate atmosphere for the growth of those high values and gives every individual the opportunity for self-fulfillment.[56]

---

[55]Divakar Jha, "Fiscal Policy and the Economic Development of Underdeveloped Countries," Indian Journal of Economics, Vol. 37 (July, 1956), p. 94.

[56]Ministry of Planning, "The Syrian Five-Year Plan, 1960-61/1964-65," Damascus, 1961 (Mimeographed), pp.2-3.

The role of the state in the creation of basic utilities in the economy is not a new phenomenon in the case of underdeveloped countries only. Many of the newly developed countries have created the economic substructure on which their economies advanced. What is significant in the case of the presently underdeveloped countries is that to quicken the pace of development these things have to be implemented by the state on a much larger scale than other countries have done in the past.

It is generally agreed that there must be an increase in the volume of public investment--a larger participation by the Government in the process of economic development in any underdeveloped country. An example of current thinking on this point is:

> Perhaps the most striking feature of the capital formation process in the underdeveloped economy is the large and inescapable role that government must play in providing social overhead capital both as a direct instrument of economic development and as prerequisite to increased participation of private capital in the development process.[57]

In the case of Syria, the foregoing has a special significance. Until the time of the establishment of the Seven-year budget for economic development, government participation in the process was very limited and increased very slowly. In fact the private sector at times had to provide many basic services which should have been

[57]Haskell P. Wald, Ed., Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development (Cambridge: Harvard University Printing Office, 1954), p. 64.

furnished by the government. The development of irrigation, for instance, has been left to private enterprise, which provided for the irrigation of 250,000 hectares as compared to only 48,000 hectares irrigated by government irrigation networks.[58]

It was not until 1955 that the Syrian government undertook any long range and integrated program of economic development. All the past public investment programs were undertaken on an individual basis and with no integration in a unified budget. The financing of the various projects executed during the period 1945-1955 was made outside the regular budget. The funds were secured either by the utilization of available treasury funds, or through loans from what was called the Currency Issue Department of the Banque de Syriaet du Liban.

On August 29, 1955, the Syrian Parliament approved the establishment of an extraordinary budget for economic development--SP 660 million--covering seven years, from 1955 to 1961.[59]

Table 23 indicates the various projects in the Seven Year Budget for economic development, along with the amounts allocated to project or groups of projects.

In addition to the projects indicated in Table 23,

---

[58]IBRD, The Economic Development of Syria, p. 23.

[59]Law No. 116 of August 29, 1955.

TABLE 23

CATEGORIES OF INVESTMENT IN SEVEN-YEAR BUDGET FOR ECONOMIC DEVELOPMENT (THOUSANDS OF SYRIAN POUNDS)

| Types of Projects(A) | New Public Projects(B) | Completion of Projects Under Way | Credits and Loans to Public Bodies |
|---|---|---|---|
| Adm. Expenses | 5,150 | -- | -- |
| Studies, Surveys and Censuses | 22,000 | 2,612 | -- |
| Water Resources Projects Irrigation, Hydro-Elect. and wells | 87,500 | 28,880 | |
| Agricultural Settlement and Misc. Agri. Projects | 10,000 | 4,500 | 87,500 |
| Road Construction and Repair | 62,500 | 20,000 | -- |
| Railways | 8,000 | -- | 18,134 |
| Airfields | 27,500 | 1,000 | -- |
| Research and Training Institutes Construction and Equipment | 11,600 | -- | -- |
| Hospitals--construction and Equipment | 7,000 | -- | -- |
| Other Public Buildings | 8,000 | 2,932 | -- |
| Electric Power Auth. | -- | -- | -- |
| Special Program of Ministry of Defense | 45,000 | -- | -- |
| Petroleum Refinery | -- | -- | 80,000 |
| Other | 7,000 | 8,780 | 6,811 |
| TOTAL | 301,250 | 68,704 | 216,946 |

Source: United Nations, Economic Development in the Middle East, 1954-1955 (New York: 1956), p. 130. (a) Not including 73 million Syrian Pounds as Capital for autonomous Public. Projects to be carried out under the Institute of Economic Development.

the budget also provides an amount of SP 73 million to be used in the formation of capital for the public institutions and enterprises mentioned below:

| | SP |
|---|---|
| Latakia Port | 38 million |
| Agricultural Bank | 20 million |
| Industrial Bank | 10 million |
| Real Estate Bank | 5 million |
| Total | 73 million |

Although this type of investment by the government was not directly productive, it was intended to facilitate the extention of credit to those undertakings which would add to the productivity of the economy.

In examining the most significant types of projects and their allocations contained in Table 23, it is obvious that the highest priority is given to projects relating to the utilization of water resources--irrigation, drilling of wells, and the generation of hydro-electricity. A considerable amount is also allocated for projects of agricultural settlement. The total allocation for these projects amounted to SP 218.4 million, more than one-third of total budget allocations. This is very significant. The prosperity of the Syrian economy depends in large measure upon the prosperity and expansion of agriculture. In addition to directly benefiting the agricultural sector of the economy, these projects contribute to the overall productivity of the economy by providing new additional hydro-electric power.

Communication projects are next on the scale of priorities. Allocations for road construction and repair, railways, and airfields amount to about SP 137.2 million, or little less than one-fourth of total budget allocations.

A new government agency, the Institute of Economic Development, was set up to implement the Seven-Year Plan. Autonomous both financially and administratively, it was charged with implementing all new projects in the program, amounting to SP 301 million. Projects started previously were to be completed by Government agencies which had originally undertaken them.

The development budget also included the sum of SP 217 million for loans and credits to be provided by the government to various autonomous public authorities, e.g., the Ghab Project Administration, which is in charge of land and development projects. Other loans and credits were to be extended for a new petroleum refinery and for the Hejaz railways, and various electric authorities.[60]

The financing of this large volume of investment--SP 660 million--was to be secured from the various sources indicated in Table 24.

The most important means of financing--the oil transit revenues--is noted. The estimated amount shown

---

[60]United Nations, Economic Development in the Middle East, 1954-1955 (New York: 1956), pp. 129-130.

TABLE 24

MEANS OF FINANCING THE SEVEN-YEAR BUDGET
FOR ECONOMIC DEVELOPMENT IN SYRIA
(THOUSANDS OF SYRIAN POUNDS)

| Sources of Financing | Amount |
|---|---|
| Contribution of Ordinary Budget, Total Six Years | 90,000 |
| Contribution of Oil Transit Revenues | 155,000 |
| Contribution of Reserve Funds | 68,954 |
| Proceeds of "Palestine Stamp" | 17,000 |
| Saving Realized from Liquidation of Certain Accounts | 5,000 |
| Domestic Loans | 34,000 |
| Loans from International Bank for Reconstruction and Development | 77,000 |
| Sales of Treasury Bonds, Loans from Banque de Syria et du Liban and Available Treasury Funds | 212,946 |
| TOTAL | 695,900 |

Source: United Nations, Economic Development in the Middle East, 1954-1955 (New York: 1956), p. 131.

is not complete--it excludes the fees expected as a result of the new agreement between the Syrian Government and IPC. The expected total amount was estimated to be SP 600 million during the period 1956-1961.[61] The importance of this method of financing is twofold--the volume, and as a source of foreign exchange needed during the execution of the Seven-Year Budget.

[61] Ibid., p. 131.

It will be noted that a heavy reliance was placed on public borrowing and the sale of treasury bonds and securities. This was the first time the government attempted to borrow directly from the public.

The entire plan was replaced in September, 1958 by a new ten-year plan for the development of the resources of Syria (Table 25). The plan, which extends over the period July, 1958 to June, 1968, envisages the expenditure of SP 2140 million of which SP 535.5 million is to be financed by loans from abroad. The ten-year plan de-emphasizes construction projects and emphasizes irrigation, electricity and communication projects. The aim is a greatly expanded framework of social overhead capital within which private economic growth in agriculture, industry and services could take place. The sources of funds for financing the ten-year development plan are shown in Table 26.

The contribution of the budget is not a new phase in contributing to the development plan. However, there are two new features of financing. The two new features of the method of financing are the loans from abroad and the revenue from completed projects, the latter accounting for almost half the total revenue. The loans from abroad is a new feature, because Syria did not contract loans from abroad before 1957, with the exception of the two loans that were provided to Syria from Saudi Arabia

TABLE 25

PUBLIC EXPENDITURE ON THE TEN-YEAR PLAN, 1958-1967
(MILLIONS OF SYRIAN POUNDS)

| Types of Expenditure | Amount |
|---|---|
| Irrigation and Hydro-electricity | 1399 |
| Other Agricultural Projects | 32 |
| Public Water and Electricity Projects | 28 |
| Transport and Communications | 365 |
| Construction | 2.5 |
| Industry and Equipment | 130 |
| Geological Surveys and Mineral Prospecting | 30 |
| Tourism | 30 |
| Administration and Miscellaneous | 25 |
| TOTAL | 2041.5 |

Source: Institute of Economic Development, The Ten-Year Plan, 1958-1967 (Damascus: Hashimite Press, 1959), p. 382.

TABLE 26

SOURCES OF FINANCING THE TEN-YEAR PLAN, 1958-1967
(MILLIONS OF SYRIAN POUNDS)

| Sources of Finance | Amount |
|---|---|
| General,Budget, and Borrowing from Central Bank and Public | 838.9 |
| Revenue from Completed Projects | 1320.0 |
| Loans from Abroad | 535.5 |
| Sub-Total | 2694.4 |
| Less Repayments of Loand and Interest | 652.9 |
| TOTAL | 2041.5 |

Source: Institute of Economic Development, The Ten-Year Plan, 1958-1967 (Damascus: Hashimite Press, 1959), pp. 383-386.

in 1950. The revenue from completed projects is expected to come mainly from the large irrigation projects, such as the Euphrates and the Ghab, in the forms of rent or sale of land and of water dues and also from the rail-ways and oil refinery. The projects, their cost and expected source of finance, as given by the ten-year plan, are shown in Table 27.

It seems that the ten-year plan did not achieve the objectives of the new regime, and as a result of this disappointment, their government set aside the ten-year plan and began a new phase in economic planning. The result was the First-Five Year Plan, 1960-1961-1964-65. The Government decided to entrust economic planning with the task of combating elements of stagnation and initiating a series of new investments. The execution of the new plan was entrusted to the Ministry of Planning instead of the Institute of Economic Development. The objective of the plan was to double the national income by planning a 7.2 per cent yearly increase.

The investment needed for the execution of this plan was estimated at SP 2,720 million. Table 28 shows the planned distribution of this total investment by major sector and the source of financing. Concentration of investment will be on agriculture, transport and communi-cations, and in industry.

The total investment of SP 2,720 million is shared

TABLE 27

THE TEN-YEAR PLAN, 1958-1967 COST AND SOURCES OF FINANCE (MILLIONS OF SYRIAN POUNDS)

| Projects | Total Cost | General Budget and Domestic Borrowing Net | Revenue from Completed Project | Loans from Abroad |
|---|---|---|---|---|
| Administrative Expenditure | 15 | -- | -- | -- |
| Technical and Vocational Training Agriculture Hydroelectricity | 10 | -- | -- | -- |
| Euphrates River | 40 | -- | 610 | 250 |
| Khabour River | 75 | -- | 48 | 1 |
| Ghab-Ashame | 100 | -- | 160 | 23 |
| Upper Orontes River | 20 | -- | 8 | 1 |
| Electricity from the Orontes | 28 | -- | 20 | 15 |
| Al-Kabir River | 20 | -- | 8 | 8 |
| Rouj | 4 | -- | 12 | -- |
| Sinn River | 8 | -- | 14 | -- |
| A'waj River-Banias | 4 | -- | -- | -- |
| Yarmuk River | 8 | -- | -- | 3 |
| Well-Drilling and Desert Dams | 29 | -- | -- | 9 |
| Agricultural Laboratory | 2 | -- | -- | 1.5 |
| Afforestation | 1 | -- | -- | -- |

TABLE 27 (continued)

| Projects | Total Cost | General Budget and Domestic Borrowing Net | Revenue from Completed Project | Loans from Abroad |
|---|---|---|---|---|
| Study and Implementation of Misc. Irrigation Works | 5 | -- | -- | -- |
| Barada River and Others | 15 | -- | 19 | 1 |
| Communications: | | | | |
| Railways and Complementary Works, Including Cereals Storage | 250 | -- | 100 | 165 |
| Airport | 50 | -- | -- | -- |
| Bridges | 15 | -- | -- | 3 |
| New Public Roads | 50 | -- | -- | -- |
| Geological map, Topographical Work and Prospecting for Oil and Minerals | 30 | -- | -- | -- |
| Tourism | 30 | -- | -- | -- |
| Industrialization: | | | | |
| Industrial Bank, Chemical and Fertilizers | 60 | -- | 21 | 36 |
| Oil Refinery, Tanks and Working Capital | 70 | -- | 200 | -- |

TABLE 27 (continued)

| Projects | Total Cost | General Budget and Domestic Borrowing Net | Revenue from Completed Project | Loans from Abroad |
|---|---|---|---|---|
| Flood Control Hama | 2.5 | -- | -- | -- |
| TOTAL | 2041.5 | 186 | 1320 | 535.5 |

| | |
|---|---|
| INTEREST: | |
| On domestic loans | 15 |
| On foreign loans (during period of plan) | 83.4 |
| On foreign loans (reserves) | 46.1 |
| REPAYMENTS: | |
| On foreign loans (during plan period) | 165 |
| On foreign loans (reserves) | 343.4 |
| Total | 652.9 |

Source: Institute of Economic Development, The Ten-Year Plan, 1958-1967 (Damascus: Hashmite Press, 1959), pp. 383-385.

TABLE 28

DISTRIBUTION OF INVESTMENT BY SECTOR AND SOURCE OF FINANCING DURING 1960-61-64-65 (MILLIONS SYRIAN POUNDS)

| Sector | Local | Foreign | Total |
|---|---|---|---|
| Agriculture | 827 | 273 | 1,100 |
| Industry, Electricity, Mining and Petroleum | 148 | 361 | 509 |
| Transport and Communication | 238 | 299 | 537 |
| Education | 72 | 28 | 100 |
| Services | 210 | 264 | 474 |
| TOTAL | 1,495 | 1,225 | 2,720 |

Source: Ministry of Planning, "The Syrian Five Year Plan for Economic and Social Development," Syria, 1962 (Mimeographed), p. 29.

both by the public and the private sector. The share of the public sector during the five years amounted to SP 1989 million and that of the private sector amounted to SP 731 million. The private sector shared in all the sectors except education and industry, electricity, mining and petroleum, which were in the public sector alone.

In 1966, Syria started its second five year plan which will end in 1970. The investment needed for the execution of this plan was estimated at SP 4,955 million for both the public and private sector of the economy. The investment for the private sector was estimated at SP 1,500 million and the public SP 3,454 million. The foreign currency needed during this period was estimated at SP 1,938 million. As usual the agricultural sector was given first priority, followed by communications. Industry still ranked third and services fourth. Thus the second five year plan is typical of the first year in the assignment of priorities with one exception--that is the increased reliance on foreign loans to finance the plan.[62]

There is no way to forecast the sufficiency or insufficiency of future foreign investment. Any decline in the share of private investment will hopefully be offset by a rise in public investment--and present evidence supports this concept.

The actual result of planned expenditure by the government on development projects will depend to a considerable extent on the volume of funds left over from public revenues after the necessary requirements have been met. In the present political climate, development expenditures are necessarily a residual item, despite the enactment of plans.

The size of this residual item will depend on several factors, most of which are unpredictable. One of them is the change in the requirements of the armed forces. A second important factor is the future volume

---

[62]Ministry of Planning, Second Five-Year Plan, 1966-1970 (Damascus: Government Press, 1966), pp. 23-25.

of revenues from transit fees and other royalties which will be paid by those oil companies that have constructed pipelines across Syrian territory. Any interruption of the oil flow automaticaaly reduces revenue.

A third major factor that influences the size of funds available for public expenditure on development is the amount of credit or grants that Syria acquires from other Countries. At present, it is possible only to speculate on the actual results of the Russian declared intention to offer economic aid to Syria. Perhaps of more importance in the future are the loans to finance projects under either the first or the second five-year plans. An agreement may be concluded but the credit may not be extended.

Finally, the fourth major factor that can influence the size of funds available for development expenditure lies in the field of monetary policy. The funds available to the government for that purpose could be increased through an expansion in the supply of money in an inflationary fashion--through the diversion of private savings towards public projects--or through the restriction of credit available for investment in the private sector and a corresponding expansion credit to the public sector.

## Fiscal Policy

The previous discussion indicates that private savings and foreign capital are inadequate for a smooth and rapid economic development of the underdeveloped countries. To overcome these obstacles, a major emphasis for development has to be placed on efforts through public finance. A policy where the rate of saving is not determined by private preferences but by social policy is desired.

Fiscal policy refers to the use of public finance--where the government through the nature and the level of public expenditure, taxation, and management of the public debt, directly or indirectly influences the allocation of resources. Fiscal policy provides a system which influences the economy in a direction that will emphasize the attainment of a predetermined objective.

Fiscal policy, as any other branches of economics, has experienced a revolutionary development in recent years. Here, as in most other fields, all the recent innovations and developments have been with reference to advanced countries. No systematic and integrated theory of fiscal policy appropriate for an underdeveloped economy has yet been formulated. In this connection Professor Lewis said:

> . . . there is regrettably very little theoretical discussion of the fiscal problems of underdeveloped countries.[63]

The problems of fiscal policy in underdeveloped economies have not been unattended. In recent years, many individuals and international agencies have been studying the

---

[63]Lewis, <u>Theory of Economic Growth</u>, p. 419.

problems. The United Nations in particular has been very active in this field. Too, the United States has sent fiscal missions to a number of countries. As a result of all the attention, knowledge and understanding of the fiscal practices and problems of underdeveloped countries has significantly increased since World War II.

But, even in advanced economies the concept of fiscal policy and the theory of the relation of fiscal policy to the working of the national economy are of fairly recent origin. The use of fiscal policy as a regulator of economic activity has increased since the great depression of the 1930's:

> During the depression years of the thirties the theory of fiscal policy developed, as an outgrowth of the long and severe depression and the relative failure of monetary policy to bring recovery. . . . By 1954 there was a substantial literature on the question and widespread acceptance of certain basic tenets of fiscal policy.[64]

In underdeveloped countries, there was no conscious attempt to influence the economy through fiscal action. In Syria, until recently, fiscal policy meant tariff policy to give protection to certain manufacturers. The efforts of the Nationalists were directed mainly towards winning protection for domestic manufacturers against foreign imports. However, this does not imply that the Syrian Government did not participate in the

---

[64] John F. Due, Government Finance (Illinois: Richard D. Irwin, Inc., 1959), p. 537.

process of capital formation of the country. Indeed, a substantial volume of public expenditure was undertaken for purposes of investment, especially after 1955.

The great importance of fiscal policy in many underdeveloped countries arises because the state is called upon to play an active role in promoting and accelerating economic development. The reason for this lies in the low ratio of savings to national income. There is another reason why public finance assumes importance in underdeveloped countries. Capital accumulation is the key problem which these countries are called upon to tackle, and the state can be the answer to that problem.

Granted that the need for an increased volume of public investment is recognized and accepted by the Government, the problem then boils down to securing the needed funds for such undertaking. The fiscal system is most important tool in the hands of the government although it is not the only tool. The regulatory power of the government can affect directly or indirectly the process of capital formation. Those powers can be used to provide incentives or restraints to various private investing groups, whether national or foreign.

In the execution of government development programs, the choice of proper fiscal policy is definitely linked to the monetary setting in the country. Thus in formulating a fiscal policy as a tool for economic development certain principles should be followed:

> To correct excessive or harmful inequalities in the distribution of income and wealth, and in doing so to expand international markets and reduce unessential imports;
>
> To counteract the inflation which might result from economic development;
>
> To provide incentives for desirable types of development proceeds and thus help to steer development into desirable directions;
>
> To increase the total volume of savings available for economic development.[65]

Another study by the United Nations concerning the role of fiscal policy in the economic development of underdeveloped countries maintains that the end result of this policy should be:

> . . . economic betterment and stability to provide the material soil within which human dignity and political freedom can grow. Pursuit of this end involves acceptance of the following:
>
> To make available for economic development the maximum flow of human and material resources consistent with minimum current consumption requirements;
>
> To maintain reasonable economic stability in the face of long-run inflationary pressure and short-run international price movements;
>
> To reduce, where they exist, the extreme inequalities in wealth, income and consumption standards which undermine productive efficiency, offend justice, and endanger political stability.[66]

---

[65]United Nations, Methods of Financing Economic Development in Underdeveloped Countries (New York: 1949), p. 15.

[66]United Nations, Taxes and Fiscal Policy in Underdeveloped Countries (New York: 1954), p. 1.

Before discussing the adaptability of the fiscal system in Syria to economic development, a review of the growth of expenditure and debt patterns will be discussed.

Since the termination of the French Mandate and the declaration of independence, the volume of Syrian expenditures has been rising. The reason for this increase is the assumption that the government must have a larger role in economic, cultural and social actions.

The expenditures discussed will cover only those of the ordinary budget of the Syrian government, because of insufficient data on the related and independent budgets. Table 29 shows government expenditure classified by purpose for the period 1962-66. The functional classification attempted in the Table is based on the regrouping of the various ministries under six classes. The figure for Other Expenditures covers the Office of the President, the Office of the Prime Minister, the Chamber of Deputies, the Ministry of Foreign Affairs, the Ministry of Justice, The Propaganda, and News Agency, and the Real Estate Registration Agency.

The Social and Cultural classification covers the Ministry of Education, the Ministry of Health, and the Ministry of Social Affairs and Labor.

The figure for Public works and Communications covers the Ministry of Public Works and the Ministry of Communications.

TABLE 29

SYRIAN EXPENDITURES OF THE ORDINARY BUDGET
BY PURPOSE, 1962-1966
(MILLIONS OF SYRIAN POUNDS)

| | 1962(1) | 1963(2) | 1964 | 1965 | 1966(3) |
|---|---|---|---|---|---|
| Public Debt Service | 30.62 | 71.35 | 46.02 | 55.56 | 75.87 |
| Social and Cultural Expenditures | 95.12 | 172.73 | 134.44 | 152.63 | 190.51 |
| Public Works and Communications | 18.63 | 21.30 | 16.81 | 18.11 | 22.88 |
| National Defense | 261.22 | 445.80 | 346.20 | 364.80 | 315.81 |
| Internal Security | 38.25 | 73.52 | 36.73 | 51.48 | 56.45 |
| Other Expenditures | 72.33 | 120.07 | 53.80 | 103.78 | 121.49 |
| TOTAL | 516.28 | 914.77 | 634.00 | 746.36 | 783.01 |

Source: United Nations, Statistical Yearbook, 1967 (New York: 1968), p. 656.

(1) Year Ending 30 June.

(2) Eighteen months ending 31 December 1963.

(3) Not actual but an estimate of Expenditures.

National Defense expenditures covers only the Ministry of Defense and that of Internal Security covers the Ministry of Interior.

The figure for Public Debt covers the single entry in the ordinary budget. This entry is not to be thought of as payments for public debt service alone; it also includes the payment of pension debt.

An examination of the Table indicates that all six classes of expenditures increased in various degrees between 1962 and 1966. Although expenditures did increase in money terms, their share in relation to the total budget expenditures seems to fluctuate from year to year. The most noticeable feature of these changes is the decline in the share of national defense expenditure in relation to total budget expenditures. Table 30 shows the distributional shares of each of the categories as a per cent of the total expenditures. Thus defense expenditures as a per cent of total government expenditures vary considerably, depending upon conditions of peace and order.

Current expenditures on public works and communications constitutes a surprisingly small percentage of total expenditures. This is probably due to the fact that the bulk of total expenditures on this category has been included in the development plans.

Social services claims about twenty-five per cent of the total expenditure in 1966. The expenditures on this category may assume a greater share of the total expenditure depending on the situation of peace and order. Of necessity, expenditure on social services means fewer resources for economic development purposes. On the other hand, the urgency of social services precludes its postponement until after economic development has been attained. If a nation desired more social services,

TABLE 30

DISTRIBUTION OF THE ORDINARY BUDGET EXPENDITURES
IN SYRIA BY PURPOSES, 1962-1966
(IN PER CENT OF TOTAL EXPENDITURES)

| Fiscal Year | Public Debt | Social and Cultural | Public Works and Communications | National Defense | Internal Security | Other Expenditures | Total |
|---|---|---|---|---|---|---|---|
| 1962 | 6.0 | 18.4 | 3.6 | 50.6 | 7.4 | 14.0 | 100.0 |
| 1963 | 7.8 | 18.9 | 2.3 | 48.8 | 8.0 | 14.2 | 100.0 |
| 1964 | 7.3 | 21.2 | 2.6 | 54.6 | 5.8 | 8.5 | 100.0 |
| 1965 | 7.4 | 20.4 | 2.4 | 48.9 | 7.0 | 13.9 | 100.0 |
| 1966 | 9.7 | 24.3 | 3.0 | 40.3 | 7.2 | 15.5 | 100.0 |

Source: Derived from Table 29.

it may have to be content with a slower rate of economic development.

Other current expenditure, consisting mainly of general administration, has consistently risen with the growth in total expenditure. Three major factors explain this phenomenon: (1) Population increase; (2) intensive and extensive participation of government in economic activity; and (3) general price increases--the same amount of resources must be secured at higher prices.

Public debt expenditures have also been on the rise and this may be explained by two factors: (1) the increased reliance by the Syrian government on external aid to finance its development; and (2) the increased number of persons, especially military personnel, who are forced to retire after every coup. The Junta that assumes power will retire all the elements in the army that are not friendly and their "retirements" entitle them to draw pensions from the government.

Although government revenues have generally increased, expenditure excluding development expenditure still outstrips revenue for this period 1962-1965, so the government is operating at a deficit as shown in Table 31.

By the existence of the deficit would lead one to expect an increased government dependence on borrowing from the Central Bank because the surplus anticipated did not materialize within the ordinary budget. The Syrian government intended to finance part of its development plans from the surplus--which was non-existent.

TABLE 31

SYRIAN GOVERNMENT REVENUE AND EXPENDITURE, 1962-66
(MILLIONS OF SYRIAN POUNDS)

| | 1962 | 1963 | 1964 | 1965 | 1966 |
|---|---|---|---|---|---|
| Revenue-Total | 493.77 | 762.65 | 568.33 | 605.17 | 783.01 |
| Expenditure-Total | 516.28 | 914.77 | 634.00 | 746.36 | 783.01 |
| Balance (+),(-1) | -22.51 | -152.12 | -65.67 | -141.19 | --- |

Source: United Nations, Statistical Yearbook, 1967 (New York: 1968), p. 656.

The need to borrow from the Central Bank for the purposes of development arises essentially from the fact that Syria, like other underdeveloped countries, has unemployed resources, particularly labor. Too, the shortage of capital is a major obstacle toward the full employment of these resources.

In the literature on economic development, public borrowing is considered an important source of government financing. Public borrowing is considered as a device to utilize a substantial part of voluntary private saving for financing the development plan of the public sector. However, borrowing has some special problems in underdeveloped countries. In many of these countries, there are no organized money and capital markets and in those where such markets exist, they constitute a very small portion of the total financial markets of the country. Also, the resources of the organized capital market may be inadequate to fulfill the capital needs of the small number of organized industries existing in the private sector of the economy.

