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"THE USE OF SALES TAXES IN LESS-DEVELOPED COUNTRIES"

Thesis presented for the degree of
Doctor of Philosophy

by

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CHAPTER I.
CHAPTER I.

INTRODUCTION

The aim of this thesis is to demonstrate that for less-developed countries in general, and for Egypt in particular, the use of sales taxes may be justified, and that the case for relying upon an income tax has been overstated in much of the literature dealing in this subject.

The problem confronting most less-developed countries is well known. It amounts to finding ways and means of stimulating and sustaining an increase in real income per head. Economists agree that an important, if not the most important ingredient required to achieve an increase in the level of production and consumption, is capital. This in turn requires a fiscal policy which will make available a greater source of finance necessary for investment.¹

The object of this thesis is to demonstrate that reliance upon sales taxation is at least as equitable and efficient a method of raising revenue in

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¹ The difficulties of increasing the level of savings and private investment in the short-period in less-developed countries include the following: (a) a high proportion of income is derived from the agricultural sector where the majority of the population is located; (b) very little capital per head; (c) low income per head; (d) high level as well as a fast increase in the rate of consumption expenditure; (e) low level of savings due to high preference for present consumption, lack of savings habits and savings institutions, and the lack of capital markets; (f) poor market facilities and lack of initiative to invest in industrial investment whose risk is unknown and liable to extend over a long period of time on the part of private investors.
less-developed countries as is reliance upon an income tax. This view has hitherto attracted little support. The originality of subsequent chapters lies mainly in the fact that the literature of taxation tends, on the whole, to make the case for an income tax. This applies with greater force in more developed countries than in less-developed countries.

The analysis in this study will be based upon the following assumptions:

1. The analysis will be short-run rather than long-run, i.e., where there is a great need to raise additional revenue to help governments to initiate and promote a rapid rate of increase of aggregate income, we define the short-period to be from 5-7 years. After this period, the growth of income, the development of savings habits, government investment in social overhead capital, and other types of investment complementary to private investment, are all likely to lead to more private savings and investment with a lesser reliance on the government.

2. In this study, we will follow the assumption that sales taxes are shifted in full to consumers, while an income tax will rest on the statutory taxpayer.

3. The incidence of government expenditure is taken as given, and the analysis concentrates on a comparative study of the effects of the different types of taxes.

4. The degree of tax progression imposed on different income groups is decided upon by the policy-maker within the social, political and economic condition of the country.
Monetary policy, institutional factors and the whole range of non-economic factors, are taken to be operating "normally" in their allotted channels. The analysis of fiscal policy then proceeds ceteris paribus.

Based on these assumptions, this study proceeds in two parts. Part I is concerned with an analysis of the theoretical framework. It suggests that more reliance should be put on those types of taxes which we call "sales taxes" rather than on the familiar income tax. This constitutes the criteria on which the Egyptian tax system will be assessed in Part II.

Traditionally, less-developed countries have relied upon "indirect taxation", largely because of the ease of administration. More recently, however, less-developed countries have been attempting, often at greater cost, to develop the income tax. This is partly because of the prejudice in the literature on taxation against reliance upon those taxes included in the "indirect" category, and in favour of those included in the "direct" category. The former types of taxes are held to be not only regressive in their incidence, but also unstable as a source of revenue. It is difficult to arrive at any conclusion about equity in taxation by relying on the broad grouping of taxes into "direct" and "indirect". Taxes with substantially different incidence may be grouped together under one category. To reach a conclusion about the equity of any tax requires a more detailed analysis of the rate structure and incidence. It is for this reason that we argue in Chapter II that "direct-indirect" classification is unsatisfactory. Instead, we concentrate on a comparative study of specific types of taxes which are:
(1) a. import duties; b. excises; c. wholesale and retail sales taxes, all of which are called "Sales taxes"; these are then compared with:

(2) an income tax.

There are primarily three criteria on which the efficiency of sales taxes, relative to an income tax, should be judged. These are: revenue productivity, equity, and economic efficiency in terms of the impact of these taxes on incentives.

An important factor influencing the choice of one tax or another is that it should provide revenue at 'minimum social cost'. By 'minimum social cost' we mean that the type of tax chosen should contribute an increasing amount of revenue following an increase in national income. This increase should be at a minimum burden to the community in terms of the quantity of resources used to collect the tax and its effect on allocation.

In the light of these criteria, we proceed in Chapter III to examine the importance of sales taxes in the revenue structure of less-developed countries. Statistical data is introduced to show that sales taxes provide the treasuries of less-developed countries with the major part of their tax revenue at the present time. The reasons for this reliance are discussed. Further reliance on sales taxes to provide the additional amount of revenue required is then considered in terms of the theoretical obstacles facing sales taxes which are advanced against reliance on them in spite of their ease of administration.

The most important criticisms of sales taxes discussed are:

(a) Sales taxes impose an excess burden on the community which could be avoided by raising the same amount of revenue by an income tax;
(b) reliance on sales taxes will expose the treasury to instability in its revenue;

(c) sales taxes cannot be relied upon as a source of revenue since they are likely to decline following the movement to industrialization and the effect on the structure of imports.

An examination of these criticisms attempts to assess their merits and validity in terms of sales tax as an easier device for raising revenue than an income tax.

Chapter IV deals with the efficiency of sales taxes as compared with income taxes in securing equity. There is a fairly wide agreement in the literature on taxation that equity should be interpreted in terms of the principle of 'ability to pay'. The way in which this principle is applied gives rise to a prejudice against reliance on sales taxes as a source of revenue on the ground that they are regressive in their incidence. This interpretation is based upon:

(a) a value judgement that income rather than consumption is a proper measure of taxable capacity; and,

(b) the view that sales taxes are levied at a uniform rate on consumption expenditure which is only part of income.

It is argued in this chapter that such an interpretation does not fit the circumstances prevailing in less-developed countries and the modern ways of levying sales taxes. Instead, it will be argued that in countries which experience a high rate of consumption coupled with under-investment, equity should be
interpreted to require taxation be levied according to the rate at which goods
and services are withdrawn from, rather than added to, the common pool. This
interpretation will be supported by reference to the characteristics prevailing
in less-developed countries. (The way in which national income is distributed
by factors shares, the high level as well as the high rate of increase in
consumption expenditure, and the efficiency of tax administration.)

The analysis in Chapter IV recognizes some of the difficulties which face
a definition of consumption, comparing some of these difficulties with difficulties under income. Certain solutions will be proposed to minimize these
difficulties without significantly departing from equity. Further, the
differentiation between a system of tax on consumption expenditure as in Kaldor's
model, and a tax on consumption expenditure on different goods and services as
suggested in this thesis, is discussed. This is a step towards demonstrating
the difficulties which face an expenditure tax in practice and its possible
substitution by a tax on different consumer goods and services in the short
period.

Finally, the conditions necessary to secure equity, (i.e., exemption limits,
allowances and progressive rates), are examined in order to see how far a tax on
consumption expenditure on different goods and services fulfills these conditions.
This will be shown to require:

(a) a system of social dividends varying with the circumstances
    of different taxpayers; and,

(b) progressive rates varying with the degree of income
    elasticity of demand for different goods and services.

The effect of the use of progressive rates on the demand for different goods
and services is examined to show their relative unimportance in injuring the equity secured by sales taxes. This is analysed within a system of sales taxes which takes into consideration the effect of the income, price and substitution effects, on the demand for different commodities.

The discussion in Chapter V is concerned with comparing the incentive effects of sales taxes and income taxes (i.e. their effect on the supply of different factors of production and their influence on entrepreneurial decisions. This discussion is conducted within one assumption, mentioned earlier, of a given rate of tax progression designed to impose the same incidence on different income groups under the two taxes. Only a tentative conclusion can be reached. We then examine the effect of both types of tax on the individual's incentives to work, save and invest.

Further, the assumption of using taxes with equal incidence on different income groups is critically examined within the coverage of both income and sales taxes in less-developed countries. We later relax this assumption and compare the effect of equal yield sales and income taxes on incentives.

Finally, the effects of sales taxes compared with income taxes as devices to stabilize the economy are discussed. The important criteria here are a wide tax coverage and efficiency in the tax administration.

An Egyptian case study constitutes the subject matter of Part II. An introductory chapter (Chapter VI) indicates the objective of economic policy in Egypt. In addition, important features of the Egyptian economy are outlined as a background to questions of revenue productivity and equity discussed later. The important taxes used in Egypt, and their revenue productivity, are given in order to show the relative importance of different kinds of tax receipts between
1938 and 1959. This enables us to examine later the reasons for changes in the revenue structure of Egypt. At the same time we evaluate the validity of the conclusion reached in Part I.

In Chapter VII, the government's policy is stated. This is necessary to help in analyzing its effect on the decline in the percentage of tax revenue to total government receipts and to national income in 1959 as compared with that in 1938. This helps to explain the role played by sales and income taxes in the decline and the deficiencies of each. This is a preliminary step towards evaluating the advantages of relying on sales taxes.

Finally, an appraisal of sales taxes on the basis of the analysis given in Chapter III and the data available for Egypt is attempted.

Chapter VIII sets out to examine the principles upon which equity rests in Egypt, and to explain the deficiencies noticed within the system. Within the conditions prevailing in the economy, a different interpretation is needed. Equity is, therefore, interpreted as suggested in Chapter VI (i.e. taxation should be levied according to the rate of withdrawals of goods and services rather than as additions to them). The way in which other requirements of equity are applied, (exemption limits and progressive rates), are examined.

Chapter IX is concerned with two important points:

(a) The effects of the existing taxes on the supply of different factors of production and on investment; and,

(b) the effects of hypothetical extensions of the coverage of sales taxes on the functioning of the economy.

With the help of the data available for Egypt, the effect of both sales and income taxes on the efficiency of the economic system is discussed. This
provides us with a necessary background to explain the weakness of different types of taxes and their responsibility for the low rate of growth of aggregate income. A modification of the existing taxes follows, and it is contended that sales taxes can be modified more easily in the short-period than income taxes. Such modifications will take the form of expanding the coverage of these taxes and devising the proper rate structure. The effect of such a system is examined on the basis of the analysis given in Chapter V. The effects of granting exemption limits and allowances are discussed insofar as they affect revenue productivity, equity, and economic efficiency.

The last chapter - Chapter X - summarizes the main findings of this study.
PART ONE.
CHAPTER II.
CHAPTER II.

DIRECT AND INDIRECT TAX CLASSIFICATION AS RELATED TO EQUITY.

Traditionally, economists have classified taxes as 'direct' and 'indirect'. Less happily, later economists have used this dichotomy as the basis of their equity conclusions. These conclusions state that direct taxes are equitable whereas indirect taxes are inequitable.

This preliminary chapter attempts to show that the classification of a tax as 'direct' or 'indirect' is a misleading method of reaching conclusions as to its equity. The remainder of this thesis attempts to substantiate this assertion, somewhat more adequately by means of an examination of some of the so-called 'indirect taxes' and their equity aspects.

I. DEFINITIONS:

Although writers may vary to a certain extent when classifying taxes, the area of their agreement is fairly broad. In particular, they invariably include import and export taxes as indirect taxes. Thus Shirras considered that:

"... indirect taxes are normally collected from the manufacturer as for instance in the case of excise duties, or from the importer or the exporter as in the case of custom duties ..." 1

In the U.N. Report on Colombia it was argued that:

"The most important indirect taxes are custom duties, the stamp duties, and the tax on the transfer of foreign exchange abroad." 2 (Custom duties are taken to include: import duties, and export tax as can be seen in Table III on p.28 of the same reference.)

1. Shirras, Findlay; The Science of Public Finance, London 1924, p. 343
Furthermore, the I.B.R.D. in its Report on Iraq included in its classification of indirect taxes:

"... turnover tax on agricultural produce and animals, customs, excises, stamp duties, tobacco monopoly." ①

Moreover, all the writers quoted above adopt the prevailing idea that direct taxes are progressive while indirect taxes are regressive. Furthermore, they all accept that the latter are less equitable than the former. Shirras, for example, concluded that:

"Indirect taxes are regressive in character and originally fall heavily on the poor than on the rich because the poor are the larger consumers." ②

In the U.N. Report on Colombia it was argued that:

"The ratio of receipts from direct taxes to total tax receipts rose constantly throughout this period indicating that the tax system became increasingly progressive during the period". ③

Also the I.B.R.D. Report on Iraq concluded that:

"... some revision in the tax structure to provide a more equitable apportionment of the burden would be desirable. In common with many other underdeveloped countries, Iraq relies strongly on indirect taxes which bear heavily on consumers without taking into account capacity to pay. Thus, in the last three years, indirect taxes contributed 82 per cent of all tax receipts and 71.5 per cent of all budget income, while direct taxes accounted for only 18 per cent of all tax revenue and 13 per cent of total government receipts. While drastic changes in the tax structure may not be feasible, some decrease in the burden of import taxes appear desirable." ④

Mrs. Hicks' discussion of the British tax structure illustrates the belief that the higher the ratio of direct taxes, the more progressive the tax system will

② Shirras, F., op. cit., p. 347.
③ U.N., Public Finance Information Papers, Colombia, New York, 1950, p. 10
be, and the higher the rates of indirect taxes, the more regressive; she states that:

"The other taxes in the structure were traditionally designated 'indirect'; with a few exceptions they are collected by the 'Board of Customs and Excise'. For the most part those taxes tend to be regressive with income ..." 1

Finally, in recent writings, Professor Samuelson, when discussing import duties, seems to be influenced by the same ideas about the equity of indirect taxes. He considers that:

"... a custom duty on import is only one of the regressive sales taxes and a peculiarly obnoxious one." 2

From the above examples, it is clear that these writers were influenced in their conclusions by the implicit assumption that indirect taxes are regressive, and consequently less equitable. This assumption originates in a belief that indirect taxes are levied on expenditure which normally represents a larger proportion of the budgets of the lower income groups than of the higher income groups. In addition, it rests on the belief that these taxes cannot be levied at progressive rates. This ignores the qualifications introduced by further analysis of the possible ways in which these taxes can be levied. It also neglects the differences between the many varying taxes included in this group, or the expenditure of tax proceeds. The contention of this thesis is that equity does not depend on the group in which the tax is classified but rather on the structure of any particular tax and its consequent incidence, given the incidence of expenditure of tax proceeds. The clearest example of this, and the main one to be developed now, is the equity of import and export taxes.

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From the quotations given above, it is evident that these are looked upon as amongst the most typical of indirect taxes and also amongst the most inequitable. Thereafter we shall discuss some types of taxes which are of great importance in less-developed countries but whose effect on the distribution of income is doubtful. The most important of these are profits from public undertakings and monopolies, and royalties and income taxes on foreign companies.

II. IMPORT DUTIES.

Import Duties are levied on that part of consumers' expenditure which arises from foreign trade. Although such a tax falls on only a part of consumers' expenditure, it does not necessarily follow that it is inequitable. The relevant factors are the relative importance of the imported commodities in the budgets of different income groups, and the rates applied to each.

For example, if imports represent an important part of consumers' expenditure, especially that of the higher income groups, as is the case in some less-developed countries, import duties are not necessarily regressive. The commodities taxed rank higher in the consumers' budget of the high income groups than those of the low income groups. Indeed, they will provide for a wider tax base for the high income groups as compared to the low income groups. It follows, then, that even if the rates are proportional, import duties cannot be considered regressive (as it is contended), since the higher income groups pay a relatively larger amount of tax than do the lower income groups.

The structure of import duties need not be limited to proportional rates. They may be levied at discriminatory rates varying from high rates for 'luxury' commodities to very low rates, or even exemption for other goods - 'non-luxury' goods or 'necessities'. In these circumstances, the tax will discriminate between
high and low income groups in the same way as any other taxes included in the
direct tax classification. Given the fact that commodities liable to higher
rates are those which are consumed largely by the higher income groups, while
those which are exempted or liable to low rates are those consumed largely by
the low income groups, it is difficult to contend that import duties are
regressive with respect to income compared to an income tax. This is
especially true if import duties are devised in such a way as to have the same
incidence on different income groups as an income tax. In such a situation,
it would be misleading to consider that import duties (or any other type of
indirect tax following the same lines) are still regressive with income compared
to a tax on income having the same incidence. Here then is an example of a
tax which is traditionally called indirect but can be manipulated so as to be
equitable in its incidence. If we are to preserve the equating of indirect¬
ness with inequity, it will be necessary to reclassify import duties as a form
of direct taxes.

III. EXPORT TAXES.

It is even more difficult to see why export taxes are regressive merely
because of their inclusion in the indirect tax group. This is because tax
shifting in this case might not be restricted to the exporting country, but
might spread to other importing countries as well. Therefore, before reaching
any conclusion about the equity of an export tax, we first have to know its
incidence.

The incidence of an export tax depends on the elasticity of demand and supply
for the exported commodities in the world market. If the importer faces
demand schedules that are highly inelastic relative to supply, or the exporting
country has a monopolistic position in the world market, the tax is likely to
be shifted forward to the final consumers, who are foreigners in this case.¹

In those cases where the international incidence falls on the exporting country,
a number of possibilities for shifting export taxes might arise. On the one
hand, the exporters might be home-producers who bear the incidence or shift it
(if they could) to other factors of production. The distributional effect of
an export tax depends in this case on the income group who bear the incidence of
the tax. On the other hand, the exporter might be a foreign company or a
government marketing board and it is difficult in this case to see why the tax
necessarily has a distributional effect on the exporting country.

