"Dialogue for Development"
Lecture 2007

TAX REFORM for Stability and Growth in Jamaica

Lecture by Professor Vito Tanzi

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For Sophia
who had much
to do with the
preparation of this
lecture.

With friendship

Vito Tanzi

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Tax Reform for Stability and Growth in Jamaica

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Professor Tanzi has been an advisor to the Inter-American Development Bank, the Organization of American States, the World Bank, the United Nations, the European Commission, the European Central Bank, the Stanford Research Institute and other institutions. His main areas of interest are public finance, macroeconomics, and economic development.

From 1990–94, he was President of the International Institute of Public Finance and in 1989 was made "Commendatore della Repubblica Italiana" by the President of Italy. He has received honorary degrees from the University of Cordoba (Argentina); the University of Liege (Belgium); the University of Torino (Italy); the University of Bari (Italy); and the University of Lisbon (Portugal).

Prof Tanzi is the author of nine books and the editor of six, and has published numerous articles in professional economic journals and in edited volumes. The "Tanzi effect" in economics is named after him. Two volumes, *Macroeconomic Dimensions of Public Finance* and *Fiscal Policy and Economic Reform* (Rutledge 1997) were published in his honour.

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Preface

The Government of Jamaica recognizes the importance and necessity of tax reform in Jamaica. To that end, *Tax Reform for Stability and Growth in Jamaica* aims to re-open the dialogue that was started by the Tax Policy Review Committee (the Matalon Report) on tax reform in Jamaica and the immense potential for growth and development if the tax system is overhauled. At the heart of tax reform in Jamaica is the need to take a full inventory of the existing incentives and to simplify and reduce the number of applicable taxes so as to broaden the tax base.

Tax reform has the potential to increase growth rates and make the society and economy perform more efficiently. However, tax reform is inextricably linked to public spending. If public spending cannot be reduced, taxes will, invariably, have to remain high to support public expenditure. Therefore, tax reform must not precede a reduction in public spending but must succeed a reduction in public expenditure. The intricacies of taxation must, therefore, be fully understood in order to initiate and sustain meaningful, sustainable tax reform in Jamaica. There is too much to gain for tax reform not to be an imperative and, similarly, too much to lose.

The Planning Institute of Jamaica, in its strategic role, has to provide the impetus for such an initiative. The collaboration with Pan-Caribbean Jamaica Limited and the Inter-American Development Bank signals a shift from the paradigm of seeing taxes as the Government's business to cognizance of the fact that tax reform is a sustainable development issue and requires the participation of all stakeholders if it is to be a success.

The dialogue continues. This publication is one step further along the path to transformation of the tax system in Jamaica to drive growth and development.

I. Introduction

Taxation is often the most political and difficult of the activities of a government. It is difficult because it affects various groups in visible and differentiated ways, thus eliciting strong reactions. It is also difficult because citizens often push for high public spending while, at the same time, resisting higher taxes. The normal attitude of individual taxpayers toward taxation was once summarized, in a colourful way, by an American senator: "don't tax him; don't tax me; tax the fellow behind the tree."

Individuals and groups try hard to push the burden of taxation on the shoulders of the "fellows behind the trees," those who cannot be seen and who, it is hoped, will not be fully aware of the extent to which they are being taxed. A century ago, an Italian economist, Puviani, recommended that governments use "fiscal illusion," that is that they hide their taxes in various ways so that the taxpayers will react less.

The attempts on the part of taxpayers to reduce or minimize their tax burden come in several ways: through political lobbying to get tax incentives, tax expenditures, or other preferential treatments in the legislation; through manoeuvres aimed at getting a preferential "administrative" decision; at times through the bribing of corrupted tax inspectors; through the moving of economic activities into the informal or underground economy; or through forms of explicit tax evasion that involve hiding incomes or sales or exaggerating deductions and expenses. Taxes may lead to the substitution of work with leisure and riskier activities (which are better compensated) with less risky ones.

Faced with these legal or illegal attempts at avoiding the tax payments, the government often has no choice but to increase the number of taxes that it uses or to raise the rates on existing taxes on those who cannot evade or avoid the tax payments. This, of course, tends to make the tax system less equitable, more complex, and distorted. The tax burden on the "official" part of the economy becomes higher than the statistics on the average tax rate for the whole country indicate. Thus, the average tax rate can be a misleading indicator of the burden on those who cannot avoid their tax obligations. At times, lower levels of taxation lead to public borrowing and to a high and growing public debt. This, in time, absorbs fiscal resources because of the need to service the debt.