A substantial volume of savings originates in the rural sector of these countries. These savings cannot be mobilized through taxation because a portion of the rural sector income does not flow through monetary channels since most of the financial institutions are concentrated in the urban areas. A large scale mobilization of savings for capital formation through public borrowing policy in the rural sector is dependent to a large extent on the development and extension of financial institutions into those areas.

In view of these problems confronting the borrowing programs of governments in underdeveloped countries, a case may be made for resorting to the techniques of forced loans for the mobilization of resources. These countries may adopt the device of compulsory loans on behalf of economic development for various reasons. These countries may not be able to mobilize adequate resources for development through the normal channels of taxation and borrowing. Therefore, they may demand compulsory subscription to government bonds from that section of the population which spends its income to a large extent on conspicuous consumption and unproductive investment. These countries would then be able to mobilize useful resources at a lower cost to the country; and repayment would be made when the projects financed by these loans begin to yield increased output. A program of heavy investment in the public sector generates inflationary pressure in the economy, and through forced loans purchasing power may be withdrawn to counteract it.[67]

It may not be possible for an underdeveloped country to undertake a continuous policy of forced loans--it may generate political opposition. Such a policy may be suited for a specific project of development which benefits a specific region or group of persons. The particular sector may be asked to subscribe to government bonds issued to finance projects which in the end will prove advantageous to the contributing sector. If, on the other hand, the projects are of national importance, main reliance for financing them will have to be placed on voluntary public borrowing

---

[67]Ram Miranjan Tripathy, Public Finance in Underdeveloped Countries (Calcutta: The World Press, Ltd., 1964), pp. 179-180.

programs.[68]

The techniques of borrowing adopted in different underdeveloped countries have not been uniform. This is because of the differences in the development of money and capital markets in the various underdeveloped countries, and in the structure of their economic and financial organization. Public borrowing from the money market, which is the most direct means of diverting private savings toward the financing of public projects, has not so far been tried in Syria; and there is a suspicion that it may not be utilized in the near future and for some time to come. This suspicion is based on the fact that as far back as 1957 the Syrian government declared its intention to float the first loan to the public but this idea seems to have been abandoned.[69] If public bonds are to be issued in the future, it is likely that the subscribers will be banks rather than individuals.

Thus, it appears that the most practical--and the cheapest--method of financing development projects would be by expanding the public debt held by the Central Bank. The stated preference for using the Central Bank rather than public borrowing is due to poor

---

[68] Ibid., p. 180.

[69] Asfour, Syria Development and Monetary Policy, p. 166.

public response to government securities. Due to the political instability of the country the public has very little confidence in its government or any of its operations. When the government borrows from the Central Bank, it expects the Central Bank to sell these bonds to commercial banks who in turn market [illegible] securities to [illegible] banking system [illegible] effect is bound to be [illegible] the event of its failure, the increase in the quantity of the government bonds in the portfolios of the banking system is likely to produce inflationary effects.

The available data on public debt covers the period 1948-1957.

TABLE 32

PUBLIC DEBT, 1948-1957
(MILLIONS SYRIAN POUNDS)

| Year | Domestic Public Debt |
|---|---|
| 1948 | 158 |
| 1949 | 176 |
| 1950 | 198 |
| 1951 | 242 |
| 1952 | 287 |
| 1953 | 312 |
| 1954 | 260 |
| 1955 | 260 |
| 1956 | 287 |
| 1957 | 289 |

Source: Edmund Y. Asfour, Syria: Development and Monetary Policy (Cambridge, Massachusetts: Harvard University Press, 1959), p. 95.

## Adaptability of the Fiscal System in Syria to Economic Development Policy

The problem in Syria is whether the fiscal system as presently structured is adapted to the requirements of the economic development of the country.

The adaptability of any fiscal system to the economic development policy is a function of its capacity, efficiency and flexibility. These three elements are themselves interdependent. It might be possible to raise the level of taxation by the private sector and without inflicting severe inequality in the distribution of the fiscal charges among the various taxpayers. However, the raising of the level of taxes does not automatically assure an increasing yield to the government.

Even if there is both capacity and efficiency in the fiscal system, there must be flexibility which enables it to change with changing economic conditions.

### Capacity of the Fiscal System

Capacity is the ability of the fiscal system to raise its share in national income to a higher level without inflicting injuries on the economy. It has been argued by some that the level of expenditures in underdeveloped countries, in contrast to developed countries, is much more dependent on the ability of the tax system to furnish the required amounts of revenues. The conclusion is that the capacity of the tax system is a limiting factor in the expansion of government expenditures in general and the development programs in particular.[70]

Many experts in public finance hold that most underdeveloped countries could increase their proportionate share without unduly disturbing the economy. An increase in the share of taxes may even prove to be beneficial in combating inflationary pressures. It is further argued that:

> Underdeveloped countries are under no illusion that they can or should push their tax ratios of 10 to 15 per cent of national income to the 30 or 40 per cent levels reached in advanced countries.[71]

What are the criteria which should be followed in raising the level of taxation? The most important consideration in this respect is that additional taxes must be levied in a way to tap those funds which, if not taxed, are usually either spent on luxuries or socially unproductive investment, or hoarded in the form of foreign exchange or precious metals and the like.[72] Some appropriate taxes, therefore, would be high import duties and excises on luxury items. Too, personal income taxes with steeply progressive rates in the upper income brackets would increase the tax yield without disturbing the economy. Also recommended are taxes which penalize the

---

[70]U.N. Taxes and Fiscal Policy in Underdeveloped Countries, p. 6.

[71]Ibid., pp. 6-7.

[72]Ibid., p. 7.

diversion of savings into land, building, inventories, and similar investments of speculative and unproductive character.

In Syria with the exception of 1963 the proportion of national income taken in taxes did not exceed 20 per cent during the period 1961-1965. The year 1963 did not represent a fiscal year since it extended to eighteen months. Table 33 shows the tax burden in Syria during the 1961-1965 period. Per capita tax receipts also kept rising despite population increases.

If the portion of national income taken in taxes can be increased safely to about 20 per cent of the national income, then there is room in Syria for an increased level of taxation of about 4 per cent. Thus the possibility of a further increase in tax revenue depends largely on the efficiency of tax administration.

## Efficiency of the Fiscal System

The efficiency of the tax system may convey two meanings: The first is that a tax system is said to be efficient if its yield can be increased without any changes in its structure and without any variation in its rates, and provided that no additional cost is incurred by the government. The second meaning is that a tax system is said to be efficient if by addition of one unit of cost to total cost of collection the resulting

TABLE 33

THE BURDEN OF SYRIAN TAXATION, 1961-65

| Fiscal Year | Population (Thousands) | National Income (L.S. Millions) | Total Tax Receipts (L.S. Thousands) | Tax Receipts as Per Cent of National Income | Per Capita Tax Receipt |
|---|---|---|---|---|---|
| 1961 | 4,972 | 2,496 | 477,086 | 19.1 | 96 |
| 1962 | 5,178 | 3,183 | 493,775 | 15.5 | 95 |
| 1963 | 5,308 | 3,311 | 762,651 | 24.8 | 143 |
| 1964 | 5,467 | 3,594 | 568,333 | 16.0 | 104 |
| 1965 | 5,634 | 3,589 | 605,168 | 16.6 | 107 |

Source: Ministry of Planning, Statistical Abstract, 1965 (Damascus: Government Press, 1966), p. 21, 327, 372.

receipts is larger than unit cost (briefly, if marginal cost is less than marginal revenue).[73]

The efficiency of the tax system is controlled to a great extent by the attitude of the taxpayers. The efficiency will improve considerably if taxpayers are cooperative--if they refrain from devising ways and means to evade the taxes--or to completely conceal the base on which the tax is assessed.

It is unfortunate that any quantitative analysis of the efficiency of the tax system in Syria is impossible due to the unavailability of the appropriate statistical data regarding the cost of each individual tax or group of taxes.

On the whole the tax system is inefficient due to many built in factors. Such factors that may undermine the efficiency are the lack of well-trained tax assessors and collectors and the lack of modern equipment to facilitate tax administration. The livestock tax will suffice to demonstrate the point.

The yield of this tax is quite considerable compared to the yield of other direct taxes in the fiscal system. The administration is said to be very costly. There are two stages of assessment involved: The first

---

[73]John H. Adler, Eugene R. Schlesinger and Ernest C. Olson, Public Finance and Economic Development in Guatemala (Stanford, California: Stanford University Press, 1952), p. 153.

is the counting stage when the Ministry of Finance sends its agents to the grazing territory to count the number of livestock. The second stage takes place when the same agents make another round to make sure that no livestock were overlooked in the counting--in effect doubling the cost of assessment.

However, the inefficiency of this tax is not only its administrative costs--evasion is the principal problem. The Bedouins who roam the desert with their cattle know the time of year when the assessors appear. They move their cattle to places of concealment and thus evade the count. Briefly, then, administrative costs are too high and tax collections are too low, which results in a high percentage cost chargeable to administration.

## Flexibility of the Fiscal System

The flexibility of the tax system refers to the ability of the total tax receipts to fluctuate with the changing level of economic activity. If tax receipts fluctuate more widely than national income, the tax system is considered highly flexible. Flexibility is of two kinds--built-in and administrative. When tax receipts change automatically with changes in national income without adjustment in the tax structure and tax rates, the flexibility is of the built-in type. Administrative flexibility is that resulting from specific legislative action.[74]

In Syria, although tax receipts have been increasing, they have not progressed proportional to the increase in economic activity. The major increase in the revenue occurred in the areas of customs duties and oil transit receipts. In this respect it may be said that generally, and under normal conditions, customs receipts and oil revenues possess a fairly high degree of flexibility.

An analysis of the 1961-1965 relationship between changes in national income, changes in price level, and changes in total revenue in Syria is presented in Table 34. On the basis of the information in the table, it is obvious that the total revenue did not retain a systematic relationship with national income--ignoring 1963 because it covered an eighteen month period. While national income was rising in 1962 as compared to 1961, total revenue declined by about 4 per cent. When national income declined in 1965 as compared to 1964, total revenue increased in relation to the preceding year.

The correlation between total revenue and the price level was systematic in a sense. While the price level was on a general decline, total revenues were on a general rise.

It may be concluded on the basis of the above analysis that while total revenue was increasing generally

---

[74] *Ibid.*, p. 174.

TABLE 34

CHANGES IN NATIONAL INCOME, TAX RECEIPTS
AND PRICE LEVEL IN SYRIA 1961-1965
(1961 = 100)

| Fiscal Year | National Income | Total Revenue | Import Taxes | Indirect Taxes | Direct Taxes | Registration Fees | Price Index |
|---|---|---|---|---|---|---|---|
| 1961 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 1962 | 127 | 96 | 82 | 91 | 92 | 147 | 93 |
| 1963 | 132 | 148 | 99 | 137 | 184 | 341 | 95 |
| 1964 | 143 | 111 | 123 | 112 | 127 | 189 | 96 |
| 1965 | 142 | 118 | 115 | 120 | 152 | 196 | 98 |

Source: Data on Total Revenue, as well as other group of taxes, are taken from the Statistical Abstract, published by the Ministry of Planning (Damascus: Government Press, 1966), pp. 190, 326-327, 372.

as a result of an expanding economy, the revenue did not increase proportionately with the increased economic activity. This is not to deny the existence of some degree of flexibility; some flexibility of the administrative type has been in operation since independence. Many changes took place in the tax systems both in tax structure and in tax rates.

Table 34 indicates that the greatest percentage increases (96 per cent) occurred in the area of registration fees. The next major increase took place in the field of direct taxes which rose by 52 per cent. Next in order was the 20 per cent increase in indirect taxes. The smallest increase, only 15 per cent, was in the area of import duties.

These developments are significant in the examination of the degree of built-in flexibility of the tax system in Syria. For example, the increase in registration fee collections is directly related to the increased economic activity--the greater the volume of taxable transactions, the greater the amount of collectible fees. In this sense, the registration fees contain a certain degree of built-in flexibility.

The second largest increase took place in direct taxes. This may be attributed to administrative flexibility brought about by various legislative measures. Measures that introduced higher progressive rates in the case of the income taxes and changes in taxes on urban real estate from a proportional rate to a graduated rate. To these a tax on inheritance and gifts was added. These legislative measures enhanced the degree of built-in flexibility since taxes with progressive rates are usually considered highly flexible. Thus the steady increase in direct taxes can be explained on the basis of administrative flexibility first and built-in flexibility second.

All indirect taxes are specific. They are levied on the basis of a fixed amount of money per unit of commodity. The commodities in Syria are the following: fuel, alcoholic products, sugar, tobacco, salt and cement. A tax on entertainment is also included in this category. Since it is widely assumed that consumption patterns are fairly stable, a rise in national income would not entail a proportionate increase in consumption. It may be said that the group of indirect taxes does not possess a large degree of flexibility in relation to change in income.

The custom duties are mainly collected on an ad valorem basis, which makes these duties proportional to the total value of imports. The correlation between total receipts from imports and changes in income may be said to be flexible in principle. The propensity to import, other things being equal, is dependent upon the level of income. If real income rises, imports should be expected to rise and, consequently, an increased yield from import duties. This, in turn, give these duties a large degree of flexibility. This flexibility is obscured, however, by administrative measures such as protective tariffs designed to restrict. In this case, and despite a rise in real income, the yield of custom duties may not show a proportionate increase. However, it may be said that in general and under normal conditions, customs receipts possess a fairly high degree of flexibility.

To recapitulate, the point of emphasis in the present analysis was the examination of the adaptability of the fiscal policy in Syria to its economic development policy. Any fiscal system adaptable to a policy of economic development and growth must be capable of carrying out the financial burden of a public investment program. This means that the capacity of the fiscal system must be increased to a volume commensurate with the needs of government. This is not attainable by a simple decision to do so--a high degree of efficiency must be present in the system to allow it to expand.

Assuming, at the same time, that the capacity of this fiscal system can be increased and the required degree of efficiency is attained, a high degree of flexibility must be present for two reasons. In the first place, a high degree of flexibility ensures a larger governmental share in an expanding national income. In the case of a declining national income and slackening economic activity, the flexibility of the fiscal system should operate in the opposite direction. This time the share of government from national income should decline faster than the decline in national income. In a declining period, the government has to resort to means of financing other than taxation if it desires an uninterrupted flow of public spending.

A high degree of flexibility is assured when the marginal rate of taxation is greater than the average rate. When this is the case, government receipts increase or decrease more rapidly than national income. Ideally, steeply progressive income taxes must be adhered to since they insure a high degree of built-in flexibility in the tax system. There is a danger, however, in the case of underdeveloped countries that incentives might be affected by the steeply progressive taxes. The alternative--put a high rate on luxury items and items for which the demand increases rapidly with increase in income.[75] In other words, place more reliance upon the administrative type of flexibility.

In this context, how flexible is the tax system in Syria? From the information contained in Table 34, the tax system in Syria may not claim any high degree of

---

[75]Lewis, <u>Theory of Economic Growth</u>, pp. 402-403.

overall flexibility--on the contrary, the system as a whole tends more toward rigidity. If that is the case, what proposals should be made to make the tax system more flexible and adaptable to the needs of economic development?

It must be remembered that current economic conditions make it necessary for the countries that seek development to depend primarily on themselves, at least for the present. It must be borne in mind that underdeveloped countries should not rely on external finance except within the narrowest of limits.

## Summary

In light of the preceding discussion, it may be concluded that the present financial system in Syria does not provide the financial capabilities to launch an adequate development plan and concurrently meet administrative commitments. The underdeveloped countries have to look for other sources of revenue and not limit themselves to some to the exclusion of others. The search for other alternatives is based on the belief that the desired external resources may not be forthcoming and surpluses from the ordinary budget and other administrative agencies may not materialize.

The next chapter will examine one alternative used in more advanced countries in their search for addit onal revenuses--the sales tax--and its importance in their overall tax structure.

CHAPTER V

SALES TAXATION

## Introduction

Taxes upon the transfer of commodities are of a very ancient origin. Ancient Athens imposed various taxes on the sale of commodities in the market and on sales of landed property. Ancient states like Egypt, China, and India as well as others employed a sales tax on specific commodities such as salt. The Romans established a general sales tax after conquering Egypt--it apparently amounted to as much as ten per cent, but was later reduced to one per cent. The Romans transported the general sales tax to France and Spain where sales taxation continued even after the Romans lost their control of Western Europe.[1]

However, the general sales tax that has received the most attention and publicity was the Spanish *al cabala* which was introduced and developed as a national tax in 1342. It taxed virtually all articles sold and was levied first at a rate of one per cent, then at five

[1] Alfred D. Buchler, *General Sales Taxation* (New York: The Business Bourse, 1932), p. 3.

per cent, and later at ten per cent.[2] This tax was repugnant to the masses who were oppressed by it for centuries. The tax was discontinued in the early nineteenth century.

The Spanish did not retain the al cabala for themselves, but carried the idea of general consumption taxes across the Atlantic into Mexico. In Mexico, Spain imposed a two per cent upon sales of all commodities. This was the beginning of various schemes of general sales taxation which have thrived in Mexico to this day.[3]

The general sales tax has never disappeared completely from Western Europe and England. During the seventeenth and eighteenth century, there were many proposals for a general consumption tax. The movement for a general sales tax did not confine itself to Europe and England. The idea also spread to the United States. The first movement for a general sales tax in the United States occurred during the Civil War, but Congress turned down all proposals. Ever since the Civil War, the United States Government has levied excises on various commodities and services. Most of them have been

---

[2]Ibid., p. 3.

[3]Ibid., p. 4.

collected from manufacturers but some from retailers.[4]

The issue of levying a general sales tax in the United States and in Western Europe came to life during and following the First World War.

The Post-War movement for a general sales tax in the United States originated in opposition to the new order of taxation with its heavy claims upon business profits and personal income. Thus in 1918, Senator Borah introduced a transaction tax bill in the Senate. The tax was to be imposed upon every purchase made within the United States and was to be collected through the use of stamps. As usual, and like earlier general sales taxes suggested in Congress, it was not adopted. In 1921, Senator Smoot introduced his manufacturers and producers tax bill. Representatives of the organized movement appeared before the Senate and House committees and the proponents of the tax marshalled their greatest strength for the adoption of a national general sales tax, but their efforts in this direction were futile. During the 1930's the movement for a general sales tax came to life again due to financial stress of the period. In 1932, the Committee on Ways and Means went so far as to write into the proposed House tax bill a section providing for a manufacturers sales tax, but the House

---

[4]R. G. Blackey and G. C. Blackey, Sales Taxes and Other Excises (Chicago: Public Administration Service, 1945), p. 41.

refused to accept it, as usual.[5]

After that, no important interest was shown in the national sales tax until the war needs of 1942 stimulated public discussion of methods to finance the emergency. The end result, however, was that no general sales tax was adopted.

The revival of sales tax in Europe and elsewhere was started by the financial crisis created by World War I. It usually appeared in Europe as an emergency tax adapted to the needs of post-war finance and to supplement existing excise duties. From Europe the general sales tax has spread rapidly to many nations, losing, in part, its character as an emergency tax, and assuming a regular place in the tax system. Opposition to the tax developed sufficient strength so that several countries almost repealed it. The advent of the depressed 1930's, however, resulted in the retention of the existing taxes and enactment of new ones. A stable yield in the face of declining business activity made these taxes more attractive to governments. World War II accentuated the need for them and entrenched them in the countries which had been using them.

Recently opposition to the tax has lessened, and governments now openly defend them as a desirable element

---

[5] *Ibid.*, p. 4.

in the tax structure but critics of the tax are still vocal.[6]

## Meaning and Forms of Sales Taxations

Sales taxes may be defined as general taxes on sales of products. Sales taxes generally apply to all, or a wide range of goods and services. They are distinguished from special excises or selective sales taxes, such as those on tobacco, liquor, and motor fuels.[7] Selective sales or excise taxes are intended to discourage the production or consumption of particular items or as "special benefit levies" such as motor fuel taxes used to finance road construction.

Sales tax concepts may be classified into three groups: the general turnover tax; the single stage tax; and the value-added tax. From one point of view, these different forms of tax may be regarded as alternative methods of collection.

The oldest and the crudest form of a sales tax is the general turnover tax--a tax which is imposed whenever a product undergoes a market transfer. The fact that the tax base includes previously taxed transfers causes the burdens on the value of the final product to vary with the numbers of previous transfers. In other

---

[6] John F. Due, _Sales Taxation_ (Urbana, Illinois: University of Illinois Press, 1957), p. 2.

[7] _Ibid._, p. 3.

words, the tax varies with the number of independent firms involved in adding value to the product.

The single-stage and value-added sales taxes have been devised in order to avoid the multiple taxation characteristic of the general turnover form. This is accomplished under a single-stage tax which applies to commodities <u>only once</u> in production or distribution channels. This tax may be imposed at different levels--sale by the manufacturer; the last wholesale transaction; or at the retail level. The value-added tax, on the other hand, imposes the tax on all business sales but limits the tax liability of each business firm to the value it adds to the final product.

At present, there are many nations that utilize a general sales tax in one form or another. Table 35 outlines the nature of the major sales taxes in operation today in non-communist countries. The table also indicates the importance of these taxes in relation to total governmental revenues and national income. On the basis of the data, the burden of the sales tax, in relation to national income, is greater in France than in any other country. Likewise, taxes in Brazil, West Germany, and Belgium impose a very substantial burden. The burden of the tax in the United States and Great Britain is very light. A number of countries do not use this tax at all, but are employing excise taxes in varying degrees.

TABLE 35

SALES TAXES OF VARIOUS NON-COMMUNIST COUNTRIES, 1955-56

| Country | Level of Tax and Basic Rate | Yield as a Per Cent of Total Govern-ment Revenue | Yield as a Per Cent of Total Tax Revenue | Yield as a Per Cent of National Income |
|---|---|---|---|---|
| Europe | | | | |
| Switzerland | wholesale (5.4%) | 26 | 31 | 2 |
| Finland | Mfg. (20%) | 22 | 24 | 6 |
| Norway | retail (10%) | 27 | 30 | 7 |
| Great Britain | Whse. (varying) | 7 | 8 | 2 |
| Netherlands | multiple (5%) | 21 | 25 | 5 |
| Belgium | multiple except retail (5%) | 28 | 30 | 7 |
| Luxembourg | multiple (2%) | -- | 15 | 4 |
| Germany | multiple (4%) | 42 | 45 | 8 |
| Austria | multiple (5¼%) | 25 | 27 | 6 |
| France | Value-added (19.5%) | 38 | 41 | 10 |
| Italy | multiple (3%) | 21 | 22 | 5 |
| Greece | mfg. (6%) | 30 | 41 | 6 |
| Asia and Australia | | | | |
| India-states | retail; multiple | 12 | 19 | 1 |
| Pakistan | wholesale (10%) | 15 | 20 | 1 |
| Indonesia | mfg. (5%) | -- | -- | - |
| Phillipines | mfg. (7%) | -- | -- | - |
| Australia | whse. (varying) | 10 | 11 | 2 |
| New Zealand | whse. (20%) | 9 | 10 | 3 |
| North and South America | | | | |
| Canada-Federal | Mfg. (10%) | 15 | 16 | 5 |
| Canada-Prov. | retail (2-5%) | 9 | 17 | - |
| United States-States | retail (2-3%) | 15 | 21 | 1 |
| Mexico | multiple (1.8%) | -- | -- | - |
| Cuba | Mfg. (7.2%) | -- | -- | - |
| Brazil-Fed. | Mfg. (varying) | 30 | 33 | 8 |
| Brazil-states | multiple | 62 | 69 | - |
| Uruguay | Mfg. (5%) | -- | -- | - |

TABLE 35 (continued)

| Country | Level of Tax and Basic Rate | Yield as a Per Cent of Total Govern-ment Revenue | Yield as a Per Cent of Total Tax Revenue | Yield as a Per Cent of National Income |
|---|---|---|---|---|
| Argentina | Mfg. (8%) | 20 | 30 | 3 |
| Chile | Mfg. (6%) | 25 | 26 | 5 |
| Ecuador | Mfg. (1½%) | -- | -- | - |

Source: Due, <u>Sales Taxation</u>, p. 6.

There are many countries that employ such a tax as indicated in Table 35. Only the turnover tax in Germany; the single-stage tax in Canada; the value-added tax in France; and the purchase tax in Great Britain will be examined.

## The Turnover Tax in Germany

Development of the tax. The turnover tax, in its crudest form, applies a uniform rate to all stages in production and distribution channels. The taxing of all sales at all levels is not without precedent in history of sales taxes. This kind of taxation finds its antecedents in ancient Athens and in medieval Spain with its al cabala.

The modern turnover tax was introduced in Germany during World War I, and was the model for sales taxes introduced in a number of European Countries during the 1920's. The importance of this form of sales tax increased during World War II, when Germany introduced it in countries which were intended to become an integral part of Germany.

The German turnover tax is one of the products of War finance, and the history of the tax is closely interwoven in the financial history of Germany during the War and after the War. In 1916, Germany adopted 0.1 per cent turnover tax on all commodity transfers. As the war progressed, the financial situation became more acute and revenues had to be augmented. As a result, the tax was amended to cover virtually all transactions and the rate was riased to 0.5 per cent with a supplementary 1.0 per cent single luxury tax imposed. Revenues still were inadequate, and in 1919 the scope of both the turnover and luxury taxes were increased and the rates of the former raised to 1.5 per cent.

By the end of World War I hostilities, the luxury tax was eliminated but the structure of the turnover tax remains basically the same. Nonetheless the basic rate of 1.5 per cent was raised to 2.5 per cent in 1924. However, strenuous objections to the high rates and improved financial conditions of the government led to the reduction of the rate of 0.75 per cent in 1926. Pressure to eliminate the tax completely was strong, but the depression of the Thirties halted these attempts and because of deficits in the government budget the rates were increased to 2 per cent in 1932, a figure which prevailed until after World War II. In 1946 the rate was raised to 3 per cent and in 1951 up to 4 per cent, a rate that is still effective.[8]

<u>Coverage</u>. The tax applies to sales at all levels in production and distribution channels of raw materials,

---

[8] <u>Ibid</u>., p. 52.

semi-finished goods, and finished products. In case of services, the tax is limited to those rendered by business firms to customers. The coverage of the tax is extremely broad. The tax also applies in two other instances:

> Use by owners of business firms (except small farmers) of products of the firm for their own personal purposes. There will be no tax on products used within the firm for business purposes. Thus, if a furniture firm uses some of the furniture in offices, the tax does not apply to the value of the furniture used.
>
> Imports. Goods imported are subject to a compensating tax, either at the basic tax rate, or in some cases as the case of finished goods, at a higher rate.

<u>Rates and exemptions</u>. The basic rate is 4 per cent levied upon the selling price of taxable goods and services. The tax, however, does not always take its pure form since there are some departures from uniformity. For example, several modificational adjustments in the tax are directed downward and in few cases upward.

Some modifications are designed to lessen the burden on lower income groups. A few products that are regarded as basic necessities are tax free, while others are subject to lower rates. The items that are exempted from the tax are:

> Rental of real property, except hotel rooms; water, gas, electricity, medical service covered by medical insurance, public hospital service, postal, telephone, and telegraph services, and few minor items.
>
> The items that are subject to a rate of 1.5 per cent are: bakery products, cereals, flour, and related items.