To describe an export tax as regressive in all these circumstances is to
give a false impression as to the equity of the tax system. An export tax in
the cases mentioned above does not have any effect on the distribution of income
in the exporting country unless it is absorbed out of the profits or the income
of the factors of production. Even in this case it is difficult to contend that
the tax is regressive unless we know its impact on different income groups, i.e.,
its incidence.

IV. PROFITS FROM PUBLIC UNDERTAKINGS AND MONOPOLIES:

The theoretical treatment of government receipts from public undertakings
and monopolies, that is whether or not receipts are classified as profits or as

¹. This is based on the assumption that home consumers either do not consume
any of the product exported or else only a very small proportion which can
be neglected. This seems to be a reasonable assumption under the conditions
of less-developed countries where most exports are primary products which
are little used within the exporting countries.
indirect taxes, partly influences the resulting impression of the equity of the tax system. Some writers consider profits from such undertakings as a kind of indirect tax.\(^1\)

But this conclusion is difficult to justify on theoretical grounds, because it does not differentiate between tax revenue and the return on risk taking. Profits from public undertakings cannot be considered as an indirect tax unless prices are raised to such a high level that they produce a net revenue in addition to the return necessary to cover risk taking. It is necessary, therefore, to examine the price policy of public undertakings in order to demonstrate the implication for monopoly profits and equity.

Early welfare economists, influenced by their consideration of optimum welfare conditions, advocated the use of the marginal cost pricing rule for public undertakings. At a later stage, doubts set in, and subsequent writers have analysed and qualified the assumptions underlying the basic conclusion.\(^2\)

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2. Literature on the pricing policy of public undertakings is extensive. It is not necessary to dwell on a discussion of the price policy since it lies largely outside the field of our study. Only a very brief examination of the price policy will be given as preliminary data for determining the question to be settled in this section, that is, whether the profits realized by public undertakings are to be considered as profits or an indirect tax. For a summary of the Marginal cost pricing rule, its assumptions and conclusions and detailed References to the literature, see: Ruggles, N., in two articles, "The Welfare Basis of the Marginal-Cost Pricing Principle", and "Recent Development in the Theory of Marginal Cost Pricing", both in *Review of Economic Studies*, 1949/1950. Little, I.M.D., *Critique of Welfare Economics*, Oxford 1949, Chapter XI; Henderson, A. M., "The Policy of Public Utility Undertakings", *The Manchester School of Economics and Social Studies*, 1947.
It was realized that the contention that this rule would secure an optimum allocation of resources involved complications which led to doubts as to its validity as a general rule for price policy. There are several reasons for these doubts and we shall mention the most important.

In the first place, due to the employment of indivisible factors, the use of this rule, while tending to secure an optimum allocation of resources, ignores the effect of such a price policy on the distribution of income. In this case, whether average cost is rising or falling, the conditions of cost are not of unique importance as, under either condition, the resulting surplus or deficit may result in an unfavourable distribution of income. In addition, the use of general taxation (i.e., income tax) to finance the resulting deficit may involve a violation of the marginal conditions relating to the factors of production. These considerations make it difficult to rely on marginal cost pricing as a general rule for public undertakings. This conclusion is reinforced by taking into consideration the actual conditions prevailing in different economies in the real world since the marginal cost rule is based on the assumption of perfect competition. In the real world, imperfect competition is the rule rather than the exception and indirect taxes are used on a wide scale. In addition, external economies and diseconomies are frequently operative even where perfect competition is assumed. Therefore, it is difficult to contend that the allocation of resources is optimum under these conditions. It is not appropriate to apply the marginal cost pricing rule to a small part of the economy, while the larger part, i.e., the private sector, is following the full cost rule. The result of such a procedure would be a diversion of resources towards the public sector. This diversion would be without economic justification and a further misallocation of resources would arise.
Moreover, the real world is characterized by risk and uncertainty concerning future events which justifies a return to risk takers and encourages them to assume risk. In these circumstances it is difficult to apply welfare rules which take no account of the differing abilities of investors. ¹

It is often argued that a multi-part tariff avoids the anomalies of the marginal cost pricing rule. ² According to this principle, prices consist of two components. The first is a marginal cost element determined by the increase in cost required to produce an additional unit of output. The second is a fixed charge to cover overhead costs. By this method, costs are covered and welfare conditions are satisfied without any apparent redistribution of income.

However, this suggestion raises a number of problems, the most important being the impossibility of precisely computing and allocating the separate element of 'fixed and common' cost between different consumers. ³ Overhead costs are normally 'common' costs which are difficult to estimate and distribute between consumers and their distribution must, therefore, be based on more or less arbitrary decision which may well appear unfair.

An improvement on this method has been suggested through the 'club' principle, but this method gives rise to price discrimination since different people will be willing to pay different prices for the purchase of a given product. This would

imply a redistribution of real income which may be contrary to public policy.⁴ A conflict of objectives is, therefore, likely to arise, since although the welfare conditions are met, an unfavourable redistribution of income may occur as a result of the discriminatory element in the price policy.

If one ignores the marginal cost dictum and follows the average pricing rule, the optimum allocation of resources will be sacrificed, although income redistribution will be untouched. Therefore, one must decide which of the two objectives, optimum allocation of resources or the ability to influence the distribution of income should be sacrificed. The answer to this question depends, of course, on a value judgement about the preference for one objective rather than the other.

It would, therefore, seem desirable to use an alternative to the marginal cost rule so as to reflect conditions in the actual world and minimize any undesirable movement of resources or any effect on the distribution of income.² The alternative proposed is the full cost principle. Under this rule a public undertaking is treated like a firm in the private sector which is of comparable size and which invests its capital and is influenced in its decision by its expectations about the conditions of demand and supply. If a policy of making a price equal to full cost is followed, it is not likely to have any significant effect on resource allocation or on the distribution of income. The government,

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2. We are excluding here any government policy designed to use the prices of public undertakings to achieve certain economic or social objectives, i.e., which would involve a deliberate deficit or surplus.
by using this price policy, does not influence resource allocation in one way or the other but leaves it to market forces which also govern the private sector. Prices in this case cover the costs which are necessary to produce the output and thus do not involve any redistributational question. It should be noted that full cost price includes in this context, a net return considered to be sufficient to cover risk taking since the government is investing its capital and assuming risks in the same way as any private investor. It is difficult to decide upon the net return which is sufficient to remunerate public undertakings for risk taking as there is no optimum return criterion which can be applied. Therefore, for practical purposes, it would seem more appropriate to take the net return to a similar private monopolist undertaking a similar degree of risk.

The price determined according to this rule will cover only the cost necessary to attract resources to produce the output. Any surplus resulting from this price has to be considered as a return for risk taking and cannot be considered an indirect tax. If, however, prices are raised to a higher level in order to produce a higher profit, then that part of the realized profits which are above the return for risk taking can be considered an indirect tax.

It would be a mistake to consider all profits realized by public undertakings as a kind of indirect tax. However, even assuming that all profits are a type of indirect tax, it is difficult to consider that, as such, they are regressive, as this depends on the incidence of the tax. If the commodity produced is consumed largely by the higher income groups, or if the price is fixed in a way which allows the use of discriminatory prices according to the class of buyers, the tax element may not be regressive in its incidence.

The importance of these profits on the degree of equity of the tax system -
if we follow the idea that direct and indirect taxes can give an impression about the equity of the tax system - can be shown by looking at the figures about the revenue from public undertakings and monopolies in Egypt. For example, in 1959 this item supplied the Treasury with about 40 per cent of total government receipts. If these receipts are considered a type of direct tax, it would seem that the tax system in Egypt is more progressive than those of many developed countries. If they are considered as a type of indirect tax, the tax system will appear to be very regressive.

V. ROYALTIES AND INCOME TAXES ON FOREIGN COMPANIES.

Royalties supply the treasuries of some countries with a high proportion of their revenue. They are often payable by foreign companies developing the natural resources. In addition, these companies often contribute a high proportion of the government's receipts from income and profit taxes.

This can be illustrated in the case of Venezuela, where a large part of the revenue is derived from royalties, and the income tax on petroleum companies, as shown in Table 1.

Table 1. The Relative Importance of Royalties and Other Taxes on Petroleum in Venezuela in 1951 and 1954. (percentage of total government receipts)

<table>
<thead>
<tr>
<th></th>
<th>Revenue Derived from Petroleum</th>
<th>Income Tax on the Internal Sector</th>
<th>Indirect Tax Returns</th>
<th>Total Ordinary Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Hydro Carbon Taxes</td>
<td>Export Tax</td>
<td>Income Tax</td>
<td>Total</td>
</tr>
<tr>
<td>1951</td>
<td>37</td>
<td>5</td>
<td>16</td>
<td>58</td>
</tr>
<tr>
<td>1954</td>
<td>34</td>
<td>5</td>
<td>22</td>
<td>61</td>
</tr>
</tbody>
</table>

It can readily be seen that the tax revenue derived from the petroleum industry represents over half of total government receipts. However, the distributional effect of this tax revenue depends on its incidence. Revenue from the petroleum industry - as can be seen from Table 1 - is composed of different types of taxes, and it will be difficult to reach any general conclusion about the incidence of the whole tax revenue unless we specify different parts of that revenue.

In the first place, part of that revenue is derived from a hydrocarbons tax levied on the production of specified types of petrol. This is considered as a type of indirect tax. It supplied the Treasury of Venezuela with 34 per cent of total government receipts in 1954. However, the inclusion of this revenue in the indirect tax group should not be taken to mean that the tax system in Venezuela is leaning towards a regressive tax structure, because regressive-ness depends partly on the incidence of such a tax. Since the petroleum products are exported to a large extent the imposition of a hydrocarbon tax is not likely to affect home consumers to any significant degree but will fall largely on foreigners, perhaps via the profits of foreign companies operating in Venezuela or via the prices of petroleum products.

Secondly, another part of the revenue is derived from the tax on the profits of foreign companies and on the wages and salaries of the employees in these companies. This represented little less than a quarter of total government receipts in 1954. The inclusion of this element in the direct tax category should not be taken to indicate a more equitable tax system in a country like Venezuela. A large part of this revenue is derived from the profits of foreign companies developing natural resources whilst having no effect on the distribution
of private income. On the other hand, revenue derived from the income tax on wages and salaries affects the private income earned in Venezuela and thus tends to have an effect on the equity of the tax system in that country. However, the mere fact that this tax is levied on the income of employees does not mean that the tax is more equitable since equity depends on the way in which the income tax affects different income groups regardless of the source of their income. Consequently, we can say that even if the income tax on wages and salaries has a redistributive effect, it is still difficult to judge equity with reference only to the name given to the tax. A wider analysis has to be made to examine the extent to which an income tax reaches different income groups receiving their income from different sources.

The subsequent discussion, therefore, deals with 'Sales Taxes' which consist of: import duties, excises, wholesale and retail sales taxes, and income taxes.

VI. CONCLUSIONS.

The conclusion to be drawn is that the classification of a tax as direct or indirect, or the name given to a particular tax, is a poor guide to its equity, since taxes with substantially different incidence may be lumped together in one group or under one name. The equity of any tax system does not rest upon the extensive use of one or other group of taxes, but depends mainly on:

(a) the incidence of the particular tax, given the incidence of the expenditure of tax proceeds; and

(b) the detailed rate structure.

In a thesis devoted to the equity of taxation, the general grouping of a tax as direct or indirect should be ignored as irrelevant.
CHAPTER III.
CHAPTER III.
A COMPARISON OF THE REVENUE PRODUCTIVITY OF SALES TAXES
AND INCOME TAXES.

The common factor of these taxes we are calling 'Sales Taxes' is that they are all designed to affect individuals according to their expenditure.

This chapter examines the relative importance as indicated by their revenue productivity, of taxes on persons and taxes on commodities, leaving the refutation of the regressive nature of the latter until the next chapter. Consideration of the export tax, clearly one of the taxes on commodities, is discussed later in the present chapter where its influence on the tax structure of less-developed countries is examined. Then we shall separate those taxes we classified as "sales taxes" in order to show their importance in the revenue structure of these countries.

Statistics about the tax revenue of less-developed countries usually demonstrate that these countries rely on a group of taxes quite different from those used in developed countries. But reliance on these statistics alone, to draw conclusions about the equity of the tax system in any country, will be misleading, as they can bear more than one interpretation depending on the criterion adopted for classification, e.g., the 'incidence' criterion or the 'administrative' criterion. From statistics based on one or other criterion quite different conclusions can be drawn. Therefore, to avoid using terms which might prejudice the issue, let us divide all taxes into 'taxes on persons' and 'taxes on commodities'.

I. TAXES ON PERSONS AND TAXES ON COMMODITIES.

"Persons" in the first class is to be used in the legal sense of the term, i.e., it includes not only "natural" persons but also "juristic" persons such as
limited liability companies to whom the law ascribes a personality distinct from that of shareholders or members, and who can be assessed for taxes and sued for the payment thereof as distinct entities.

Applying this classification to our discussion of the revenue productivity of taxes in different countries, we find that less-developed countries depend largely on taxes on commodities. This feature is considered not only to be regressive, but also to result in wide fluctuations of revenue from year to year, especially in the case of import duties. If this is so, difficulties arise when less-developed countries depend on these taxes to provide the continuous source of finance necessary for their development programmes. Let us consider first the relative importance of taxes on persons and commodities in less-developed and more developed countries. It will not be necessary to produce figures relating to every country included in the United Nations' Statistical Yearbook. We can, however, illustrate the position sufficiently accurately by a sample of low and high income countries. The figures for less-developed countries are the result of averaging those for Egypt, Ceylon, and Mexico; and for more developed countries, those of the United Kingdom, Canada and Sweden, all for the years 1950-1958.

Table 2. THE REVENUE PRODUCTIVITY OF TAXES ON PERSONS AND TAXES ON COMMODITIES IN DEVELOPED AND LESS-DEVELOPED COUNTRIES

<table>
<thead>
<tr>
<th></th>
<th>% of Taxes on Persons to</th>
<th>% of Taxes on Commodities to</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Govt. Receipts</td>
<td>Total Tax Receipts</td>
</tr>
<tr>
<td>More Developed</td>
<td>51</td>
<td>55</td>
</tr>
<tr>
<td>Countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less-Developed</td>
<td>23</td>
<td>29</td>
</tr>
<tr>
<td>Countries</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: see foot of next page.
From Table 2, it is apparent that the total tax burden in less-developed countries is far less than that in more developed countries, averaging 26 per cent in the three countries chosen as more developed, and 14 per cent in the three countries chosen as less-developed.

The breakdown of tax receipts into the two main groups shows that the less-developed countries in the sample - unlike the developed ones - depended largely on taxes on commodities as their major source of revenue. From these taxes they derived about 2.5 times the revenue derived from taxes on persons. Moreover, these taxes supplied the treasuries of these countries with a little over one-half of total government receipts by these countries on taxes on commodities should not be taken to imply that less-developed countries rely heavily on less equitable taxes. Taxes on commodities can be made as progressive as taxes on persons as will be demonstrated in the next chapter.

Different reasons can be cited for the reliance of less-developed countries on commodity taxes. The most important of these reasons is the structure of less-developed economies where the agricultural sector predominates, thus creating heavy reliance on imports for certain types of manufactured commodities which can

Source to Table 2:

Summary from Tables A - C in the Appendix, Compiled from U.N.: Statistical Yearbooks 1951, 1954 and 1958. For each country, government and tax receipts are averaged for the years 1950-1958. As to the per cent to national income, it is an average of the years 1950-1954 due to the lack of National Income statistics in some countries.

Footnote 1 from previous page:

See also Appendices A, B and C.
be easily taxed. Also, where administrative machinery is underdeveloped and tax morality is low, a government naturally chooses those types of taxes most acceptable to taxpayers, most productive of revenue and most simple to administer. Moreover, when the higher income groups are also the politically powerful, taxes on persons seldom play an important role.

The above analysis was based on the inclusion of the export tax under taxes on commodities. Export taxes supply the treasuries of some countries with a considerable amount of revenue and, therefore, have a big influence on the relative revenue productivity of the one group of taxes or the other, according to the way export taxes are classified. The U.N. statistics will be used to show the difference made by classifying export taxes alternatively one way or the other. These statistics use the "direct" and "indirect" classification which we do not accept. We shall, however, make use of them for the present purpose. By "direct taxes" it is generally meant taxes on persons, and by "indirect taxes" it is generally meant taxes on commodities; but there is an ambiguity in their treatment of the export tax, which in their classification may be treated as being in one group or the other according to the way its incidence is regarded.

The same three less-developed countries are taken as in the last table, and the figures given are the average for the years 1953-1956. This averages out lags in tax assessment and collection in the case of income taxes as well as the effect of good or bad harvest and favourable or unfavourable market conditions in the case of the export market.

Table 3 summarizes the empirical results and shows that although the importance of the export tax differed from one country to another, its contribution to the revenue of less-developed countries invariably alters the importance of that
Table 3.
THE EFFECT OF THE EXPORT TAX ON THE RELATIVE IMPORTANCE OF "DIRECT" AND "INDIRECT" TAXES IN SELECTED COUNTRIES.