As we shall see in the rest of this paper, some of the problems mentioned above have characterized the fiscal system and the economy of Jamaica.

II. Recent Economic Developments in Jamaica

Over the past several decades, the Jamaican economy went through some difficult times, some as a result of international developments, and some as the consequence of domestic policies that were, at times, not market-friendly. However, in the last decade there has been a significant improvement in the country's economic performance, once again partly as a reflection of the improved international economic situation and partly as a consequence of better economic policies undertaken by the Jamaican government. The growth rate rose recently to a respectable, if not spectacular, three per cent per year while the inflation rate went down to around six per cent.

There is no question, though, that Jamaica could do better than that. Its geographical position is very good, being close to several major markets. Its climate is attractive, and it has significant natural resources and a skilled and well-educated population. Jamaica is also an attractive tourist destination for the citizens of the United States, Canada, and several European countries. The fact that English is its language is also an important asset. Thus, with good economic policies, Jamaica could grow at a considerably faster rate so that its citizens can enjoy higher standards of living.

There are several areas in which economic polices could improve. However, in this presentation the focus will be on public finance, especially, tax policy.

We shall start with fiscal policy in its macroeconomic dimension. At around 130 per cent of GDP, Jamaica's public debt is very high by almost any standard. There are few countries in the world with shares of public debt into their gross domestic products higher than Jamaica's. A debt of this magnitude creates serious, immediate, and potential problems. In the first place, it is a strong signal or warning that taxes may rise in the future in order to service or reduce the debt. This is likely to discourage foreign investors and encourage domestic savers to place their savings abroad. It may also encourage some of the more able citizens to leave the country.[1] Second, it necessitates a higher tax burden, than would be necessary without the debt, in order to produce enough revenue to keep current on debt servicing. Third, it creates a large wedge between the taxes that citizens pay and the public services that they get in exchange from the government (the primary spending). Primary spending becomes significantly lower than taxes, as a share of GDP. Of course, if the debt had been incurred to make valuable public investments with high social rates of return, one could argue that the citizens are still getting full compensation for the taxes that they pay. But this is rarely the case. Finally, there are potential macroeconomic dangers.

The major macroeconomic risks that accompany a public debt as high as that of Jamaica are essentially twofold. The first is associated with a weakening of the exchange rate. The second is associated with an increase in interest rates. Because about one-half of Jamaica's public debt is due to foreigners, a

1 For an analysis of this point see: The International Mobility of Talent: Types, Causes, and Development Impact, edited by Andres Solimano (Oxford University Press, forthcoming).

devaluation of the exchange rate would immediately increase the cost, in domestic money, of the foreign share of the debt. Apart from the inherent risk of that occurrence, this means that Jamaica has lost one of the most important instruments of economic policy, namely the exchange rate. It cannot contemplate devaluation to stimulate exports or to encourage the inflow of tourists.

A significant increase in international interest rates (which might be caused by the reluctance of lenders to continue lending to risky borrowers) could quickly make the high level of Jamaican public debt much more costly to service. The experience of countries that have run into difficulties in servicing their debt indicates that when the share of public debt to GDP is high, the current fiscal deficit, which is the variable that attracts most attention in economic discussions, may not reveal the full risk to the country that comes from its fiscal accounts. The fiscal deficit implicitly assumes that the country will be able to continue to borrow in the future at unchanged interest rates. But, when perceived risks (domestically or internationally) change, this assumption will not hold and the country may have difficulty in replacing maturing debt.

Fiscal risks may not come only from changes in tax revenue or in primary (i.e. net of interest payments) spending, but also from the changing cost of servicing the debt. This is what happened to Argentina in 2001. Within a relatively short time, the "country risk," as perceived by foreign lenders, increased sharply, to reach 2000 basis points. This made it impossible for Argentina to continue to service its debt even though its tax revenue and its primary spending had not changed.[2] The current international problems in the sub-prime part of the financial market imply that there may be grounds for concern especially because riskier

2 See Vito Tanzi, Argentina: An Economic Chronicle (New York: Jorge Pinto Publishing House, 2007).

borrowers may experience sudden increases in their "country risk," even when their fiscal behaviour has not changed.