Items subject to a rate of 3 per cent are: milk, and milk products, margarine, sugar, and a few other items.

Some of the variations designed to lessen competitive disturbances are:

Exemptions of the importation and sale at wholesale of many basic raw materials, such as wool, cotton, cellulose, fuel, grains, basic metal such as iron and steel, etc. The exemption at wholesale is granted provided the seller has performed no processing whatsoever.

Other sales by the wholesaler are taxed at a rate of 1 per cent even if he has not processed them.

A supplementary tax of 3 per cent is applied to retail sales by manufacturers. This tax is designed to equalize tax between sales through retailers and direct sales by manufacturers.

A 4 per cent supplementary tax is applied to internal transfers of yarn produced by a firm for its weaving department. This is designed to protect the independent firms in this field against competition of the integrated ones.

Some exports are exempted. Merchants selling for export are subject to a refund of tax which they paid when purchasing the commodities, and exporting manufacturers are allowed a refund of a flat percentage of the selling price ranging from .5 to 2.5 per cent, depending on the nature of the good.

Farmers and woodcutting enterprises are subject to reduced rates of 1.5 per cent on their sales. The reduced rate is partly designed to lessen the burden on food stuffs, and to avoid excessive burden on farmers when tax shifting is difficult, and to lessen possible inequalities arising out of the difficulties of assessing the tax accurately against small farmers.

Shifting of the Tax and Collection. The intent of the legislators is that the tax will be shifted to the final consumer. The levy, although imposed upon the transaction, places the liability of paying the tax upon the business firms.[9]

No attempt has been made to defend the tax either on grounds of equity or social desirability. The tax is collected at all stages of production and distribution leaving the manufacturers and tradesmen the decision as to what amount of the tax will be passed to consumers and what the final burden on the consumer will be.[10]

However, attempts have been made to estimate the amount of the tax contained in the purchase of various commodities and its variation with the changes in the composition of the consumers' market basket. It is believed that the turnover tax too, like a sales tax imposed at retail level, is completely shifted forward to the consumers. Thus it may be assumed that the tax is finally borne by income brackets according

[9] Ibid., pp. 53-55.

[10] Karl Kauser, "West German," in Foreign Tax Policies and Economic Growth, National Bureau of Economic Research (New York: Columbia University Press, 1966), p. 101.

to their total expenditures for consumer goods.[11]

A study was made in 1959 to trace the effect of this tax on the various sectors of the economy, and it was found that in 1954 about 69 per cent of the tax ended up in consumer goods, 27 per cent in investment goods, and 3.6 per cent in exports. Thus there is no great difference between the burden of a general sales tax imposed at retail level and that of the general turnover tax.[12]

Place of the tax in the tax system. The turnover tax accounted for 22 per cent of West German tax revenue in 1962. Germany, like the United States, has a tripartite system--federal, state, and local. Each level receives specific taxes. As far as the federal government is concerned, the turnover tax is by far the most important single tax in the revenue system. The federal government has as the main source of its revenue the yield from the turnover tax, excise taxes, customs, and other minor indirect taxes. Besides this, it is entitled to receive a certain percentage of the personal and corporate income tax. In 1962, the federal government of Germany received 35 per cent of the

---

[11] Karl W. Roskamp, Capital Formation in West Germany (Detroit: Wayne State University Press, 1965), pp. 216-217.

[12] Ibid., p. 217.

income taxes.[13] Table 36 shows the sources from which the three levels of government derive their revenue. As the table indicates, the turnover tax is by far the most important single revenue for the federal government. Also, the table shows that the federal government derives about 70 per cent of its revenue from indirect taxes and 30 per cent from direct taxes.

Arguments for and against the use of the Turnover Tax. The tax has been subjected to an intensive study and evaluation, at both governmental and non-governmental levels. The case for the use of the tax will be presented first.

a. The case for its use. Many features of the tax have been responsible for its continued use and importance. The first is, naturally, the high revenue yield with a moderate tax rate. This high yield is the product of the extremely broad base, despite the various exemptions made in this tax. Secondly, the Germans feel that their income tax is already too high in terms of its effects upon economic development, and they argue for the retention of the tax and to increase its yield (rate) so as to minimize reliance upon direct taxes. Thirdly, the hidden character of the tax is regarded as an advantage which lessens the opposition to it by consumers and

---

[13] *Ibid.*, p. 138.

TABLE 36

RETURN TO DIFFERENT LEVELS OF GOVERNMENT OF MAIN TYPES OF TAXES AND APPROPRIATIONS, 1962 (BILLION DM)

| Type of Taxes | Level of Government Federal | State | Local | Total |
|---|---|---|---|---|
| Taxes on income and profits | 11.9 | 22.1 | | 34.0 |
| Taxes on Net Wealth and Property | 2.1 | 2.2 | | 4.3 |
| Equilization of burden levy | 2.1 | | | 2.1 |
| Taxes on net wealth | | 1.9 | | 1.9 |
| Turnover tax | 19.2 | | | 19.2 |
| Excises | 10.2 | .8 | | 11.0 |
| Taxes on transfers and transports | .8 | 3.1 | | 3.9 |
| Automobile tax | | 1.9 | | 1.9 |
| Customs | 3.3 | | | 3.3 |
| Local taxes | -- | -- | | -- |
| Enterprise tax | | | 8.8 | 8.8 |
| Real estate tax | | | 1.8 | 1.8 |
| Others | | | .6 | .6 |
| TOTAL | 47.5 | 28.5 | 11.2 | 86.9 |

Source: Karl Kauser, "West German," in Foreign Tax Policies and Economic Growth, National Bureau of Economic Research (New York: Columbia University Press, 1966), p. 146.

business and thus makes it feasible politically and makes it possible to obtain the high yield.

The tax has a further merit. The revenues from this tax vary with changing economic conditions as these conditions are reflected in the volume of business transactions. In fact, the tax collections are taken as a current index of changing business conditions. As in other countries, receipts increase in prosperity or in periods of inflation, and decline in periods of depression.

The considerable use of indirect taxes, particularly the turnover tax, has helped to spread the burden in such a way that specific oppression was avoided. Kauser said:

> In this respect the general turnover tax has played a decisive role because in addition to all of its other virtues the turnover tax possesses a key one which is highly important to production: its burden adjusts to all the joints, cracks and corners of the entire economy like soft cement and so does not hinder production in any way.[14]

b. The case against its use. Although the criticism of the tax has been less than what might have been expected, the tax has not been without critics. The criticism of the tax is based on the following:

1. Regressiveness. The traditional complaint is the regressivity of the tax which falls more heavily upon the poor than the rich. The taxation of basic commodities will absorb a larger part of the expenditure of the poor than of the rich, so that a tax on these commodities is a

---

[14] Karl Kauser, "West Germany" in Foreign Tax Policies and Economic Growth, p. 104.

heavier proportionate tax on the income of the poor.

Attempts to reduce the regressivity of the tax have been made by lowering the rate on few basic necessities, but the attempt is far less extensive than that in most European sales taxes. Due explains that:

> Rate differentiation is difficult in a turnover tax; if it is limited to one stage its effectiveness is greatly restricted, and if it is applied to all stages through which the goods pass, operation of the tax is greatly complicated.[15]

2. Encouragement of Exports. In order to encourage exports two main incentives were introduced. The first took the form of a tax-free reserve equal to a fixed percentage of the individual firm's export turnover--3.0 to 3.5 per cent in case of producers. This was meant to encourage the risking of expenses incurred in developing new markets. The second incentive took the form of a deduction from taxable income equal to from 1 to 10 per cent of export-derived income. Though these measures helped to funnel more production into exports and strengthened the exporting firm's ability to invest by reducing its income or corporate profit taxes, it nonetheless proved to be beneficial to persons in upper income brackets. Needless to say, this violated the principle of equal taxation and set the trend toward concentration of income and wealth in the hands of big business and persons with high income.[16]

---

[15] Due, Sales Taxation, p. 59.

[16] Karl Kauser, "West Germany," in Foreign Tax Policies and Economic Growth, pp. 121-122.

3. <u>Integrative Effects of the Tax</u>. This is the most significant and controversial argument against the turnover tax in Germany. The argument has centered around the question of discrimination against non-integrated firms, and the encouragement given to the integration, in both production and distribution channels. The structure of the tax offers an inducement to vertical integration. The first inducement is given to the consolidation of various stages of production activity into the confines of a single firm. Thus if a business produces its iron materials and parts, supplies, machinery, etc., and is not buying from other firms, the business can avoid the tax which otherwise would have been applied. The second encouragement is found in the distributional field. The direct selling by manufacturers to consumers or retailers is encouraged, since the combined tax burden can be reduced by this means.

To the extent that such an action has taken place, the results are not only inequitable to the owners of small independent producing units, but produce uneconomic readjustments in the production and distribution channels. The integration which is dictated by economic considerations is desirable and will take place whether the tax is present or not. On the other hand, integration which is uneconomical and unprofitable will not take place whether the tax is there or not.

Studies of the effects of the tax on integration are not available in Germany, but there is a widespread belief that the effects are not negligible. Even the strongest defenders of the sales tax as a major revenue source grant this.

> But to the outside observer, it appears strange that more vigorous pressures to reform the tax to eliminate the integrative effects were not made at an earlier date; in Canada, for example, the protests were so violent against this form of tax that it was drastically modified within one month after it was introduced, and the multiple stage form abandoned completely after three years of operation.[17]

The reasons for no outright opposition may be due to the fact that in the early stages of the employment of this tax the low rates had effects that could scarcely have been serious. In the postwar period, the attention was focused on more pressing problems than sales taxes.

> Furthermore, there has been considerable popular acceptance in Germany for a long time of the view that integration is inherently desirable, regardless of its cause, as a step twoard further rationalization of industry; integration became synonymous with efficiency, the independent middle man with waste and high cost. Finally the various steps taken by the government, although rather limited and incomplete, mitigate some of the worst inequities.[18]

As indicated previously, these steps included the exemption of sales by wholesalers of basic raw materials; taxation of other wholesalers at low rate; provision of special measures for the textile industry, and in more

---

[17] Due, Sales Taxation, p. 63.

[18] Ibid.

recent years, the levying of an additional tax upon retail sales by manufacturers to eliminate the tax advantage of direct sales.

## Manufacturers Sales Tax in Canada

Development of the tax. Like the general sales taxes of many other nations, the Canadian sales tax was introduced in the distressing and critical period of post war financial reconstruction. Before World War I, the Canadian Federal Government had relied primarily on customs duties and a limited number of traditional excise taxes. During the war, an income tax and excess profits tax was introduced. The new source of revenue was inadequate to meet the expenditures of the war, and a substantial portion of the war costs were met by borrowing. At the end of the war, expenditures remained high, even higher than pre-war level, and pressures for reduction of the income taxes were substantial. The financial situation was grave. The Minister of Finance recommended a program to Parliament which called, among other things, the imposition of a general sales tax at a rate of one per cent to eliminate the deficit and retire the war debt. The recommendation of the Minister of Finance was favorably received by Parliament and the sales tax was adopted to become effective in 1920. The support of the sales tax came from the commercial and industrial interests of the nation, who looked at the tax as an emergency measure which should be given a fair trial to determine its suitability in the Canadian tax system.[19] The tax was to apply to all levels of production and distribution except retailers and farmers.

After adoption of the "turnover tax," the tax has been raised frequently to meet the changing financial requirements. In the period of its existence, differentiation has been introduced to please the critics of the tax but criticism continued, and agitation for reform culminated in 1923. The government announced that it would replace the turnover tax with a manufacturers sales tax, limited to finished products and to become effective in 1924.

The new rate was set at 6 per cent, but opposition to the tax continued. The critics were led by the Canadian Manufacturers Association. It condemned the tax as regressive, because of the pyramiding process of the tax which burdened the final consumer. The merchant did not absorb the tax--he passed it on to the consumer by higher prices.

Due to continuous opposition, and by a series of annual reductions the rates were cut--down to one per cent in 1930; and it was anticipated that all the sales tax would be eliminated completely next year.

The coming of the thirties intervened. Larger

---

[19]Buchler, General Sales Taxation, p. 116.

revenues were needed to eliminate the deficit so the government raised the rate to 4 per cent in 1931; to 6 per cent in 1932; and to 8 per cent in 1936. The tax was productive from the beginning, and it soon became one of the most important major revenue suppliers, and yielded about 31 per cent of the total Dominion revenue in 1938.

World War II ended any hope of eliminating the use of the tax, but during the duration of the war the tax was not increased, partly because it was recognized that in reases in the tax would result in demands for wage increases.[20]

By the end of the war, the Canadian government began to look at the tax as a permanent one and one that would play a permanent role in the tax structure of the country. The government, for the first time, began to defend the tax as a desirable element in the tax structure. The government contended that the tax was necessary to avoid the use of direct taxes so high as to impede incentives--and economic development--and beyond the levels which the public would tolerate.[21]

Coverage. The present sales tax is purely a manufacturers tax imposed upon their sales of finished goods. All manufacturers are required to obtain licenses. The

---

[20]Due, Sales Taxation, p. 149.

[21]Ibid., p. 149.

tax normally applies to sales made by a licensed manufacturer to an unlicensed buyer-wholesaler, retailer, or final consumer. However, if sales are made by one licensed firm to another licensed firm, the transaction will not be subject to the tax. On the other hand, sales by an unlicensed firm are never subject to the tax. This basic pattern, however, is not always followed, because of exceptions to this rule. The exceptions are:

> Some wholesalers are licensed. This pattern existed in the earlier years of the tax when the government licensed. The licensing of new wholesalers has been restricted since 1938, and wholesalers now starting are licensed only if 50 per cent of their sales are of exempt goods and they have procided a bond ranging from a minimum of $2,000 to a maximum of $25,000. On this basis, when wholesalers are licensed, they buy tax-free and apply the tax to their sales.
>
> Licensed manufacturers are permitted to pass materials and semi-manufactured goods from one owner to another without the necessity of paying the tax on the sale. However if a manufacturer buys an item for his own use, as office equipment and supplies, he has to pay the tax at the time of purchase and not buy it tax-free and then account for the tax himself, and if he uses items which he produces he must account for the tax.
>
> Importation of goods are subject to the tax at the time the goods are imported or taken out of warehouse for consumption. Here the tax applies to the duty paid value.
>
> If goods are purchased and delivered, but are to be paid for by installments, the tax is to be paid at the time of each installment in the same proportion that the installment bears to the total sale price.[22]

Rates and Exemptions. The present rate of the tax is 11 per cent. Of this, 8 per cent goes to the general

---

[22] J. Harvey Perry, Taxation in Canada (third ed.; Toronto: University of Toronto Press, 1961), p. 130-132.

budget, and 3 per cent is earmarked to the social security fund. The present tax is levied upon all sales by manufacturers, except those of commodities specifically exempted. There is one reduced rate, that of 5 per cent on articles produced by the blind, deaf, and dumb.

There are a number of exemptions from the tax. The government has exempted certain types of producers' goods in order to avoid excessive burden on business development. The exemptions include the following:

> Materials, parts, and other physical ingredients to be incorporated into the final products. This exemption is conditional upon use, except where there is unconditional exemptions such as use of unprocessed products of mines, farms, and forests.
>
> Industrial consumable articles which will be consumed in the production but not become physical ingredients, such as bleaches, lubricating oil, and acids.
>
> Machinery used directly in the production.
>
> Farm implements and machinery.
>
> Fuel and power, except fuel for internal combustion engines.
>
> Building materials.

The second major exemptions includes certain consumer goods. The categories exempted include:

> Almost all food. The taxable items are candy, nuts, and margarine.
>
> Limited number of medicines like insulin, crutches, and sales of supplies and equipment to public hospitals.
>
> Building materials, fuel and power for both business and household use.
>
> Books and other items of educational and religious use.

Besides these exemptions, certain other transactions, such as exports and services, are in no instance subject to tax.[23]

*Shifting of the tax*. The tax law contains no provisions relating to shifting of the tax. The seller is free to include the tax in the price or to quote the tax separately. However, when a manufacturer is selling to an unlicensed wholesaler, he must quote the price separately on the invoice to facilitate tax refunds should the article be sold for tax free purposes.

The general assumption is that the tax will be shifted forward to the consumers of the product. To determine the distribution of the tax burden by income groups, several studies were undertaken. Table 37 is a study of the distribution of the tax burden by income class in five major cities in Canada in 1953. The data in the table show a relatively proportional distribution of the present tax, except at the lowest level.

*Administration*. Licenses are required for all manufacturers except small firms. Besides manufacturers, there are some wholesalers who are licensed.

These two groups are required to submit monthly returns, stating taxable sales and tax due. This information is submitted to the Excise Division of the Department

---

[23] *Ibid*.

TABLE 37

DISTRIBUTION OF BURDEN BY INCOME CLASS, CANADIAN MANUFACTURERS SALES TAX, FIVE MAJOR CITIES, 1953

| Income Class | Taxable Expenditure as Percentage of Income: Present Tax, Food Exempt |
|---|---|
| 1800-2499 | 41 |
| 2500-2999 | 41 |
| 3000-3499 | 37 |
| 3500-3999 | 39 |
| 4000-4499 | 37 |
| 4500-4999 | 38 |
| 5000-5499 | 36 |
| 5000-5999 | 39 |
| 6000-6500 | 37 |

Source: Based upon data in Dominion Bureau of Statistics, City Family Expenditure, 1953 (Reference Paper No. 64, Ottawa; 1956), cited in Due, Sales Taxation, p. 26.

of National Revenue, because it is this division that administers the tax. An extensive audit staff is maintained, but it is possible to audit an individual firm only at an interval of from 18 to 36 months, and often longer. The cost of collection cannot be ascertained precisely, because the tax is collected by the same branch that administers other excise taxes. There is little complaint against the efficiency of collection, and little is heard about tax evasion.

<u>Place of the tax in the tax system</u>. The place of the tax as an element in the federal tax system is not as important as the turnover tax in Germany. In Canada its importance fluctuates between the third and second place in the tax system. In the 1965 and 1966 fiscal years, the general sales tax has contributed $1,587,761 and $1,917,215 thousands respectively, or about 21.5 and 23.9 per cent of the tax revenue for the federal government. If the general sales tax is combined with the other indirect taxes--excises and customs--their contribution in 1965 and 1966 were 41.4 and 43.7 per cent of the total federal tax revenue. So it seems that indirect taxes play a major role in financing the federal government in Canada. Table 38 presents the sources of revenue to the Canadian Federal Government in 1965 and 1966.

<u>Advantages and Difficulties of the Tax</u>. The Canadian sales tax, as any other form of sales taxes, has its advantages and difficulties. Some of these are as follows:

Advantages: The advantage of the use of the manufacturing level for the imposition of the tax rather than the production and distribution level is obvious. At the manufacturing level the tax decreases the incentives toward integration, and does not discriminate against the independent firms. A further advantage, compared to retail, is the relatively small number of taxpaying firms, as

TABLE 38

SOURCES OF REVENUE TO CANADIAN FEDERAL GOVERNMENT
(THOUSAND DOLLARS)

| Type of Taxes | 1965 | 1966 |
|---|---|---|
| Corporation Income Tax | 1,669,065 | 1,758,870 |
| Individual Income Tax | 2,535,182 | 2,637,356 |
| General Sales Tax | 1,587,761 | 1,917,215 |
| Excise Duties | 823,101 | 910,589 |
| Customs | 622,102 | 685,519 |
| Estate Taxes | 88,626 | 108,353 |
| Total Taxes | 7,325,837 | 8,017,902 |
| Non-Tax Revenue | 6.4,247 | 698,078 |
| Total Revenue | 7,940,084 | 8,715,980 |

Source: Ministry of Trade and Commerce, Canadian Year Book, 1968 (Ottawa, Canada: Queen's Printer, 1968), p. 1025.

opposed to a larger number of small retailers. The small number offers an advantage from the administration and collection standpoint. This is so, because the typical manufacturing establishment is a relatively large firm, with an adequate accounting system for effective tax control.

Difficulties: The determination of sale price is one of the major problems encountered, and of course is of great importance in determining the proper amount of the tax. To overcome this difficulty the Excise Act defines what the sales price should be at the time the sale is made by a licensed manufacturer. However, this problem has tended to become more serious with the complexity of economic life and complexity of the distribution shannels.

Other criticism has centered around:

> Pyramiding--There is a substantial evidence of pyramiding, but competition tends to eliminate the pyramiding over a period of time.
> Hidden nature of the tax--The consumers are not aware of the tax, since it is not quoted separately in the final sale.[24]

Value-added Tax in France

Development of the tax. France was one of the nations that began the experiment with general sales taxes. In contrast to other countries, however, the sales tax structure has undergone substantial modifications. The most recent change is the introduction of value-added form of sales tax and the elimination of the Turnover Tax.

The tax in France, before the 1954 and 1955 reforms, was called a Turnover Tax. This tax is not without precedent in French history. In the financial crisis of 1870, a stamp tax at low rates was imposed on all receipts. This tax was revised several times, and by 1917, in an effort to augment revenue, the tax was extended to all retail sales at a rate of .2 per cent, and a tax of 10 per cent was imposed upon the retail sales of certain luxuries. Purchasers were responsible to government for payments of

---

[24] Perry, Taxation in Canada.

these taxes. The yield was low due to extensive evasion.

In spite of the cessation of War I hostilities, the financial problems of France grew more complicated and more menacing after the war. The need for increased revenue was imperative and a new source has to be sought, since existing taxes were not enough to cover current expenses. The one major remaining source to increase revenue was a sales tax. After substantial debate the government proposed a turnover tax to replace the payment tax and this was approved in 1920. It was suggested that the tax would produce a larger revenue without serious interfering with the process of business.

A general tax at a rate of 1.1 per cent was enacted, with a 10 per cent on retail sales of luxury items. The Turnover Tax was imposed on all stages in production and distribution. The new tax exempted agricultural producers selling their own products, the liberal professions, cooperative societies of producers and consumers, cooperative credit societies, mutual insurance associations, and artisans' societies. The tax did not apply also to government monopolies and to other operations whose operations were already taxable under existing laws. Moreover, the Turnover Tax did not apply to export transactions, but it taxed importation at rates equivalent to those on internal transactions.

The French Turnover Tax was very popular at the time of its introduction, but within a few months of its operation numerous complaints began to be heard. The yield was disappointing, yielding less than 2 billion francs instead of the 3 to 5 billion anticipated. The tax turned out to be not as simple as its sponsors had promised and its administration was attended by a certain amount of confusion.

Since the introduction of the tax in 1920, the French Turnover Tax has experienced numerous modifications. In the first place, the tax has varied in scope and rates with the changing revenue needs of France. The tax has been reformed in its administration to assure greater ease of control. The rate of the Turnover Tax has been modified to meet the pressing revenues needs--it increased to 2 per cent in 1926.

There were also other modifications. In 1924, France introduced the forfeit system in order to facilitate the collection of the tax from small numerous tax payers. This system called for small firms to file an estimate of sales during the coming year, and on this basis the firm would be assessed for payment of the tax; accordingly there would be no requirement on their behalf to keep records of sales.

After 1926, the tax remained virtually unchanged, except for minor modifications, until it was replaced by the value-added tax in 1955.[25]

The Value-added Tax. The value-added taxes are imposed upon firms at each level of production according to their sales of products, but only to the value-added--that is, allowance is made for costs incurred in the purchase of goods from other firms. Accordingly, the tax base for each firm is gross receipts from current output, during the period, less amounts paid to other firms for goods and services.[26]

The taxpayers for this kind of tax consist of several groups:

> Manufacturers and wholesale liquor dealers: All firms engaged in manufacturing and wholesale liquor dealers are subject to the tax, except those excluded.
>
> Wholesalers: Wholesalers are defined as those who resell commodities without further processing. However, those firms have the option of being subject to the value-added tax and enjoy the privilege of deducting the tax on articles purchased, or being subject to paying the local sales tax--2.83 per cent--on the gross amount of their sales.
>
> Importers: Those engaged in the importation business who import taxable goods are subject to payment of the tax on the import transaction.
>
> Building Contractors: Those engaged in fixed construction, including public works and demolition, are subject to the value-added tax. However, a reduction of 40 per cent of receipts is permitted in determining tax liability, which is in effect the same as taxing them at a rate of 13.64 per cent and not the normal rate of 25 per cent.
>
> Table Retailers: These establishments are required to pay the value-added tax on the basis of the wholesale value of their sales if they possess more than

---

[25] Buckler, General Sales Taxation, pp. 72-75.

[26] Clara K. Sullivan, The Tax on Value Added (New York: Columbia University Press, 1965), p. 83.

four retail stores or if they combined retail and wholesale sales and their wholesale sales exceed half of their aggregate turnover in the preceding year. The subjection of these establishments to the tax is to effect some equalization of the tax burden when distributive functions are transferred to nontaxable retail stage.

The rates and exemptions. The value-added tax rates range from complete exemption to the maximum rate on certain luxuries of 33.33 per cent. Most products are subject to the general rate of 25 per cent.

There are two reduced and two increased rates. The reduced rates are:

A rate of 6.38 per cent applies to various food products widely consumed and, moreover, they are taxed only at the manufacturing stage.

Other food categories or producers' goods are subject to 11.11 per cent. The list includes, baby food, water, ice, household soap, and brooms. The rate also applies to agricultural products which have undergone only a slight transformation, also to preserves which at 20 per cent of the net weight is composed of meat products. The 11.11 per cent applies to producers' goods such as fuel and energy, resin and insecticides for agricultural use, soil nutriments, sulphur and copper sulphate products destined for agricultural use. The rate also applies to sales of gas and electricity, water, compressed air, and steam used in central urban heating.

The high rates are:

A rate of 29.87 is applied to ventilators, waxers, and washing machines, various games and sporting and athletic equipment, trunks and ornaments, motion picture apparatus and supplies, floral and decorator pieces, and yard goods whose price exceeds 70 NF a yard.

A rate of 33.33 per cent applies to a long list of goods classified as luxuries. The list includes: ornament and jewelry, perfumes and beauty products, furs, photographic equipment other than those used by professional photographers, smokers' supplies, watches, mirrors and glass, various alcoholic and nonalcoholic beverages including mineral waters.

The tax does not apply to all commodities. The government has allowed certain commodities to be exempted. the exemption list includes the following:

> Exports. The tax does not apply to export transactions. Exports are not exempt from the tax but all taxes paid prior to the export stage are either exempt or reimbursed.
> Sales by farmers of their own products. Also bread, milk, cream, butter, and cheese are exempt.

Taxable price and collection. The value-added tax is assessed on the amount of sale. This has been interpreted to mean that the taxable price encompasses almost all charges inclusive of any outlays--for example, packaging, transportation finance, warranty, installation, and advertising charges. Also, the value-added tax itself is included in the taxable price.

The returns for most taxpayers are required on a monthly basis. The exception to this rule occurs when the firm is subject to the forfeit system. Taxpaying firms are required to keep an adequate system of accounting and firms are audited on a three year basis.[27]

Shifting and Revenue Importance of the Tax. The law required that the tax be quoted separately. This rule is necessary, because the firm cannot deduct the tax on its purchase unless it has been indicated on the invoice.

---

[27] Sullivan, Value Added, pp. 83-93.

The law does not require the shifting of the tax, but it has been assumed that the tax will be shifted forward at each stage.