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage of &quot;Direct&quot; Taxes to Total Government Receipts</th>
<th>Percentage of &quot;Indirect&quot; Taxes to Total Government Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Export Tax Excluded</td>
<td>Export Tax Included</td>
</tr>
<tr>
<td>Mexico</td>
<td>24.2</td>
<td>40.2</td>
</tr>
<tr>
<td>Ceylon</td>
<td>24.9</td>
<td>53.7</td>
</tr>
<tr>
<td>Egypt</td>
<td>17.9</td>
<td>22.8</td>
</tr>
</tbody>
</table>

group in which it is placed. The contribution of what are called "direct taxes" when the export tax is included, rose by almost 115 per cent in Ceylon, 66 per cent in Mexico, and by 27 per cent in Egypt (both relative to total tax receipts). But this result should be interpreted with care. The rise in the revenue from "direct taxes" to 60 per cent in Ceylon, or even to 50 per cent in the case of Mexico (once again both figures relate to total tax receipts), gives the impression that direct taxes in these countries approximate or exceed their contribution in developed countries. The figures suggest that these countries have a well developed system of "direct" taxation, which is of course contrary to the facts.

"Direct" taxation, particularly the income tax, is not yet extensively employed in less-developed countries. The productiveness of the export tax does not reflect the fact that it is a highly developed direct tax, but rather that it is readily collected at one source in large amounts. Exports are concentrated in the hands of a relatively few firms who have a reliable system of accounting and documentation. Moreover, these firms must export through relatively few outlets and, therefore, a few checking points can ascertain the value of goods exported and collect the tax. These considerations make the export tax easy to administer.

The exclusion of the export tax from "indirect" taxes does not make a large difference to their percentage contribution to total tax receipts. The decline in the "indirect" tax contribution was about 46 per cent in Ceylon, 27 per cent in Mexico and 10 per cent in Egypt, compared with the rise of the "direct" tax contribution, when the export tax was included, by 115 per cent in Ceylon, 66 per cent in Mexico, and 27 per cent in Egypt (all relative to total tax receipts). This is due to the relatively higher contribution of "indirect" taxes in the revenue structure of less-developed countries, and the small size of "direct"
Thus a shift of a given amount of tax revenue from "indirect" to "direct" taxes will result in the latter rising to a greater degree than the former fall. The exclusion of the export tax, in the case of Ceylon, reduces the average percentage of "indirect" taxes from 72 per cent to 40 per cent of total tax receipts. This compares with a rise from 27 per cent to 60 per cent of total receipts when the export tax is included in the "direct" tax group.

It is now necessary to examine sales taxes and consider the importance of different types in less-developed countries.

II. SALES TAXES:

Table 4 shows the share of revenue supplied by sales taxes (Column 'C') in our three selected less-developed countries, and also the percentage of sales taxes to total receipts from taxes on commodities (Column 'D') for 1953. Columns 'A' and 'B' show the breakdown of Column 'C' into import duties and the other 'sales taxes' which are here called 'General' consumption taxes to show the importance of revenue from taxes on the external and internal sector.

The importance of sales taxes as a source of revenue in less-developed countries is readily apparent, the figures showing that they contributed just under or just over one-half of total tax receipts. Moreover, they comprise from two-thirds to four-fifths of the receipts from all taxes on commodities.

The figures also show, however, that the relative importance of different kinds of "sales taxes" varies considerably from one country to another, and a more detailed consideration of each is required in order to explain the criticisms which have been levelled against them.

As classified in this thesis, sales taxes comprise: (A) import duties; (B) 'general' consumption taxes - including excises, wholesale, retail and turnover taxes. We shall consider each in turn.
### Table 4.

**THE RELATIVE IMPORTANCE OF SALES TAX REVENUE IN THE REVENUE STRUCTURE OF CERTAIN LESS-DEVELOPED COUNTRIES FOR THE YEAR 1955**

<table>
<thead>
<tr>
<th>Country</th>
<th>% of Import Duties</th>
<th>% of 'General' Consumption Taxes</th>
<th>% of Total Sales Taxes Revenue</th>
<th>% of Sales Tax Receipts to Total Receipts from Taxes on Commodities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>to Total Tax Receipts</td>
<td>to National Income</td>
<td>to Total Tax Receipts</td>
<td>to National Income</td>
</tr>
<tr>
<td>Mexico</td>
<td>14</td>
<td>1.3</td>
<td>39</td>
<td>3.0</td>
</tr>
<tr>
<td>Ceylon</td>
<td>33</td>
<td>5.6</td>
<td>8</td>
<td>1.3</td>
</tr>
<tr>
<td>Egypt</td>
<td>42</td>
<td>7.3</td>
<td>10</td>
<td>1.8</td>
</tr>
</tbody>
</table>

(A) Import Duties:

Generally speaking, revenue from import duties is by far the most important source of revenue from any one tax in less-developed countries. Relative to total tax receipts, its contribution varied from 14 per cent to 42 per cent in the example given in the table. (Relative to national income its contribution varied from 1 per cent to 7 per cent.) As noted earlier, this significance stems from the fact that most less-developed countries are primary producing countries and depend largely on the importation of manufactured goods. As imports are concentrated in a few hands, a tax on them can easily be administered. Less-developed countries, therefore, find the point where the goods are imported as a ready made opportunity to buy a fruitful tax. The relative importance of such a tax in the revenue depends on the circumstances of each country as they affect the level and the structure of imports. Such circumstances are: the stage of industrial development of the country; the degree of substitution between home-produced and imported commodities; and the degree of government restriction of imports.

(B) 'General' Consumption Taxes:

Revenue from excises and retail sales taxes—shown in the table under 'General' taxes on consumption—is less important than that from import duties in most less-developed countries. The figures in the table show that these taxes contributed as little as 8 per cent in Ceylon (1.3 per cent of national income) and 10 per cent in Egypt (1.8 per cent of national income), but in one case (Mexico) as much as 39 per cent (3 per cent of national income). The variation between these countries is great and seems roughly in inverse proportion to the revenue from import duties. A large proportion of the revenue arising from excises and retail sales taxes might reflect the greater diversification of
some economies, and the consequent lesser reliance on imports. This explanation would fit the facts in the case of the countries used as examples for the tables.

Although sales taxes are in fact the major source of revenue in less-developed countries, it is argued that these taxes cannot be relied upon to provide a continuous flow of revenue to finance development programmes. This leads to a discussion of the possibility of relying on sales taxes to raise the necessary revenue, and the criticisms which are made against these taxes.

(c) The Extent to Which Less-Developed Countries can Rely on Sales Taxes for Raising Revenue:

Reliance on sales taxes, as a major source of revenue, is generally welcomed in less-developed countries on the ground that sales taxes are easier to administer. However, such reliance is often criticised on ground which tend to favour a reduction in reliance on these taxes as a source of revenue, in spite of their ease of administration. Therefore, to suggest a continuing reliance on sales taxes from the point of view of raising revenue, it is necessary to demonstrate that the criticisms made against them are unjustified. This will be the purpose of the present section. The alleged defects of sales taxes under this heading are three in number:

(i) Selective sales taxes impose an excess burden relative to an income tax;

(ii) Selective sales taxes are expected to be an unstable source of revenue in the short run, especially when import duties constitute a large part of the revenue from sales taxes;

(iii) The revenue from sales taxes is expected to decline because the relative importance of imports in the economy declines as a country moves towards industrialization and changes the structure of its imports.
The Excess Burden of Selective Sales Taxes:

For any tax to be an efficient device for raising a given amount of revenue, it should impose the least burden upon taxpayers, i.e., avoid any exposable excess burden. Some writers contend that partial or discriminatory sales taxes impose an excess burden on taxpayers compared to an income tax raising the same amount of revenue.\(^1\) Therefore, on welfare grounds, it is argued that it would be better to raise the same amount of revenue by an income tax that would avoid the excess burden.

It is difficult to accept the unequivocal validity of this conclusion since both income and selective sales taxes have proved to possess different types of distortion (either on consumer preferences or on the supply of factors of production), depending upon the type of tax used.\(^2\) Thus each tax will involve an excess burden and, therefore, no conclusive result can be reached concerning the extent of the excess burden which each tax may impose. This depends rather

\(^1\) For example, see: Joseph, M. F. W., "The Excess Burden of Indirect Taxation", Review of Economic Studies, June 1939.

\(^2\) Furthermore, the conclusion rests on certain assumptions of which the most important are: firstly, resources are allocated in an optimum way so that the marginal cost is equal to the price for each commodity and the price of each factor is equal to its net marginal product throughout the economy; secondly, there is no divergence between private and social costs and benefits; thirdly, the analysis is in terms of partial equilibrium; fourthly, the supply of different factors of production have a zero elasticity; fifthly, each consumer and producer has identical tastes, ability, etc.; sixthly, an equal amount of revenue will be raised under income and selective sales taxes. The presence of these assumptions tends to diminish confidence in the usefulness of the conclusions.
on the initial allocation of resources and the possibility of assessing the
different burdens and benefits which each tax may have. There is no need to
repeat in this context the arguments upon which this conclusion is based, and
the criticisms made against it, as these have been discussed in detail in the
literature. However, it is necessary to stress four points which have not
received much attention in the literature. These are:

(a) the importance of cost conditions as a factor affecting
    excess burden;
(b) the benefits which might arise in other parts of the
    economy;
(c) the assumption that the supply of effort and saving
    remains constant;
(d) the comparison made between ideal types of income tax
    and selective sales taxes without regard to actual
    types of taxes in practice.

(a) Cost Conditions and Excess Burden:

A necessary condition for a welfare optimum is that the marginal conditions
of the Pareto optimum must be fulfilled, i.e., marginal cost equal to price
and the price of each factor equal to the value of its marginal product, through¬
out the economy. The imposition of selective sales taxes within these conditions,
it is argued, will distort the prices of different goods and services to consumers
and will thus produce a divergence between marginal cost and price. This means

    Finance*, A Study in Public Economy, McGraw Hill, 1959, Chapter 7, and
    Berry, D., "Modern Welfare Analysis and the Forms of Income Redistribution"
    1954.
that an excess burden is created as selective sales taxes alter resource-product allocation in a way which is inferior from the consumer's point of view.

Though reference to the marginal costs of different industries is necessary for any assessment of excess burden which may result, the excess burden analysis makes no reference to the cost conditions of different industries in the economy. It is impossible, within the limits of this assumption, to contend that selective sales taxes would upset the optimum conditions. Even if it is accepted that the initial conditions before the imposition of the tax are optimal, the introduction of the public sector (which is also neglected in this analysis), may upset the applicability of excess burden conclusions. This is because government expenditures involve a transfer of resources from the private to the public sector. Such a transfer does not necessarily mean that resources absorbed by the public sector will produce the same commodities that were produced when these resources were employed in the private sector because public and private goods are by nature different. Consequently, the transfer of resources must have different effects on the cost conditions of different industries, these effects depending, for example, on factors such as the size of the resource transfer, the types of commodities produced by the public sector compared with those produced by the private sector, consumer preferences, and the original cost conditions of different industries. Therefore, relative to an income tax, the use of sales taxes to finance these expenditures may improve rather than distort the allocation of resources. If this happens, then selective sales taxes will have less excess burden and indeed may possibly involve a benefit to the community as a whole.
(b) Possible Benefits Elsewhere in the Economy:

The excess burden analysis, because of its partial bias, tends to ignore the effect of selective sales taxes on other parts of the economy. The use of discriminatory sales taxes, for example, may discourage the demand for the highly taxed commodities and encourage non-specific resources to shift from the highly taxed to the lightly taxed, or exempted commodities. This opportunity to avoid any possible backward shifting of the tax to their earnings may face entrepreneurs. Within perfectly competitive market conditions, competition between the factors of production will tend to reduce factor prices with the resultant effect on the prices of the lightly taxed and exempted commodities. It may happen, as a result of this shift, that the prices of some commodities which are lightly taxed or exempted from tax decline. This would occur when the prices of these commodities fall to a lower level where consumers derive an excess benefit. It is necessary, therefore, to assess the excess burden as well as the excess benefit which results from the use of selective sales taxes, if it is desired to reach any conclusions about the excess burden or benefit which may arise.

(c) The Assumption of a Constant Supply of Effort and Saving:

The assumption that taxes are neutral in their effects on the relationship between work and leisure and between present and future consumption is unrealistic and, therefore, difficult to accept. It must, therefore, be removed. Once it is removed, however, it is difficult to demonstrate that sales taxes have an

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1. This is based on the conclusion reached about the incidence of selective sales taxes propounded in Ralph, E., The Theory of Fiscal Economics, University of California Press, 1956, Chapters 6 and 7.
excess burden relative to other taxes.

In the first place, if the supply of effort is variable, an income tax involves an excess burden as it distorts the price relationship between work and leisure. It may be argued that sales taxes introduce a similar distortion when they have the same incidence and reduce real income to the same extent. Yet, this need not necessarily follow as money illusion may play a part in influencing the consumption of the taxed commodities. A sales tax which raises prices - and which is paid in relatively small and diversified amounts - might therefore be felt to a lesser extent than an income tax which leaves prices constant but lowers money income. Furthermore, it is possible to levy progressive sales taxes on commodities complementary to leisure.\(^1\) This will tend to encourage workers to reduce their consumption of leisure in order to obtain these commodities.

Secondly, if the supply of saving is variable, income taxes also tend to distort the saving-consumption relationship. This is not necessarily so under progressive sales taxes. People may believe these taxes to be temporary and save more in consequence. Moreover, when saving is for the sake of accumulation, the desire to save will be encouraged since the net returns from saving will be high. Finally, the exemption of saving under a system of sales taxes means that taxpayers will benefit from the interest which accrues on the exempted saving. Here too, saving will be stimulated.

The importance of these factors depends on the interest elasticity of saving. Within the assumptions of excess burden analysis, therefore, the net effect of sales taxes may be to encourage more output in future periods (operating through

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\(^1\) Little, I. M. D., "Direct Versus Indirect Taxes", Economic Journal, September 1951.
the familiar income analysis) with consequent benefits to consumers. Such benefits may outweigh any excess burden that sales taxes may impose in other directions. Consequently, it is very arbitrary to state that sales taxes will have greater excess burden than income taxes.

(d) Qualifications When Comparing Actual Types of Taxes in Practice:

Excess burden analysis rests on the analytical assumption that 'ideal' income and sales taxes are imposed. Yet, it is difficult to find an ideal tax in practice. Taxes may depart from the ideal in several respects. For example, there are multifarious practical difficulties in defining the tax base. Or there are the administrative problems of minimizing evasion and avoidance. Under an income tax, all sorts of problems arise in assessing capital gains, and this source of income is excluded from the tax base in some countries. In others it is treated lightly. In addition, expense allowances vary in definition from one source of income to another. These defects may influence entrepreneurs to shift resources from one use to another. This may run contrary to an efficient allocation of resources and, therefore, introduce an excess burden. On the other hand, the use of sales taxes may introduce less difficulties and may be easier to administer in an effective way, thus reducing excess burden.

We reach the conclusion that sales taxes cannot be held to necessarily involve an excess burden relative to income taxes as the assumptions upon which the analysis rests are unrealistic. Although all assumptions are by nature unrealistic insofar as they all abstract from 'reality' to a certain extent, these particular assumptions fail because more comprehensive assumptions should replace them if the analysis is to be not only logically consistent, but have a greater relevance to policy problems as well. In the meantime, the welfare case against reliance on sales taxes as a device for raising revenue in less-developed countries is weakened, especially when resources are already inefficiently allocated in the real world.
(ii) The Instability of Revenue from Sales Taxes:

In less-developed countries, one of the basic considerations in choosing one tax rather than another, (especially when the revenue is needed to finance a steady development programme), is freedom from serious fluctuations in revenue productivity. By this criteria, it is usually argued that reliance on sales taxes in general, and on import duties in particular, is dangerous as these are unstable sources of revenue where imports depend to a large extent on fluctuation in the balance of payments.¹

However, this conclusion is not altogether verified on theoretical or empirical grounds. On the contrary, it would seem that theoretical analysis would support a contrary conclusion, i.e., that revenue from sales taxes should be a more stable source of revenue than other taxes, if the proper commodities are chosen for taxation.

This can be clearly demonstrated by examining the necessary features of a tax which will secure revenues that will rise with the level of economic activity as the country develops without exhibiting a comparable fall during a cyclical downswing.

The following are the most important points to be considered:

(a) the elasticity of demand for the taxed commodities;
(b) the foreign exchange reserve position of different countries.

(a) The Elasticity of Demand for the Taxed Commodities:

The theoretical discussion supports the view that revenue from sales taxes depends largely on the price elasticity of demand, which in turn reflects in part the elasticity of substitution and income elasticity.

Ceteris paribus, the lower the price elasticity of demand for the taxed commodities, the smaller the fluctuation in demand and the more stable the revenue. However, this stability can be undermined by the existence of close substitutes whose

prices remain unchanged, and whose presence, therefore, tends to increase the price elasticity of demand for the taxed commodities because of the possible gain to the consumer from shifting to cheaper substitutes. Higher price elasticity of demand resulting from the possibility of substitution will be reflected in wider fluctuations in revenues. But by widening tax coverage to include the taxation of possible substitutes to the same extent, it is possible to reduce the extent of substitution, and to preserve the low price elasticity of demand for the taxed commodities. Sales taxes follow this pattern in practice and thus tend to have stability in their revenue.