In Jamaica, the budget deficit has remained on the high side in spite of the recent, good performance of the country's economy. Thus, some fiscal tightening would be desirable. If this tightening occurred, and the economy continued to perform well, it could initiate a "virtuous cycle", a cycle that would progressively reduce and eventually eliminate the fiscal deficit, making it possible to reduce the public debt and to increase the income available to the Jamaican authorities for domestic non-interest spending. A combination of a lower fiscal deficit with a higher growth rate of the economy would help reduce the public debt.

In spite of the relatively high level of total public spending in Jamaica, the fact that a large share of it goes to service the public debt, implies that primary spending, at about 18 per cent of the country's GDP, is not particularly high by international standards. This spending could surely be made more efficient; it could be prevented from increasing; and, if possible, it could even be marginally reduced. However, it is not likely that it can be significantly reduced below its current share of GDP in order to create space for the fiscal adjustment. Thus, inevitably, the tax system will have to play a significant role in any fiscal adjustment. A reform of the tax system could make that system more efficient and more "pro-growth" while at the same time, allowing it to contribute to the fiscal adjustment. In the next sections we focus more directly on the needed reform of the tax system.

III. Reforming the Tax System: General Principles

For Jamaica, a reformed tax system should be able to achieve several important objectives, such as:

- provide more revenue than the current system is capable of doing. In view of the need to reduce the fiscal deficit and the public debt, this would be an important goal, at least over the medium run;

- make the system more income elastic so that, in future years, a faster growing economy would automatically, and without the need for policy changes, generate more revenue, thus contributing to the "virtuous cycle" mentioned earlier;
- remove existing tax-induced distortions that may be reducing the growth rate of the economy;
- make the system more equitable by removing or reducing the disparity between those who are exposed to the full legal tax liabilities and those who, for various reasons, manage to evade or avoid the full tax burden that they should bear;
- contemplate the possibility of reducing the highest marginal tax rates by widening tax bases; and
- make the system simpler and more transparent.

For Jamaica, major and detailed tax studies are available that provide recommendations on the kind of reforms that would be most beneficial.[3] These studies agree that the tax system can be a useful tool to promote stabilization; to help improve the allocation of resources; to promote equity; and to stimulate growth. However, it requires major reform.

3 See especially the studies carried out under the direction of Professor Roy Bahl.

To be able to promote the above-mentioned objectives, tax systems in general, and that of Jamaica in particular, should have many of the following characteristics:

First of all, it is helpful when tax revenue comes predominantly from a few taxes rather than from a multitude of taxes. This makes it easier for policymakers and experts to assess the impact of taxes on both equity and efficiency. It also makes it easier to pursue tax policy and better tax administration. However, at times the limited revenue collected from major taxes (for example the general consumption tax) forces governments to try to increase revenue by adding new and less productive taxes.

Secondly and closely related to the first, the number of low-yielding taxes must be kept low because these taxes can absorb significant administrative resources and distract, from essential and important tasks, both those who make tax policy and those who administer the system. In past decades, the degree of tax dispersion in some developing or emerging countries was very high. In other words, there were too many taxes. In recent years, the number of taxes has been reduced as policymakers have tried to focus more on fewer taxes. This process is similar to that of pruning a tree in order to remove unproductive branches.

Thirdly, and of particular importance in Jamaica, is that the bases on which the taxes are applied must be close to their potential values, estimated perhaps from the national accounts or through other means. For example, the base of the general consumption tax (GCT) should be close to consumption; that of the personal income tax should be close to personal income; that of the tax on enterprises should be close to profits, and so on. There will always be, of course, some erosion of the potential bases due to legal decisions or to other factors and some of this erosion will be justified. However, it must not be allowed to become large.

Fourthly, tax payments must be made as close as possible to the time when the taxable event, that has given rise to the tax liability, occurs. When the "collection lag" — the delay between taxable event and tax payment — is long, various factors (inflation, the desire to evade, efforts to influence the tax administration, changes in economic circumstances, and so on) may generate problems that could damage the system and reduce the actual, real payment.

Fifthly, the reliance on <u>specific</u> taxes must be limited except when they clearly facilitate the tax administration or have some specific merits. A common exception is petroleum taxes, which are easier to collect when they are specific and which should be disconnected from the wide fluctuation of petroleum prices that have characterized recent years.