Those who believe that the tax will be shifted argue that the tax may induce wage increases and increase inflationary pressures by raising the cost of living. However, it has been argued that the tax does exempt the basic necessities of life, and the application of reduced rates to other items greatly reduces the significance of the tax with respect to the cost of living, and thus for wage levels.[28]

As to the importance of the value-added tax in the national tax structure of France, it is by far the most important source of revenue. The relative importance of various categories of national tax receipts and non-tax receipts is shown for 1962 to 1965 in Table 39. The contribution of indirect taxes--value-added tax, service tax, import duties and various other indirect taxes--amounted to two-thirds of the total tax and non-tax receipts in the period, 1962 to 1965. If the total government revenues are compared to tax revenue and non-tax revenues, tax revenues comprise about 95 per cent of the total government net revenue; and the remainder comes primarily from transfers of public authorities, repayment of loans and from the rest of the world.

---

[28] Due, Sales Taxation, p. 130.

TABLE 39

SOURCES OF REVENUE AND THEIR CONTRIBUTION TO THE FRENCH NATIONAL BUDGET, 1962-1965 (MILLION OF FRANCS)

| Type of Tax | 1962 | 1963 | 1964 | 1965 |
|---|---|---|---|---|
| Individual Income Tax | 11,579 | 13,174 | 16,722 | 18,658 |
| Corporation Income Tax | 7,601 | 8,154 | 8,836 | 9,755 |
| Income from Property and Entrepreneurship | 1,843 | 2,133 | 1,888 | 1,979 |
| Turnover Taxes | 24,206 | 28,332 | 32,304 | 33,780 |
| Import Duties | 2,222 | 2,665 | 3,035 | 3,245 |
| Other Indirect Taxes | 14,698 | 16,427 | 18,326 | 18,992 |
| Depreciation Allowances on Public Buildings | 150 | 180 | 210 | 240 |
| Current Transfers from: | | | | |
| Other Public Authorities | 235 | 269 | 263 | 352 |
| The Rest of the World | 370 | 384 | 441 | 288 |
| Capital Transfers from: | | | | |
| Other Public Authorities | 175 | 249 | 281 | 363 |
| Other Domestic Sectors | 686 | 666 | 834 | 932 |
| The Rest of the World | 187 | 188 | 26 | 31 |
| Repayment of Loans and Advances | 1,330 | 1,048 | 1,156 | 1,400 |
| TOTAL RECEIPTS | 72,728 | 82,047 | 93,275 | 99,748 |

Source: United Nations, *Statistical Year Book, 1966* (New York: 1967), p. 658.

<u>Merit and limitation of the tax</u>. Merits--the present French tax offers the following advantages:

> The value-added tax eliminates completely the multiple application of the tax, with consequent discrimination and encouragement to integration.
>
> Incentive to investment. Allowance is made for the deductability of the tax on equipment purchases. This removes a great burden that would otherwise be placed by the high rate tax on the acquisition of new capital equipment.
>
> Cross-checking. Since the tax is separately quoted, this offers a great advantage in facilitating cross-checking, since amounts reported as tax deductions by one firm reflects tax payments by other firms. This facilitates control of the tax and the prevention of evasion.
>
> Imports and Exports: On the import side, the tax places completely equal burden on goods imported and those domestically produced. On the other hand, it completely frees the exports from any tax, and thus facilitates the competition of domestically produced items in world markets against firms not subject to sales taxes.

Limitations--Despite the above merits, the tax still suffers from the following defects:

> Exemptions, rate differentiation, and other special features, tend to make the tax more complex and obscure its merits. As an example, consider the special treatment of farm equipment. This equipment is excluded from the tax, although farmers are not liable for the tax and therefore have no tax liability from which to deduct the tax borne on purchases.
>
> Special treatment of artisans. The failure to apply the value-added tax to artisan producers gives incentives for large and efficient firms to split up and take advantage of the tax exemptions.

## The British Purchase Tax

<u>Development of the tax</u>. In contrast to other sales taxes, the British purchase tax is a recent addition to their tax system. The tax was imposed in 1940, and called for a wide range of exemptions, and two rates,

16 2/3 per cent on items regarded as necessities, and 33 1/3 per cent on luxuries. The tax is levied on the last wholesale transaction.

The purchase tax is essentially a comprehensive sales tax which uses different rates for different classes of commodities. In its application, the differentiated rate structure distinguishes between necessary goods and luxury goods.

The tax has been subject to many revisions. The major change came in 1942, when the utility system was established. The utility system exempted clothing, shoes, and furniture produced according to specification. The exemptions encouraged consumers to buy utility items rather than non-utility. At the same time, a new rate of 66 2/3 per cent was established to discourage the production of non-utility goods by making the consumers who chose to buy them suffer the tax penalty. In a sense, it was used as an instrument to influence consumption patterns. Apart from minor changes in classification, the tax remained unchanged until the end of World War II.

By the end of the war, it was believed that the purchase tax could be eliminated. However, the government gave priority to reduction of direct taxes, because it believed that direct taxes were seriously discouraging incentives. With the reduction of direct taxes, the government took another step and liberalized the purchase tax by exempting many household appliances, and a number of items were moved to lower tax classes.

There were other changes after the war. The rates were increased and/or decreased depending on the economic circumstances that faced the country in a particular period.

These changes lasted until 1957, when the tax was established in its present form and classification. Due explained the classification as:

> The classification is now primarily upon the basis of estimate of necessity of the commodities, although it is still influenced by the desire to restrict use of particular classes of commodities, particularly those which are primarily imported, or are potential objects for export.[29]

Rates and Exemptions. According to the purchase tax, there is no one basic rate, but several differentiated rates--from 11 to 27.5 per cent--with durable consumer goods the most important part of its base.[30] The tax does not apply to all commodities. The exemptions include exports, foodstuffs, raw materials for industry, as well as goods subject to excise taxes.

Tax base and collection. The tax is imposed upon the last wholesale transaction, that is, upon the sale to

---

[29]Due, Sales Taxation, p. 205.

[30]Richard A. and Peggy B. Musgrave, "Fiscal Policy," in Britain's Economic Prospects, by Richard E. Caves and Associates (Washington, D.C.: The Brookings Institution, 1968), p. 46.

the retailer, whether by manufacturer or wholesaler. Dealers subject to the tax must register, unless their annual receipts do not exceed 500 pounds.

The tax does not apply to sales of taxable goods from one registered firm to another so long as the goods are purchased for use as materials or for resale at wholesale. On the other hand, if a registered firm buys taxable goods for its own use, it must pay the tax on the purchase. Moreover if a firm has a retail branch, the tax normally applies when the goods are transferred to the retailer branch.

Wholesalers and manufacturers who deal in goods subject to the tax are responsible for the payment of the tax. Returns are filed on a quarterly basis, payment being due within one month after the end of the quarter. To calculate the tax liability, the firms simply sum up the amounts of tax charged on each transaction.

The tax is administered by the Commissioners of Customs and Excise. The returns are inspected thoroughly, and the returns of all firms are reviewed on at least a quarterly basis.

The cost of collection cannot be estimated precisely, since the tax is collected by the same administrative branch which collects customs and excises. For customs and excises, the cost of collection has been estimated to be about .76 per cent of the yield, and this cost cannot be broken down by individual tax.

*Shifting of the tax.* The registered firms are required to quote the tax separately on their sales invoices, except when the buyers are final consumers. Retailers are not required to show the tax element separately, but they are not prohibited from doing so. Of course, retailers prefer not to indicate the tax element separately--the consumer may be discouraged from buying when the tax is added separately. The tax is usually shown separately in the price of automobiles, and this practice is generally followed by retailers of fur and a few luxury items. It is argued that the tax would discourage consumption of the taxed items--if quoted separately--the consumer is made aware of the tax, and he might postpone a purchase hoping the tax might be reduced.

The law does not require the seller to shift the tax. In order to prevent price increases of more than the amount of the tax, the law provides that the retail price may be raised by the amount of the tax.

*Place of the tax in the tax system.* The introduction of the purchase tax appears to have been regarded as a major new source of revenue. However, on several occasions, adjustments in the tax have been made primarily in terms of fiscal policy considerations. Thus, from the start, the relative emphasis on the goals of the purchase tax--revenue and fiscal policy aspects--has shifted from time to time. Nonetheless, the fiscal aspect of the tax has played a major role in the life of the tax.

Compared to the sales taxes of other countries, the purchase tax has never been a major producer, partly because its power to yield revenue depends on the volume of taxable purchases made by consumers, and partly because the limited scope of the base has severely restricted the yield despite the moderate rates. Table 40 shows the trend in the composition of United Kingdom tax revenue for the period 1960-1966. The table indicates that there has been a slow but steady increase in the relative importance of taxes on personal income, matched by a corresponding decline in taxes on corporate income.

As shown in Table 40, the yield has jumped from 3 per cent of total revenue during the war years to a range of about 7 per cent in the years after 1948. Due observed that if all of the indirect taxes were added together--the purchase tax, excise tax, and customs duty revenue in 1956 fiscal year amounted to 2,013 million pounds or 43 per cent of total tax revenue.[31]

The effectiveness of the purchase tax as a fiscal device depends on the degree to which it inhibits consumer spending. Whenever the consumer decides not to spend because of the weight of the tax, it is an aid to fiscal

[31] Due, Sales Taxation, p. 226.

TABLE 40

TAXES ON INCOME, CAPITAL, EXPENDITURE, AND PROPERTY IN UNITED KINGDOM AS A PERCENTAGE OF TOTAL TAXES 1960-66

| Year | Taxes on Income: Personal | Taxes on Income: Corporation | Taxes on Income: Total | Taxes on Capital | Taxes on Expenditures: Import Duties | Taxes on Expenditures: Purchases | Taxes on Expenditures: Excises, etc. | Taxes on Expenditures: Total | Taxes on Property |
|---|---|---|---|---|---|---|---|---|---|
| 1960 | 31.4 | 11.4 | 42.8 | 3.7 | 2.4 | 8.0 | 30.9 | 41.3 | 12.2 |
| 1961 | 32.3 | 11.7 | 44.0 | 3.7 | 2.2 | 7.5 | 30.7 | 40.4 | 11.9 |
| 1962 | 32.3 | 13.0 | 45.3 | 3.5 | 1.9 | 7.5 | 29.8 | 39.2 | 12.0 |
| 1963 | 32.4 | 11.3 | 43.7 | 4.0 | 2.0 | 7.3 | 29.9 | 39.2 | 13.1 |
| 1964 | 33.8 | 8.7 | 42.5 | 3.7 | 2.5 | 7.6 | 30.4 | 40.5 | 13.3 |
| 1965 | 36.3 | 6.8 | 43.2 | 3.1 | 3.7 | 6.4 | 30.3 | 40.4 | 13.2 |
| 1966 | 35.3 | 7.5 | 42.7 | 3.1 | 3.0 | 5.7 | 32.3 | 41.0 | 13.1 |

Source: United Kingdom, National Income and Expenditure, 1961 and annual issues through 1967. Cited in Richard E. Caves and Associates, Britain's Economic Prospects (Washington, D. C.: The Brookings Institution, 1968), p. 48.

objectives; however, if the consumers do spend on taxable goods despite the weight of the tax, additional revenue can be expected from them and their potential for further spending would be reduced by the amount of the tax.[32]

Besides its effectiveness in reducing total spending, the purchase tax does not have as damaging an effect on incentives as would occur when income is taxed before receipt by a spender. The purchase tax succeeds in draining away more of the spending power without reducing work incentives. Without increasing direct tax any further, consumers are allowed to keep a greater portion of their income, and are free to spend on necessities or to save with no further penalty. However, additional heavy taxes are extracted from them whenever they enter the market for non-essential goods. Thus through its high rates, the purchase tax accentuates the desirability of postponing current consumption and increases the propensity to save.[33]

Finally the purchase tax may be used as a device to lessen balance-of-trade deficits. This can be accomplished by imposing high rates on commodities which are imported in substantial quantities. Total imports are reduced by the amount of tax since purchases of those

---

[32]Arnold M. Seloway, "Economic Aspects of the British Purchase Tax," *The Journal of Finance*, IX (May, 1954), p. 191.

[33]*Ibid.*, p. 192.

goods are reduced.

On the other hand, the purchase tax may be used as a deliberate policy to discourage domestic purchases of goods which might be exported. The taxation of the specified goods will cut down on domestic use, and thus free the output for export purposes. "Apart from the taxation of specific products for this purpose, the overall effect of the tax in reducing domestic spending tended to free materials and manpower for the production of other goods which might be exported."[34]

Evaluation of the tax. From an operational standpoint, as well as one of economic effects, the purchase tax has many advantages. The primary advantage of the tax is its potentiality as an instrument for inflation control. The high rate, made possible by the exemption and rate differentiation, provides an effective incentive to curtail consumption without producing any adverse effects on incentives to work. This superiority, however, will be weakened, if people believe that the high rates will continue.

Finally, major producers' goods are excluded from the purchase tax. The only exception to this rule are the motor vehicles which have been included in the base of the tax for special reasons.

---

[34] Due, Sales Taxation, p. 228.

On the other hand, despite its merits, the tax has been subject to criticism. The most significant objection is to the differentiated rates. The objection has centered around the application of tax on certain commodities while others are untaxed or taxed less heavily. Moreover the tax is very complex and the numerous lines that have to be drawn between taxable and nontaxable items have complicated the tasks of both the taxpaying firms and those in tax administration. "A tax of this type can be employed only when standards of tax administration and tax morality are high, taxpayers' records are good, and the number of taxpayers is limited. While the tax appears to function surprisingly well, the compliance costs and nuisance are not inconsiderable."[35]

Finally, the purchase tax has created the problem of uncertainty in the business community. This uncertainty has resulted from the constant changing of tax rates which interferes with planning by business for future production. This has also led the consumers to speculate about rate changes and caused postponement of spending by consumers.

## Summary

The preceding discussion has indicated that the sales tax is not a new concept in the modern world, but has been in use for centuries. The sales tax is one method

---

[35] Ibid., p. 231.

of imposing a tax upon expenditures to raise the necessary revenue to meet the diversified obligations of the state. As a practical matter, nearly all forms of sales taxes in use today have been introduced in periods of financial emergency--a period in which additional revenue was urgently needed.

The need for revenues to meet the emergencies forced the developed nations to look for alternatives--other than raising the income tax--to augment their revenues. One method was to impose a sales tax on expenditures.

With respect to the question of the form of the tax, it may take the form of a retail sales tax, turnover tax, manufacturer or wholesale sales tax. The form of sales tax will depend upon the historical experience of the particular country. However, apart from certain administrative aspects, the retail sales tax is the superior type. Experience with the multiple stage or turnover tax has demonstrated its complete unsuitability, because of discrimination against various business firms, and the inevitable complexities which arise out of attempts to mitigate the discriminatory features.

As between taxes on the manufacturing level and those at the last wholesale level, either type can operate satisfactorily. The wholesale levy places the burden closer to the consumer particularly in minimizing the number of cases in which price must be adjusted for tax purposes to prevent discrimination among various firms.

The value-added tax offers no fundamental advantages over an equivalent single stage tax, except that of spreading out the impact of the tax over a greater number of firms. It also facilitates cross-auditing of the returns of various firms, and the excluding of producers' goods from the tax.

In the establishment of the tax structure of a sales tax, it is desirable to confine the tax as far as possible to the sale of consumption goods. It is desirable to exclude producers' goods from taxation especially in countries in which maintenance of a high level of investment is important. Also, it is desirable to insure as broad a coverage of consumption expenditure as possible, and to avoid discrimination against various consumers with different preferences and administrative problems.

To sum up, with high and increasing levels of government expenditures, and pressure against extremely high income tax rates, the sales tax--highly productive of revenue at moderate rate so long as the coverage is broad--is almost certain to remain an important element in the tax structure of most countries.[36]

The information in this chapter is to prevail upon those underdeveloped countries who oppose the adoption of

---

[36]*Ibid.*, p. 389.

sales tax in their tax structure, that it is time to reconsider their traditional opposition. Their consideration for the imposition of such a tax stems from an urgent need to increase their revenues. Their expenditures are increasing at a faster pace than their revenues. The present tax structure does not provide room for expansion. At the present time, the state of their economic development, their administrative standards, and taxpayers education and morality do not permit adequate sums to be raised from a highly progressive income tax. Facing such a situation, the sales tax must be used to get adequate revenues.

The next chapter examines selected internal methods of financing economic development. One of those methods will be concerned with the adoption of a sales tax.

# CHAPTER VI

## METHODS OF FINANCING ECONOMIC DEVELOPMENT

The present means of obtaining internal and external funds for economic development are not enough to meet the needs of the plans envisioned by the underdeveloped countries. The present resources cannot fulfill the needs because the process of development is inevitably very costly and requires more money than they can raise.

Being faced with the shortage of capital, these countries have to find other alternatives to alleviate that condition in order to accelerate their economic development. The alternative which they choose to employ to secure more capital may at times produce injustices and inequalities in the distribution of fiscal charges. However, such considerations should not deter them from accepting such alternative if this will lead them to a sustained growth. Thus this chapter will analyze the following alternatives: (1) the role of land tax in economic development; (2) the role of inflation as an aid to development; and (3) the sales tax as a means of financing development.

## The Role of Land Tax in Economic Development

Many writers in the field of development have expressed the belief that the agricultural sector in a number of underdeveloped economies is capable of providing a source of capital, capital which might be productively channelled, either by the government or by private enterprise, into social overhead capital or into industrial projects in the country. There is, among these writers, also a belief that perhaps agriculture's greatest contribution to development will come from underemployed agricultural workers who can be released to supply the required labor force necessary for the industrial sector. In the process of releasing agricultural workers, an increase in the productivity of the agricultural sector will occur; however, even when agricultural productivity is increasing, there may not result in any substantial surplus for investment in the industrial sector because the agriculturists may fragment away the increased output on their own consumption. Thus fiscal devices, especially in the form of increased land taxation, constitute an important mechanism for siphoning off the increased productivity of the agricultural sector into resources for investment in non-agricultural sectors. Some writers have pointed out that:

> The transition from a level of saving and investment that spells stagnation to one permitting a tolerable rate of economic growth cannot be achieved unless

> agriculture makes a significant contribution to capital formation in the expanding sectors.[1]

There is, however, another possible contribution which agriculture can make to the development process. By a properly operated fiscal policy, the government can obtain tax revenues and through various incentive effects, may direct production into desired agricultural areas and at the same time increase overall production. However, there may be serious objections to the governmental policy of discriminatory taxation aimed at a particular segment of the economy in order to finance economic growth. However, this concern need not create a problem if it is viewed within the context of using fiscal policy as a positive tool for economic growth. Walter Heller notes the importance of an analysis of the special problems of agriculture in the underdeveloped economies to achieve:

> . . . a better understanding of how agricultural taxes can be used to provide compulsory savings for economic development and how "manipulative taxation" can be used to motivate increases in agricultural effort investment and output as well as desired changes in its composition, distribution, and so on.[2]

Since one of the situations that faces an underdeveloped nation is a critical shortage of capital--a

---

[1] B. F. Johnston and J. W. Mellor, "The Role of Agriculture in Economic Development," American Economic Review, Vol. 51 (September, 1961), p. 579.

[2] Walter Heller, "A Survey of Agricultural Taxation and Economic Development," Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development, Ed. by Haskell P. Wald and Joseph M. Froomkin (Cambridge: Harvard University Press, 1954), p. 120.

source must be found for the needed funds. As stated earlier economists have argued that the agricultural sector of underdeveloped nations can provide a significant portion of the increased savings necessary to finance development. As will be described later, a land tax will fall primarily on that particular segment of the agrarian economy which not only has the ability-to-pay, but which also tends to consume a large percentage of its income in sumptuous living. A correct fiscal remedy for this situation would be for a land tax to be so structured, that after implementation it would be more progressive than "a politically possible progressive income tax." Such a tax structure may also curtail unproductive, speculative investments in idle real estate.

Ability-to-pay. In that land taxes discriminate against a particular form of wealth, it is important that they conform, at least in a general way, to the ability-to-pay principle. Rather than adopt this principle as the absolute guiding standard for assessment of land taxes, other objectives and considerations enter the decisions for the support of land taxes such as: (1) Theory that the state has historical rights in land; (2) Familiar argument of the single-taxers and other that there is a public equity in land values; (3) Benefit principle; and above all, (4) Considerations of fiscal expediency and administrative convenience.[3] Wald concludes by stating: "To the extent that a land tax has its raison d'etre in any of these arguments, the economic and personal status of the taxpayer need not enter into the determination of the tax liability."[4]

Some countries have attempted to eliminate the discrimination involved in taxation of land with a special tax by incorporating the tax into the general income tax structure (by using gross income or net income as the tax assessment base) or by exempting land income from other forms of taxation. Other countries have apparently decided to maintain the ability-to-pay criteria within the agricultural community while continuing or instituting an unequal tax between the various sectors of the economy. One way of obtaining more equity within the agricultural sector is accomplished by using, at the tax base, cadastral surveys which would classify land recording to its productive capacity, and making allowances for costs of production, methods of irrigation and distances from markets. The aim of such a tax policy is an equitable distribution of taxes among different farms, rather than among different farmers.[5]

---

[3]Haskell P. Wald, *Taxation of Agricultural Land in Underdeveloped Economies* (Cambridge: Harvard University Press, 1959), p. 43-44.

[4]*Ibid.*, p. 44.

[5]*Ibid.*, p. 44-45.

There is one readily apparent paradox in the attempts of most underdeveloped nations which are concerned with the ability-to-pay approach within the agricultural sectors--after putting forth the effort to apportion tax assessments according to some abstract standard of net produce, rental value, or capital value, little effort is made to keep data on the assessment base current.[6]

Equity Approach. The problems of economic analysis when dealing with equity are numerous. Equity is a subjective concept which means different things to different people. Even if a standard of equity is agreed upon, this does not insure agreement on the degree to which a given tax approximates that standard. Analysis of land tax from the criterion of equity is even more difficult than analysis of "individual income taxes which are specifically designed to serve as comparatively refined instruments of equitable taxation, land taxes are much more the product of fiscal expediency or opportunism. This characteristic of the taxes creates a presumption . . . that even the best land taxes promote only rough justice."[7]

To see the equitability of the land tax, the theoretical arguments which demonstrate where the burden of

---

[6]*Ibid.*, p. 51.

[7]*Ibid.*, p. 86.

the tax finally rests must be surveyed.

First, according to price theory principles, a tax on "pure" economic rent will have no effect on price or output and will thus be borne by the landlord. This doctrine is based on a competitive economy in which the price of the output is determined by the cost of production on marginal land. By definition such land yields no surplus or rent and carries no tax when the tax base is restricted to economic rent. Therefore, a tax that is no greater than the economic rent will not affect the supply of land under cultivation or induce the owners to shift their production. Without change in supply the market price of agricultural commodities will be unaffected by the tax, assuming no effect on cost of production as a result of the tax.

The initial principle has two important corollaries. First, the tax will be absorbed by the landlord whether the land is rented or owner cultivated. Since the supply of land remains the same as before and there has been no change in the number of tenants, a competitive land market will force the landlord to absorb the tax on "pure" economic rent. Likewise, the landlord cannot shift such a tax to farm laborers or to other suppliers of production inputs.

A second possibility deals with a tax greater than economic rent but less than total rent. In this case the tax will be shifted since it would discourage landlords from replacing capital improvements which account for the difference between economic rent and total rent. This would, in the long run, result in decreasd output which may be sold at higher prices. Thus part of the tax will be shifted forward in the form of increased prices to consumers of agricultural products. Also if the tax causes capital to move from the agricultural to the non-agricultural sectors, this will decrease the return on capital in the latter sectors, reduce the price of non-agricultural goods relative to agricultural goods, and result in less shifting to consumers than would otherwise have occurred.[8]

Various Systems of Land Taxation. Any comprehensive discussion of land taxation must recognize a variety of possible forms which a land tax might take. Various possibilities include land taxes proper, property taxes, land income taxes, tithes, and marketing taxes. In any system of taxation, it is first necessary to establish a tax base to determine the obligation. According to Haskell Wald, the general structure of land taxes in the underdeveloped nations of the World can be categorized into any of four areas: (1) land area, (2) rental value concept, (3) income concept, and (4) special purpose taxes.

[8] *Ibid.*, pp. 88-90.

These four divisions can also be subdivided. A distinction can be made between land areas which are classified at a uniform rate or a classified rate. A rental value concept can similarly be divided into two distinct areas, annual value and capital value. The income concept lends itself to a four part division: (1) Tithe, (2) gross yield or gross income, (3) net income, and (4) marketed produce.[9]

Taxes Based on Land Areas. Historically, this was one of the first methods of levying a land tax. In its most elementary form a uniform rate was applied according to the physical area of each taxpayer's holdings. Each unit of land area was taxed at a certain rate regardless of the income-producing potential or location of the land. The simplicity of administrating such a tax is, however, outweighed by the obvious drawbacks to such a system. For the uniform rate to be successfully applied and collected, it is necessary that either the rate be extremely low or that it only apply to land which is under cultivation. As shall be seen later, these solutions are not highly inducive to financing economic growth from agricultural savings. A uniform tax rate might, however, be applied if all of the taxable units were highly homogeneous. One of the few areas in the world using such a

---

[9] *Ibid.*, p. 12.

tax system is in Paraguay. The tax rate varies among different districts even though it is uniform within any given district. In determining what the particular tax rate will be within a district, the tax director uses the average value of property in that district.[10] A modified area tax is also applied in Tunisia where a unit tax is placed on market gardens. The tax unit for market gardens is a hectare. There are two rates depending on whether or not the land is irrigated or not, irrespective of the garden crop grown. The tax on irrigated land is more than three times that of non-irrigated land.[11]

The classified rate base is more complex than the simple land area base. The classified rate retains land area as the assessment base. But tax liability is determined according to a rate schedule which is expressed per unit of land area and is graduated according to the economic classification of the land. Possibilities for classification range from the Ethiopian system which created four categories (fertile, semi-fertile, poor, and unmeasured) to a more complex pattern used in West Jordan which established sixteen categories depending on both fertility and use. In Jordan, the tax rates for the

---

[10] *Ibid.*, p. 12.

[11] Anwar Iqbal Qureshi, "Structure and Taxation of Agriculture in Tunisia," *Papers and Proceedings of the Conference of Agricultural Taxation and Economic Development*, p. 364.

different categories range from 4 fils to 70 fils per donum.[12] By use of this system, it is possible to change the revenue yield of the tax by either changing the tax rate or the classification of the land--fiscal authorities may then adjust revenue yields by either of the two methods. This may be of some advantage when the development drive dictates the need for additional revenues. An undesirable feature of this system is that classification must be broad and, due to administrative considerations, this will leave the structure of taxation somewhat less than what would be theoretically desirable. Thus, while the land tax based on land area is relatively simple to administer, there are complexities.

Taxes based on a rental value concept. This method of taxation is conceptually linked with the Ricardian theory of rent. As originally written, Ricardian theory stated that the amount of rent for any given plot was determined by the excess which it received over the amount received from the production of "marginal land." The cultivation of marginal land was forced by the growth of population and would only be utilized when the revenue from its cultivation covered the cost of production, including wages of the cultivator, and leaves nothing for rent. From this theory it follows that a tenant farmer

---

[12] Wald, Taxation of Agricultural Land in Underdeveloped Economies, p. 12-13.

can afford to pay the landlord as much as the full "differential rent" and still retain the ordinary rate of return for his labor and capital.