The income elasticity of demand as a factor effecting the revenue productivity of sales taxes has so far been ignored. In fact, income elasticity of demand is an important variable affecting the revenue productivity of the tax. As income rises and falls, demand for certain commodities increases and decreases in sympathy. The higher the income elasticity of demand for a commodity, the higher will be the fluctuation in demand accompanying a given fluctuation in income. Therefore, to achieve a steady long-term increase of revenue as the economy expands, it is necessary to tax those commodities whose income elasticity of demand is not less than one. But in the short-run this will result in wide fluctuations in revenue and with consequent undesirable effects on the stability of government revenue especially during a downswing in the cycle. The extent of these fluctuations will increase as the rate of tax progression increases. The higher the rates of tax applied to these commodities, the higher will be the revenue fluctuations. However, this ignores the important features of a sales tax - that it is a tax on consumption and hence a lagging variable whose response to income is more sensitive in the upswing than in the downswing. As income rises, it induces a rapid rise in consumption in order to satisfy unsatiated wants. On the other hand, consumption tends to lag behind a decline in incomes as it is difficult to reduce the pattern of consump-
tion quickly in the short-run. This is especially true in less-developed countries where savings are considered a residual due to the lack of contractual savings and the lack of habitual savings. These properties of the consumption function tend to ensure that there is an increasing amount of sales taxes revenue as income increases. Similarly, there is no commensurate fall in revenue as income decreases. The extent of the decline in revenue can be checked even further by combining high income elasticity of demand with low price elasticity of demand, in selecting the goods to be taxed. The taxation of such commodities will produce a relatively stable revenue in the downswing.

The question is whether there is a wide enough range of commodities having these properties to provide a suitable tax base in less-developed countries. The experience of less-developed countries affords ample evidence of persons moving up the income scale and increasing their expenditure on goods such as cars, refrigerators and other consumer durables, which have a high income elasticity of demand. A further feature of such goods is their low price elasticity of demand due to persons with rising incomes being susceptible to the "demonstration effect" so that consumption responds to social pressures such as conformity or prestige rather than to price factors. Such goods are obvious choices for sales taxes in less-developed countries where they provide a wide enough tax coverage to produce a revenue which is large enough in absolute terms and which moves relatively in the desired manner.

Other suitable commodities and services will be those which have a low price elasticity of demand so that consumption declines relatively as income rises.

1. There is no fear in this case that the available savings of the community will be reduced thereby reducing the supply of risk capital. This will be explained in detail in Chapter V.
These are mostly composed of basic necessities - items such as food, shelter and clothing. The implication is that revenue will be stable.

However, it is argued that the taxation of commodities with a low price elasticity of demand will not only be a favourable way of raising a stable revenue, but also will result in a smaller loss of surplus compared to other taxes. There is no doubt that this conclusion is true within the limits of partial analysis. Once a general equilibrium situation is introduced, it is misleading to generalize from such a conclusion. This is because of the assumption that the taxed commodity is specific. If this assumption is relaxed, taxation of a commodity with a low elasticity of demand may possibly divert purchasing power from other commodities with consequent effects on the production and prices of these commodities. While a tax on a commodity with inelastic demand will involve a smaller loss of surplus to either consumers or producers (under partial equilibrium analysis) this must subsequently be balanced against losses of surplus resulting from the diversion from other commodities of purchasing power and productive resources by consumers and producers respectively (under general equilibrium analysis). Moreover, the gain in surplus resulting from the change in the prices of different products as a result of the tax on some of them must be taken into account. Finally, within a general equilibrium analysis, the gain in surplus resulting from the use of tax proceeds by the government must also be allowed for. This is especially important in less-developed countries where the government's use of tax proceeds will create new industries and new employment opportunities out of unemployed resources thus leading to a large consumers' and producers' surplus.

It can be seen that the loss or gain of surplus resulting from the income effect of sales taxes can be reduced even more by devising a system which will
have the following characteristics:

(1) The coverage of the tax is extended to other commodities, especially to those which are readily substitutable, with the result that the whole group of commodities has no ready substitutes, so that the inelastic demand for taxed commodities is maintained.

(2) These commodities, especially those liable to the higher tax rates, are grouped under the preceding principle. These groups are on the whole complementary to leisure, with the result that their distortion of work/leisure and saving/consumption patterns are avoided.

If these conditions are secured, as they well might be in less-developed countries, any distortion which sales taxes may have will be minimized and sales taxes will probably be a better way of raising a given amount of revenue with minimum loss of surplus.

But it may be argued that the choice of a group of commodities having a low price elasticity of demand runs counter to the objective of equity as most of these commodities will be basic necessities. This does not seem to hold good, however, in less-developed countries, where commodities with high income elasticity of demand also possess a low price elasticity of demand. This will be explained in detail in the following chapter.

(b) The Foreign Exchange Reserve Position of Different Countries:

It is usually argued that because of the dependence of imports on the balance of payments position, revenue from import duties is likely to fluctuate widely analogously to that from export taxes, especially in the downswing. But this
criticism tends to exaggerate the extent of fluctuations due to this factor. First of all, imports are not as rigidly dependent on developments in the balance of payments as is implied. This is especially true in the very short period where imports can be carried on without any severe limitations. There is always a margin within which imports can be undertaken without any undue restrictions. This is especially important when the foreign exchange reserves are subject to seasonal or cyclical fluctuations as is often the case in less-developed countries. These factors tend to reduce the need for drastic or prompt action.

Secondly, it should be noticed that there is always a time lag between the fall in the foreign exchange reserves, say as a result of a fall in export earnings, and the consequent reduction in imports. The flow of imports already ordered in the peak boom period begins to arrive and it is difficult to cancel these orders. Consequently, imports are likely to reach their peak during the decline in export earnings and foreign exchange reserves. Thereafter they will decline. Even then the decline may be slow because consumption expenditures resist downward pressures and thus make it more difficult to reduce imports promptly in the short period. All these factors would tend to stabilize imports and import revenues.

Thirdly, the argument implies that the period of decline in the foreign exchange reserves due to the fall in exports is so long as to require a drastic reduction in the volume of imports. In fact this is not necessarily the case as the period of the fall in the export market is usually short in duration and followed by an upward movement - unless there is a severe world depression, or unless the country depends on products of declining importance. This is
especially true as the large industrial countries are committed nowadays to policies of full employment. These factors tend to alleviate the severity of the shortage of foreign exchange reserves and to ease import restrictions.

Finally, the argument seems to assume that we are dealing with a static economy where export earnings are not likely to increase but are, on the contrary, liable to fluctuate downwards. There is no overwhelming reason to suppose that this will necessarily be the case. It may happen that the export sector will expand with the expansion of industrialization thus resulting in an increase in export earnings. In this case, the fall in export earnings will be checked in part by a rise in foreign exchange reserves which allow the importation of different commodities without the need for severe action.

Therefore, although the "foreign exchange" criticism of sales taxes cannot be ignored, it is greatly exaggerated because it takes no account of the time lag necessary to reduce imports and the relative improvement in the balance of payments after the recession. It seems reasonable to conclude, therefore, that revenue from import duties is not likely to fluctuate as widely as other tax revenues. This is illustrated by comparing the revenue from import duties with the revenue from export and income taxes in Ceylon. Ceylon is chosen for this purpose because all these taxes are important elements in its revenue structure. Table 5 gives a comparison of the movement of different types of tax receipts over the period from 1947-1957.

These figures are shown graphically in Figure 1 from whence it is apparent that the revenue from import duties appears to be the most stable of the three, Export tax receipts are the most variable, especially during the downswing. Taxes on income and wealth also show wide revenue fluctuations relative to import
### Table 5

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<th>Year</th>
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<th>Taxes on Income &amp; Wealth</th>
<th>Export Taxes</th>
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</table>


3. See also Appendix "D".

### Note:

(100 = 1947 = 100)

(index numbers of the revenue from import duties, taxes on income and wealth, and export taxes in Ceylon in the years 1947 - 1957)
Diagram 1.

Fluctuation in Import Duties, Taxes on Income and Wealth, and Export Taxes in Ceylon in the Years 1947 - 1957.

Index Numbers 1947 = 100

- Import Duties Revenue
- Export Tax Revenue
- Taxes on Income & Wealth Revenue

Graph shows trends and changes over the years from 1957 to 1957.
duties. Again, this is most obvious during the downswing. In the case of these taxes allowance has to be made for an obvious lag due to the time needed to present returns and assess the tax. This places the income tax lower relative to import duties as the revenue tends to lag behind earnings, which means that an increase in economic activity is not reflected as quickly in receipts as is the case with import duties. The lag in assessment is in effect a short term loan to the taxpayers with which they may finance expenditure free of interest charge, while depriving the government of revenue at the desired moment, or at least increasing the cost to the government of raising the necessary revenue when it borrows money to finance expenditure until the collection of the tax.

Therefore, from the revenue point of view, import duties seem to be a suitable, quick and stable source of revenue for less-developed countries.

(iii) The Decline in the Revenue Importance of Sales Taxes as Economic Development Proceeds:

It has been shown before that sales taxes are of considerable importance in the revenue structure of less-developed countries. But it may be argued that this importance is likely to decline as development proceeds. Changes in the structure of less-developed economies due to development programmes tend to reduce the reliance on import duties, especially when the resulting structure of imports shifts more towards capital goods, which are exempted or lightly taxed relative to consumers' goods. This criticism is only relevant to import duties, and even there it seems to exaggerate the extent of the likely reduction. Several factors peculiar to less-developed countries are responsible for this conclusion.

In the first place, the idea that receipts from import duties will decline as home production rises is questionable because it ignores the fact that
the increase in income resulting from development programmes will be reflected in a high expenditure on consumption. Since all expenditures on consumption are not on home produced commodities, but partly on imported goods, higher incomes will be reflected also in a higher volume of imports depending upon the size of the marginal propensity to import. That is to say, imports will increase with the rise in income, and may increase more rapidly due to the influence of the "international demonstration effect".

Secondly, the structure of the economies of less-developed countries makes them unlikely to reduce their imports in any significant way in the short-run. They are primary producers and rely mostly on imports for their manufactured goods. The industrial sector in these countries is very small, and its capacity to expand and substitute its products for imported commodities is very low in the short-run. Moreover, most of the imported commodities are those which are consumed largely by the rich. Industrialization starts with the production of more essential goods and attempts to establish an industrial base (i.e., power, transport, steel, etc.) to encourage future industrialization. The home production of commodities consumed by the upper income groups is at a later stage of development.

Thirdly, the use of highly progressive rates to reduce the imports of goods with a high income elasticity of demand is not likely to affect them greatly since people in the income groups purchasing them are influenced by the "demonstration effect" which tends to reduce their price elasticity of demand for these commodities. It is fairly easy, therefore, to offset any small decline in the revenue from taxes on such imports which is due to a reduction in demand, (caused by the substitution of home products), by an increase in duty rates.
Fourthly, in any case, any fall in import duty revenues due to the above causes should *ex hypothesi* be matched by a corresponding rise and wider coverage of excise rates and, therefore, sales taxes as a whole are likely to produce a larger rather than a smaller amount of revenue. There is no fear that the widening of the tax coverage of excises may discourage the production of these goods as less-developed countries are usually suffering from excess demand rather than abundant supply. Finally, it should be noticed that the argument that imports of consumers' goods are likely to be controlled so as to free resources for use in paying for the import of capital goods, rests on the assumption that exports remain constant and foreign exchange will be correspondingly limited. But there is no reason to believe that exports will remain limited as development programmes may well expand the capacity of the export industries or develop new export products which will provide more foreign exchange to allow for the import of both capital and consumption goods without severe restriction on the latter.

To sum up, import duties are not likely to be reduced greatly in the short run, and any reduction due to the restriction of imports will be outweighed in part through the use of highly progressive rates on imports with high income elasticity of demand, while the price elasticity of demand will allow the use of these progressive rates without significant reduction in revenue. Those goods which used to be imported and are now produced at home can be taxed. This will tend to supplement any loss in revenue due to the reduction in imports as well as provide the government with an increasing source of revenue which will rise steadily with the development of the economy.
III. **INCOME TAXES**

Although the main emphasis of this thesis is on sales taxes, the importance of income taxes cannot be neglected, especially in so far as they afford a basis of comparison by which to assess the importance of sales taxes. The following table shows the relative importance of revenue from income taxes, whether related to total tax receipts or to national income, both for the year 1953.

| Table 6. INCOME TAXES AS A PERCENTAGE OF NATIONAL INCOME AND TOTAL TAX RECEIPTS IN CERTAIN LESS-DEVELOPED COUNTRIES FOR THE YEAR 1953. |
|---|---|---|
| Mexico | 28% | 2.2% |
| Ceylon | 31% | 5.4% |
| Egypt | 17% | 3.0% |

**Source:** Compiled from U.N.; Economic Survey for Asia and Far East, 1956 for Ceylon; U.N.; Statistical Yearbook 1957 for Mexico and Egypt.

It is apparent from the above table that income taxes are providing the government of these countries with a small share of tax revenues whether related to total tax receipts or to national income. In the three selected countries, their contribution varied from 17 to 31 per cent of total tax receipts and from 2 to 5 per cent of total tax receipts (or 4 to 7 per cent of national income). This compares with the 41 to 53 per cent of total tax receipts (or 4 to 7 per cent of national income derived from sales taxes) [from Table 4.7. The variation
between the chosen countries is largely the result of the presence of large companies developing natural resources in some countries (e.g., Ceylon and Mexico) rather than the availability of a well developed system of income taxes. However, it is not surprising to find that the revenue from income taxes accounts for a smaller percentage of total tax receipts and national income in less-developed countries. This can largely be explained by the circumstances in these countries which are an obstacle to reliance on income taxes, especially personal income taxes, as a major source of revenue. In the first place, a large part of national income is outside the monetary sector. This tends to limit the coverage of personal income taxes. In addition, the exemption limit, influenced by administrative considerations, is set up at a higher level compared with that prevailing in more developed countries. This tends to limit the coverage of personal income taxes even further with the result that only a very small proportion of the population is covered. Finally, the difficulties inherent in administering a highly developed system of taxation such as income taxes are beyond the existing administrative capacities of less-developed countries so that revenue productivity is diminished. Inefficiency of administration coupled with low tax morale, tends to encourage evasion and avoidance with further effects on revenue productivity. All these factors help to explain the low revenue importance of income taxes relative to sales taxes in less-developed countries.

1. For example, the exemption limit expressed as a multiple of income per head is about 2 times in more developed countries, while it is 17 times in India (1955), 15 times in Ceylon (1952), and 26 times in Peru (1952). See: U.N.; Economic Survey of Latin America 1955, New York 1956, p. 143.

2. The percentage of people liable to income tax is very small in less-developed countries. It is 1% in India, 1% in Egypt, 0.6% in Ceylon, and 2% in Jamaica; this compares with 25% in the U.S.A., and 30% in the U.K. See: Lewis, W. A., and Martins, A., "Patterns of Public Revenue and Expenditure", The Manchester School of Economic and Social Studies, 1956 p. 224.
IV. **CONCLUSIONS:**

The above discussions have shown that less-developed countries, if the sample chosen is typical, rely on sales taxes (defined to include import duties, excises and retail sales taxes) as a major source of their revenue.

It was found that the dependence of these countries on these taxes could be justified on the ground that a large amount of revenue can be obtained with a minimum burden to consumers and producers so long as the appropriate types of commodities are chosen. Commodities with a high income elasticity but a low price elasticity of demand, (especially those which are complementary to leisure), were found to be suitable for sales taxes designed to achieve this end.

Moreover, the choice of commodities having these properties was also found to be a suitable way of raising revenue which increases with the long-term expansion of the economy while remaining relatively stable during the short-term downswings. The fear expressed by some writers that sales taxes are subject to wide fluctuations in revenue productivity is to this extent exaggerated; indeed, it has been suggested that the revenue is more stable than that from any other tax.

Finally, the observed decline in revenues from sales taxes was due to a reduction in imports of commodities produced at home and, therefore, excluded from the tax base. The re-inclusion of these in the tax base under the subdivision of excises will restore the position of sales taxes as a major source of revenue.

The high percentage of revenue derived from sales taxes in less-developed countries is condemned on the ground of equity. It is considered that taxes on commodities in general and sales taxes in particular are regressive. That is
why the governments in these countries do not include many home produced commodities in sales tax coverage, but prefer to use income tax to raise the necessary revenue.

The next chapter is intended to cast doubt on this contention, to show that sales taxes may be more equitable than other forms of taxation within the conditions of less-developed countries, and to suggest that equity is no bar to reliance on them for revenue production.
CHAPTER IV.
CHAPTER IV.

THE EQUITY OF SALES TAXES.

According to the usual classification, sales taxes, unlike income taxes, are generally regarded as regressive. This suggests that countries relying upon sales taxes as a major source of revenue will have a less equitable tax system than those which depend on personal taxation. The purpose of this chapter is to indicate that, this conclusion is subject to important qualifications, often neglected in the literature, which may even suggest that the converse is true. In fact, we shall attempt to show that sales taxes are as equitable, if not more equitable than income taxes, at least in the circumstances of less-developed countries. To substantiate such a hypothesis we need to establish that the following conditions exist:

1. Expenditure reflects taxable capacity as accurately, if not more accurately, than does income.

2. It is possible to apply the same kind of progression as is possible through a progressive income tax.

If we can demonstrate that these conditions do exist in less-developed countries, then sales taxes should be equally acceptable as it no longer can be easy to support the conclusion that sales taxes are a priori regressive.