Sixthly, it is normally preferable to impose taxes on <u>actual</u> market values rather than on <u>presumptive</u> values. Thus presumptive taxes ought to be limited even though they cannot be totally avoided. Presumptive taxes are normally used for the taxation of real properties, such as houses and land. The market value of a house or a piece of land is not known until, or unless, the property is sold in an "arm's length" contract and the paid price is honestly reported to the tax authorities. However, most properties are not sold in the year when they are taxed and, when sold, the price reported to the authorities is often a fraction of the real one. There is, thus, a need for cadastral or presumptive values. For various reasons, these values often do not bear a close relationship to the current market values. Over the years, cadastral values tend to diverge significantly from true market values.

Seventhly, the tax laws must be enforced fairly and effectively, and meaningful (but not excessive) penalties must be applied to punish tax evaders. The penalties must not be so high as to make those who must impose them (the judges) reluctant to do so.[4] They must also be imposed without much delay because in this area, as in other areas of justice, justice delayed may become justice denied. Furthermore, the penalties must be more severe when the tax evasion involves the collaboration of corrupted tax inspectors.[5]

Eighthly, the "cost of administration" — how much the tax administration spends to collect, say $100? — must be kept within reasonable levels. These costs depend in part on the kind of tax collected. They tend to be high for some taxes and low for others. While keeping the costs of administration low should be an objective, it should not be achieved by limiting tax collection mainly to easy-to-collect taxes. For example, income taxes collected at the source from dependent workers tend to require low administrative costs. The same is often the case for import duties. This does not imply that, to reduce the costs of administration, a country should limit or concentrate its tax collection only on these taxes.

Ninthly, while the cost of administration on the part of the government is important, the "cost of compliance" is equally important. In addition to the money that they pay to the government to comply with their tax obligations, taxpayers have other tax-related costs to deal with. These are the costs of collecting and keeping accounts, filing forms, standing in line to make payments, informing themselves on the changing legal requirements, or paying an accountant to deal with the filing. These compliance costs, which are only partly financial, can become high when the tax system is complex and may annoy the taxpayers leading to negative attitudes vis-à-vis the tax system. Tax

4 See Tanzi and Shome (1993).

5 Governments tend to collect only small shares of the identified evaded taxes.

simplification aimed at reducing these compliance costs should, thus, be an important goal of good tax policy.

Tenthly, the tax system must not only be fair but must be seen as being fair. When the citizens of a country consider the tax system unfair, they are more likely to engage in negative behaviour such as tax evasion, tax avoidance, or in lobbying efforts at the political level aimed at reducing their own share of the total tax burden. Fairness may involve "vertical equity," that is, the extent to which those with higher incomes pay a larger proportion of their income in taxes. Or it may involve "horizontal equity," that is, the extent to which individuals or families in similar economic circumstances, say with similar incomes, pay similar taxes. Failure in satisfying the objective of horizontal equity, and the knowledge of it on the part of taxpayers, is often particularly annoying to taxpayers. Tax systems are often criticized with respect to both forms of equity.

Finally, there is the fundamental question of the level of taxation in a country. Often, it is argued that taxes are too high and that they should be reduced. Some years ago, it was common for economists to address this question by estimating the "taxable capacity" of a country. This taxable capacity was estimated on the basis of comparisons with other countries, taking into account factors that presumably influence the ability of a country to collect more or less taxes.[6] These factors were (a) per capita income; (b) the degree of openness of its economy; (c) the share of the country's agricultural output; (d) the degree of urbanization; (e) the literacy rate; (f) the share of mineral exports; and some others. On the basis of these variables, econometric relationships were derived where the dependent variable was the share of taxes into GDP. These relationships gave the "expected" or "potential" level of taxation for a country. If the country's actual tax level was lower than the

6 See Tanzi (1987) and (1992).

calculated level, it was assumed that the country could, or even should, increase its tax burden. In case the actual tax level was higher than the estimated, the country was advised or expected to lower taxes.