The problems of applying the annual rental value concept in an underdeveloped country are numerous. If land tax were to be based on actual rentals paid by tenants, with the landlord granted allowances which cover his expenses, this would theoretically reveal the annual rent. If the land were owner-cultivated, it would be possible for assessments to be made with reference to rentals and expenses for similar properties which are cultivated by tenants. This plan, however, does pose certain problems. First, the land market in an underdeveloped country diverges from the perfect market which would be necessary for the successful implementation of such a theory. Also the rental payments of tenants may include provisions relating to security of tenure; the rental agreements may be for varying years; the respective responsibilities of the landlord and the tenants may be different in each case; rents may be other than "competitive rents" because of some historical phenomenon; and rents are sometimes paid in kind which would provide a fluctuating base depending upon the market value of the produce.[13]

---

[13] *Ibid.*, pp. 16-17.

A better plan for assessments which operates within the conceptual frame work of the annual rental base would require tax officials to estimate the income producing capacity of each class of land (assuming standardized land classification and assessment producers) and then to strike out the part representing rental value. Secondly, the officials could appraise the capital value of land, either by reference to current land prices or in accordance with established standards of appraisal, and then compute the rental value on the basis of an assumed rate of return. The primary disadvantage to this proporal is that the necessary personnel to administer the project may not be available in an underdeveloped nation.

An alternative theoretical structure is one which begins with the proposition that land has an economic value for the same reason as any other productive agent and that it will secure a net return for its owner. Wald defines rental value:

> In the specific case of agricultural land, rental value is the payment that can be obtained in a competitive market for the opportunity to apply common techniques of agriculture in the cultivation of the land, after taking into account its location and other inherent qualities and whatever additional qualities it contains as a result of past human action.[14]

Under this concept the theoretical justification for capital value as a base for land taxation can be made. If capital value is used as the basis for land taxes, current value

---

[14] *Ibid.*, p. 15.

is often used as the definition of capital value. Capital value may be defined as exchange or market value, that is, as the price at which properties are being sold or can be sold. In the case of pure competition, the land value is determined by economic factors and the capital value of land is nothing more than the capitalized net annual rental value which is represented in the formula below:

$$\text{Market value} = \frac{\text{Net Rental Income}}{\text{Interest Rate or Capitalization Rate}}$$

For illustration, suppose a plot was expected to produce a net yearly rental income of $100 for an indefinite number of years. If the current rate of interest is 20 per cent, then the competitive market value of land is $500. If the rate of interest is 10 per cent the market value of land, theoretically, increases to $1000. From the viewpoint of the buyer of land, rent is the rate of return on a capital investment.

Since land markets are influenced by institutional factors and market imperfections, the actual price may deviate from the theoretical price. In addition, there are other factors which necessitate an arbitrary establishment of values. Since only a small portion of the taxable land holdings are sold in any given year, there is ample reason to question whether or not their selling price is an adequate reflection of capital value, and a minimum amount of discretion must be placed in the hands of tax assessors in valuing the land.

If these problems can be assumed to be solved by administrative procedures, other problems concerning capitalized value also arise. By assuming that the selling price of land is determined solely by economic considerations rather than by social benefits, such as prestige derived through ownership of land, then the selling price reflects the discounted value of anticipated rental income and not necessarily the capitalized value of current rental income income. Other considerations are likely to be present when the selling price is not associated with the optimum economic use but with its value under less than optimum use.[15]

At this point, it is beneficial to compare the annual rental value base with the capital value base. Due to the administrative operations of the tax assessing units in underdeveloped nations, a tax assessed on rental value is more likely to be based on current income from the land in its present use rather than its optimal use. Wald contends that in actual practice, taxing capital value is a means of reaching both current income and wealth, whereas taxing annual value permits reaching only the former.[16] The difference between these two approaches is important when considering the economic effects of each specific

---

[15] Ibid., p. 25.

[16] Ibid., p. 26.

case. Consider, for example, idle land at the edge of a rapidly expanding urban area. Under the annual rental concept the taxes would be much less than if the capital value assessment were made considering optimum use as opposed to current market price or value.

Taxes Based on an Income Concept. The third major category of land taxes uses an income concept as the base upon which to make tax assessment. The distinction between this tax and that previously discussed--rental value

> . . . is not a matter of outward form, which may be similar for both groups, but rather of below the surface characteristics related to how the tax base is defined in the law and assessed in practice.[17]

The rental value concept is primarily directed towards identifying a special class of income which is attributable to the properties of the land, to the quality of the soil, the location as related to climate, irrigation, and accessibility to markets. The income concept is much broader and concentrates on agricultural income from land plus the other means of production (labor and capital). Once again problems exist in the successful implementation of a tax.

The base of the tax can be measured in terms of physical production or in monetary terms; the base can be either total income or cash income, and either gross or net. Within each of these categories other problems occur. For example, if the tax is on net income, should a standard

---

[17] *Ibid.*, p. 29.

percentage be deducted from gross income to arrive at net income or should the farmer's own records be used to determine the costs of production? In a non-monetary sector of an underdeveloped nation, it is highly unlikely that adequate records will be maintained and a standard deduction may not accurately reflect actual production costs for the vast majority of farmers.

One of the oldest methods of taxation which employs gross income as the basis for taxation is the tithe. In ancient times, payment in this form was made to the secular power based on the principle that the ruler had a part-proprietorship in the land and that his claim to the tithe was a result of his ownership rights and not his taxing power. This concept has been carried over to the present in parts of the Middle East and presents an institutional barrier to attempts to revise agricultural taxation along modern principles.[18] The tithe did not necessitate, in actual practice, land surveys or land valuation and was generally paid in kind. Most often inspectors made on-the-spot assessments during the harvest period.

Another form of income tax is based on gross yield or gross income. This tax differs from the tithe because the gross yield or gross income is assessed according to the rated productivity of the land rather than on-the-spot inspection. One such example is Morocco. Agricultural

---

[18] _Ibid._, p. 30.

land is classified into eight categories, according to productivity, and then taxed on the basis of the taxpayer's declaration as to his gross output. There are two tax rates, one for the Europeans and the other for the natives. The Europeans pay a higher rate because of their greater productivity. Only fruits and vegetables are taxed according to the cash value of production.

Another method is to assess taxes on net income. Examples of this system are few and in each one a presumptive assessment is used. When a tax on net income is employed, it generally indicates that the country has vacated the view that agricultural incomes should be taxed differently than other incomes; thus, the net income tax on agriculture can be easily incorporated into a system utilizing a general income tax.

A tax with a net income base is used in Nigeria. The village, a collective unit, is assessed in accordance with estimates of yield--if the land were cultivated to yield an average. The assessment is then divided among the villagers according to their individual net incomes.

The remaining category for various land taxing methods is the special tax. Taxes which fall in this area are generally designed to serve nonfiscal objectives of an economic, political, or social nature. One such base is a tax on incremental value. Many economists have discussed the peculiar taxable capacity of increases in land values, on the grounds that such increases are often due to the ordinary progress of society and not to any effort or investment by the landlord.

Several methods present themselves for taxing the unearned increment in land values. Wald describes these:

> Imposition of one time levy on the basis of the increment in land value from a fixed date in the past; past increments in value may be taxed at the time of transfer, possibly at rates which vary according to the class of land and the length of time held; and, provision could be made for taxing future increments in value at a specified interval.[19]

One method of administering an increment tax when value increments are localized, and result from a specific public improvement project is to impose a special assessment. This levy, theoretically, determines and taxes that part of the specific benefits created by the improvement which are obtained by the land holders. Implementation of these taxes raises fewer cries of confiscatory taxes since the projects are tangible and benefit the local taxpayer directly.

Apparently the underdeveloped countries lack the skilled administrative staffs to successfully employ such devices. Special assessments are widely used in the United States with a somewhat more sophisticated administrative force than is available in most underdeveloped countries. They are especially adaptable to specific projects which are necessary for the development of underdeveloped countries,

---

[19] *Ibid.*, p. 37.

i.e., irrigation projects, flood-control systems, and certain types of roads, etc. These countries have thus far showed little interest in seeking out refined fiscal tools of this type.[20]

Another type of special taxation tool is the penalty (or incentive) tax. The attempt is made to either subsidize, if increased production of a specific nature is desired, or to tax, if that will stimulate general production or eliminate production of undesired commodities. Chile, for example, has levied a special tax on newly planted vineyards based upon the area of new plantations. The purpose of this tax is to discourage domestic consumption of wine. Producers of grapes for consumption as such are exempted, as well as producers for export in certain conditions.[21] South Korea uses a method by which agricultural production can be readily channelled. Tax rates on staple crops (rice, barley, wheat, and rye) are graduated by tax brackets according to the assessed yield of the taxpayer's land and the tax must be paid in kind. Brazil and Argentina use a method of progressive property taxes as a penalty tax to promote the breaking up of large land holdings.

---

[20] Ibid., p. 38.

[21] United Nations, Fiscal Division, "Structure and Taxation of Agriculture in Chile," Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development, p. 346.

*Effects of Various Taxes.* In any analytical discussion of agricultural taxation, the objective of the fiscal authorities must be kept in mind. The role of taxation to alter the distribution of income, wealth, and land ownership will be neglected in this analysis. The concentration will be on the use of taxation to stimulate desired changes in private use and allocation of agricultural resources--with incentive effects of such taxes as may be implemented by the government. Incentive taxes primarily deal directly with the farmer as a producer rather than affect his actions indirectly as consumer. Also incentive taxes work through the structure of taxes and not through the level of taxation even though they are interrelated, i.e., if the level of taxes is low, the impact of incentive taxes may be weak but with a high tax level, the imposition of the same tax may yield the desired results. There are a multitude of incentive taxes and perhaps the best method of condensing the subject is to note the basic objectives and in certain of these objectives, show what taxes were imposed to obtain the desired results.

*Taxes to Increase Incentives to Work.* There are a number of fiscal tools which can be used to encourage the farmer to work harder and produce more. Such actions as decreasing the marginal rates on income or produce taxes would result in an increased work effort. Japan replaced a fixed percentage tax on gross (or net) crop with a tax on the value of land. The government in its valuation of land took its revenue needs into consideration and placed valuation at the level which insured the revenue necessary to finance development.

The industrialization of Japan was largely financed by the mobilization of resources, through the medium of land taxation, from the agricultural sector. The total production of major crops in Japan increased throughout the four decades 1880-1920. The increase in output was associated with a reduction in the agricultural labor force. The output per farm worker rose by 106 per cent. Thus labor productivity in agriculture in Japan was practically doubled in a span of 20 years, i.e., from about 1885 to 1915.[22]

In Japan heavy land taxes were the device which was used to siphon off a part of the increment in productivity in agriculture, and these revenues were channelled directly into investment projects by government action. At the beginning of Japan's industrialization the land tax accounted for nearly all the revenues of the national government (50 out of 58 million yen of tax revenue in 1875-76). In 1893-94, the land tax yielded approximately 38.8 million yen or 45 per cent of the tax revenue of the

[22]B. F. Johnston, "Agricultural Productivity and Economic Development in Japan," The Journal of Political Economy, Vol. 59 (December, 1951), pp. 499-500.

general account. Although the yield from the land tax had declined in relative importance due to the development of other taxes, the land tax revenue of 86 million yen in 1906-7 still represented 22 per cent of the tax revenue.[23]

In Soviet Russia, the increase in productivity in agriculture was of great significance as a source of financing a rapid rate of capital formation. In Russia, the farm population not only failed to improve its level of living but experienced a deterioration in economic well-being; the farm population food consumption clearly declined both in quantity and quality.[24] The forced collection of grains played the role in Soviet Russia that land taxation played in Japan; it was the principal means whereby the gains in agricultural productivity were siphoned off to help in the financing of a rapid accumulation of capital.

It has been suggested that land taxation in under-developed countries should provide sufficient incentives for the increase of production in the agricultural sector by individual farmers. In order to increase the incentive to work on the part of the peasants, high marginal rates of income or produce taxes on agriculture may be reduced or taxes which respond directly to the size of gross or net output should be replaced by taxes which are either fixed in amount or which are indirectly responsive to

---

[23] *Ibid.*, p. 502.

[24] *Ibid.*, p. 510.

changes in output. The objective of such taxation would be to leave rewards for additional effort undiminished, i.e., to minimize the substitution effects of taxes.[25]

A quite different approach to stimulating additional effort in agricultural production would be to operate through the income effect of heavy agricultural taxation. Due to the heavy taxation the disposable income of the farmers would be reduced below customary levels, and, as a result, they will have the incentive to strive harder to increase their output in order to attain their customary levels of living. Such an approach is usually advocated in areas where land is abundant relative to labor and additional labor is the chief source of increase in output. A variant of such an incentive is the "head tax," payable in cash and levied on the native population in Africa. This tax will force the individual to either exert additional effort to produce and market agricultural crops or it forces him to work in urban locations for money wages.[26]

_Taxes to Increase Incentives to Invest_. These taxes attempt to motivate the landowner to make capital improvements of land. General exemptions or preferential

---

[25]Walter W. Heller, "The Use of Agricultural Taxation for Incentive Purposes," _Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development_, p. 223.

[26]_Ibid_., p. 224.

treatment are granted for such improvements under land or income taxes. Australia and New Zealand have imposed graduated taxes on unimproved land values. New Zealand grants liberal depreciation allowances under its income tax for initial land development expenditures.[27]

Once again, the opposite approach has been suggested. By heavily taxing landlords, it may be possible to force them to undertake many of these projects in order to make their land productive enough to pay the taxes. The graduated land tax, levied on capital value rather than on current output, would accomplish this goal.[28]

Taxes to Discourage Undercultivation. There is strong support from the United Nations and economists advocating taxation of land to either put idle land into production or to increase the utilization of land by shifting from low productivity to high productive activities, i.e., from grazing to cropping. In many underdeveloped countries, land is held for prestige or for speculation as an inflation hedge. When held for these considerations, the tendency is to underutilize its productive potential. In an effort to increase total agricultural output, penalty taxes on utilled or underutilized land are probably necessary. The World Bank mission to

---

[27] *Ibid.*, p. 25.

[28] *Ibid.*

Colombia suggested a graduated penalty tax based on income from the land.

Estimates were made that a fenced plot of land in a certain area of Colombia would yield a return of at least 10 per cent of market value. If the income from the land amounted to at least 10 per cent, then the basic rate would be applied; if not, then depending upon the deviation from the maximum income, a progressive penalty tax would be applied so that the effective tax rate on grossly underutilized land was at least 320 per cent.[29]

<u>To Channel Agricultural Resources into Particular Crops</u>. The goal in this operation is not to increase production on underutilized land as above but rather to redirect production into areas which national policy deems more desirable. Thus if large agricultural imports are excessive, measures may be taken to stimulate production of food crops for domestic consumption. Conversely, crops which are a source of foreign exchange may be favored. Exemption from tax may be given for production of slow maturing products (forest). The use of export and import taxes, of multiple exchange rates, and of direct subsidies to redirect agricultural production are also effectively used. Not only can they be used to stimulate production,

---

[29] World Bank Mission to Colombia, "A Graduated Land Tax," <u>Readings on Taxation in Developing Countries</u>, Richard Bird and Oliver Oldman, Editors (Baltimore: John Hopkins Press, 1964), pp. 413-414.

they can be used to improve the quality of the commodities grown. Brazil and Haiti have differential export tax rates on coffee exported (high rates for low quality and low rates for high quality) for the expressed purpose of improving the quality of coffee grown and delivered.[30]

To Discourage Land Speculation. Tax measures to prevent or deter land speculation may be used (1) to encourage active rather than passive use of land; (2) to help discourage accumulation of land; and (3) to prevent "windfall" gains derived from either inflation or economic development. Possible means of attaining this goal include a highly progressive land value not due to capital and labor improvements; and taxation incremental increases after they have existed for a specific number of years.[31]

It seems apparent that there are ample fiscal tools for tapping the agricultural sector in underdeveloped nations. Most of these countries are primarily agricultural. A sharp increase in agricultural productivity is a necessary forerunner of industrialization. The burden of the initial gross increase in taxation, if the need for this increase is faced honestly, will necessarily fall rather heavily upon the agricultural sector. Agricultural taxation may be the chief technique for mobilizing the

---

[30] Heller, "The Use of Agricultural Taxation for Incentive Purposes," p. 228.

[31] Ibid., p. 229.

initial savings necessary for financing a development program.

The necessity to tax agriculture has often been noted by many writers who have examined the development process. Bangs puts it as follows:

> The taxation of agriculture, by one means or another, has a critical role to play in the acceleration of economic development since it is only the imposition of compulsory levies on the agricultural sector itself which enlarges the supply of savings in the required sense for economic development. Countries as different in their social institutions or economic circumstances as Japan and Soviet Russia have been similar in their dependence on heavy agricultural taxation for financing their economic development.[32]

However, land tax increase may be militantly resisted in countries where the landowners have substantial political power. Peasant cultivators, already close to subsistence may also resist heavier land taxation because they fear this taxation will be directly reflected in their rents and will thus diminish their already inadequate net income from farming.[33] To overcome this resistance it has been suggested that this tax be replaced by an income tax on agricultural income. It has been pointed out that an income tax would be the best tax instrument to put the criterion of equity into effect. Heller explains:

> Its features of personal exemption and graduated rates particularly commend it to use in the rural sectors of less advanced economies, many of which are characterized by a mass of income units living side by side with a few great wealth concentrations. . . . The

---

[32]Robert B. Bangs, *Financing Economic Development* (Chicago: The University of Chicago Press, 1968), p. 22.

[33]*Ibid.*, p. 128.

> progressive income tax attracts governments which desire to redress their distributional grievances.[34]

Secondly, a progressive income tax on agricultural income would be a more effective mobilizer of rural savings. The potential savings of the agricultural sector in underdeveloped countries are unevenly distributed and a large part of them are concentrated in few hands.

> A tax, which exempts the great mass of the rural population but taxes progressively the large incomes offers promise as an instrument for locating and tapping the surplus elements which can be spared for productive investment. . . . The large incomes tend to be non-entrepreneurial, being derived in large part from rent and interest. . . . It is usually drawn from inactive land-ownership and is often channelled mainly into luxury consumption, hoarding, speculation, and capital flight. An effective income tax could thus gather substantial funds for developmental capital formation with little impairment of essential economic activity.[35]

A progressive income tax on agricultural income would be able to incorporate the incentive devices for the increase of agricultural production.

> The income effect of the income tax may be strong relative to the substitution effect in the upper income ranges of the agricultural sector. That is, by reducing the incomes of large landholders, traders, and moneylenders, the income tax may motivate them to seek more productive employment of their resources to restore their incomes.[36]

An income tax with high marginal rates would be the most effective instrument for siphoning off the

---

[34]Heller, "The Adaptation of Income Taxation to Agriculture in Underdeveloped Countries," p. 270.

[35]*Ibid.*, p. 271.

[36]*Ibid.*

increase in agricultural productivity into resources for development. Besides, the process of economic development in underdeveloped countries is generally associated with inflationary pressures, and a progressive income tax is better suited in maintaining the revenues of the government from the rural sector. "Its revenue superiority is buttressed by obvious equity and anti-inflationary advantages over fixed sum taxes."[37]

In spite of these obvious advantages of a progressive income tax as applied to the taxation of rural incomes, it may not operate as an effective instrument of development finance in the existing organizational and economic set up of the rural economy in most of the underdeveloped countries. In such countries, land holdings owned by individual peasants are scattered in small parcels and subsistence farming predominates. As a result, it is difficult both to assess income accurately and to collect taxes. Income taxation requires self-assessment, maintenance of records of output and costs, a high degree of tax morale and honesty, and efficiency and technical competence of fiscal administration. The conditions in the rural sector of the underdeveloped countries do not generally conform to those criteria. Furthermore, if the principle of exemption is applied to make the system of income taxation compatible with the criterion of equity, most of

[37] Ibid., p. 272.

the agricultural incomes will escape taxation, and the yield from the income tax may be reduced substantially. This means that in the existing set-up of the rural economy in underdeveloped countries, a progressive income tax on agricultural income, in spite of its superiority in terms of fiscal economies, may not be a financially sound fiscal proposition. Ward commented:

> If you do not change agriculture you will not change the economy; this is I think one of the safe rules one can lay down for developing communities. At the same time agriculture is the most difficult sector to change for the simple reason that agricultural methods are thousands of years old and people prefer on the whole to go on the ways of their fathers.[38]

Although this may be the case, there still exists a scope for mobilization of resources through one or more of the approaches discussed in this section. It may be said that the proposed goal for taxation in an underdeveloped country is a tax:

> . . . That recognizes, within the limits of a country's administrative capabilities, individual differences in ability-to-pay, and that also serves, in combination with other taxes on agriculture, as an efficient instrument for mobilizing savings for capital formation. The more closely the tax measures up to that goal, the greater likelihood of its attracting taxpayer cooperation in its administration and the easier it will be for the government to build the tax into an effective revenue.[39]

---

[38]Barbara Ward, <u>The Rich Nations and the Poor Nations</u> (New York: W. W. Norton and Company, Inc., 1962), p. 106.

[39]Wald, <u>Taxation of Agricultural Land in Underdeveloped Economies</u>, p. 207-208.

## The Role of Inflation in Economic Development

In many of the underdeveloped countries, personal incomes are low, personal savings are low, and only limited resources are released for the expansion of capital formation in these countries. At the same time, a very small surplus is available to finance development. Under these circumstances, inflation may appear to be an easy way of providing additional revenue to expand investment and accelerate their economic growth.

> If a government can persuade the central bank to create money to finance a development program, or if the banking system freely makes loans to private investors for the finance of physical investment, the problem of expanding the community's real assets may appear to be easily solvable. Consequently, it is sometimes argued that a case could be made for making inflation an instrument of development policy, rather than the control of inflation an object of policy.[40]

Although deficit financing appears to be the simplest way to finance economic development it is not free of risk. Too, the relation between inflation and economic development in underdeveloped countries is a subject on which there are still very wide differences of opinion. Thus this section will review inflation as an aid to development and inflation as a hindrance to the development process in underdeveloped countries.

---

[40]Graeme S. Dorrance, "The Effect of Inflation on Economic Development," International Monetary Fund Staff Papers, Vol. X (March, 1963), p. 1.

<u>Inflation as an Aid to Development</u>. Proponents of inflation argue that inflation, by raising the prices of goods and services, prevents the people from consuming as much as they had planned and thereby creates forced savings which become available for capital formation.

The case of Soviet economic development in its initial stages is a well-known illustration of investment being financed out of forced savings.

> Between 1929 and 1939, the prices of consumer goods went up by about 700 per cent in Soviet Russia. The prices were deliberately raised and the difference between the raised market-price and the normal (or cost) price was diverted into the Budget by means of a Turnover Tax. Speaking in monetary terms, one can say that it was the main source from which the investment was financed.[41]

The case of Japan from the 1880's until 1914 also illustrates the necessity of resorting to inflation for financing capital formation.

> Some developed countries (Japan being perhaps the best example) accumulated the bulk of the capital for development from the masses of the people. In Japan, this was done by keeping the peasants at the subsistence level through increasing land taxes and holding real wages down through inflation and monopsonistic labor practices.[42]

Between 1880-1900 the currency in Japan almost quadrupled and the prices rose by nearly 60 per cent which made

---

[41] A. K. Poddar, "Inflation and Economic Growth," <u>Indian Journal of Economics</u>, Vol. 44 (January, 1964), pp. 156-157.

[42] Martin Bronfenbrenner, "The Appeal of Confiscation in Economic Development," In the <u>Economic of Underdevelopment</u>, ed. by A. N. Agarwala and S. P. Singh (New York: Oxford University Press, 1963), pp. 486-487.

possible a considerable stopping up of the rate of investment.[43] Thus forced savings created by currency inflation have played an important role in the initial stages of economic expansion and it can be safely concluded that because of inadequacy of voluntary savings in the underdeveloped countries, forced savings and forced investment are inevitable if there is to be a massive investment to break the chronic vicious circle of poverty.[44]

The argument that price inflation might induce an increase in saving by raising profits relies on the probability of wage lags in the economy during the periods of rising prices. In practice, there are institutional barriers to this effect of inflation. Even in the underdeveloped countries trade unions are sufficiently powerful to force up wages in response to increases in the cost of living, so that wage lags cannot be assumed to be an adequate source of increased savings.[45]

Insofar as the government of an underdeveloped country resorts to deficit financing as an instrument of forced saving to acquire the resources for the public sector, the success of transferring adequate resources

---

[43]William W. Lookwood, The Economic Development of Japan: Growth and Structual Change, 1868-1938 (Princeton: Princeton University Press, 1954), pp. 248-50.

[44]P. Wiles, "Growth vs Choice," Economic Journal, Vol. 66 (June, 1956), p. 255.

[45]Rattan J. Bhatia, "Inflation, Deflation, and Economic Development," International Monetary Staff Papers, Vol. 8 (November, 1960), p. 104.

to the public sector depends upon a number of conditions. The transfer of real resources through forced saving which is caused by inflationary price rises is unpredictable. Too, there is a possibility that the transfer of real resources thus affected may fall short of the requirements of planned development in the public sector--this may induce further increases in the budget deficit. This further increases in the budget deficit may become necessary to acquire the needed resources and as such has the danger of producing a process of cumulative inflation. Furthermore, deficit financing adopted by the government may result in increasing profits of entrepreneurs in a mixed economy and entrepreneurial incentive to invest would be strengthened. As a result the private sector if not controlled, will compete with the government for resources which are limited in underdeveloped countries. Thus the public sector may fail to transfer adequate real resources to itself through deficit inflation.[46]

Inflation, besides creating forced savings, generates profit inflation which becomes an additional source of capital formation. As commodity prices rise, the factor prices, especially wages and salaries, lag behind on account of psychological factors such as the money

---

[46] Ram N. Tripathy, Public Finance in Underdeveloped Countries (Calcutta: The World Press Ltd., 1964), p. 229.

illusion[47]--and the institutional bottlenecks and rigidities such as monpsonistic labor practices are in evidence. This enlarges the relative share of profits in the national income, and as the profit-makers are the most thrifty of all social classes, a redistribution of income in favor of profits promotes saving and facilitates the flow of resources into the channels of capital formation.[48]

Hamilton explained that profit inflation played a crucial role in the early stages of capitalist development. He has contended that inflation was a powerful promoter of industrial growth. In England, during the period of Industrial Revolution there was an acute profit inflation. During long periods of inflation, rising prices tend to outrun compensating wage adjustments. The result is profit inflation. This windfall to industrialists, partly ploughed back into capital formation, was, according to Hamilton, the chief blessing from inflation during the period of Industrial Revolution, and in many subsequent inflationary eras. Profit inflation in these periods enabled a much more rapid rate of industrial growth to occur than would have obtained under stable prices. In his view, inflation has been a powerful stimulant in a

---

[47]J. M. Keynes, The General Theory of Employment, Interest and Money (New York: Harcourt, Brace and World, Inc., 1936), p. 14.