For the sake of this analysis we shall use the usual assumption concerning the incidence of both taxes, i.e., sales taxes are shifted forward to consumers, while income taxes are absorbed by the statutory taxpayers.
I. THE DEFINITION OF 'EQUITY'.

A review of the literature on equity in taxation discloses different principles for assessing the justice and fairness of the tax systems, the most widely accepted of these being the 'ability to pay' principle. However, the literature is inconclusive about the way this principle is to be interpreted. There are difficulties involved in any interpretation of 'ability to pay', one of which lies in measuring and comparing satisfactions. Another is the definition of income as a tax base. These difficulties were soon realized and the belief developed that the interpretation of the principle of 'ability to pay' rests on a value judgment reflecting the social philosophy prevailing at any one time. If this is accepted, then we can argue that it is as equitable to tax people according to the rate at which goods are withdrawn from the stock of goods and services available, as it is to take the rate at which this stock is added to.

A. 'Withdrawals From' and 'Contributions To' Wealth.

It may be suggested that in societies where accumulation is held in high esteem and where investment in fixed capital is of primary concern to the community, those who contribute to the mounting stocks of goods and services may be regarded as benefiting society. 'Equity' might then require that taxes be levied on withdrawals from the available stock. The circumstances in less-developed countries which prevent resources from being used in capital formation support this view.

A number of reasons can be given to explain these features of less-developed countries. In the first place, as people become a little better off they are inclined to devote most, if not all, of the increase in income to consumption expenditure. A second, though closely related point, is the fact that part of the rise in consumers' expenditures in these countries is on imports. The increase in income, together with the change in the position and the slope of the consumption schedule, tends to increase the marginal propensity to import and consequently affects the capacity to increase imports of capital goods. Thus, an increase in imports of consumption goods may lead to a greater pressure on the balance of payments, leaving less room for the imports of capital goods.

Finally, a substantial proportion of the small amount of the remaining disposable income is spent in a way which adds little to productive capacity and hence contributes to the slow rate of economic growth. This includes spending on gold, jewels and the finance of speculative stocks in trade. This is largely the result of unfamiliarity with the risks of industrial investment.

All these factors emphasise the strain on the economies of less-developed countries that results from the high level of demand for goods and services. Thus the crucial problem for economic progress is to encourage the use of any increase in output for developmental investment.

Additions to the stock of capital equipment can be considered advantageous since the available plants, buildings, machinery and vehicles are increased, this being a necessary condition for increasing wealth and raising the standard of living.

The strain thus imposed on the economy can be reduced only by reducing the demand for consumer goods and services so that resources may be freed for use in
capital formation. Thus equity can be said to consist in distributing this restraint on current consumption expenditure among different people according to their claim over resources. In other words, the sacrifice involved in reducing the rate of increase of current consumption expenditure should be imposed in relation to different people's expenditures. This follows from the contention that the higher an individual's current consumption expenditure, the greater the burden he imposes on the rest of the economy in supplying the means to increase output.

This conclusion is in agreement with Hobbes' contention, (extended by Kaldor), that equity requires that people should be taxed ... "according to the amount they (consumers) take out of the pool and not according to what they put into it ... It is only by spending and not by earning that an individual imposes a burden on the rest of the community in attaining his own end." 1

Within the context of less-developed countries there are further reasons to support the superiority of expenditure over income as a measure of taxable capacity. The most important of these reasons relate to the distribution of national income and the influence of "other" sources of spending power on expenditure.

B. The Distribution of the National Incomes.

The distribution of shares of national income among different groups play an important part in shaping an equitable tax structure. For example, the fact that a large proportion of national income is derived from employment, interest and dividends in more developed countries, facilitates the taxing of income at

source. In less-developed countries a large proportion of national income (much of it outwith the monetary sector) is derived from rent, agricultural profits, small scale trade and other services. These types of incomes are difficult to trace in less-developed countries, thus such a large part of the income of taxpayers will either be excluded or underestimated that it would be difficult to rely on income as a measure of taxable capacity.¹ As a result, income from wages and salaries which represents a small proportion of national income, is the only source of income which is effectively taxed.

These problems are reduced to a certain extent if expenditure is taken as the tax base. The difficulties of evaluation or assessment are greatly reduced as the commodities which are usually considered to be most justifiably taxable fall within the monetary sector. The wealth of different income groups can be effectively taxed as it is spent. Moreover, as will be seen later, 'expenditure' can be more vigorously defined than 'income' and many of the complications which surround the use of income as a tax base can be avoided.

¹ Other problems associated with income as a tax base and which may lead to inequity in the distribution after tax, can be summarized as follows:

(a) The lack of a clear and comprehensive definition of 'income'. In fact, the decision about what is to be included as income is usually based on administrative and political considerations rather than on an effort to represent the true taxable capacity. In most cases this results in the exclusion from the tax base of some irregular receipts, such as capital gains, chance winnings, etc.

(b) The definition of expenses necessary to produce income varies according to the sources of income. It is elastic with some sources of income from employment. This tends to favour some income groups (especially the higher) relative to others, without economic or social justification.

(c) There are considerable difficulties relating to the period of time during which tax assessment takes place in addition to the complications arising from the choice of accrued or actual receipts of income.
C. Consumption Expenditure and "Other" Sources of Purchasing Power.

In the literature on taxation the ideal measure for taxable capacity is usually taken to be the level of satisfaction of consumers' wants. As satisfaction is an ordinal concept not capable of comparison between different people, only an approximation to this ideal can be attempted. For less-developed countries, expenditure rather than income, seems to approximate to this ideal, because satisfaction is determined by the amount of goods and services a given budget can command, given the level of prices. A given consumers' budget is not necessarily limited by income but can be expanded by the liquidation of wealth. This additional source of satisfaction is important in less-developed countries where the attraction of present consumption is very great due to the influence of the 'demonstration effect' and the need to advertise wealth for prestige reasons. In India, for example, it was found that borrowing for family expenditures varied between 37 and 41 per cent of the total expenditure of big cultivators who mortgaged and sold land to finance personal expenditure. The same tendency is evident in Egypt although figures are not available.\(^1\)

Therefore, reliance on income as the only source of spending power underestimates the taxable capacity of owners of wealth.\(^2\)

It should be noted, however, that the concept of expenditure adopted here is

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2. Special difficulties arise as soon as one attempts to lay down criteria for the taxation of wealth. To assess wealth (especially in the form of hoards, jewellery, or gold) and measure taxable capacity is one problem, but the administrative machinery necessary to uncover such items would be even more formidable. Arbitrary criteria, even if effective, would be difficult to justify.
different from that used in Kaldor's model. While Kaldor's model stresses total personal expenditure in a given period of time as the tax base, our concept of expenditure stresses the expenditures of consumers on different goods and services at discriminatory rates. Consequently, expenditure on consumer durables, which Kaldor suggested could be spread over their life span (normally 10 years), could be taxed on purchase at the appropriate rate without any need to spread them over time. The main reason for rejecting Kaldor's model is the difficulty of applying it to less-developed countries in the short-run. This can be explained more clearly with reference to Kaldor's model itself.

Kaldor takes total personal expenditure as the tax base for his model. Each taxpayer is required to declare his personal expenditure over a period of time together with a comprehensive statement of his receipts, investments, and all other items which are entitled for exemption in order to provide a check on his declared expenditures. Expenditures which are exempted include investment outlays, bank accounts, gifts, funeral and birth expenses, medical expenses up to a fixed amount per head, etc. Moreover, family allowances take the form of an exemption of a fixed sum per person from the tax. In this regard he followed the quotient system of the French income tax, where the tax varies with income per head (in his case expenditure per head), rather than income (expenditure) per family.

To begin with, it is difficult to apply such a model within the context of less-developed countries because it is almost impossible to check the reliability of tax returns. Indeed, formidable difficulties are encountered in administering

income tax returns which by their nature are simpler than the return for an expenditure tax. Insofar as checking would be less exacting, equity would be more difficult to secure. Kaldor's suggestion that it would be possible to rely on the taxpayers' statement of his receipts and expenditures is attractive, but if at all applicable, certainly not so to the circumstances of less-developed countries.

We have already discussed the difficulties associated with the assessment of income in less-developed countries. Insofar as income is easy to conceal, expenditure out of income will be easy to conceal as well. Moreover, the ease of concealing income in the non-monetary sector would discourage the development of a monetary economy and hence retard the rate of economic growth.

Secondly, in societies where it is customary to hold savings in cash, gold, or precious stones, it is more difficult to check all sources of purchasing power. The hoarding of wealth for future consumption may, therefore, be encouraged.

Thirdly, the expenditure system suggested by Kaldor is based on the quotient system in which the tax varies with expenditure per head rather than per family. As the size of families is large and family ties are strong, taxpayers would benefit more by including distant relatives thus reducing the per capita expenditure and the tax liability.

Finally, taxpayers can make use of exempted expenditure such as gifts, donations, medical expenses, birth and marriage expenditure, etc., to evade tax. Moreover, the carry-forward idea of expenditures for consumers' durables would complicate the administration of the tax, and might have the effect of making public revenue more uncertain.  

All these factors suggest that total expenditure - as proposed by Kaldor - is difficult to apply as a tax base in less-developed countries. The alternative we propose is expenditure on different types of goods and services. The objective of such a tax is not to tax goods and services per se, but rather to tax people according to their expenditure on goods and services. The Kaldor model taxes personal expenditure as declared by the taxpayer, with a progressive element relating to income. In less-developed countries administrative realism demands that in order to reduce evasions to a minimum, the tax be levied, not on the declared consumption of the individual, but at the stage where the commodity can be most conveniently and efficiently taxed. The element of progression in this case must relate to the income elasticity of demand. Therefore, our variant of the Kaldor model has a differential element, distinguishing between 'necessities' and 'luxuries', which would be taxed at low and high marginal rates respectively. This is an important point since it affects consumption incentives. In the Kaldor model, this is not necessarily the case, the ultimate incidence depending on the distribution of expenditures over the income range. (For example, 'necessities' purchased with the last increment of income would be subjected to high marginal rates of tax, and vice versa.)

We can now examine the difficulties which surround the definition of expenditure on goods and services as opposed to other types of expenditure. We will then discuss exemption limits and progression.

II. CONCEPTUAL DIFFICULTIES IN THE DEFINITION OF 'EXPENDITURE'.

It may be contended that expenditure is more easily delineated as a tax base than income and hence that its use avoids many of the problems associated with taxing income. Some difficulties peculiar to expenditure as a tax base remain, however, although we do not judge them to have such serious implications for equity.
as those associated with income. These difficulties fall under four heads:

A. The distinction between consumption and consumption expenditure;
B. the distinction between consumption and the expenses of production;
C. the distinction between consumption and investment expenditure;
D. expenditure on services.

A. The Distinction between Consumption and Consumption Expenditure:

An important condition for an equitable tax base is that difficulties in its definition should be reduced to a minimum. This is to ensure that the tax base will represent the taxable capacity of different taxpayers more closely than another tax base where difficulties in definitions are numerous. On this basis, it might be argued that the choice of consumption as a tax base is faced with many definitional difficulties which might not be less than those encountered were income to be chosen as the tax base.

Consumption, properly defined, means that part of production which is used up. We leave the question of distinguishing between personal consumption and the expenses of production, (for example, maintenance and depreciation), till the next section. Here we are only concerned with the distinction between two flows: expenditure and the rate of actual consumption. This distinction requires that real expenditure on items like consumer durables which have a long life cannot be considered as consumption in the year of purchase. Consumer durables normally last for some years during which the consumer benefits from their use. Therefore, the consumption of these goods should be considered as only that part
of the value belonging to the year under consideration. If such a definition is followed consumption as a tax base will be faced with formidable difficulties in differentiating between the used up part of expenditure and the unused part. In fact, these problems will result in many difficulties, probably as many as those encountered under income.

Fortunately, it is unnecessary for our purposes to rely on consumption as such, as a tax base in the model. It may be permissible to refer to consumption expenditure instead, since the rate of consumption or using up, (which is equal to the rate of withdrawals), may be equal to consumption expenditure.

Consumption expenditure in this case is likely to be a fair approximation to consumption, and the equity implications are lessened in consequence. 1

B. The Distinction between Consumption and the Expenses of Production:

It has been argued that the choice of consumption as a tax base involves the difficulty of distinguishing between consumption expenditure and expenses of production (for example, maintenance and depreciation). 2 This may be the case in a more developed economy with a complex capital intensive technique and high standard of living. In less-developed agricultural economies, the expenses of production are less complex. The simple and primitive tools of production used, and the reliance on labour intensive techniques, is likely to facilitate the distinction.

Problems arise in cases outside the agricultural sector. Due to the small size of these sectors these difficulties can be reduced by relying on arbitrary

1. The rates of obsolescence and depreciation (especially high in less-developed countries due to inadequate technical knowledge, maintenance, etc.) tend to equate consumption (the used up part) and consumption expenditure, (the used plus the unused up part, i.e., the total price), over a period of time.

rules that lend to a workable tax system with minimal adverse effects on equity. In practice, every workable tax system relies on certain arbitrary rules. For example, under a tax based on income, the difficulties of defining income cause tax legislators in different countries to exclude arbitrarily certain types of income (for example, leisure, capital gains, and so on). This makes the definition of income in the tax base more influenced by administrative considerations than by a proper definition of income. Therefore, if under a tax based on consumption expenditure we apply certain arbitrary rules limited to some cases only, their coverage is likely to be small, and a tax on consumption expenditure will not necessarily present unfamiliar problems. Let us consider the case of capital gains. Under an income tax realized capital gains are often exempted or taxed at low rates because of the problems of enforcement. This results in a certain inequity between taxpayers receiving their income from different sources. Under a tax based on expenditure, such a problem is solved more easily and equitably by leaving the decision as to whether the gains are real or illusory to the taxpayer who can spend these gains or save them to keep his capital intact.

It may be argued that there are problems under a tax based on consumption expenditure which cause difficulties of definition. These problems centre around the distinction between consumption expenditure and expenditure on investment. This forms the subject of the following section.

C. The Distinction between Consumption and Investment Expenditure.

A second difficulty facing the use of expenditure as a tax base is the need to differentiate consumption from forms of investment, the most important being in precious stones and consumers' durables. This would seem to present a difficult problem, but it can be simplified to a considerable extent within the context of
less-developed countries.

Most expenditures which are on the border line between consumption and investment are made in order to maintain appearances rather than for the sake of investment or to safeguard savings as such. It is difficult to maintain that these forms of expenditures are investment in the usual sense because they yield no future returns which are the main factor in determining the present value of assets. Moreover, it is difficult to treat them in the same way as investment proper (such as in a machine) in connection with depreciation allowances and scrap value. Consequently, it would seem more appropriate to include these expenditures under consumption rather than under investment.

D. Expenditures on Services:

The equity of a tax levied on people according to the different types of expenditures, within our model, requires that expenditures on services be liable to the tax since wealthier persons spend a larger percentage of their income on services than do those in the lower income groups. The exclusion of expenditures on services from tax liability would, therefore, discriminate in favour of the wealthy groups. Moreover, it would encourage a malallocation of resources towards increased production of services. Consequently, from the point of view of equity, as well as from that of optimum allocation of resources, it is important to tax expenditures on services as well as on commodities.

Although this argument is usually accepted as sound in the design of an equitable expenditure tax system, the difficulty of administering the tax on services is often held to be so great as to warrant their exclusion. These difficulties may have been exaggerated in less-developed countries where expenditures on services are largely on a small number of categories, namely rents, travel,
public utilities and railways, hotel and restaurant services, and entertainments. 1

Rent accounts for 40 per cent of total expenditures on services in India and 43 per cent in Egypt. 2 It is often argued that rent is difficult to tax. In practice the tax is often imposed on the rental value (which is fixed for a long period of time), rather than the actual rent. Under sales tax system, these administrative difficulties can be reduced, by choosing a proper point of tax collection (for example, the landlord as a point of tax collection for sales taxes on rent paid by tenants. The landlord has no interest in concealing the true rent paid and hence the tax liability). Owner/occupiers of houses are not likely to pose any serious difficulties either. The tax could be levied on the estimated rental value of houses and collected in addition to building taxes. These two taxes should not be confused with each other though the tax base is the same in both cases. Sales taxes are levied on the estimated rental value which represents the rent paid by the owner as part of his expenditure to himself as the owner of building in the one case, whereas it is levied on his income received from the rent of the building in the other case.

There do not seem to be many obstacles in applying these rules, especially when the machinery of the building tax will be used to collect the tax on rent. The experience of some less-developed countries has proved the possibility of levying this tax in a workable manner. 3

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1. For example of the 20.5 per cent of total expenditure devoted to services, rent represented 8 per cent, conveyance 3.1 per cent, amusements 1.0 per cent, and other miscellaneous services 7.5 per cent. Thus rent only represents 40 per cent of total expenditure on services. See the Report of the Indian Taxation Enquiry Commission 1953/1954, Vol. I, p. 64.