The strange thing about this exercise was that it omitted the most significant variable, namely, the level of public spending. Equally strange is the fact that today's discussion of taxes, even in countries such as the United States or Italy, is often conducted without any reference to public spending. But, of course in a fundamental way, taxes are the price that, collectively, the citizens of countries pay for the activities of their governments. The more expensive those activities are, the higher the tax level needs to be. A country that insists on spending much, must tax much to avoid the macroeconomic problems that originate from excessive borrowing. If public spending is wasteful or excessive, it is the spending that must be reduced not the taxes. Tax reductions must follow a reduction in spending.

Some recent discussions of tax levels have relied on a "starve the beast" argument. This argument appeared in the early 1980s in the United States during the Reagan Administration. It assumed that cutting taxes would necessarily lead to, or force, a reduction in public spending which the administration in power wanted to achieve. If this happened, the tax cut would, in a way, finance itself. There has also been a supply-side argument, connected with the so-called "Laffer curve," that argues that tax reductions set in motion automatic reactions in the economy that make the economy more efficient and thus generate more tax revenue that will finance the tax cut. This view is strongly favoured by the writers of the editorial page of the *Wall Street Journal* who have made it popular. It has influenced the tax policy of the current U.S. Administration.

Unfortunately, neither the "starve the beast" theory nor the "Laffer curve" hypothesis is likely to work as expected even though they both contain some kernel of truth in them. Therefore, countries that cut taxes ahead of cuts in public spending often end up with larger fiscal deficits and public debts that can lead to serious macroeconomic problems. The irony is that the increase in public debt, caused by the attempt to keep taxes too low when public spending is rising will, in time, force a tax increase. In conclusion, it is important that the list of key characteristics of a good tax system includes its capacity to finance (most of) the public spending. Of course, these characteristics do not remove from public policy the need to keep public spending as efficient and as low as possible. When public spending becomes too high and inefficient, it becomes very difficult for the tax system to continue financing it and the marginal cost of taxation rises sharply.

In the next section, we shall deal more specifically with the Jamaican tax system, trying to relate the discussion to some of the general principles mentioned above. Obviously, only some of the main issues can be discussed in a short paper.

IV. Reforming the Jamaican Tax System

In the previous section, various criteria were listed that can be used to assess the tax system of Jamaica or, for that matter, of any country. The criteria are several but they can relate to a few basic categories. These would include: (a) sufficiency of revenue; (b) efficiency; (c) simplicity; and (d) fairness.

It must be noted that sufficiency of revenue — that is, the extent to which taxes cover public spending — is listed first because, in the view of this writer, it is the most fundamental objective in the short-run. Taxes are levied to pay for public expenditures. If there were no expenditures, there would be no need for taxes. Thus, if taxes are not sufficient to cover what the government spends, they fail in their most fundamental objective even when the real fault may lie on the spending side. The revenue objective must condition or set limits on any reform. For example, in a practical sense it may not be particularly useful to ask whether Jamaica should, or should not, tax a particular base, such as corporate income, when that base provides an important share of badly needed revenue.[7] In the particular example of the corporate income tax, its share of total revenue, at about 10 per cent, would be very difficult to make up from other sources in the short-run. Thus, the question of whether or not to tax corporate income is an interesting but academic one, as long as public spending cannot be reduced; or as long as a truly fundamental tax reform that would make other bases available is not a feasible option.[8]

The level of taxation in Jamaica is around 24.0 per cent of GDP. By emerging markets' or developing countries' standards, it is not particularly high. When assessed in terms of the taxable capacity methodology, as done in the *Final Report*,[99] it may not be far from what one would expect for a country with the structural characteristics of Jamaica and its level of economic development. However, as argued earlier, for macroeconomic policy, what counts is the current tax level in relation to the current, and expected, level of public spending. On this ground, the tax system has failed because it has not generated enough revenue to finance all public spending. As already mentioned, in judging the current level of revenue, it is not relevant whether all public spending is necessary or productive. As long as the spending is legislated and takes place, and it is not likely to be reduced, it becomes an essential requirement or a kind of floor for the tax level. In conclusion, given the current level of public spending, and especially, given the high level of public debt, it would be desirable

7 See the title of Rider's paper in the bibliography.

8 An article by the author of this paper written almost four decades ago had asked the same question. Thus it is an academically relevant one. See Tanzi (1975).

9 See Bahl and Wallace (2004).

if the level of taxation could be raised. Of course, it might be better to reduce public spending, if that were possible. However, because of the perception among the citizens of Jamaica that taxes are already high, the way in which the increase in taxes will come about will be very important.