[48]W. A. Lewis, The Theory of Economic Growth (Homewood, Illinois: Richard D. Irwin, Inc., 1955), p. 232.

wide number of historical instances and could perform a similar function in underdeveloped countries.[49]

W. W. Rostow has maintained that inflation has been important to several take-offs. In Britain of the late 1790's, the United States of the 1850's, Japan of the 1870's there is no doubt that capital formation was aided by price inflation, which shifted resources away from consumption to profits.[50]

There are some difficulties with using inflation as an investment incentive, because it would be a mistake to assume that all the inflation profits become available for economic development. There may be positive dis-savings on the part of other income groups in the community in their attempt to protect their customary levels of consumption which are threatened by an inflationary rise in prices. The consumption of profit receivers may also be increased as their real income rises. Thus, only a fraction, perhaps only one half or one third, of the inflation profits emerges as an addition of real resources for development. And even this is accomplished only at the cost of severe disruption in the economy and

---

[49] E. J. Hamilton, "Profit Inflation and the Industrial Revolution," Quarterly Journal of Economic, Vol. 56 (February, 1942), pp. 256-273.

[50] W. W. Rostow, The Stages of Economic Growth (Cambridge: Cambridge University Press, 1962), pp. 47-48.

grave injustice to a large number of people.[51]

Furthermore inflation can be used to shift resources either to the private sector or to the public sector. One inflationary method to shift resources to private investors is by allowing profits to inflate. Inflation would create the phenomenon of profit inflation due to a wage price lag and this would tend to swell the incomes of entrepreneurial classes. Of course, as prices rise, workers will eventually press for, and acquire higher wages, but so long as there is a time lag between the price increase and the wage increase, profits will be inflated. As prices continue to increase, however, workers will begin to anticipate the increase and will seek to reduce the time lag between price increases and wage increases. Thus unless the wage sector eventually agrees to a reduction of their share of national income, so that the profit sector may have an increased share, this price-wage spiral will continue.[52]

This method of shifting resources to investors depends on the reasonable assumptions that the private sector is also the investing sector and that profit receivers have a higher marginal propensity to save than

---

[51] E. M. Bernstein, R. B. Goods, M. Friedberge, "Economic Development with Stability," _International Monetary Fund Staff Papers_, Vol. 3 (February, 1954), p. 358.

[52] Paul A. M. V. Phillips, _Public Finance and Less Developed Economy_ (Hague: Martin Highoff, 1957), p. 157.

the wage sector.

The other inflationary method of shifting resources to private investors is by permitting them to borrow from commercial banks. This direct credit allows the investors to increase their share of the goods and services available to the community; and too, the investors can acquire the goods and services before prices rise. In this instance, there would be no need to wait for inflated profits to increase their share of national output.

In both of these cases, investment will be increased by an amount which is less than the amount of increase in profit or credit. First, the proportion saved from the profit increase will depend on the marginal propensity to save of the profit receivers; and it is likely that this will be much lower than one. Second, entrepreneurs will use some of their borrowings for consumption, or they will use part of the borrowed funds for some investments which they would have made with savings from their prior income.[53]

However, instead of shifting resources to private investors, inflation can also be used to shift resources to a governmental agency. This shift to government is desirable for two reasons. First, the government will endeavor to invest in projects with a high social yield, whereas private investors seek projects with a high private

---

[53]Ibid., p. 376.

yield. Whether the government enterprise or private enterprise is more efficient in an underdeveloped country is not the point. Government enterprise has access to greater resources of funds, talent, and information about the economy, whereas private enterprise has the incentive for efficiency provided by the profit motive. Secondly, the government development agency will invest a high proportion, and perhaps all, of the funds it receives, whereas private entrepreneurs will invest a smaller proportion.[54]

When resources are shifted to a government development agency by inflationary means, i.e., through direct credit creation rather than through taxation, it is usually because credit creation and inflation is less painful, politically and administratively, than taxation.[55]

Inflation may also facilitate economic growth by altering favorably the elasticity of supply of productive resources. Inflation by impinging upon the real income of labor increases the willingness to work and thus raises the elasticity of supply of labor. Thus according to Professor Bronfenbrenner, inflation may be helpful first because it may permit "the authorities . . . to raise the relative prices of the types of labor and capital goods

---

[54]Phillips, Public Finance and Less Developed Economy, p. 161.

[55]Lewis, The Theory of Economic Growth, p. 219.

required for development projects without imposing on other sectors of the economy the reductions in money wages and prices which would otherwise be required."[56] This device would permit the reallocation of resources in a manner which would be conducive to economic development without hurting other groups in the economy. Furthermore, Bronfenbrenner maintained that under the "money illusion":

> A slow inflation or even a rapid one, in its early stages induces laborers to work more intensively for real incomes which are no higher and which may be lower than their previous level. To a lesser extent owners of land and capital may be induced to put their property to work more intensively in the same way when money incomes rise.[57]

Inflation as a Hindrance to Development. Inflation, however attractive it may appear at first glance as a device for financing economic growth, is fraught with considerable risk and uncertainty. Upon closer examination, many of the claims made in favor of inflation seem to lose much strength.

The extent of the savings generated by inflation depends upon the degree of wage-price differential; the greater the gap between wages and prices, the larger would be the forced savings. The inequality in the

---

[56] Martin Bronfenbrenner, "The High Cost of Economic Development," In Readings in Economic Development, ed. by T. Morgan, G. W. Betz, and N. K. Choudry (Belmont, California: Wadsworth Publishing Company, Inc., 1963), p. 387.

[57] Ibid.

distribution of income and wealth which this creates entails a heavy burden upon the common masses, and the potential political repercussions cannot always be ignored. Because of lack of statistical evidence, no precise estimate of the burden of redistribution can be made. But, it can be said with a fair degree of certainty that the burden is likely to be heavy. According to one study, in order to raise the level of savings from 6 per cent to 8 per cent of the national income, the share of wages would have to be reduced by nearly 33 per cent and that of profits would have to be raised by more than 50 per cent. To achieve this result, with money wages constant, prices would have to rise by 50 per cent of their original level.[58]

Even if this heavy burden of the regressive redistribution effect could be brushed aside as the inevitable cost of economic growth, there is no guarantee that such policy would be successful in the long run. The condition for the successful generation of forced savings is the existence of the "money illusion."

> As inflation gathers momentum, the laborers become more alert and try to protect their interests, demanding higher wages and sometimes an increase in wages greater than the anticipated future rise in the price level. Thus the economy is faced with a dilemma. On

---

[58]S. H. Axilord, "Inflation and the Development of Underdeveloped Areas," <u>Review of Economics and Statistics</u>, Vol. 36 (August, 1954), p. 335.

> the one hand, inflation promotes redistribution of income that undermines the ideal of social justice. On the other hand, to the extent that wage-earners are able to defend themselves and obtain salary increases at the same or higher rates than the rate of rise in prices, the social argument (against inflation) loses strength but the economic argument is correspondingly weakened.[59]

Commenting on the role of deficit financing as a mechanism of forced saving, Nurkse has pointed out that:

> . . . over a wide range, inflation can be effective as an engine of forced saving. . . . But it frequently leads to a misdirection of the saving it creates, favoring investment, for example, in luxury industries and leaving essential public facilities in decay. The shifts in income from the poor to the rich . . . make it a wasteful form of forced saving, since the rich may consume some of the extra income coming to them and not save all of it; better tax the poor and invest the proceeds without the intermediary of the rich.[60]

An increase in the size of the profit margin by no means guarantees an increase in savings and investment of the corresponding order. The investors in the underdeveloped country are not always in pired with the true capitalist spirit and an increase in their income may merely induce them to emulate the conspicuous consumption habits of the landed aristocracy and other dominant social classes.

An increase in savings does not insure an equivalent

---

[59] Felipe Pazos, "Economic Development and Financial Stability," International Monetary Fund Staff Papers, Vol. 3 (October, 1953), p. 249.

[60] Ragner Nurkse, Problems of Capital Formation in Underdeveloped Countries (Oxford: Basil Blackwell, 1957), pp. 144-145.

increase in productive investment as inflation tends to encourage malinvestment. Bernstein and Patel have maintained that continuous inflation induces the wrong kind of investment in the private sector of an underdeveloped economy. They contend that inflation tends to widen the gap in returns between investment where social benefits are high such as agriculture and industry, and investment whose private benefits are high such as inventories and luxury housing. The windfall profits and capital gains associated with inflation broaden the scope for privately profitable investments and direct resources to them at the expense of socially profitable investment.[61]

An empirical investigation into the impact of inflation on the distribution of investment in some of the underdeveloped countries concluded that long periods of continuous inflation were not associated with large investment in inventories. Short periods of inflation tended to bias the composition of investment toward inventories. With respect to the effect of inflation on the composition of investment in fixed assets, it is pointed out in the study that:

> . . . price distortions arising in an inflationary environment may well affect both factor and product prices in a manner leading to a relatively less

---

[61] E. M. Bernstein and I. B. Patel, "Inflation in Relation to Economic Development," International Monetary Fund Staff Papers, Vol. 2 (November, 1952), pp. 363-98.

productive allocation of resources which in turn may be reflected in a low capital output ratio.[62]

Inflation and Economic Development Based upon Empirical Studies. Though an inflationary rise of prices may affect the process of growth adversely, a condition of slow rise of prices has been considered necessary for a continuous process of economic development. As Kaldor has pointed out a slow and steady rate of inflation provides a most powerful aid to attainment of a steady rate of economic progress. He maintained that price stability is only consistent with steady growth when the rate of growth of productivity and/or of the working population is sufficiently large to give a relatively high rate of growth to the total national product. In a weakly growing economy, price stability will mean stagnation unless the propensity to consume is raised sufficiently to offset the effect of a lower rate of growth of profits through a higher share of profits in total income. A process of slowly rising prices provides an inducement to the growth of investment in an economy dominated by private enterprise by widening the margin between the rate of return on capital and the rate of interest.[63]

---

[62] A. S. Shaalam, "The Impact of Inflation on the Composition of Private Domestic Investment," International Monetary Fund Staff Papers, Vol. 9 (July, 1962), pp. 255-260.

[63] Nicholas Kaldor, "Economic Growth and the Problem of Inflation," Economica, Vol. 26 (November, 1959), pp. 290-291.

Development efforts by most of the underdeveloped countries have been accompanied by inflationary price increases. Empirical studies that have been made with regard to the relationship between price changes and economic growth have not been able to establish any consistent correlation between the two. One study has pointed out that even if some consistent statistical relationship could be established between price changes and rates of economic growth, the relationship would not justify any definite conclusion about causation--therefore, it would not be possible to distinguish between the independent variable and the dependent variable. Further, the study points out that there is no systematic relationship between price changes and the rate of growth. The relationship, if any, has differed from country to country. The rates of growth were inversely related to the rates of price change in Germany and Japan, whereas in Sweden and Canada the two tended to move together.[64]

It is often argued that, by shifting resources from wage earners to entrepreneurs, inflation aids capital formation. However, it has been pointed out that although a greater proportion of periods of rising prices tends to be associated with rising profits, periods of falling

---

[64]Rattan J. Bhatia, "Inflation, Deflation, and Economic Development," International Monetary Fund Staff Papers, Vol. 8 (November, 1960), pp. 101-102.

prices are by no means always periods of falling profits. Profits have increased in some periods of falling prices, and decreased in some periods of rising prices.[65]

Another statistical inductive study considered a large number of underdeveloped countries. The study pointed out that the operation of factors other than inflation might have been of more significance than that of inflation upon the rate of development. For those reasons, the study revealed no clear relationship, either positive or negative, between inflation and growth. For the underdeveloped countries, in general, the findings proved to be inconclusive. Most of the small number of individual countries for which there are available statistics cover periods in which the rates of price increase differ significantly--the evidence suggests that the rate of growth was higher when the inflation was lower.[66]

Another study related to central bank policies and inflation in four underdeveloped countries. The study pointed out that inflationary pressures in those countries were caused by attempts of one or more sectors of the economy to secure a large share of the total product. The primary motivations for such attempts were the desire

---

[65] Ibid.

[66] U Tun Wai, "The Relation Between Inflation and Economic Development," International Monetary Fund Staff Papers, Vol. 7 (October, 1959), p. 302.

of either the public sector or the private sector, or both, to undertake additional investments but to put the burden of the required additional saving on the other sector. The attempts of one sector, once made effective, tended to induce defensive reactions of other sectors that desired to maintain their share in total product. This was the case not only for investment but also for consumption and especially on the part of wage and salary earners. These defensive reactions usually intensified the inflationary pressures and such reactions have tended to defeat any one sector's attempt to increase its share in total product.[67]

No definite conclusion has been drawn in respect to the relationship between inflation and economic growth. The empirical evidence tends to suggest that in an underdeveloped country, which follows a long-run policy of inflationary financing, the process of economic development and capital formation may be adversely affected.

On the other hand, inflationary financing--if properly phased and controlled and adopted only as a stimulant--could accelerate the rate of economic development of an underdeveloped country. If not properly controlled and adopted on a large scale, the inflationary

---

[67] Joachim Ahrensdarf, "Central Bank Policies and Inflation: A Case Study of Four Less Developed Economies, 1949-57," International Monetary Fund Staff Papers, Vol. 7 (October, 1959), p. 274.

process would tend to be robbed of its healthy and stimulating effects. It could degenerate into a competitive race for acquiring an increasing command over resources by the government, the private producers and the wage earners. Too, there is a possibility that none of the sectors could succeed in acquiring a dominant command over real resources in an economy where resources are very limited.

A 1963 study has indicated that inflation is likely to evoke forces which divert the resources available for domestic investment to less desirable sectors. An excessive accumulation of inventories; and the building of houses for occupancy by the relatively wealthy at the expense of the disadvantaged are examples. Of the productive facilities actually built, a bias will develop towards investment in relatively short-lived projects. Moreover resources will be diverted from the production of basic necessities and investment goods to the production of luxury consumer goods. The apparent profitability of certain short lived investments will lead to distortions in the productive structure and that makes the economy less adaptable.[68]

---

[68] Graeme S. Dorrance, "The Effect of Inflation on Economic Development," International Monetary Fund Staff Papers, Vol. 10 (March, 1963), pp. 1-47.

## Sales Tax as a Means of Financing Economic Development

When the duties of government were few--defense and the maintenance of order--taxes were imposed primarily to raise a revenue to meet these obligations. Today government is much more complex. Most governments today have certain social objectives, and their fiscal policy is adjusted to that end. Often some of those objectives are, to say the least, contradictory. The government must set priorities. It must make decisions as to which objective should be sacrificed in deference to others.

The extended sphere of government participation in the economic life of the underdeveloped countries has been inspired by the desire and the determination of the people in these countries to improve their well-being. A desire to emulate the living standards in the more advanced countries of the West and that desire has made it imperative that governments undertake an ever-increasing number of tasks in an ever-extending sphere of public action.

It is generally accepted that there are two primary areas in which state activity is expanding at a relatively rapid rate. One is the sector of social services, i.e., health, education, and welfare. The other sector is investment in social overhead capital. The question of the size of these two forms of government activity and their reconciliation within the constraints set by limited resources, present nearly insurmountable difficulties to decision makers who seek to accelerate economic development.

In order to isolate the financial aspects of the development problem, an assumption is made that the government will establish an overall economic and social development program. The targets of economic growth could include: (1) an increase in per capita income; (2) a decline in unemployment and underemployment; (3) a redistribution of income among individuals, groups, and regions of the country; (4) national security and prestige items; and (5) other items that the government considers necessary to economic and social development. Once a growth path has been selected, its implications for the ratio of total investment to national income over the prospective planning period will then be determined.[69]

Under the circumstances, the primary task of fiscal policy in the first stage of development is to finance an expansion--of critical size--in the program of public investment without resort to ruinous inflation or frequent balance-of-payments deficits. Secondly, there must be insurance that the public investment program is devoted to areas that will contribute most to starting a cumulative process of expansion. Prest has expressed a

---

[69] Benjamin Higgins, "Financing Accelerated Growth," Government Finance and Economic Development, ed. by Alan T. Peacock and Gerald Hauser (Paris, 1965), p. 17.

similar view and pointed out that:

> The very minimum that a government is expected to do nowadays in any country is to remove or cut down the obstacles to economic growth met by the private sector; and much more frequently, it is deemed to have the task of striving for growth in a positive manner both by example and by precept.[70]

The objective plans in the first stage of growth involves: (1) laying out of a general plan for public investment; (2) insure that the plan is properly oriented to resources and capabilities of the country; and (3) to secure public acceptance of the plan which includes the sacrifices it will entail.

Moreover, the primary task of fiscal policy at this early stage of development will be to obtain a substantial increase in tax revenue to finance the transfer of resources to the public use. The tax system which exists, and which doubtless consists primarily of indirect levies, must be broadened and the rates increased in a manner that will fall primarily on consumption rather than on investment.[71]

<u>Tax Structure</u>. Some writers on the fiscal problems of underdeveloped economies hold that an income tax at a very early stage of development will provide enough money to finance early development projects, if it is limited to

---

[70]A. R. Prest, <u>Public Finance in Underdeveloped Countries</u> (New York: Frederick A. Praeger, Inc., 1963), p. 18.

[71]Bangs, <u>Financing Economic Development</u>, p. 188.

the top income bracket and no effort is made to generalize it into a mass tax. However, Bangs has expressed the view that . . . "Having observed this type of income tax at work in certain countries which were not at the lowest level of income scale, I am inclined to doubt the efficiency of an income tax at this early stage."[72] Hicks says, ". . . naturally the outlines of a tax structure tailored for development will look substantially different in a conventional underdeveloped country than in a highly sophisticated economy like ours."[73] A similar view has been expressed by D. E. Shirley who writes that extensive reliance on income taxes or other ability-to-pay measures is a social and economic luxury which the lesser developed nations of the World cannot yet afford.[74]

To be sure, there are certain expanding profits resulting from economic development efforts that may be tapped, but the attempt to reach these by personal income taxation is often a failure in an economy where records are not kept and where there is little if any cooperation with the revenue service.

---

[72] Ibid., p. 190.

[73] Ursula K. Hicks, "Direct Taxation and Economic Growth," Oxford Economic Papers, Vol. 8 (September, 1959), p. 269.

[74] David E. Shirley, "Income Tax for Less Developed Nations," National Tax Journal, Vol. 12 (September, 1959), p. 269.

Richard Goode has given six necessary conditions for successful use of a progressive income tax. These conditions are: (1) a predominantly money economy, (2) a high standard of literacy among taxpayers, (3) prevalence of accurate accounting records, (4) a large degree of voluntary compliance in part of taxpayers, (5) free political democracy, and (6) a higher standard of administration than for other taxes.[75] Most of these conditions if not all of them are lacking in an underdeveloped country. Thus a general rule can be devised that no country can rely heavily on personal income taxes until it has reached or is close to the point of takeoff as described in Rostow's Classification of growth stages.

A similar view is implied by Surrey when he writes:

> The income tax may well be the favorite of the twentieth century, but it demands twentieth century administration. This requirement is even more urgent when one turns to the complex variations of that tax such as a tax on excess profit or a tax on an increase in individual incomes. . . . There are many who urge these variants without any comprehension of the complex legal and accounting problems which they create, without any recognition of the enormous difficulties being faced in the struggle to impose even the basic income tax, and without any realization that even countries with considerable experience in income tax administration have not yet to master these specified types of income taxation.[76]

---

[75] Richard Goode, "Reconstruction of Foreign Tax System," Readings on Taxation in Developing Countries, ed. by Bird and Oldman (Baltimore: John Hopkins Press, 1964), p. 171.

[76] S. S. Surrey, "Tax Administration in Underdeveloped Countries," Readings of Taxation in Developing Countries, p. 505.

In a country, like Syria, where only a very small fraction of the population is subject to the income tax it is inevitable that considerable reliance has to be placed on indirect taxes. There is another important consideration in a developing nation. Development necessitates an increase in the rate of savings with a proposed increase in investment.

> An increase in the saving-investment rate is one of the conditions of economic progress in the less developed countries. . . . Owing to the heavy responsibilities that governments are assuming, not only for capital formation, but also for the provision of current services, the underdeveloped countries cannot promote saving merely by maintaining low taxes. Most underdeveloped countries need to raise more revenue, many of them, much more. Tax policy has the delicate responsibility of obtaining large amounts of revenue.[77]

Several assumptions can be made. First, that the maximization of domestic savings in the national pool is the overriding consideration--irrespective of whether such savings accrue in the public sector or in the private sector of the economy. Secondly, that the level of voluntary domestic savings is low, and the level of foreign investment is highly unpredictable and unreliable--at best it can only supplement rather than substitute for the domestic effort. Third, that the diversion of the incremental income from consumption expenditure to the most

---

[77]Richard Goode, "Taxation of Saving and Consumption in Under-Developed Countries," National Tax Journal, Vol. 14 (December, 1961), p. 305.

productive investment has to be brought about by consciously designed public goals of which fiscal policy--particularly taxation--is a primary component.

Based on the assumptions--and that the present tax policy in Syria has not yielded sufficient revenues--it now appears that the present tax structure in Syria should incorporate a sales tax as a substitute for the present income tax. This type of tax seems to be the only alternative if inflation is to be avoided. It is likely this tax may impose a burden which would otherwise be unequitable, but if the government wants development, it should be willing to concede the need for extra taxation.

A developing country may face a serious problem in that a heavy reliance on a progressive income tax might have a severe disincentive effect on work, saving and enterprise. These evil effects--at least in the early stage of development--could be mitigated by the elimination of the present income tax. A sales tax will restrain consumption and stimulate savings which will help the needs of a developing economy.

It should be pointed out that in the developed Western nations, the governments with large revenues provide so many modern amenities that even the rich feel that they are getting some return from the contribution they make to the state treasury. In a poor country, the rich feel that the government confers few, if any, perceptible benefits on them--in return for their taxes, they receive only harrassment and distrust. The benefits conferred by expenditure on defense, law and order and the administration of justice are of such a general nature that they are often ignored in individual calculations. On the other hand, the expenditure on social and development services primarily benefit the poorer section of the community. The time has come for the governments of underdeveloped nations to educate the people on the necessity of taxation and its true implications.

History teaches that most of the advanced countries did not employ the income tax until they had reached a mature stage in their development process. For example, the United States had its first modern income tax in 1913 and at this stage, the economy was already on its drive to maturities. On the other hand, the underdeveloped countries have such a tax even though they are still in the "take-off stage" and some of them have yet to pass the "pre-condition stage." The reason for their use of the income tax or the rationale behind their action is that the progressive income tax represents a symbol of modernization. However, they tend to forget that although they live in the twentieth century, some if not most of them are still existing as if it were the seventeenth century. They ignore the fact that tax policies that are suitable for advanced countries may not be appropriate for backwards ones. Enke writes some people hate or envy another particular class and demands high taxes on its incomes as a practical way of confiscating its property.[78]

To advocate a sales tax in a poor country with the great majority of the people close to the margin of subsistence is a harsh doctrine. It will require unusual political courage on the part of those leaders who espouse this policy. Nevertheless, leadership has its obligation, and development has its price. The people must be brought to realize that this price has to be paid in one way or another if effective support for development effort is to be won.

If the process of economic growth were costless, there would be fewer less developed countries than there are at present. Only a lack of resources, poor organization, or bad policies would be excuses for lagging in the competitive race toward higher living standards. In reality, all politicians realize that development is not easily attained and that sustained effort and sacrifice by all elements in the population is necessary. Development is paid for only by saving more and consuming less.

The idea of sales taxes is not a new concept. In an earlier chapter the various types of sales taxes were

---

[78] Stephen Enke, Economics for Development (Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1963), p. 247.

examined and it was indicated that this type tax was often a product of war finance. The wartime experience of such advanced countries as Australia, Canada, United Kingdom and the United States may hold lessons for countries now embarking on economic development. The wartime problem in those countries, like the development problem, was essentially one of achieving rapid large-scale transformation of the economy and that involved a rapid and substantial re-allocation of resources. When the war effort was at its peak, all the above mentioned countries were devoting more than half of the gross national product to war effort. Higgins concludes that:

> The appropriate policy for developing countries would be the same as that pursued by the belligerent countries during the war: to undertake the public investment and encourage the private investment needed to achieve the major objective, and to use every possible means to mop up excess purchasing power.[79]

Most of the underdeveloped countries tend to look at Soviet Russia as their model in pursuing their economic development. If that is the case, then let them by all means imitate their idol in the way the Soviet pursued and financed their economic development. In the process of development, the Soviet has relied on commodity taxes. One view of this technique has been expressed by Holzman in the following language:

---

[79]Higgins, "Financing Accelerated Growth," in Government Finance and Economic Development, pp. 24-25.

> Most of the compulsory savings of the economy are collected by the state in the form of taxes and are reflected in the budget accounts; and indirect or commodity taxes are responsible for from two-thirds to three-fourths of budgetary receipts. . . . The reliance of the Soviet on commodity taxation is contrary to their ideology . . . that the Soviets rely on commodity taxation in spite of their ideological bias attests to its superiority for their purpose.[80]

The Soviet Union has a turnover tax and this tax has played a very important part in the mobilization of resources in the Soviet Union. This tax was first levied in 1931 when it replaced a variety of excise duties. The Turnover tax as levied in the Soviet Union has three aspects: (a) the first is an excise duty levied at a fixed rate and the tax on vodka, matches and salt are some of the examples; (b) the second aspect of the tax is described as a tax by difference, and since 1939 it has been applied to a large number of industrial consumers' goods. The tax emerges as the difference between the retail price less trade margin and the wholesale price. The retail price is fixed in relation to supply and demand, and the wholesale is based on average cost plus a small margin of profit and thus the tax emerges as equal to the gap between them; (c) the third aspect of the tax is regarded as a "difference with a difference" and arises in connection with the acquisition by the state of farm produce at low prices. The difference between the second and the

---

[80] F. D. Holzman, "Financing Soviet Economic Development," Readings on Taxation in Developing Countries, pp. 74-75.

third kind of turnover tax is that the second kind of turnover tax falls on consumers, while the third kind of the tax falls mainly on peasants who have been compelled to deliver the grain to the state at low prices.[81]

Capital accumulation is the key problem which the underdeveloped countries are called upon to adjudicate, therefore, taxation is to be looked upon as a powerful tool in the hand of the government for raising the ratio of saving to national income. Thus underdeveloped countries should reorganize their tax structure in a way that is conducive to rapid economic development--in a way that will make it possible to raise more revenue in the long run. Hicks in discussing taxation in the United Kingdom concludes, ". . . Nevertheless we should clearly also look at more adventurous alternatives, such as Mr. Kaldor's expenditure tax."[82]

The device that is proposed in this section is a sales tax. However the question may arise as to what kind of a sales tax--will it be a retail, wholesale, or manufacturer sales tax? The retail tax, though it may have the advantage over both wholesale and manufacture taxes in preventing the pyramiding of the original taxes,

---

[81] Alecnove, The Soviet Economy (New York: Frederick A. Praeger, Inc., 1961), p. 98.

[82] Ursula K. Hicks, "Direct Taxation and Economic Growth," Oxford Economic Papers, Vol. 8 (September, 1956), p. 309.

is not suited for the underdeveloped countries because there is a large number of small retailers, the majority of whom are illiterate and do not have adequate bookkeeping. Moreover it would be administratively difficult if not impossible to handle the large number of retailers spread throughout the rural areas. There is also the primitive selling by the roadside, and similar methods of retailing that can hardly be subjected to the tax.

The turnover tax is levied on the total value of sales of goods as they pass from firm to firm, and finally into consumption, in the processes of manufacturing and marketing. It is thus in essence a business tax, but insofar as firms add the tax to the selling prices of their products it operates as a very general sales tax, and can exert a strong control over consumption. The traditional turnover tax is assessed on the full value of sales, without deduction, at each transfer. This has two disadvantages. First the tax is "pyramided" as the goods pass from firm to firm since at each stage the price charged includes the tax on that stage. In the end, the consumer pays more than the straight costs of production and marketing would warrant. Secondly, the tax encourages the integration of productive processes within a single firm and this as a result, ends in saving the tax. This tends to discriminate against small firms and discourage competition.