3. Egypt applied the system of a tax on rent for many years in Alexandria. The success of this method encouraged the government to extend this system in 1956 by levying a defence tax on the rent paid by tenants of houses built before 1944.
Travel abroad is likely to occupy an important part of expenditure on services in less-developed countries, particularly among wealthy groups.

The administrative difficulties of taxing expenditure on travel in these countries would appear to be negligible. The sale of tickets takes place in a small number of agencies. Transfers of money abroad fall under foreign exchange control and are normally made through banks; they may be taxed either directly or indirectly through the use of multiple exchange rates.

It may be argued that it is difficult to distinguish between exports of capital and imports of services for tax purposes. In less-developed countries, however, this problem is mitigated by the extensive use of import licences which can be relied upon to differentiate between capital imports and services. In these countries, therefore, it may be concluded that sales taxes can be effectively applied to spending on travel.

Expenditure on other types of services does not involve complicated problems of taxation. In fact a large proportion of such spending is taxed in some countries. In the first place, public utilities (gas, electricity, telephones) are almost always very large monopolies and hence form convenient bases for the levy of taxes.

In the case of transport, apparent difficulties are not likely to seriously hinder the application of the tax. Transport in the form of private cars can be taxed through licences and petrol taxes. Transport in the form of bus services can be reached as well. Other automobile transport such as taxi services present a more difficult tax problem, but may be reached indirectly through taxes on licences and petrol. Such taxes, which would constitute cost elements in the determination of prices, would be effectively borne by expenditure on these services.
Hotels and restaurants are usually concentrated in a few big cities and are operated on a fairly large scale which simplifies the levying of a tax. The tax could simply be added to the bill to be paid by the users of these services.

Admission to places of amusement is already taxed in most countries and presents few problems.

We have therefore argued that it is necessary in principle to tax expenditure on services as well as on commodities in order to ensure equity and avoid malallocation of resources. This desire is not necessarily frustrated by administrative difficulties in less-developed countries.

III. THE PROBLEM OF SATISFYING THE CONDITIONS NECESSARY TO SECURE EQUITY.

Modern standards of equity require that a tax system should satisfy at least two pre-conditions. These are:

(A) The provision of an exemption limit sufficient to secure minimum needs, in addition to allowances which take individual circumstances into account;

(B) the use of progressive rates to differentiate in the treatment of unequals.

We shall consider each in turn.

(A) The Exemption Limit and Allowances:

Exemption limits and allowances are necessary features in an equitable tax system since the individual circumstances of each taxpayer must be accounted for in order to secure for him that minimum standard of living necessary to maintain his efficiency in contributing to production. Further, such allowances help to discriminate between the treatment of equals in different circumstances.
This is particularly important for a tax on expenditure where the increase in expenditure might not represent an increase in the taxable capacity.

Exemption limits represent a difficult problem, the solution of which must depend upon the particular form of taxation used. In the case of the income tax, the primary problem of allowing for the different circumstances of taxpayers is solved by granting a fixed exemption limit and a number of allowances which will permit "minimum income requirements" to go untaxed. There would appear to be no serious difficulty in using a comparable system with sales taxes.

An allowance, or "social dividend", the value of which would depend upon individual circumstances, could be given to each taxpayer. (Individual circumstances might be based on an estimate of the amount of tax to be paid on those goods and services considered to be 'basic' to the majority of the population.) It may prove desirable, in order to prevent abuse of the system, to limit any one taxpayer's dependents to his immediate family. The age of dependents could be taken into consideration in fixing the amount of the dividend.¹

However, a social dividend may be criticised on the ground that taxpayers who consume home produced commodities will benefit from the use of a tax on expenditure, as they will get double exemption. On the one hand, the exemption

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¹ The amount of the 'social dividend' as well as its effect on incentives will be discussed in the next chapter. It should be noted that the exemption limit and allowances advocated here are quite different from those suggested by Kaldor. In his model, Kaldor suggests a quotient system whereby the tax varies with the expenditure per head rather than expenditure per family (after minimum exemption allowances). He suggests no limit to the number of dependents which the taxpayer might include in his family. In the system suggested here, the taxpayer, is the head of the family and the exemption limit and allowances take the form of a 'social dividend', while the number of dependents is limited to his immediate family only. This method is better suited to the type of tax which we suggest; a tax on different types of goods and services. In addition, it would prevent evasion resulting from the inclusion of distant relatives.
given to them through the use of home produced commodities would escape the
tax, and on the other hand the social dividend given to them would supplement
their income. The likelihood of avoidance in this way, however, is at least
no more serious than in the case of a tax on income, where income in kind
similarly escapes tax. Consequently it cannot be held that a tax on different
types of expenditures, as suggested, will be inferior to an income tax or the
expenditure tax in Kaldor's model.

It may be concluded that the problem of providing exemptions and allowances
presents no special difficulty for a system of tax on the expenditure of different
goods and services.

(B) The Use of Progressive Rates:

It is generally held that an equitable tax structure must be progressive.
The need for progression was supported by the sophisticated principle of the
least aggregate sacrifice which was supposed to rest on scientific principles.
However, more recent literature on welfare economics, by demonstrating the
impossibility of a cardinal measure of utility and hence interpersonal
comparisons, has since disproved the scientific basis of this principle.
Moreover, the definition of 'ability to pay' (i.e., whether it can be measured
by wealth, income, consumption, etc.), so complicates the problem that there can
be no final proof that the principle of 'ability to pay' necessitates tax
progression. The 'ability to pay' principle requires no more than that those
with high means pay more tax.

Nevertheless, the most important justification for progression is the need
to reduce inequality on the distribution of income. This justification seems
to have a particular appeal in less-developed countries where people are influenced

1. Prest, A. R.; Public Finance, In Theory and Practice, Weidenfeld & Nicolson,
by the ideas prevalent in more advanced communities. But in these countries, the most apparent form of inequality is the widespread difference in the standard of living between income groups which results from different sources of spending power. This attracts the attention of the majority of people and can lead to social and political unrest. It is, therefore, necessary to turn to the problem of deciding on the rate of tax progression.

There is, of course, no 'optimal' rate of tax progression. The selection of any particular rate must rest on a value judgment which will be tempered by the social, political and economic conditions prevailing in any specific country. Probably the most important consideration in this regard is the effect of progression on incentives.

The application of progressive tax rates does not present any insuperable problem for a tax on expenditure on different goods and services in less-developed countries. Progression can be applied by using different rates of tax on different goods and services according to their income elasticity of demand - the higher the income elasticity of demand, the higher the tax rate.

In less-developed countries, the concept of income elasticity of demand must be interpreted in a wider sense insofar as the income of wealthy groups can

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1. In fact, the need for a more equal distribution of income is an unsatisfactory justification for progressive taxation in less-developed countries. Although inequality is responsible for a wide difference in the standard of living between income groups, it appears that the main problem is not inequality as such, but the high rate of increase in expenditure on goods and services which accompanies the increase in income. If this is accepted, then progressive rates can be justified more logically as a means to reduce the rate of increase in consumption to provide resources for investment and thus help to raise the standard of living, especially that of low income groups.
usually be supplemented by the liquidation of wealth. Bearing this fact in mind, the commodities with a high income elasticity of demand, which are consumed by the wealthier groups, will bear the highest tax rates, while those goods which have a low income elasticity of demand (comprising the bulk of purchases of the poor) will bear low rates. This approach would require a careful classification of goods and services according to their income elasticity of demand and their substitutability, though this is greatly simplified in less-developed countries because of the marked difference in the patterns of consumption of high and low income groups.¹

Nevertheless, it might be argued that a tax on expenditure on different goods and services has two shortcomings on equity grounds. These are:-

(1) The use of expenditure as a tax base will result in an increase in the inequality in the distribution of wealth since savings are excluded.

(2) The use of highly discriminatory rates might encourage the higher income groups to shift their expenditures towards highly taxed commodities with a consequent aggravating effect on resource allocation.

It can be shown, however, that neither of these criticisms are completely valid within the circumstances of less-developed countries.

IV. THE EFFECTS OF A TAX BASED ON EXPENDITURE ON THE EQUALITY OF WEALTH:

It is usually argued that the exclusion of savings from the tax base will encourage people to save and thus tend to increase the inequality of wealth, with its consequent effect on economic and social instability.

Although it may be true that the exemption of savings will increase the inequality of wealth, there is no reason to suppose that this increase is contrary to social and economic interests. In countries suffering from a shortage in the accumulation of wealth, especially in fixed capital, any addition to this stock is advantageous as it leads to an increase in the productive capacity of the economy. This expansion and its consequent effect on income and employment, represents a net social gain and thus tends to offset any loss arising from greater social or economic inequality. In short, this criticism ignores the effect of the increase in savings and investment in raising the standard of living of the people in general. By this process an increase in saving can be said to reduce inequality.

Furthermore, there is no doubt that the increase in savings will result in an expansion of the rentier class which is one of the social problems of less-developed countries. But this effect can be exaggerated since progressive tax rates will tend to influence available savings and consequently the accumulation of wealth as well. Highly progressive rates on expenditures would tend to reduce the real income of taxpayers and thus tend to arrest the rate of increase in wealth. This is particularly important where the demand for highly taxed commodities has a low price elasticity of demand.

Finally, any objective to reduce inequality in the distribution of wealth or prevent its increase, can readily be handled through taxes on wealth or death duties. Such taxes would help to iron out inequalities and modify further

1. Kaldor, N., op. cit., pp. 96-101
2. The effect of the tax, on savings and consequently accumulation, will be dealt with separately in the next chapter.
tendencies toward wealth inequality. But death duties cannot work without a
tax on expenditure on different goods and services which (unlike an income tax)
does not permit dissaving to escape tax.

Therefore, the increase in inequality in the distribution of wealth which
may result from the exemption of savings is likely to bring a net social gain
which will offset any loss arising from greater inequality. This will be
manifested in a higher income to the community and a reduction in the divergence
between the standards of living of the rich and the poor. Even if some inequality
does tend to increase, a progressive tax on goods and services together with
death duties, will have a modifying effect.

V. THE EFFECT OF DISCRIMINATING RATES ON THE EXPENDITURE OF THE HIGHER
INCOME GROUP.

Discriminatory rates of sales tax may induce consumers to reduce their
expenditure on the highly taxed commodities and shift to lightly taxed ones.
Hence, discriminatory taxes will distort the allocation of resources.

However, as will be explained in detail in the discussion concerning the
effects on resources allocation, this conclusion loses much of its validity in
less-developed countries. It is sufficient to say here that a proper tax
structure, which takes into consideration the importance of substitutability,
will reduce the extent of this factor. This is reinforced by the tendency for
the 'demonstration effect' and the prestige factor to reduce the price elasticity
of demand for commodities with a high income elasticity of demand. This will
result in cheaper substitutes being regarded as inferior goods by the higher
income groups, thus reducing the possible substitution between higher priced and
cheaper substitutes.

There are many types of taxes on expenditure which can be applied in
practice. An examination of the alternatives is necessary to ascertain which form is most suitable for less-developed countries.

VI. **SALES TAXES IN PRACTICE.**

Because of the wide variety of taxes on expenditure in current use, an effort will be made here to examine only the common forms of taxation which fall under our classification of sales taxes. These are:

1. **Import duties**;
2. **Manufacturers' sales taxes**;
3. **Wholesale taxes**;
4. **Retail taxes**.

It is necessary to determine which of these taxes are most effective in reaching different wealth and income groups and in securing equity.

There are three requisites of a successful tax system for less-developed countries which have a bearing on the above classification.

1. **Imported commodities must bear the tax**;
2. **Expenditure on services must be taxed at the time the services are bought**;
3. **A point of tax collection on home-produced commodities must be created**.

There does not appear to be any serious problem concerning the point of tax collection in the case of imports and services. Import duties are levied on imported commodities before they are withdrawn from the customs. This ensures the effective collection of the tax in a small number of checking points. The designation of the tax base as the price of imported commodities f.o.b. which includes the cost of transport and insurance, does not raise too difficult a problem. It is further simplified where the different components included in
the tax base are made clear.

In the case of services, the designation of the tax base as the price paid for services by consumers is fairly straightforward. The collection of the tax on services is simplified in less-developed countries because services are typically supplied by a few large firms which keep records and are located in a few large centres.

When considering sales taxes on home-produced commodities, however, the problem is greater for there is no unique point of collection, (which may be at the retail, wholesale, or manufacturing levels.)

A tax at the retail level has advantages for it avoids tax pyramiding and creates no need for price adjustment. Yet in less-developed countries it is fraught with difficulties. Firstly, there are many small-scale retail businesses, mostly on a family basis, which keep inadequate records, if at all. This could complicate administration and lead to inequity since the tax might not be fully enforced. Secondly, in countries where the non-monetary sector is large, such a tax would be difficult to operate; and thirdly, since the retail trade is mainly composed of small businesses where the mortality and bankruptcy rate is high, collection would be difficult. It is, therefore, considered that the wholesale or manufacturing level would be a better point for tax collection, and while neither is ostensibly more advantageous than the other, in less-developed countries, the latter would be preferable since:

(1) Wholesalers are probably greater in number; they operate on a small scale and thus enforcement of tax levies could be difficult.

(2) Wholesalers may also act as retailers. It might be difficult to differentiate sales made under the two heads, especially when the business is operated
on a small scale.

(3) It would be difficult to enforce differentiating rates of taxes at the wholesale level since a large number of products are handled and the scale of business is small.

(4) The choice of taxation at the manufacturers' stage would obviate price changing so that the incidence might be shifted forward. This is especially true in the cases where large retailers are also undertaking wholesale functions.

While a manufacturers' sales tax is preferable, it is not without difficulties, the most important of which is the need to adjust the prices of the commodities taxed in some instances e.g., when the manufacturers sell direct to retailers or consumers, in large quantities at a discount. These difficulties are not insurmountable, however, in less-developed countries for:

(1) The tax base may be varied according to whether a manufacturer sells to a wholesaler, a retailer or to a consumer. If a sale is made direct to a retailer or a consumer the tax will be based on the price of the commodity at the wholesale level plus the traditional mark-up necessary for each stage. While this is an arbitrary solution, it would not produce many serious problems in less-developed countries for the markets tend to be dominated by oligopolistic and monopolistic conditions and retail price maintenance is the rule rather than the exception. In these circumstances the deduction of the same percentage of mark-up at the stage under
consideration will result in the same tax base. Moreover, the large number of retailers and the fact that they are small in size, tends to influence the manufacturers to sell their products mainly to wholesalers rather than to retailers. This cuts out waste in selling costs to a large number of retailers buying small quantities.

(2) It is possible to ignore quantity discount when determining the tax base if the commodity is sold at different prices to different retailers or wholesalers according to the quantity purchased. This will tend to equalize the treatment for the same commodity in tax matters.

(3) While it has been argued that the levying of sales taxes before the retail level is reached leads to tax pyramiding and to an increase in price by an amount higher than the tax, this ignores the effect of competition among wholesalers and retailers and the possibility of substitution of cheaper goods. In addition, most of the production in less-developed countries, as mentioned earlier, is in the hands of monopolistic firms where resale price maintenance prevails. In this case, it would be difficult for tax pyramiding to occur as the price to the final consumer is fixed in advance.

It may, therefore, be suggested that in less-developed countries, manufacturers sales taxes are the most equitable and convenient to collect when
considering home-produced commodities. When import duties and taxes on different types of services are added it may be concluded that taxes on different types of expenditure on goods and services will be effective in reaching different wealth and income groups. Thus they will be more successful in reducing the rate of increase in consumption expenditure while securing equity.

VII. CONCLUSION.

This chapter is concerned with the equity of sales taxes. It has been suggested that within the conditions of less-developed countries, where capital formation is of high priority, equity requires that taxation should be levied according to the rate at which goods and services are withdrawn from the stock available to the society. It is through expenditure rather than income that an individual imposes a burden on the rest of the community, and this has to be distributed according to each individual's expenditure. Furthermore, it has been found that expenditure reflects the taxable capacity of different taxpayers more fully relative to income. This is especially true in less-developed countries where taxes on expenditure are more easy to administer and collect than tax on income. Therefore, the use of a tax on expenditure will provide a useful tool to reach those people who successfully manage to evade income tax. The extent of this factor is large in less-developed countries where a large proportion of the national income is derived from those types of income which can easily escape the income tax, e.g., income from rent, agricultural profits, capital gains, small-scale trade and other services. Moreover, the additional spending power derived from the liquidity of wealth which adds to the taxable capacity is taken into consideration under a tax on expenditure but neglected under a tax on income.

The tax suggested is not the expenditure tax in Kaldor's model, which is impracticable in the short-run, but a tax on different goods and services.
Definitional problems surrounding the use of consumption as a tax base must be recognised; these problems can only be solved by reliance on some arbitrary rules not seriously injurious to equity. The use of these arbitrary rules is not confined to consumption. Both income and consumption necessitate certain arbitrary rules. The taxation of services does not present problems so serious as to warrant their exclusion since it is possible to tax the important types of services in less-developed countries without undue difficulty. Further, there are no problems facing such taxes when an exemption limit and allowances are to be introduced, especially if the basic principle is to tax according to the rate of withdrawal. The exemption limit and allowances will take the shape of social dividends.

In the discussion, the idea was followed that although progressive rates are not a fundamental requirement for the principle of 'ability to pay', yet they are justified because of the need to reduce the widespread difference in the standard of living of the higher and lower income groups. Progressive rates can be applied more easily by classifying the commodities according to the degree of income elasticity of demand (widely defined). The higher the income elasticity of demand, the higher the tax rates will be.