The second category — efficiency of the tax systems — is especially important for the long-run where it may be even more important than the level of taxation. When a tax system is not efficient, a country pays the price in terms of a lower growth rate. Even a reduction of a few decimals of a percentage point in annual economic growth can aggregate into a large impact over many years.

It is difficult or even impossible to determine with certainty by how much an inefficient tax system reduces the growth rate of a country. Most economists agree that the reduction can be significant. The 2004 *Final Report* of the Comprehensive Tax Reform discussed various features of the system that might reduce the rate of growth in Jamaica. It is not necessary to summarize that report because it is known to Jamaican experts and is available to those interested in it. The Report gives far more detailed information than I could here. I shall call attention only to a few recommended changes that I consider particularly important and that, in my judgement, if made would dramatically improve the Jamaican tax system.

The current corporate income tax rate of 33.0 per cent is, in today's world, clearly on the high side especially when it is realized that there are successful countries, such as Ireland, that have a rate that is one-third that of Jamaica. Furthermore, the tax rates on corporations had been even higher in past years. Such a high rate is made necessary by the revenue losses caused by the tax incentives and by other aspects of the tax system such as excessive tax expenditures. Enterprises that cannot benefit from the tax incentives and that would face a 33.0 per cent rate might be reluctant to come to, or to continue operating, in Jamaica. These might be the dynamic enterprises of the future and especially those in new and technologically advanced areas.

The use of tax incentives is so widespread that their true extent or impact is difficult to ascertain. Full information on all the incentives given is apparently not available, at least not in useable form. The *Final Report* concluded that their use is clearly excessive, a conclusion that is easy to accept. It was reported that as many as 200 000 separate incentives and remissions might have been given, many in an almost ad hoc basis, leading to revenue losses that could be as high as a fifth of total tax revenue. It is also estimated that only 17.0 per cent of all profits is reported for tax purposes. This is an extraordinary loss that Jamaica can hardly afford.[10] Yet that 17.0 per cent contributes a substantial share of total tax revenue. When tax incentives are so widespread, they lose their effectiveness, assuming that they had any to start with. They create a kind of "tax jungle" so dense that it becomes difficult to form a clear idea of what the incentives do and how they affect the decisions of the investors. Naturally, those who receive them will argue that they are essential and that without these incentives they would not be able to continue in their operations.

In the calendar year 2005, some 44 companies, that made up the top 1.0 per cent of all companies, accounted for 75.0 per cent of the corporate income tax revenue while the 3 329 companies that constituted the bottom 75.0 per cent contributed only 0.5 per cent of total revenue. The role of incentives in these results is hard to determine but easy to guess. A worrisome aspect is that the 44 companies that paid most of the tax revenue were for the most part

10 On the use of tax incentives see Tanzi and Zee (2001) and Bird (forthcoming). Both of these papers, as the work of most economists, take a dim view of tax incentives. This view is similar to that of the Final Report.

from the financial or manufacturing sectors. Many of these companies might have the option of moving abroad for their activities. However, reducing the corporate tax rate without making other changes might lead to significant revenue losses.

Economists of the current generation who have been influenced by the work of Douglas North, work that won him the Nobel Prize in economics, talk a lot about the importance of stable rules of law for economic development. It is generally believed that when a country's institutions are not guided by stable, clear, and fair rules, the country will have greater difficulties in growing and developing. Strangely, this concept has rarely been related or applied to the field of taxation. But, like other institutions, tax systems must be guided by "stable rules." Administrative discretion, frequent changes in the laws, and widespread tax incentives do not make for stable, clear, and fair rules. The best tax incentives that a government can give to investors and enterprises are: (a) low and stable tax rates; (b) a transparent and simple tax system; and (c) a macroeconomic framework that guarantees that the current tax rules are not going to change in the future. Jamaica has clearly not been able to provide such a framework in years past.

Tax incentives distort competition among enterprises and tend to allocate the factors of production not towards the uses that would maximize economic returns but towards activities managed by individuals who have been more successful in convincing policymakers to give them incentives. In this framework, managers who should be directing their talent and effort towards reducing costs and increasing profits and market shares tend to allocate their talent and their time to lobbying policymakers in their search for tax incentives and preferences.