A turnover tax is not suitable for a country like Syria for several reasons. The tax does not always take its pure form. There are some modificational adjustments in the tax either upward or downward. These modifications are designed to lessen the regressiveness of the tax and make it more equitable. Thus some items may be exempted and some will be taxed at a lower rate. These modifications will complicate the tax and make it next to impossible to administer. Syria to date does not have the sophisticated type tax administration that prevails in the advanced countries. Too, goods rarely pass from one firm to another firm and the costs of collection might prove prohibitive.

The value-added tax is imposed not on total sales value but on sales less purchases from other firms--that is to say the tax falls only on the "value-added" in the firm by the labor it employs, as it operates with the capital it owns, and on raw materials which it has bought.

This tax would not be suitable for Syria because neither its firms nor the administration in Syria comprehend modern cost accounting. The value-added tax is complicated by its exemptions, its rate differentiations, and its other special features, with which the present administration is unable to cope.

The purchase tax is not suited for Syria for the same reasons that were given for the turnover and the value-added tax.

Since Syria is an underdeveloped country, the tax that would be designed for her should be easy to administer. An ideal tax for her would be a manufacturers sales tax. However, due to the peculiarity of her economy--an agricultural economy with a small industrial sector--the sales tax suited for such an economy would have to be a manufacturers tax plus a wholesale sales tax. The reason for this is simple. First the manufacturers sales tax is not levied on all consumption commodities, such as food products, cattle, etc., which are auctioned to the highest bidder present at the bazaar (public market). The bazaar in Syria actually represents the wholesaler, or middleman and if we impose a tax at this level, that with the manufacturers tax will have broadened the base sufficiently to tax all levels of consumption.

_Coverage_. The sales tax should be imposed upon the sales of finished products by the manufacturer. However, in the case of staple commodities, the tax should also be imposed on the wholesale level. The tax will not be applicable to services. If a manufacturer or a wholesaler uses a taxable article, they must account for the tax.

_Rates and Exemptions_. The rate of the tax should be 10 per cent, all going to the central government (except the services which are exempted).

However, since the intention of the tax is to help the development of the country and is designed to induce the private sector to invest, certain exemptions should be given. The exemptions are:

> All material and parts that will be incorporated in the final product. This exemption is designed to avoid excessive burden on the consumer and business development.
> All machinery that will be directly used in producing the product.
> All medicines and sales of supplies and equipment to public or private hospitals.
> Books and materials for educational purposes.

Shifting the Tax. The tax law may incorporate a provision relating to the shifting of the tax. The manufacturer, in particular, may be given the option of including the amount of the tax within the selling price or to quote the tax separately on the invoice. With regard to the wholesaler, there is no choice but to quote the tax separately.

The assumption is that the tax will be shifted forward to the final consumer of the product. As to the distribution of the tax burden by income groups, there are no available studies because the tax, as proposed, does not yet exist. However, data is available for family budgets and from these a rough estimate of the burden can be undertaken. Table 41 below shows the distribution of the total tax burden by income class for Syria in 1961/62.

TABLE 41

DISTRIBUTION OF BURDEN BY INCOME CLASS
IN SYRIA, 1961/62

| Income Class | Taxable Expenditure as Percentage of Income |
|---|---|
| Less than 500-1999 | 7.7 |
| 2000-3999 | 7.7 |
| 4000-5999 | 7.4 |
| 6000-7999 | 7.0 |
| 8000-9999 | 6.7 |
| 10,000 and over | 6.4 |

Source: Ministry of Planning, "Family Budget, 1961/62," (Damascus, 1962) (Mimeographed), p. 22.

The data shows a relatively proportional distribution of the tax, except for the top income brackets, where it is mildly regressive.

Administration. The administration of the tax will rest with the present income tax administration since this tax will replace it. The new requirement will be that the manufacturers must file with this division a statement of their gross sales quarterly--with the amount of the tax due. The division may audit the tax return for each individual manufacturer for possible evasion of the tax. However, in case of the wholesaler, the government has to send its representative to each individual bazaar and once a sale is completed a receipt will be given to the auctioner (seller) and the money due will be collected and deposited with the treasury daily. The cost of collecting the tax may not be greater than the cost of collecting the present income tax. The government does not have to hire new employees or even set up a new machinery for the new tax.

<u>Revenue Importance of the Sales Tax</u>. The sales tax has been introduced in Syria; thus no figures are available to compare it with the revenues of the income tax. The only alternative is to base the revenue estimate of the sales tax on the family budget study that was conducted by the Syrian government in 1961/62. The family budget study breaks down the expenditures of families into four categories--food, housing, clothes, and others--and indicates the expenditures of each income class on these various categories. Table 42 shows the expenditures.

The sales tax that is proposed would not be applied to all the foregoing categories. As has been suggested previously services, education, and medical expenses would be exempted. In the tabulation of Table 42 these services are included in "Others" so no tax will be applied to these expenditures. Also, an adjustment should be made on the housing expenditures since a part represents electricity and rent payments. Electricity is taxed under "Excise" so it should not be taxed again under the sales

TABLE 42

EXPENDITURES OF ALL FAMILIES BY INCOME GROUPS IN SYRIA FOR 1961/62 (IN THOUSANDS OF SYRIAN POUNDS)

| Income Class | Food | Housing | Clothing | Others | Total |
|---|---|---|---|---|---|
| Less than 500-1999 | 219,256 | 62,001 | 23,652 | 30,309 | 335,318 |
| 2000-3999 | 696,102 | 184,104 | 100,167 | 113,421 | 1,093,794 |
| 4000-5999 | 300,951 | 96,411 | 58,260 | 59,066 | 515,328 |
| 6000-7999 | 101,752 | 44,040 | 25,983 | 25,872 | 197,647 |
| 8000-9999 | 35,093 | 14,813 | 8,856 | 12,061 | 70,823 |
| 10,000 and over | 19,173 | 12,108 | 7,612 | 7,341 | 46,231 |

Source: Ministry of Planning, "Family Budget, 1961/62," (Damascus, 1962) (Mimeographed), p. 22.

tax. Rent should not be taxed since it would duplicate the property tax in Syria. Thus with these modifications and on the assumption that seventy-five per cent of the expenditures on housing will be spent on rent and electricity, the sales tax will be applied to the remaining twenty-five per cent. On the basis of the above qualifications, Table 43 indicates the amount of revenue that the Syrian Government will be collecting if they adopt the suggested sales tax.

From the foregoing estimates, the need tax would bring a substantial revenue to a needy government. Compared with the income tax in 1961-62--that is income tax from professions, salaries and wages, and circulating

TABLE 43

ANTICIPATED REVENUE TO THE CENTRAL GOVERNMENT FROM THE VARIOUS INCOME GROUPS FROM SALES TAX, 1961-62 (IN THOUSANDS OF SYRIAN POUNDS)

| Income Group | Tax Revenue From Food | Tax Revenue From Housing | Tax Revenue From Clothing | Total Tax |
|---|---|---|---|---|
| Less than 500-1999 | 21,926 | 1,550 | 2,365 | 25,841 |
| 2,000-3,999 | 69,610 | 4,602 | 10,016 | 84,228 |
| 4,000-5,999 | 30,095 | 2,410 | 5,826 | 38,331 |
| 6,000-7,999 | 10,175 | 1,101 | 2,598 | 13,874 |
| 8,000-9,999 | 3,509 | 370 | 886 | 4,765 |
| 10,000 and over | 1,917 | 303 | 761 | 2,981 |
| Total | 137,232 | 10,336 | 22,452 | 170,020 |

Source: Based on the data in Table 42.

capital--the sales tax is superior in terms of revenue. The revenue from the income tax category in 1961-62 was SP 27,437 thousand. The total revenue was SP 493,775 thousand. The income tax contribution to the budget was about six per cent. However, based on 1961-62 statistics, the had the Syrian government adopted the sales tax, its contribution to the revenue in that period would have been 34 per cent--or total revenue would have been SP 142,583 thousand greater--excluding the income tax.

<u>Advantages of the Sales Tax</u>. In underdeveloped countries and Syria is one of these, sales taxes commend

themselves as a source of revenue for various reasons. In the first place, their administrative simplicity and feasibility make them very well suited for taxing persons on the basis of their consumption. Sales taxes lessen the dependence upon progressive income taxes for augmenting their resources for development--they constitute a desirable source of development finance. Moreover, Syria has not yet evolved an effective system of income taxation and sales taxes constitute a good substitute. In Syria or in any other underdeveloped country, it is necessary to extend the tax to lower income groups in order to make these groups contribute their share to economic development and sales taxes play an important part in this regard. The sales taxes constitute an administratively flexible counter-cyclical weapon because reactions to them may be extremely rapid. In a developing economy marked by inflationary pressures one of the functions of taxation is to prevent inflation and the sales taxes help not only in ploughing back a portion of the increasing income into public savings but also in keeping the inflationary forces under check, provided the wage rates remain stable. Due in suggesting a sales tax as an alternative said the sales taxes perform a valuable function because they

> strike only at the portion of income spent, and provide incentive to consume less; thus, per dollar of revenue, they are more effective in checking

> inflation. . . . The income basis is a somewhat clumsy way of accomplishing this result.[83]

Another advantage of sales taxes is that they would include persons who had been able to evade or avoid income taxes. Sales taxes would include any expenditures out of accumulated wealth or from capital gains which may not have been effectively taxed in underdeveloped countries through other forms of taxation. Sales taxes discriminate against consumption in favor of savings--they reduce the ability to spend by taking money away from consumers--they lessen the incentive to spend since the tax liability can be reduced by saving more and spending less.

There is an argument for the sales tax in which proponents have said that such a tax--in the long run--does not restrict capital formation and economic development as much as income taxes. It is argued that the sales tax does not lessen the incentive to save as much as the income tax, and its burden is concentrated more heavily upon those persons who will be compelled to reduce consumption. Thus the sales tax will absorb a portion of the money that is spent on consumption, thus increasing the ratio of saving to national income to finance the development process and increasing the rate of capital formation without a possible increase in inflation. This argument has a significance in underdeveloped countries

---

[83] John F. Due, Government Finance (Homewood, Illinois: Richard D. Irwin, Inc., 1959), p. 278.

having inadequate capital equipment relative to manpower. In such cases an increase in the rate of capital formation may allow a sharp increase in the overall standard of living.[84]

Taxes on necessities produce one incidental result or an incentive that may be favorable to development--that is the forcing of more of the total productive activity into the money economy and out of the subsistence sectors. If the peasant cultivators must pay higher prices for the few things they buy, they will be compelled to seek more cash income. Although there may be no practical method except property tax of reaching food produced and consumed at home, sales taxes on products they take from the economy will insure that they bear at least some tax burden.[85]

The greatest advantage of the sales tax has been its high productivity where the base of the tax is broad and its rate is sufficiently high. The small piecemeal payments of the sales tax by the multitude of consumers assures large revenues to the government and a minimum resistance on the part of the taxpayers.

Equity Consideration. The advantages of the sales tax are attacked by critics as illusory. The basic and most widely accepted argument centers around the

---

[84]John F. Due, Sales Taxation (Urbana, Illinois: University of Illinois Press, 1957), pp. 32-33.

[85]Bangs, Financing Economic Development, p. 135.

distribution of the burden of the tax by income group, under the assumption that the tax is shifted forward to the final consumers of the products. The tax tends to place a relatively heavy burden on all persons whose expenditures on taxable goods constitute relatively high percentage of their incomes. It is argued that the relatively heavier burden is, in many cases, inflicted on persons who are unable to pay it, with consequent inequity. In the first place, persons with the lower incomes tend to spend higher percentages of their incomes and save lower percentages than those in the higher income groups; as a consequence, if sales taxes apply to all consumption expenditures, the taxes <u>will</u> tend to be regressive relative to income.

Apart from the overall tendency to place a relatively heavy burden on persons in the low income groups, the tax tends to penalize any group whose family circumstances compel them to spend a higher percentage of their income to attain a given standard of living. The tax tends to burden large families more heavily than smaller families with the same income, since the former must spend a higher percentage of income to attain a given living standard. Although the large family has less tax-paying ability than the smaller, the sales tax burden upon it will be greater.

It is the concern over the inequity of the sales tax and the inequality of income that exists in many of the underdeveloped countries that has led many of these countries to adopt a progressive income tax. They have accepted the idea that now prevails in the advanced countries that social justice requires taxing people according to the "ability-to-pay" principle which is measured by income; and they have also accepted the goal of reducing the income inequality by the progressive income tax. But, by accepting this goal they have neglected the possible adverse effects that a progressive income tax might have on the total saving in the economy. An economy cannot progress unless it saves, and that saving is transformed into investment. Any curtailment of saving could adversely affect the prospects of economic growth.

Concern over such consequences is reflected in the relevant economic literature. It may be said that it is almost universally accepted that the more uneven the distribution of income, the greater will be the proportion of national income saved. Keynes, in describing the prospering capitalism of the nineteenth century wrote:

> In fact, it was precisely the inequality of the distribution of wealth which made possible those vast accumulations of fixed wealth and of capital improvements which distinguished that age from all others. Herein lay, in fact, the main justification of the capitalist system. If the rich had spent their new wealth on their enjoyments, the world would long ago have found such a regime intolerable. . . . The immense accumulation based on inequality was a vital

part of the pre-war order of society and of progress.[86]

Heilbroner, writing on the growth in early capitalism, said:

> The fact that England had to hold down the level of its working class consumption in order to free productive effort for the accumulation of capital goods. . . . But social inequalities aside, the hard fact remains that had industrial wages risen very much, a vast demand for consumer's goods would have turned the direction of the English economy away from capital building, toward the satisfaction of current wants.[87]

Ashton in discussing the Industrial Revolution in England writes that the class structure was favorable to the increase in saving because it is generally recognized that more saving takes place in communities in which the distribution of wealth is uneven than those in which it approaches more closely to modern conceptions of what is just.[88]

Higgins expresses the idea that:

> . . . the political and social reawakening in many underdeveloped countries since the war inclines them toward the welfare state and a more equalitarian distribution of real income. . . . Such redistribution usually does little to raise the real income in the lower ranges, even where higher incomes have been

---

[86] John M. Keynes, The Economic Consequences of the Peace (New York: Harcourt, Brace and World, 1920), pp. 19-21.

[87] Robert L. Heilbroner, The Making of Economic Society, Second Edition (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1968), p. 89.

[88] T. S. Ashton, The Industrial Revolution, 1760-1830 (New York: Oxford University Press, 1964), p. 7.

significantly reduced. This process tends to reduce net savings.[89]

Other writers have noted that fiscal policies aimed at greater income equality have both good and bad effects on economic growth. For example, Bauer and Yamey observed that:

> Redistribution from the rich to the poorer members of a society is likely to strike at some of the most important sources of capital formation, and also to penalize, and hence inhibit, the exercise of special skills and initiative which are rare in all societies and particularly in underdeveloped ones. On the other hand, the beneficiaries of the process of redistribution, quite apart from the direct advantages which may be derived from their enlarged incomes, may become more efficient participants in economic life, though this effect is likely to be deferred.[90]

Lewis suggests the redistribution of wealth when he notes that growth causes profits to rise, which in the past has created large fortunes in a few hands. Democratic governments, he notes:

> . . . are most suspicious of this process and very reluctant to let the capitalists make substantial profits out of economic development; on the other hand if profits are kept low or taxed heavily, private saving will be small, and there will be little incentive for private enterprise. The liberal way through this dilemma is to encourage private capitalists to make all the profits they can while alive, and tax them severely when they die.[91]

---

[89] Higgins, Economic Development, p. 481.

[90] P. T. Bauer and B. S. Yamey, The Economic of Underdeveloped Countries (Chicago: The University of Chicago Press, 1957), p. 168.

[91] W. A. Lewis, The Theory of Economic Growth (Homewood, Illinois: Richard D. Irwin, Inc., 1955), pp. 400-401.

The above discussion indicates that an uneven distribution of income is desirable for economic progress. The price of development is hard work, willingness to postpone increases in consumption, and eagerness to accept change. There is no easy and painless road. This bitter choice must be confronted by every society. To assuage the needs of today or to build for tomorrow is the decision that a developing society must make. It is a decision which lies behind much of the political and economic agony of a large part of the world today.

The underdeveloped countries should concentrate in reducing the inequality--not of income--but on reducing vast inequalities in providing increasing equality in the opportunities of education and employment. The objective should be to raise the standards of those who are poor by giving them a decent education, rather than to make all the rich people poor. The effort should be directed toward upgrading everyone. Complete equality in the distribution of income and wealth is neither desirable nor practical.

Raising the savings ratio to national income is one of the most difficult problems in underdeveloped countries. It is not enough to persuade only the richer classes to save and invest. But since a substantial part of the increases in incomes which may result from the development process or the redistribution of income will accrue to the poorer sectors, the poor will be in a position to consume more than ever. The marginal propensity to consume of the poor is very near unity, so their consumption will tend to rise almost as much as their incomes. If this is allowed to materialize, the increase in productivity will be almost fully absorbed by increased consumption. The sales taxes could be used at this point to restrain increases in consumption and thus increase saving for purposes of investment. Barbara Ward sums the argument by observing that:

> A developing society must at some point begin to save, even though it is still poor. . . . It is a difficult phase in any economy--so difficult that most societies got it by forced measures. . . . No one asked the British laborers moving into the Manchester slums whether they wanted to save. . . . The Soviet workers who came to Sverdlovsk and Magnitogorsk from the primitive steppes had no say in the scale or condition of their work. Nor have the Chinese in their communes today.[92]

In the light of the above discussion, it is only at the cost of having total savings decline that an underdeveloped country can impose a system of progressive taxation. Such a system will lead to a redistribution of income which will decrease the average propensity to save. However, the governments of these countries require funds for financing the economic development projects which have been selected. The most suitable method, at least in their early stage of development, is to rely heavily on sales taxes on consumption commodities.

---

[92]Barbara Ward, India and the West (New York: W. W. Norton and Company, Inc., 1964), pp. 145-46.

On equity grounds, the sales tax is ideally suited to meeting the dictates of equity. It is levied on that portion of funds which a person withdraws from the community's pool of capital and is not levied on that portion which he adds thereto or does not withdraw therefrom. Furthermore, the sales tax does not discriminate against a particular group of taxpayers--that is, every person within the society will pay to the treasury a tax representing the extent to which that person exercises his spending power--the income tax may favor other groups who escape taxation through legislative or administrative loopholes.

# CHAPTER VII

## SUMMARY AND RECOMMENDATIONS

### Summary

The focal point in the evaluation of any fiscal system as it bears on the process of economic development and the rate of capital formation is how much it aids in the achievement of that end. It is highly unlikely that any nation today could advance far on the ladder of economic development without the mass of social overhead capital that facilitates growth. This type of capital is essential not only to provide certain essential facilities for the public but also to enable what private sector activities that exist to become functional and profitable.

The fiscal policy of a country should be directed at developing the needed social overhead capital. The fiscal system has to generate enough revenue to cover development expenditure in the widest sense. The fiscal policy in an underdeveloped country should aim at financing at least a substantial or the major part of its economic needs from domestic sources. However, the ability of the fiscal policy to do this is conditioned by the particular aspects of the economy in which it operates. These particular aspects are the result of past experience and institutional traditions. This is especially true in the case of Syria, where such past experience and institutions were causal factors in holding back the fiscal system and in obstructing its use as a powerful tool of economic development.

Chapter II was devoted to a description of the basic problems for development in underdeveloped countries. The characteristics are grouped under four headings. They include: low income, low well-being, raw material producers, foreign trade orientation, and population pressure. On the other hand, the obstacles fall under the following categories: market imperfections, vicious circle, international forces, and governments instead of entrepreneurs.

The characteristics of an underdeveloped economy stem from the fact that the economic level at which it starts, in most cases, is very low. The relationship between population and resources is usually unfavorable and this leads to low income and low well-being of the population. Most of the underdeveloped countries are raw material producers and their output and employment tend to concentrate in this field because of lack of alternative employment opportunities in other fields. As a consequence of their reliance on primary production, their export is oriented to foreign markets and usually their economies are based upon the production of only one or few items. This makes their trade with the outside world very unstable and puts them at the mercy of the movements in external prices. Thus their economies become highly susceptible to world price movements, but also because their economies usually are rather specialized--they lack diversification which could enable a country to accept some adverse price movements in regard to a primary export which might be offset by favorable prices in another area of export.

The population pressures that exist in some underdeveloped countries threaten to absorb increases in production. Immigration might be an outlet to relieve some of the pressure but is not used because of the family system that exists in many of them. Under such a family system each member of the family has the duty to assist and, if necessary, to support all other members. The duty to support others tends to discourage special effort and initiative. This puts pressure on government to accelerate development in order to outstrip population increase; otherwise, there will simply be more people at the subsistence level.

Market imperfections form an obstacle to the development process. The rigidities found in the underdeveloped economies force them to produce inside their production possibility curve. The inferior allocation of resources is an impediment to the development process.

The "vicious circle" stems from poverty which is characterized by low per capita income, low consumption, low investment, and low productivity. Little saving occurs because that which is produced is needed to sustain consumption--even at a low per capita level. Little surplus is left for saving, and development proceeds at a slow pace if at all.

The international forces manifest themselves in the argument that the poor countries have not benefited from trade. The contention here is that the terms of trade have operated against poor countries. The poor countries have not gained from trade proportionately with most of the gains having accrued to the industrial countries.

The exports of underdeveloped countries were generally concentrated in a small number of big primary products, sometimes even in one product alone. Fluctuations in world demand for these products was immediately reflected in volume and prices of exports and thus had a decisive impact on their economy.

The economy of the underdeveloped countries, insofar as it has been integrated with the world economy, has been entirely subordinated to the industrial countries of the West. Through their demand (the advanced West) and even more important, through their investments, they have directed the course of development toward satisfying their own requirements and not those of the underdeveloped countries.

Thus nearly all foreign investments made in the underdeveloped countries during the colonial period were directed toward the foreign trade, particularly exports. Little if any foreign investment was made in the manufacturing industries that supplied the domestic markets of the underdeveloped countries. The reluctance of foreign capital to finance industrialization was to some extent due to the unwillingness on the part of Western governments to develop in their own colonies, industries which would restrict the export markets of their own producers. This action led to the creation of a dual economy--a modern sector for export and a traditional sector for home markets.

It is natural that such a situation is--which on the whole still persists--considered intolerable by the public opinion of the underdeveloped countries and to look to their own governments to initiate industrialization.

The substitution of government for private entreprenurship is believed to be an obstacle to the development process. The governments of underdeveloped countries lack good administration which is a prerequisite for development. Moreover, the real problem has been that governments have been politically backwards, unstable, and uncooperative in furthering the development process.

However, this does not mean that there is no hope for these countries. They have the advantage of the present accumulated scientific and technical knowledge which they can utilize to their advantage. They should utilize all available knowledge and work their own specific techniques to fit their own values and their actual conditions. They can diversify their exports to include the exportation of manufactured goods and cooperate among themselves, or form regional markets.

Chapter III developed the theory of taxes and government receipts. In the field of theory, this chapter develops the principles of taxation. A sound tax system should be fiscally adequate, simple to administer and easily understood by the taxpayer---economically it should be cheap to collect and take from the pockets of the people as little as possible. Finally, the tax system should be equitable---that is, it should not favor particular groups or classes. However, the application of this principle is difficult, because it is difficult to define it in precise terms. The application of this test leads to various methods according to where the burden may be distributed.

The distribution of the tax burden can be based on the cost of service principle, the benefit of service principle, or the ability-to-pay principle. The cost and benefit principles were ruled out. It did not meet specified social criteria since it ignores the theory that the duty of government cannot be apportioned among the citizens on the cost or the benefit they receive from the services of the government. Most government duties are of such a nature that it would be difficult if not impossible to allocate its costs among citizens on individual basis. The protection and security of the nation, for example, is of such a nature that it is impossible to divide the cost (or benefit) among citizens.

However, in spite of its limitations, the cost and benefit principles can be partially incorporated into the tax system. There are services, such as the postal service, through which these principles could be applied--the cost or benefit could be apportioned among citizens in this example.

If the cost of service and benefit principles are both ruled out, then the distribution of the tax burden should be allocated according to the ability-to-pay principle. This principle is accepted today as the principal criterion which should guide the government in raising tax revenue--the heaviest burden should be placed on the broadest shoulders. The tax burden should be progressive but not to infinity. This means that the tax burden increases as the taxable base increases.

The Syrian government receipts were surveyed and reflected that these receipts were rising throughout the period. Of the bulk of government receipts, indirect taxes alone contributed 61.1 per cent of all receipts in 1964. Despite the element of progressiveness introduced in the tax system, direct taxes were in third place in terms of yield.

In the field of non-tax receipts, the important development was the conclusion of an agreement between the Syrian government and IPC and TAP, which caused increased revenues from the transit of oil across Syria. The budget estimate from this source in 1965 was put at SP 125,675 thousand.

Fiscal policy in underdeveloped countries was analyzed in Chapter IV. It was indicated that the rate of capital formation depends on the amount of saving that the economy can effect. The volume of saving in any country may increase as a result of a conscious choice of the people not to consume at the present time and thus devote more saving to investment purposes. It was pointed out that one of the most important causes of underdevelopment and economic stagnation in underdeveloped countries is their inability to save enough and to channel their savings into productive investment.

Unless these countries can increase their saving at an appreciable rate, rapid economic development is not possible.

The explanation of a low level of saving and investment in underdeveloped countries appear to be the presence of the "demonstration effect" which works at the international level as well as domestically. On the international level, the rich people in the underdeveloped countries try to emulate the standard of living of the advanced countries and thus increase their consumption which acts adversely on their propensity to save. Domestically, the middle class wants to emulate the standard of the rich and this exerts pressure on their propensity to save. To some writers, this emulation may inhibit saving and thus hinder economic development in poor countries.

Other writers argue that emulation of the consumption standard of the advanced countries in poor countries may profit the private sector in these countries, and instead of acting as a hindrance to capital formation and economic development. It would appear that this argument would likely prevail in the poor countries in their quest for economic development.

The dichotomy of demand and supply states that capital formation in poor countries is low due to a low demand for investment goods and a low supply of saving.

This is due to low per capita productivity, which limits demand for output, due to the small size of the market.

Since domestic savings have not been adequate, the poor countries have turned their attention to foreign capital to aid them in their development process. The sources of foreign capital available to poor countries are many. The external capital could be available through private foreign investment, inter-governmental lending, foreign aid and loans from international agencies. The conclusion of this section is, that for the time being, capital does not flow to poor countries in amounts that are in reasonable proportion to the general development needs. Furthermore, the small flow that exists trickles out in a most haphazard way, usually without any relation to real economic developmental needs.

Syria started development policy by the enactment of the Seven-Year budget and followed that with other plans. The projects to be undertaken and the type of public investment planned parallels the thinking of other countries when considering public participation in the process of capital formation. Most of the projects to be carried out would eventually provide the proper framework for private initiative and enterprise. In addition, they would directly and indirectly raise the productivity of the economy.