Finally, the choice of the manufacturers' level of tax on home-produced commodities, together with import duties and taxes on services was made to reach the expenditure of consumers on different types of commodities in an easier and more effective way. Such a choice would result in a tax which would reduce the rate of withdrawals of goods and services and be more effective in reaching the taxable capacity of different groups of taxpayers.

The exclusion of savings and the consequent effect on the distribution of
wealth should be condemned on economic and social grounds. This is because the net social gain arising from such inequality will more than outweigh the loss in any other direction. Moreover, the extent of any increase in such inequality can be modified by the use of death duties.

Equity is, however, only one of many criteria upon which a tax should be judged. The choice of any tax should also be judged in the light of other criteria such as economic efficiency. It is impossible to achieve all these objectives at any one time since they are often in conflict one with another, and it is, therefore, necessary to lay down the scale of priority for different objectives. The validity of such arguments in the circumstances of less-developed countries will be the subject of the next chapter.
CHAPTER V.

THE ECONOMIC EFFICIENCY OF SALES TAXES.

The economic efficiency of a tax can only be judged in relation to the ends of government economic policy. In less-developed countries these ends may be categorised as follows:

(1) a rapid rate of increase in aggregate income greater than the rate of population growth to provide a rising standard of living;

(2) a move towards full employment;

(3) greater equality in the distribution of income.

These objectives often conflict with one another. For example, a rapid rate of increase in aggregate income may run contrary to the achievement of a high rate of employment. Less-developed countries favour a high rate of employment consistent with a rapid rate of increase in aggregate income. Through the rapid increase in aggregate income more savings can be made and channelled towards capital accumulation. This tends to provide wider employment opportunities in the long run. 1

The purpose of this chapter is to demonstrate how far the use of progressive sales taxes is efficient in securing the above objectives. To this end we

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1. It is difficult to achieve a rapid rate of growth of aggregate income through the use of labour intensive techniques where labour productivity is low. Moreover, labour intensive techniques cannot be applied to all types of production as this depends on the nature of different investment projects, (whether they are capital intensive or labour intensive), and the degree of competition between the products of both these methods in the internal and external markets.
proceed as follows:

I. the supply and allocation of resources;

II. price stabilization.

I. THE SUPPLY AND ALLOCATION OF RESOURCES:

It is sometimes argued that highly progressive rates are accompanied by an adverse effect on the supply of different factors of production. This, it is held, is due to the fact that high marginal rates of tax reduce the remuneration resulting from marginal earnings thus discouraging people from expending additional effort or incurring additional risk. If this is the case, the use of sales taxes having an equal yield to an income tax may have an adverse effect on incentives. An examination of the validity of this argument requires a discussion of the effects of equal yield, progressive income and sales taxes, on the supply of the following factors:

(A) Effort.  (B) Investment.

(A) Effort:

Theoretical discussions of this subject are indeterminate in their conclusions. This is because these taxes tend to have two opposing pulls: (1) the income effect; and (2) the substitution effect. There is no objective way of

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deciding which of these two forces will be the stronger. Workers are human beings whose behaviour is motivated by a combination of forces which cannot easily be isolated for the individual nor generalized for the community as a whole. Therefore, it is difficult to know the preferences of workers. If this is accepted, it is difficult to contend that sales taxes are inferior in these terms.

However, in certain cases sales taxes though progressive, may have a superiority over an income tax.

In the first place, people in less-developed countries may be influenced by "money illusion". That is, they may be influenced in their work incentives by the apparent money income which they receive in compensation for their effort. They may value the utility of income relative to effort in terms of the money wage they receive as they may not know their real wages. Widespread illiteracy and similar factors encourage this situation. In less-developed countries income is low and the supply of labour may bend backward at much lower levels of income compared with more developed countries. An income tax may thus have unfavourable incentive effects in these circumstances. Insofar as this is true, the use of sales taxes is likely to have less disincentive effects since the apparent monetary returns to the worker are not reduced by the tax. Moreover, under an income tax, where the tax liability reduces the money wage which the worker receives, there may be a disincentive to shift employment to the industrial sector. This is especially important where workers are obliged to supply their family with part of their income. After fulfilling these obligations it might not be worth the worker's while to shift his employment. Similarly, since workers in less-developed countries are influenced by quick returns at present, rather than in the future, the tax, by reducing the net money margin between skilled and unskilled work, might
discourage the shift to skilled types of employment needing initial investment and the sacrifice of present earnings. Sales taxes, on the other hand, by leaving the monetary reward unchanged, tend to be neutral in their effect between different occupations, for example, agricultural and industrial, or skilled and unskilled work. They may, thus, be less restrictive in their effect on the movement of labour and consequently be conducive to a rapid rate of economic growth than an income tax.

Secondly, even if we ignore money illusion, progressive sales taxes may have less adverse effects on the supply of effort when the highly taxed commodities are those which are complementary to leisure. The imposition of sales taxes on these commodities will induce an increase rather than a decrease in the supply of effort. The consumption of these goods and services requires additional effort to enable the worker to buy these commodities. Under an income tax, on the other hand, leisure is the only commodity left untaxed. A reduction in the price of leisure as a result of an income tax may encourage more consumption of leisure.

The question, therefore, arises as to whether there are many commodities which have those characteristics in less-developed countries. Beyond doubt a considerable proportion of the commodities with a high income elasticity of demand are complementary to leisure. The most important of these are: cars, jewellery, travel abroad, places of amusement, etc. In addition, the desire for appearances, the "keeping up with the Jones'", tends to reduce the price elasticity of demand for the highly taxed commodities. This will tend to keep the pattern of expenditure fairly rigid within the short period, especially

that of the higher income groups. Sales taxes, therefore, give more stimulus to an increase in the supply of effort because of the strength of the income effect of the tax. This larger effort will be conducive to a rapid rate of economic growth.

Therefore, though theoretical conclusions are indeterminate about the effect of progressive taxes on the supply of effort, sales taxes have an advantage over an income tax where the highly taxed commodities are complementary to leisure and have a low price elasticity of demand, and also when money illusion is present.

It may be argued that the use of a social dividend as a method of providing exemption limits and allowances may encourage workers to reduce their supply of effort. This may be true if the social dividend is high enough to encourage workers to prefer leisure to work. But under a tax on expenditure on different goods and services, this need not be the case if the proper social dividend is given to the people. This can best be explained in terms of the exemption limits and allowances under an income tax. These are given in order to secure a minimum standard of living to maintain labour efficiency as factors of production. Within a system of sales taxes, however, what is needed is a minimum amount of expenditure to maintain the efficiency of workers. This can be secured by handing back to each worker a sum of money which approximates to the amount of tax paid on what is to be considered as minimum within the conditions of each country. As the rates of sales taxes on what is considered as 'basic necessities' are very low, the amount of social dividend is likely, therefore, to be small. If this is the case, then the use of social dividend, as a form of exemption limits and allowances, is not likely to produce a disincentive effect on work.
(b) Investment:

In less-developed countries, where there is a great need to encourage capital accumulation, one might suppose it necessary to avoid the use of high progressive rates which might have adverse effects on the inducement to invest.

It is difficult to reach any conclusion about the effects of one tax or another on the size of investment in general. This is because investors are influenced by different psychological factors related to their calculation of the expected returns, costs and risks, which depend in part on their subjective valuation of different investment projects as alternative to holding cash. Moreover, the effect of different types of taxes may be apparent in the composition of total investment rather than in the absolute size. The portfolios of investors differ and their reaction to different types of taxes may be difficult to assess. The individual investor is more susceptible to investigation and will be discussed later in this section.

The fundamental problem responsible for the low rate of increase in aggregate income in less-developed countries is the small size of total investment, specifically in those directions which have a capacity-creating effect. This is a prerequisite if real output is to increase at a rapid rate. Investment inadequacy is partly due to the low level of saving in these countries. It is also due to the tendency of private investors to favour those types of investment which maximize their profits in the short-run, but have little or no effect in increasing the productive capacity of the economy (for example, speculative trade, etc.). The problem is, therefore, to increase the proportion of national income diverted to investment to those types which increase the productive capacity of the economy, i.e., plant, building, machinery, vehicles, etc. To achieve this aim requires:
(1) an increase in the community's total savings. This is necessary to finance a large volume of investment without inflation;

(2) a provision of effective means of channelling the high volume of savings towards investment, especially those types of investment which provide a high rate of growth of real income.

It is on both these grounds that a preference between sales and income taxes has to be made. For the sake of analysis, it seems necessary to separate the two issues of: increasing personal savings; and, channelling these savings towards "growth-promoting lines".

On the first point, sales taxes levied at progressive rates seem more likely to increase total personal savings. Various reasons support this conclusion. Let us assume for the moment that national income is fixed in absolute amount. By raising the prices of the taxed commodities to a higher level, progressive sales taxes tend to discriminate against present consumption and in favour of future consumption, (through the substitution effect). The influence of high prices on the demand for the taxed commodities will depend on their price elasticity of demand. In the short period, habits and the influence of conspicuous consumption tend to reduce the effects of progressive sales taxes in producing a significant reduction in the level of consumption expenditure.

Now let us assume that national income increases in absolute amount. The effects of progressive sales taxes are likely to be more noticeable on the rate of increase in consumption which accompanies an increase in income. An increase in income in less-developed countries is reflected in a high rate of increase in
consumption. This is mainly due to the upward shift in the consumption schedule because of the 'demonstration effect'. Progressive sales taxes are likely to shift the schedule rather than to cause movements along it. The income effect of the tax will absorb part of the increase in income, in the same way as an income tax. The substitution effect works against present consumption and thus encourages more savings whereas an income tax favours present consumption. It is true that the 'demonstration effect' tends to reduce the price elasticity of demand of the highly taxed commodities, but this ignores the attraction of more consumption in the future, or the advantage of savings made for the sake of accumulation. Since the increase in income will be spent on non-habitual and discretionary types of consumption which could be postponed, the higher income groups are likely to evaluate the loss which may accrue from spending rather than saving. The sacrifice of higher consumption in the future, or higher wealth, may be a factor which influences the decision towards more savings. This is especially true where the attention of the higher income groups tends to be diverted towards postponable and less-pressing needs as their income rises, (e.g. cars, refrigerators, services, recreations, vacations, etc.). The use of progressive sales taxes by discriminating against present consumption, is likely to modify the shift in the consumption schedule which follows the rise in income. When future consumption is taken into consideration, the price elasticity of demand for the highly taxed commodities available for present consumption may tend to increase since the attraction of future consumption may be greater. In this case, sales taxes are likely to encourage a higher rate of increase in personal saving than an income tax. The importance of this factor depends on the rate of interest, the interest elasticity of savings, and the marginal rate of income tax.
It is difficult to reach any definite conclusion concerning interest elasticity of savings in less-developed countries. Imperfections in the capital market may conceal the effect of change in interest rates on savings. But on the whole, there is no reason to suppose that savings will not respond to changes in the rate of interest in less-developed countries. Higher income groups, the main suppliers of personal savings, are likely to be influenced in part by fluctuation in interest rates. This is especially true when we know that savings in these countries rarely take a contractual form. The attraction of a higher rate of return in the form of interest rates may weaken the stimulus to increase present consumption, especially on marginal items which can be postponed. In these cases, the use of progressive sales taxes, by discriminating against present consumption, is likely to be more favourable to saving than an income tax.

Contrary to the conditions arising under an income tax, the rise in prices which accompanies sales taxes will reduce the real value of personal assets.\footnote{This posited rise in the prices of the taxed commodities without a fall in any other prices is dependent on the implicit assumption of an elastic supply of money. This is a realistic assumption since less-developed countries are likely to have an elastic money supply to facilitate the work of their development plans. Part of these plans may be financed by deficit finance through the banking system. The rise in the general price level may be due to the increase in the money supply rather than sales taxes. This is tenable but the increase in the money supply is to facilitate the shifting forward of sales taxes while avoiding any unemployment which may result, or any rise in the rate of interest which may accompany the rise in demand for transactions. Hoards may even be used to facilitate tax shifting, especially when the economy is experiencing inflationary pressure and hoards are in liquid forms.}
Insofar as the value of assets which people own is one of the factors which influence their consumption behaviour, the reduction in the real value of assets will give wealth owners greater incentive to increase their savings so as to restore their wealth to its original position.

Finally, money illusion plays a part in reducing consumption expenditure in some cases. This happens when people's money consumption expenditure depends on money income rather than real income. It is true that the rise in the general price level is facilitated by the increase in the money supply if the rate of interest does not rise. But the main reason for the increase in the money supply is to facilitate the finance of development plans and, in addition, to allow for the forward shifting of sales taxes to consumers. This will achieve the government objectives of taxing consumers through their expenditure. In this case, sales taxes can be considered responsible for the rise in the general price level as there is a rise in the relative prices of the taxed commodities without a fall of other prices in the economy. The money supply is only the medium through which this process is secured. The use of progressive sales taxes (contrary to an income tax), will produce a real reduction in consumers' expenditure as people spend the same amount of money income on consumption in spite of the rise in the prices of the taxed goods and services. This means that their savings will be increased as a result of the use of progressive sales taxes.

All these factors suggest that the use of progressive sales taxes encourage personal savings more than an income tax having an equal yield. It may be argued that an increase in personal savings means that revenue from sales taxes will be smaller as a result of the fall in consumers' expenditure. Increased private
savings might be offset by the decline in public savings with consequent effects on the community's total savings. However, this argument does not seem consistent with our assumption that sales taxes have the same yield as an income tax. If this is true then government revenue will not be reduced through the use of sales taxes. This means that sales taxes are designed in such a way as to raise the same amount of revenue from different income groups. The net result of all these factors is that total savings are likely to increase more under sales taxes than under income taxes.

But saving, though necessary for financing a larger volume of investment without affecting the stability of the economy, is not a sufficient condition for an increase in the volume of investment. It is only a passive act which has to be supplemented by the positive act of investment. Savings may be dissipated into hoards (in gold, jewellery, or kept in cash by the holder, i.e., the "liquidity trap"). In less-developed countries the possession of wealth encourages people to hold an increasing amount of money in cash since they can afford the resultant waste or loss. In addition, private investors may not find it suitable to embark on investment programmes. In these cases, the community as a whole will not benefit from the increase in total saving, which may, on the contrary, lead to a decline in the level of economic activity.

1. If this assumption is relaxed, there is no reason to suppose that sales taxes, while increasing private savings, reduce public savings as a result of private consumption being discouraged by the tax. This is because sales tax coverage is likely to be wider than that of an income tax. Sales tax coverage will not be restricted to the section of population liable to income tax, but will apply to the expenditure of other people who are largely "middle class". This applies mostly to those whose income is somewhat above the lowest level which the income tax cannot reach. Moreover, sales taxes will apply to expenditure from liquidation of wealth and hoards.
An encouragement to investment is not easy to achieve by a general income or sales tax as such. Discrimination is necessary, especially against traditional types of investment and hoarding. The problem of comparing different types of discrimination under income and sales taxes will be left for separate discussion when we deal with the effect of these taxes on the individual investor.

It is sufficient to say here that the government can take different monetary and institutional measures to stimulate the use of saving in those types of investment which increase the productive capacity of the economy. The government can borrow these savings by offering a high rate of interest. The increase in the rate of interest is important since it raises the opportunity cost of holding savings in a liquid form. Since private investors are interested in maximizing their returns on capital invested, a higher rate of interest may be a way of satisfying their preferences. In addition, such a high rate of interest may attract some part of savings into the banking system or government bonds, which might otherwise have gone into real estate or hoards. Furthermore, the government can encourage private investors to enter certain sectors by selling appropriate bonds in order to offer security to investors against the loss of their capital. Or the government might give certain guarantees such as a minimum rate of interest on capital by private investors. In these ways the government provides a variety of financial issues suited to the varying needs of different sectors of the market, and increases their marketability.

Finally, the investment by government in projects which are complementary to private investment (e.g., social overheads), will provide an encouragement to private investment. Investment in social overheads will provide external economies and tend to reduce costs to private investors, with consequent effects
on the return from these investments. This will tend to raise the marginal efficiency of capital and encourage more private investment.

Within the limits of partial analysis, progressive sales taxes are likely to have an advantage over income taxes in certain cases. In the first place, the fact that sales taxes are levied on commodities produced rather than on the profits of an investor, tends to leave the net return from different types of investment unaffected.¹ This will mean that liquidity available for different firms for use in further investment is increased. Under a progressive income tax, on the other hand, the reduction in the net return reduces the liquidity of different firms with consequent effects on their capacity to finance further investment.

Moreover, the fact that sales taxes do not affect the net return from different investments means that the net expected return of a particular investment is higher than under an income tax. This tends to raise the marginal efficiency of capital and encourage private investors to undertake more investment.

In addition, the fact that sales taxes do not affect the net return from different types of investment means that the gap between the returns of different types of investment will be the same. Consequently, these taxes are not likely to influence the pattern of investment towards one type or another. An income tax, on the other hand, by reducing the returns from different types of investment tends to reduce the differential return between them, (i.e., between risky and less risky investments). Consequently, we can say that sales taxes are likely to

¹. This is based on the assumption that the demand for the taxed commodities, and consequently profits, will not be greatly affected by sales taxes. The validity of this assumption will be discussed later.
have an advantage over income taxes since they are neutral in their effect on the inducement to invest, as well as on the investor's choice between different types of investment.