It would be highly beneficial for Jamaica to stop giving new incentives and to let the existing ones expire. The possibility of using minimum taxes, introduced at low rates, on the real, economic income of all enterprises should be contemplated. These minimum taxes could be raised progressively over the years to wipe out the effects of those incentives that legally could not be abolished. In conclusion, the scaling down of tax incentives is, perhaps, the most important reform of the system that the government should contemplate.

It must be recognized that if tax incentives contribute to lower tax revenue (and because of this, force the government to impose high corporate tax rates on enterprises that do not benefit from the incentives) then they also contribute to higher fiscal deficits and public debt, thus indirectly defeating their own purpose. They do not help the country's economy.

Another aspect of the tax system that requires reform, and one that is similar in impact to that of tax incentives, is the existence of broad exemptions and preferences in the GCT and in import duties. Because of these preferences, the results have been (a) higher legal rates; (b) lower tax revenue; and (c) more complex taxes. Several studies from various countries have consistently concluded that a general sales tax with a single rate and no exemptions is more productive and efficient, easier to administer, and not less equitable than one with multiple rates and exemptions. It is also a better tool for macroeconomic policy because it can be changed easily and the revenue impact of the changes can easily be determined. Yet, for political reasons, policymakers continue to legislate general sales taxes, with exemptions and multiple rates, in the misguided belief that by so doing they are making the tax system more equitable or "pro-poor."[11]

11 In fact most of the studies conclude that often it is those with higher incomes and higher spending that benefit from the exemptions and the lower rates.

The removal of most exemptions from the GCT and the removal of preferences from the import duties would be a gigantic step towards a more efficient, productive and probably fairer tax system. Countries that have chosen this road, even after great reluctance, have never regretted taking it. Political courage is needed more than detailed studies in order to achieve this reform.

The broadening of the tax bases of the GCT, the import duties, and the tax on enterprises (through the scaling down of exemptions and incentives) would provide more, perhaps significantly more, revenue. The additional revenue could be used (a) to reduce the fiscal deficit; (b) possibly, to reduce the corporate income tax rate; and (c) to reduce payroll taxes that, in Jamaica, continue to be high and are likely to contribute to unemployment and to underground economic activities.

The *Final Report* estimated that tax expenditures may amount to as much as 60.0 per cent of the budget. This estimate is so high that it is almost hard to believe. However, if it is broadly right, it gives an idea of how much Jamaica could gain from tax simplification and from the broadening of tax bases.

The objectives of simplicity and fairness also deserve some mention. Over many years, successive Jamaican governments attempted to create a tax system that, in their view, satisfied the objective of fairness better than a simpler one with broad bases. As a consequence they allowed the use of many exemptions and differentiated tax treatments to both individuals and enterprises. The erosion to tax revenue that this generated was partly balanced by increasing tax rates on the easier-to-tax taxpayers, who were mainly dependent workers and large enterprises. This created major problems of equity between the enterprises that paid the high corporate income tax rates and those that did not; and between the dependent workers and the self-employed. Bahl and Wallace (2007) have reported that, if fully taxed, revenue from the self-employed could generate 50.0 per cent more revenue. This additional revenue could be used to reduce the rates on personal incomes thus making the system more equitable.

Finally, quite apart from the points made above, there is a great need for simplification in many areas. For example, it is strange to read that for tax purposes there are 11 categories of properties, five tariff categories, and five payroll taxes. Whatever their initial justification, these complications inevitably affect the functioning of the tax administration besides affecting the compliance costs of the taxpayers. A tax system is often as good as its administration. It has been said that tax administration is tax policy. However, it is also true that complex laws lead to inefficient administrations. For example, property taxes work well when they are applied with a single and low rate, say 1.0 per cent, on the best estimates of property values without discriminating among various kinds of properties.

V. Concluding Remarks

This paper has discussed tax reform and the need for it in Jamaica. It has concluded that a truly fundamental tax reform that broadens bases — by dramatically scaling down tax incentives, tax expenditures, and other tax treatments that differentiate between different individuals, enterprises, goods, type of work, properties, and so on — and possibly, reduces some high rates, could be highly beneficial to the Jamaican economy. It could lead to higher economic growth and higher tax revenue. These could help reduce Jamaica's fiscal deficit and public debt while improving the fairness and the quality of its tax system.

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