However, the need for larger participation by the government in the capital formation process raises some difficulty concerning the capacity of the fiscal system to carry out the burden. The examination of the capacity of the fiscal system brings forth, in turn, further problems connected with the efficiency and flexibility of the system. In analyzing these problems as they prevail in Syria, it is believed that the capacity of the fiscal system could be increased to 20 per cent of national income without undue effects on private savings and investment. In order to achieve this objective in Syria, a major improvement must be brought about in the administration of the fiscal systems.

Furthermore, it was found that for purposes of economic development, a rise in the capacity of the fiscal system and a favorable degree of efficiency are not alone sufficient to insure a good working system. The fiscal system in Syria lacks the proper degree of flexibility.

In Chapter V, the analysis centered around the discussion of the various sales taxes. It was pointed out that virtually all sales taxes in use today have been introduced in periods of financial emergency, in which additional revenue was urgently needed. Once the tax is introduced, its high revenue productivity insures it a permanent place in the tax structure.

The goal of distributing the burden in relation to consumption expenditures is attained to the extent to which the pattern of reductions in real income that results from the tax is related to consumption. The distribution of the tax burden depends on the amount prices are going to increase as a result of the imposition of the tax, or in other words, the burden of the tax will depend upon the elasticity of supply and demand of the taxed commodities.

Furthermore it was pointed out that the advantage of a manufacturing sales tax and the value-added tax over the turnover tax is that the latter favors vertical integration and discriminates against independent enterprises. The Canadian manufacturing tax and the French value-added decrease the incentive toward integration and to not discriminate against the independent firms.

The primary advantage of the purchase tax is its potential as an instrument of inflation control. A minor disadvantage of the tax would be frequent changes in tax rates which could interfere with the planning of business for future production and cause the consumers to speculate about rate changes.

Chapter VI is devoted to the methods of financing economic development of the poor countries. It was pointed out that there seems to be ample fiscal tools for tapping the agricultural sector in underdeveloped nations. The levels of sumptuous living which the wealthy landlords maintain would indicate a taxable capacity, whatever that might be, which could provide some of the funds necessary to undertake a development program. It was pointed out that this tax has played an important role in financing the economic development of few countries. The poor nations have not utilized this source of revenue as a means of financing their development. One reason might be that due to land reforms taking place in most of the undeveloped countries, the governments decided not to burden the poor farmers with such a tax and look for other alternatives to finance the development plans.

The other alternative is through inflation. The ways in which inflation can be an aid and hindrance to economic development were examined. It was pointed out how inflation may result from development efforts--and methods of avoiding inflation from development efforts were discussed. It is difficult to arrive at specific conclusions regarding the role of inflation in economic development.

The majority of writers seem to be opposed to the adoption of inflation as a means for economic development. Rapid or continuous inflation provides incentive for non-productive, speculative type investments, discourages savings, and brings payment problems and controls which hurt the development efforts.

Others argued that inflation has some ability to shift resources to investors, and that a moderate inflation in its early stages can have useful effects on the development process.

The conclusion was reached that inflation could be helpful and utilized as a means of stepping up the process of economic development, if the country or countries concerned make a correct assessment of their economic conditions. Moreover, in order to have a successful development, the poor countries should have monetary and fiscal tools to control inflation when it threatens the economy. At the present time, the poor nations lack such economic institutions and it is advisable for these nations not to resort to inflation as a means of financing development projects.

## Recommendation

Syria possesses most of the traits of an underdeveloped country. These include a very low per capita income, a high rate of illiteracy, a high rate of unemployment, a high degree of resource immobility, an unequal distribution of income and wealth, and a low productivity of labor.

It was noted that if Syria is to maintain growth in per capita income and accelerate economic growth, more than 20 per cent of the national income must be invested. The present tax structure does not bring enough financial resources to finance development and foreign capital is not available in sufficient amounts.

In the face of these difficulties, it is recommended that the Syrian government should introduce a sales tax to secure the necessary revenue for development. It was pointed out that the sales tax has the advantage of yielding a relatively large revenue at a low rate because it covers most consumers' expenditures and can reach many persons.

The introduction of sales tax will benefit the society as a whole. In order to enjoy a higher level of consumption in the future, present consumption must be restrained and the surplus thus mobilized must be used for productive investment. A growing proportion of national income must be saved and invested if growth is to be accelerated, and it is the act of refraining from consuming which constitutes the real sacrifice or cost of economic development. It is not of crucial importance, at least in the early stages of development, just whose consumption is going to be restrained. The important aspect to concentrate on is the best and, most workable method to raise the revenues necessary to finance development. No cost for rapid economic development is too great, in the long run. It is true that standards of living are already too low, but if necessary for the sake of rapid development, this standard may be lowered still more. The people and government must be wise enough to agree to fall one step backward in order to facilitate jumping several steps forward. If necessary, people must tighten their belts and be prepared to undergo the utmost possible sacrifice temporarily for the present in the interest of a bright and prosperous future.

The sales tax may be regarded as a "second-best" tax, in terms of usual standards of tax policy and can be substituted for the income tax in circumstances in which the state of development does not permit adequate use of that form of tax. It may be argued that the sales tax burden is regressive relative to income, if the sales tax base is universal in scope. However, it may have less adverse incentive effects than income taxes--particularly progressive one--and permit a higher rate for capital formation without inflation. More specifically the use of sales tax can be defended. First as a mean of avoiding serious adverse incentive effects of high income taxes, and second, to allow a higher rate of long range capital formation than that possible with exclusive use of income taxation. This consideration is of particular importance to underdeveloped countries. Moreover when the state of economic development, administrative standards, and taxpayer education and morality do not permit adequate sums to be raised from income taxes, the sales tax must be used to secure adequate revenues.

A sales tax can be substituted for any and all forms of income tax. It has been pointed out that by the substitution of the proposed sales tax--manufacturers and wholesale--government revenues based on 1961-62 statistics, would have been increased some SP 142,583 thousand. There is no contrary evidence that would negate the "sales tax" assumption for later periods.

The intention here is not to take a stand for social injustice and continued inequalities of income distribution. The basic contention is that no low-income society has yet evolved a painless way of stimulating capital formation and at the same time distributing incomes more equally.

Furthermore, it is not implied that welfare activities are not unimportant to continued economic growth, but for poor countries they represent luxuries that either delay more fundamental investment or cause the budget to be overly large.

Economic development implies a continuous process of capital accumulation to increase the productive equipment available to the economy. To make this accumulation possible, the structure of the economy must be such as to provide a surplus over and above essential consumption requirements. Such surpluses have been obtained in many economies, even in those where standards of living were once at subsistence level or below.

Economic development depends largely on the successful solution of certain basic problems--in particular the accumulation and use of maximum human and material resources in order to increase and improve production.

Although the underdeveloped countries sense the urge for development, they find themselves in a dilemma: how to reconcile their aspiration for economic and social development pursued in accordance with the wishes of the population--and without imposing on its people a severe hardship and sacrifice, in order to attain a sufficiently rapid rate of economic development with a concurrent increase in per capita income.

However, this sense of urgency to achieve development is expressed not in mobilizing the energies of the people to this end, but unfortunately is expressed mainly in demands for material benefits expected from it now. Demands for social security benefits are sometimes pressed before the progress achieved by the economy makes it possible to afford these improvements. While at the start of economic development the general levels of productivity and incomes are those of pre-industrial economy, public opinion has a tendency to expect rapid attainment of the same standards of mass consumption and social welfare as the most highly developed and industrialized states were able to afford only after a long period of development and capital formation. This urge provokes the thought of the proverb "having the cake and eat it too."

It is high time for poor countries, in particular Syria, to open their eyes and admit that excesses in the distribution of incomes are inevitable during a free enterprise development process--and relearn the lesson of history--that appropriate policies which are conducive to economic development must be instituted, despite the interim hardships.

# BIBLIOGRAPHY

## A. Primary Sources


AID, _Proposed Foreign Aid Program Fy 1968_. Washington, D. C.: Government Printing Office, 1968.

Export-Import Bank, _34th Fiscal Year-End Report, 1968_. Washington, D. C.: Government Printing Office, 1968.

Food and Agriculture Organization of the United Nations. _Report of the Sixth FAO Regional Conference for the Near East_. Tel-Amara: Lebanon, 1962.

Food and Agriculture Organization of United Nations. _United Arab Republic: Syrian Region_. Rome, Italy, 1959.

International Bank for Reconstruction and Development. _The Economic Development of Syria_. Baltimore: The Johns Hopkins Press, 1955.

Institute of Economic Development. _The Ten-Year Plan, 1958-67_. Damascus: Hashimite Press, 1959.

Ministry of Planning. "Family Budget, 1961-62." Damascus, 1962. (Mimeographed).

Ministry of Planning. _Statistical Abstract, 1965_. Damascus: Government Press, 1966.

Ministry of Planning. _Statistical Abstract, 1956_. Damascus: Government Press, 1957.

Ministry of Planning. _Statistical Abstract, 1958_. Damascus: Government Press, 1959.

Ministry of Planning. "The Syrian Five-Year Plan, 1960/61-1964/65." Damascus, 1961. (Mimeographed).

Ministry of Planning. _Second Five-Year Plan, 1966-70_. Damascus: Government Press, 1966.

Ministry of Trade and Commerce. Canadian Yearbook, 1968. Ottawa, Canada: Queen's Printer, 1968.

United Nations. Statistical Yearbook, 1967. New York, 1968.

________. Economic Development of Latin America and Its Principal Problems. New York, 1950.

________. Relative Prices of Exports and Imports of Underdeveloped Countries. New York, 1949.

________. Towards a New Trade Policy for Development. New York, 1964.

________. Statistical Yearbook, 1965. New York, 1966.

________. Methods of Financing Economic Development in Underdeveloped Countries. New York, 1949.

________. World Economic Survey, 1959. New York, 1960.

________. Yearbook of National Accounts Statistics, 1966. New York, 1967.

________. World Economic Survey, 1960. New York, 1961.

________. World Economic Survey, 1965. New York, 1966.

________. Economic Development in the Middle East, 1954-55. New York, 1956.

________. Taxes and Fiscal Policy in Underdeveloped Countries. New York, 1954.

United States Senate. Foreign Aid Program, Document No. 52. Washington, July, 1957.

United States, Department of Commerce. "Survey of Current Business," Volume 48 (October, 1968), Washington, D. C.: Government Printing Office, 1968.

World Bank and IDA, Annual Report, 1966/67. Washington, D. C., 1967.

## B. Secondary Sources

### Books

Adams, Henry Carter. The Science of Finance. New York: Henry Holt and Company, 1898.

Agar Wala, A. N., and S. P. Singh (ed.). The Economics of Underdevelopment. New York: Oxford University Press, 1963.

Alexander, Robert J. A Primer of Economic Development. New York: The Macmillan Company, 1962.

Allen, G. C. A Short Economic History of Modern Japan, 1867-1939. London: George Allen and Unwin Ltd., 1946.

Alnasrawi, Abbas. Financing Economic Development. New York: Frederick A. Praeger, Inc., 1967.

Alpert, Paul. Economic Development. New York: The Free Press of Glencoe, 1963.

Asfour, Edmund Y. Syria: Development and Monetary Policy. Cambridge, Massachusetts: Harvard University Press, 1959.

Ashton, T. S. The Industrial Revolution, 1760-1830. New York: Oxford University Press, 1964.

Banks, Robert B. Financing Economic Development. Chicago: The University of Chicago Press, 1968.

Bastable, C. F. Public Finance. 3rd ed. London: Macmillan and Company, Ltd., 1917.

Bauer, Peter T., and Basil S. Yamey. The Economics of Underdeveloped Countries. Chicago: The University of Chicago Press, 1957.

Belshaw, Horace. Population Growth and Levels of Consumption. London: George Allen and Unwin, Ltd., 1956.

Bennett, Orval, and Isaac Lippincott. Public Finance. Dallas: SouthWestern Publishing Company, 1949.

Bird, Richard, and Oliver Oldman (ed.). Readings on Taxation in Developing Countries. Baltimore: The John Hopkins Press, 1964.

Blackey, Roy G., and Gladys C. Blackey. Sales Taxes and Other Excises. Chicago: Public Administration Service, 1945,

Bolino, August C. The Development of the American Economy. Columbus, Ohio: Charles E. Merril Books, Inc., 1966.

Brand, W. The Struggle for Higher Standard of Living. Glencoe, Illinois: The Free Press, 1958.

Buchanan, Norman S. International Investment and Domestic Welfare. New York: Henry Hact and Company, 1945.

Buchanan, Norman S., and Howard S. Ellis. Approaches to Economic Development. New York: The Twentieth Century Fund, 1955.

Buchanan, Norman S., and Friedrich A. Lutz. Rebuilding the World Economy. New York: The Twentieth Century Fund, 1947.

Buehler, Alfred D. General Sales Taxation. New York: The Business Bourse, 1932.

Cairncross, A. K. Home and Foreign Investment, 1870-1930. Cambridge: The Cambridge University Press, 1953.

Caves, Richard E., and Associates (ed.). Britain's Economic Prospects. Washington, D. C.: The Brookings Institutions, 1968.

Chellish, Raja H. Fiscal Policy in Underdeveloped Countries. London: George Allen and Unwin, Ltd., 1960.

Coale, Ansley J., and Edgar M. Hoover. Population Growth and Economic Development in Low-Income Countries. Princeton, New Jersey: Princeton University Press, 1958.

Cohn, Gustave. The Science of Finance. Chicago: The University of Chicago Press, 1895.

Dalton, Hugh. Principles of Public Finance. New York: Alfred A. Knopf, 1923.

Dobb, Maurie. Soviet Economic Development since 1917. New York: International Publishers Co., Inc., 1948.

Due, John F. Government Finance. Homewood, Illinois: Richard D. Irwin, Inc., 1959.

_______. Sales Taxation. London: Routledge and Kegan Paul Ltd., 1957.

Duesenberry, James S. Income, Saving, and the Theory of Consumer Behavior. New York: Oxford University Press, 1967.

Enke, Stephen. Economics for Development. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1963.

Fagan, Elmer D., and C. Ward Macy (ed.). Public Finance. New York: Longmans, Green and Co., 1934.

Haq, Mahbub U. The Strategy of Economic Development: A Case Study of Pakistan. Karachi: Oxford University Press, 1966.

Hays, H. Gordon. Spending, Saving, and Employment. New York: Alfred A. Knopf, Inc., 1947.

Hellbroner, Robert L. The Making of Economic Society. 2nd Ed. Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1968.

Heller, Walter W., Francis M. Boddy, and Carl L. Nelson (ed.). Savings in the Modern Economy. Minneapolis: The University of Minnesota Press, 1953.

Higgins, Benjamin. Economic Development: Principles, Problems, and Policies. New York: W. W. Norton and Company, Inc., 1959.

Hirschman, Albert O. The Strategy of Economic Development. New Haven: Yale University Press, 1961.

Jensen, Jens P. Problems of Public Finance. New York: Thomas Y. Crowell Company, 1924.

Keynes, J. Maynard. The Economic Consequences of the Peace. New York: Harcourt, Brace and Hawe, 1920.

_______. The General Theory of Employment, Interest, and Money. New York: Harcourt, Brace, and World, Inc., 1936.

Kindleberger, Charles P. Economic Development. New York: The McGraw-Hill Book Company, Inc., 1958.

Knowles, L. C. A. Economic Development in the Nineteenth Century. London: George Routledge and Sons, Ltd., 1932.

Krause, Walter. Economic Development. San Francisco: Wadsworth Publishing Company, Inc., 1961.

Lange, Oskar. Economic Development, Planning and International Cooperation. New York: Monthly Review Press, 1963.

Leibenstein, Harvey. Economic Backwardness and Economic Growth. New York: John Wiley and Sons, Inc., 1957.

Lewis, W. Arthur. Development Planning, the Essential of Economic Policy. New York: Harper and Row, Publishers, 1966.

________. The Theory of Economic Growth. Homewood, Illinois: Richard D. Irwin, Inc., 1955.

Lockwood, William W. The Economic Development of Japan: Growth and Structural Change, 1868-1938. Princeton: Princeton University Press, 1954.

Lutz, Harley Leist. Public Finance. New York: D. Appleton and Co., 1924.

Mathews, George, and Frank T. Devyver. Development of Economic Society. Vol. I. Boston: Little Brown and Company, 1937.

Meier, Gerald M. (ed.). Leading Issues in Development Economics. New York: Oxford University Press, 1964.

Meier, Gerald M., and Robert E. Baldwin. Economic Development: Theory, History, Policy. New York: John Wiley and Sons, Inc., 1957.

Mill, John Stuart. Principles of Political Economy. W. J. Ashley (ed.). London: Longmans, Green, anc Company, Ltd., 1915.

Morgan, T., J. W. Betz, and N. K. Choudhry (ed.). Readings in Economic Development. Belmont, California: Wadsworth Publishing Company, Inc., 1963.

Musgrave, Richard M. The Theory of Public Finance. New York: McGraw-Hill Book Company, Inc., 1959.

Myrdal, Gunnar. An International Economy: Problems and Prospects. New York: Harper and Brothers Publishers, 1956.

_______. Rich Lands and Poor. New York: Harper and Brothers Publishers, 1957.

National Bureau of Economic Research. Foreign Tax Policies and Economic Growth. New York: Columbia University Press, 1966.

Nove, Alec. The Soviet Economy. New York: Frederick A. Praeger, Inc., 1961.

Nurkse, Ragner. Patterns of Trade and Development. New York: Oxford University Press, 1961.

_______. Problems of Capital Formation and Underdeveloped. Oxford: Basil Blackwell, 1957.

Orchard, John E. Japan Economic Position. New York: McGraw-Hill Book Company, Inc., 1930.

Paish, F. W. The Post-War Financial Problem. New York: Council on Foreign Relations, 1954.

Perry, J. Harvey. Taxation in Canada. 3rd ed. Toronto: University of Toronto Press, 1961.

Philips, Paul A. M. V. Public Finance and Less Developed Economy. Hague: Martinus Nighoff, 1957.

Prest, A. R. Public Finance in Theory and Practice. London: Weidenfeld and Nicolson, 1960.

_______. Public Finance in Underdeveloped Countries. New York: Frederick A. Praeger, Inc., 1963.

Robinson, M. E. Public Finance. London: Misbet and Co., Ltd., 1928.

Roskamp, Karl W. Capital Formation in West Germany. Detroit: Wayne State University Press, 1965.

Rosovsky, Henry. Capital Formation in Japan, 1868-1940. New York: The Free Press of Glencoe, 1961.

Rostow, W. W. The Stages of Economic Growth. Cambridge: Cambridge University Press, 1962.

Royal Institute of International Affairs. The Problems of International Investment. London: Oxford University Press, 1937.

Seligman, Edwin R. A. _Essays in Taxation_. 9th ed. New York: The Macmillan Company, 1921.

Sharp, Ansel M., and Bernard F. Sliger. _Public Finance_. Homewood, Illinois: The Dorsey Press, 1964.

Shultz, William J., and C. Lowell Harris. _American Public Finance_. 5th ed. New York: Prentice-Hall, Inc., 1949.

Singer, H. W. _International Development: Growth and Change_. New York: McGraw-Hill Book Company, 1964.

Smith, Adam. _The Wealth of Nations_. The Modern Library. New York: Random House, Inc., 1937.

Smith, G. Armitage. _Principles and Methods of Taxation_. 9th ed. London: John Murray, 1924.

Staley, Eugene. _The Future of Underdeveloped Countries_. New York: Harper and Brothers, 1954.

Stamp, Josiah. _The Fundamental Principles of Taxation_. London: Macmillan and Co., 1921.

Sullivan, Clara K. _The Tax on Value-Added_. New York: Columbia University Press, 1965.

Tansky, Leo. _U. S. and U. S. S. R. Aid to Developing Countries_. New York: Frederick A. Prager, Inc., 1967.

Tripathy, Ram Niranjan. _Fiscal Policy and Economic Development in India_. Calcutta: The World Press Private, Ltd., 1958.

_______. _Public Finance in Underdeveloped Countries_. Calcutta: The World Press Private, Ltd., 1964.

Villard, Henry H. _Economic Development_. New York: Holt, Rinehard, and Winston, 1961.

Wald, Haskell P. _Taxation of Agricultural Land in Underdeveloped Economies_. Cambridge: Harvard University Press, 1959.

_______ and Joseph M. Froomkin (ed.). _Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development_. Cambridge: Harvard University Press, 1954.

Ward, Barbara. _India and the West._ New York: W. W. Norton and Company, Inc., 1964.

________. _Rich Nations and the Poor Nations._ New York: W. W. Norton and Company, Inc., 1962.

Wolf, Harold A. _Monetary and Fiscal Policy._ Columbus, Ohio: Charles E. Merrill Books, Inc., 1966.

Yewis, Cleona. _America's Stake in International Investments._ Washington, D. C.: The Brooking Institution, 1938.

Yoingco, Angel Q., and Ruben F. Trinidad. _Fiscal Systems and Practices in Asian Countries._ New York: Frederick A. Praeger, Inc., 1968.

Articles and Periodicals

Ahrensdrof, Joachim. "Central Bank Policies and Inflation: A Case Study of Four Less Developed Economies, 1949-57," _International Monetary Fund Staff Papers_, VII (October, 1959).

Axilord, S. H. "Inflation and the Development of Underdeveloped Areas," _Review of Economics Statistics_, XXXVI (August, 1954).

Benham, Frederic. "Colombo Plan," _Economica_, XXI (May, 1954).

Bernstein, E. M. "Financing Economic Growth in Underdeveloped Countries," _Savings in the Modern Economy_. Edited by W. W. Hellor, F. M. Boddy, and C. L. Nelson. Minneapolis: The University of Minnesota Press, 1953.

________. "Financial Problems of Underdeveloped Countries," _The Journal of Finance_, XII (May, 1957).

________ and I. G. Patel. "Inflation in Relation to Economic Development," _International Monetary Fund Staff Papers_, II (November, 1952).

Bernstein, E. M., R. B. Goode and M. Friedberge. "Economic Development with Stability," _International Monetary Fund Staff Papers_, III (February, 1954).

Bhatia, Rattan J. "Inflation, Deflation, and Economic Development," _International Monetary Fund Staff Papers_, VIII (November, 1960).

Bronfenbrenner, M. "The Appeal of Confiscation in Economic Development," The Economics of Underdevelopment. Edited by A. N. Agarwala and S. P. Singh. New York: Oxford University Press, 1963.

________. "The High Cost of Economic Development," Readings in Economic Development. Edited by T. Morgan, G. W. Betz, and N. K. Choudhry. Belmont, California: Wadsworth Publishing Company, Inc., 1963.

Cairncross, A. K. "International Trade and Economic Development," Kyklos, XIII, 1961.

Deyrup, Felicia J. "Limits of Government Activity in Underdeveloped Countries," Social Research, XXIV (Summer, 1957).

Dorrance, Graeme S. "The Effect of Inflation on Economic Development," International Monetary Fund Staff Papers, X (March, 1963).

Goode, Richard. "Reconstruction of Foreign Tax System," Readings on Taxation in Developing Countries. Edited by R. Bird and O. Oldman. Baltimore: The Johns Hopkins Press, 1964.

________. "Taxation of Saving and Consumption in Underdeveloped Countries," National Tax Journal, XIV (December, 1961).

Hamilton, E. J. "Profit Inflation and the Industrial Revolution," Quarterly Journal of Economics, LVI (February, 1942).

Helbaoui, Youssef. "Major Trends in Syria's Foreign Trade, 1951-1962," Middle East Economic Papers. Beirut: American University, 1964.

Heller, Walter W. "The Adaptation of Income Taxation to Agriculture in Underdeveloped Countries," Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development. Edited by H. Wald and J. M. Froomkin. Cambridge: Harvard University Press, 1954.

________. "A Survey of Agricultural Taxation and Economic Development," Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development. Edited by H. Wald and J. M. Froomkin. Cambridge: Harvard University Press, 1954.

Heller, Walter W. "The Use of Agricultural Taxation for Incentive Purposes," Papers and Proceeding of the Conference on Agricultural Taxation and Economic Development. Edited by H. Wald and J. M. Froomkin. Cambridge: Harvard University Press, 1954.

Hicks, U. K. "Direct Taxation and Economic Growth," Oxford Economic Papers, VIII (September, 1956).

Holzman, F. D. "Financing Soviet Economic Development," Reading on Taxation in Developing Countries. Edited by R. Bird and O. Oldman. Baltimore: The Johns Hopkins Press, 1964.

Johnston, B. F. "Agricultural Productivity and Economic Development in Japan," The Journal of Political Economy, LIX (December, 1951).

________ and J. W. Mellor. "The Role of Agriculture in Economic Development," American Economic Review, LI (September, 1961).

Kaldor, Nicholas. "Economic Growth and the Problem of Inflation," Economica, XXVI (November, 1959).

Kause, Karl. "West Germany," Foreign Tax Policies and Economic Growth, National Bureau of Economic Research. New York: Columbia University Press, 1966.

Lewis, W. Arthur. "Economic Development with Unlimited Supplies of Labor," Readings in Economic Development. Edited by T. Morgan, G. W. Betz, and N. K. Choudhry. Belmont, California: Wadsworth Publishing Company, Inc., 1963.

Maizels, M. "The Effects of Industrialization on Exports of Primary Producing Countries," Kyklos, IV, 1961.

Makdisi, Samir. "Some Aspects of Syrian Economic Growth," Middle East Economic Papers. Beirut: American University, 1961.

Pazos, Felipe. "Economic Development and Financial Stability," International Monetary Fund Staff Papers, III (October, 1953).

Poddar, A. K. "Inflation and Economic Growth," Indian Journal of Economics, XXXXIV (January, 1964).

Qureshi, Anwar Iqbal. "Structure and Taxation of Agriculture in Tunisia," Papers and Proceedings of the Conference on Agricultural Taxation and Economic

Development. Edited by Haskel P. Wald and Joseph M. Froomkin. Cambridge: Harvard University Press, 1954.

Ranis, Gustav. "Trade, Aid, and What," Kyklos, XVII, 1964.

Shaalan, A. J. "The Impact of Inflation on the Composition of Private Domestic Investment," International Monetary Fund Staff Papers, IX (July, 1962).

Shirley, David E. "Income Tax for Less Developed Nations," National Tax Journal, XII (September, 1959).

Slesinger, Reuben E. "Fiscal Policy Consideration for Underdeveloped Economies," Kyklos, XV, 1962.

Surrey, S. S. "Tax Administration in Underdeveloped Countries," Reading on Taxation in Developing Countries. Edited by R. Bird and O. Oldman. Baltimore: The Johns Hopkins Press, 1964.

United Nations, Fiscal Division. "Structure and Taxation of Agriculture in Chile," Papers and Proceeding of the Conference on Agricultural Taxation and Economic Development. Edited by H. Wald and J. M. Froomkin. Cambridge: Harvard University Press, 1954.

Wai, U. Tun. "The Relation Between Inflation and Economic Development," International Monetary Fund Staff Papers, VII (October, 1959).

________. "Taxation Problems and Policies of Underdeveloped Countries," International Monetary Fund Staff Papers, IX (November, 1962).

Wiles, P. "Growth vs. Choice," Economic Journal, LVI (June, 1956).

World Bank Mission to Colombia. "A Graduated Land Tax," Reading on Taxation in Developing Countries. Edited by R. Bird and O. Oldman. Baltimore: The Johns Hopkins Press, 1964.