Furthermore, the fact that the net return from investment is not reduced by sales taxes means that the individual investor can recover his capital within a shorter period than under an income tax. This is likely to encourage private investors since the risk involved in committing capital to a particular field is reduced by limiting the period of recovering capital. This is not so with an income tax. The fact that this tax is progressive means that expected profits will be reduced at a higher rate. The introduction of a loss offset as a factor which reduces the extent of the risk element is not very effective in this case since progressive rates mean that profits will be reduced at a higher rate than losses. This is because of the difference in the marginal rate of tax in each case.

If sales taxes are used in a discriminatory way to encourage investment they are more likely to be favourable to the inducement to invest than an income tax.

In the first place, the use of protective import duties is likely to give a powerful inducement to invest to private investors: This is because protective duties ensure the investor a market for his product. Since demand is one of the important factors upon which expected returns are calculated, security of demand means that the risk involved in estimating demand is reduced, and the profitability of this type of investment is partly secured. This means that the marginal efficiency of capital, including the risk element, will be higher, and this will encourage further investment.

The exclusion of capital goods from the sales tax base is another encourage-
ment to the inducement to invest as the supply price of a particular investment will be lower. Given the demand price, this tends to raise the marginal efficiency of capital and provide more stimulus to investment. Moreover, the exclusion of capital goods from the tax base may encourage investment from other sources. The reduction in costs resulting from the exemption of capital goods means that costs of production and prices of products will be lower. ¹ If the demand for these products has some degree of elasticity, the reduction in the prices of these commodities might provide an investor with a demand sufficient to secure a profitable scale of output. This is a further inducement to investment.

The use of discriminatory measures under an income tax are not likely to offer the same stimulus to the inducement to invest. This is because the effect of discriminatory concessions are likely to be small and temporary, while the use of progressive rates might sometimes outweigh the gain from these concessions. For example, the use of accelerated depreciation reduces the tax burden during the period of the concession, i.e., till the value of the assets has depreciated. But in fact, the tax burden is likely to be low in the initial period of investment due to the low level of profits. It takes time for a firm to produce at full capacity at that scale of output that maximizes its profits. Therefore, the

¹ It should be remembered that this discussion is based on the assumption that sales taxes are shifted forward to consumers while factor prices are unaffected. Even if we relax this assumption and the cost price of capital goods declines, there is no reason to suppose that this will lead to an encouragement to investment. Recent studies reveal that the demand for investment is not likely to possess any high degree of price elasticity of demand, at least in the less-developed countries.
reduction of the tax burden due to the use of this method of discrimination is likely to be small. On the other hand, the fact that the assets are depreciated more rapidly before their life ends (by the use of accelerated depreciation method) means that the expenses of production will be low and profits high in these later years, and might perhaps outweigh any gain received in earlier years. Since the prospective yield is taken to represent the expected return during the lifetime of the asset, the net effect of the tax will be to greatly reduce these net expected returns, with consequent effects on the marginal efficiency of capital.

It may be argued that further investment by the firm may reduce the effect of a high tax burden in future years by the continuous use of accelerated depreciation concessions on new investment. The extent of this factor, however, is limited by the possibility of increasing investment within the limited markets of less-developed countries. If the market is limited, the further increase in output cannot be sold. If the demand for the product is inelastic, then the benefits from accelerated depreciation are limited and will in fact be unfavourable to the inducement to invest.

Finally, in less-developed countries, with favourable possibilities for using labour intensive techniques, the use of accelerated depreciation is of limited use. A tax levied on the realized profits means that expected future returns are reduced by the tax, thus tending to lower the marginal efficiency of capital. As mentioned before, sales taxes do not suffer from this deficit since they leave the profits of a particular investment unchanged. Consequently, sales taxes may well be more favourable to labour intensive techniques.

Consider the effects of the exemption of profits from income tax for a limited
period. It is likely that this effect will be limited. This is because of
the low level of profits in the initial period of investment analysed above.
This will tend to reduce the effects of the concession since the tax burden is
likely to be low. Moreover, the higher tax burden to which an investor will
later be liable, after this initial period of concession under a progressive
income tax, may outweigh any gain in this direction. Finally, it is difficult
to apply these concessions in a discriminatory way. Not all types of invest¬
ment attract favourable discrimination. It may be desired to discourage
certain types of investment (e.g., speculative trade). It is difficult to
isolate these cases. Moreover, new additions to already existing investment
do not admit of easily applicable concession procedures.

It may be argued that the use of progressive sales taxes will have a dis¬
couraging effect on the demand for the taxed commodities and that this may result
in an adverse investment effect.

However, the conditions prevailing in less-developed countries, coupled with
the objectives of economic policy, are likely to reduce any effects in this
direction. In the first place, the use of progressive sales taxes, especially
when they take the form of discriminatory protective duties, will encourage rather
than discourage the inducement to invest. In these countries, highly taxed
commodities are often those which are only produced at home at a later stage of
development, (cars, consumer durables, etc.). In addition, these high rates are
intended to discourage the import of commodities newly produced in the home market.
Therefore, the effect of progressive sales taxes is to reduce the demand for
imported commodities and direct purchasing power to home-produced ones. This
will give a stimulus to private investors since it will secure the demand for
profitable investment. Finally, the reduction of imports by the use of protective duties will free foreign exchange reserves to be used for increasing the imports of capital goods. Again, this will provide these countries with additional resources to be used in capital formation to aid in further increases in national income.

But the advantages mentioned above are those derived from the use of discriminatory sales taxes, and as such must be compared with those resulting from a discriminatory income tax. The advantages of discriminatory sales taxes relative to an income tax have been examined earlier. It is necessary here to add that discriminatory sales taxes are likely to encourage people to save. This helps to provide the government with more finance, (through borrowing for example), to embark on those types of investment which increase the productive capacity of the economy. This is a necessary prerequisite of a rapid rate of increase in national income with consequent effects on the inducement to invest operating through the accelerator.

The above argument ignores goods and services liable to progressive sales taxes produced in the home market. However, the effect of highly progressive sales taxes on the demand for these goods and services depends on their elasticity of demand, which is related in part to their elasticity of substitution.¹

The use of highly progressive sales taxes is not likely to depress the demand for these commodities to any significant extent, although this should not be taken to mean that the reduction in demand will significantly affect the inducement to invest. This is because the large amount of investment by the government, (and

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¹ Compare the discussion in Chapter III of the price and income relationships of 'luxuries' and 'necessities' in less-developed countries.
also by the private investors encouraged by the government), may result in a higher rate of increase of national income and consequently a higher rate of increase of demand for different goods and services. The net effect of progressive sales taxes is to slow down the rate of increase in demand rather than to produce a depressing effect on the absolute demand for these commodities. The slow rate of investment in consumer goods industries is to be welcomed since it provides the government with more resources to be used in investment goods industries. This will help provide for a higher rate of growth of aggregate income, a priority objective in less-developed countries.

Our discussion of the relationship between the demand for the taxed commodities and investment, seems to rest on the assumption that entrepreneurs were not maximizing their profits before the imposition of the tax, although they were in a monopolistic position. If they find it possible to raise the prices of these commodities after the imposition of sales taxes without losing any significant part of their demand, then there is scant reason why they should not have done so before taxes were imposed.

This seems to ignore some of the factors underestimated by the profit maximization hypothesis. Entrepreneurs in less-developed countries may aim at maximizing their profits in the short-period. Nevertheless, in an uncertain world, an entrepreneur seldom knows the price that would maximize his profits. He tries to maximize his profits in terms of the knowledge available to him. This knowledge is not related to long-run planning. Definite information about the factors determining an optimal price-output policy is seldom available. The most important factors are: the size of the market for his product; his share in the market; the price at which he can sell the most profitable output;
the cost of producing that output; and the cost of transport of raw materials and final products. The available information and statistics will shape his price policy. Market behaviour must be by trial and error based on subjective evaluations and the little objective data available over a long period of time. There does not seem to be any inconsistency in our conclusion that the higher prices of the taxed products will not seriously affect the demand for them through an entrepreneur seeking to maximize his profits.

However, there are other factors which may tend to modify the entrepreneur's behaviour in maximizing his profits in the short period in conditions of imperfect competition. In the first place, an entrepreneur may not raise his price to the highest level possible because of the fear that his competitors may not follow suit in order to capture his share of the limited market for the product. This will be a factor restraining an entrepreneur from exploiting the highest price he can get in certain circumstances.

Secondly, even if he is sure that the higher prices are not likely to reduce the demand for his product in any significant way, he may refrain from raising the price because of his fear that high profits may encourage new entrants to the industry thus spoiling future profitability. This is especially true in less-developed countries where investors are 'imitators' rather than 'innovators'. The success of an adventure in the industrial field may encourage additional entrepreneurs to invest in this field. With a limited market in the short-run the rapid rate of increase in supply relative to demand may tend to reduce prices to a lower level at which production might become unprofitable. A rise in prices, following the imposition of sales taxes, without a significant effect on demand, does not necessarily mean that the entrepreneur is irrational in his
profit maximizing behaviour.

The comparison between sales and income taxes in this chapter is based on the assumption that both taxes have an equal incidence on different income groups. In other words, this means that both taxes will have the same yield. This assumption has its limitations. Income tax in less-developed countries is normally limited in its coverage to a small proportion of the population. The main reasons for this situation are the exclusion of certain sources of income from the tax base, and the high exemption limit granted for administrative reasons. The fact that sales taxes are levied on the expenditure of consumers on different goods and services means that a large part of the expenditure of people who escape income tax will be liable to tax. This will provide for a wider tax coverage. Given a fixed amount of revenue to be raised under both taxes, it will also require a lower incidence on different income groups. The progressive structure falling on different income groups will be lower than under an income tax. Since it is generally agreed in the literature on taxation that a less progressive tax structure has less disincentive effects than a more progressive one, this suggests that sales taxes have fewer disincentive effects than income taxes in less-developed countries. If this conclusion is accepted, it adds more support to the presumption in favour of sales taxes in promoting a higher rate of economic growth.

1. For example, the number of people liable to income tax in most less-developed countries represent about 1 per cent of the total population. For details see: U.N., Economic Survey of Latin America 1955, New York, 1956, pp. 140-142.
II. **PRICE STABILITY.**

Dependence on the export sector as an important source of income has been the cause of much of the instability characteristic of most less-developed countries. These countries are usually primary producers with a large proportion of national income derived from the export of a few primary products. Since the elasticity of supply of these products is low in the short-run, and demand is governed by the level of economic activity in more developed countries, and by expectations about prices, wide fluctuations in prices result. This is a serious problem facing less-developed countries and one which does not normally admit of unilateral solution.

The extent of this problem may have been exaggerated. The structure of these economies may modify these effects. The agricultural sector is an important source of income in these countries. Therefore, cyclical fluctuations which accompany fluctuations in exports need not create or increase employment because of the low elasticity of the supply in the short-run and the seasonal nature of agricultural employment. Moreover, the decline in agricultural prices does not encourage farmers to leave the land but influences them to increase their production in later periods so as to compensate for the decline in their incomes.

Furthermore, the size of the industrial sector is very small and is mainly engaged in the production of light consumer goods. The elasticity of supply in this sector is normally low and any increase or decrease in demand is unlikely to affect employment to any significant extent. In the downswing, the decline

1. For example, export of cotton in Egypt represented 13 per cent of national income in 1954, while export of three primary products was 30 per cent in Tanganyika in 1959, and 24 per cent in East Africa in 1959. See: Newlyn, T. W., "'Take-Off' Considered in An African Setting", in Yorkshire Bulletin of Economic and Social Research, May 1961.
in export proceeds is not likely to create any significant amount of unemployment as is the case in more developed countries. Any little resultant unemployment is normally absorbed in the agricultural sector where family ties are strong and unemployment in the real sense is negligible. On the other hand, in the case of an upward movement, the rise in income and expenditure does not affect agricultural production or home-produced commodities very greatly. This is due to the low elasticity of supply in both agricultural and industrial production in the short-run.

Therefore, the accelerator, the chief dis-stabilizer in more developed countries, plays a relatively small role in less-developed countries. Cyclical unemployment tends to be localized and small. In addition, cyclical fluctuations are reflected more in changes in money income, prices, balance of payments and government revenue, than in employment or production. These fluctuations are normally outwith the control of any single country. The effect of these fluctuations will be reflected largely in the standard of living of the lower income groups who have virtually no savings to maintain consumption in low income periods. A comparison between sales and income taxes as price stabilizers must, therefore, be made.¹

Contrary to the accepted view, sales taxes may be superior to income taxes as tools of stabilization. In the first place, the coverage of sales taxes is likely to be wider than that of an income tax.² Secondly, the income tax exemption limit is normally determined in relation to administrative convenience in

¹. The importance of price stability should also be recognized in less-developed countries to avoid inflationary pressure which might result from development programmes.

². This is discussed more fully in Chapter VII.
addition to the basic needs necessary to an individual or family. Most people within this income limit are characterized by a high propensity to consume. Since some part of their expenditure on different goods and services will be liable to sales tax, sales taxes may be more effective in influencing consumption expenditure. Thus sales taxes may be a more appropriate tool of price stabilization than income taxes.

The advantages of sales taxes become more apparent when we take into consideration the ease of administration. This provides more evidence of the effectiveness of sales taxes as tools of price stabilization. The time-lag under a system of sales taxes between earning of income and the collection of the tax is very short. There is no need to wait for the assessment of income and the collection of the tax, or one might add for the collection of tax arrears. The lag in tax collection under an income tax system may accentuate the fluctuation of the level of economic activity since the revenue of boom years may be collected in recession periods. The result will be an increase in the burden of the tax in depression periods when practically no tax reserves are kept for paying taxes and for meeting arrears for these years. Sales taxes, being automatically collected at the point of import or the manufacturers' level, will avoid such lags and the accumulation of arrears. Therefore, their impact will be felt at a more appropriate time.

In addition, import duties can be used in a discriminatory way to reduce

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1. For example, while exemption expressed as a multiple of the income per head is about 2 to 2.5 times as great as per capita income in more developed countries, it is very much higher in less-developed countries. For example, it was 16.8 times in India in 1953, 15.0 times in Ceylon in 1952, and 21.4 times in Burma in 1950. For details see: U.N., Economic Survey of Latin America 1955, New York 1956, p. 143.
balance of payment difficulties through a raising or lowering of rates as the situation requires. This is facilitated as sales taxes are not faced with the administrative problems concerning quick changes in rates under an income tax.

Within the progressive system of sales taxes proposed in this thesis, revenue will fluctuate upward and downward during the cycle because high rates are levied on commodities with a high income elasticity of demand. This will reduce the burden of the tax in the downswing and increase it in the upswing. In the downswing consumption does not fall as rapidly as the decline in income. This will be a factor which will tend to check the extent of the price decline especially when sales tax rates are reduced.

Finally, it might be argued that a tax on expenditure on goods and services may increase inflationary pressures by raising the general level of prices and thus encouraging wage claims. The intelligent use of exemption limits should avoid these effects and reduce the strength of this criticism.

III. CONCLUSIONS.

This chapter has argued that in less-developed countries, progressive sales taxes are likely to have less harmful effects on the supply of effort than an income tax of equal yield. This is because the highly taxed commodities in less-developed countries are largely complementary to leisure and normally have a low price elasticity of demand. In addition, money illusion may be relevant.

This advantage of sales taxes is not necessarily outweighed by the tendency of sales taxes to depress the level of employment by raising prices and depressing demand. The low price elasticity of demand for the highly taxed commodities may prevent any significant decline in demand. In addition, the rapid rise in
income resulting from a large amount of developmental investment projects, and
the use of protective import duties, will tend to check any decline in demand
and may even provide a rising demand for the taxed commodities.

It is not possible to reach any general conclusions on the question of
comparing the effect of equally progressive sales and income taxes on investment.
The variables affecting investment are manifold and depend in part on the
subjective valuation of different investors of various investment opportunities.
This makes it difficult to assess the two types of taxes in relation to invest-
ment. Since the main objective of less-developed countries is to secure a rapid
rate of growth of aggregate income, the need for investment projects which
increase the productive capacity of the economy tends to award preference to
those taxes which secure a rapid increase in saving without adversely affecting
the inducement to invest. Progressive sales taxes will have an advantage in
increasing the community's total savings. The diversion of these savings to
'growth promoting lines' requires the use of concomitant measures to encourage
people to lend their savings to the government, or to co-operate with it in
capacity creating types of investment.

A comparison between sales taxes and an income tax on the individual's
inducement to invest shows that in certain cases sales taxes have certain
advantages over an income tax. (e.g., sales taxes do not affect the profits
realized from different types of investment; progressive income tax rates do not
exert an equal effect on gains and losses because of the difference in the
marginal rates of tax in both cases) When discrimination is introduced under
both types of taxes, it is not possible to reach any definite conclusion about
the superiority of one tax relative to the other. Generally speaking, the use
of discriminatory protective duties accompanied by a rapid rise in demand, (resulting from a large amount of investment), is likely to be more advantageous than an income tax.

Finally, sales taxes as a tool of stabilization are quicker and more effective in reaching the objective of influencing the level of demand and reducing the adverse effect of instability.

This concludes Part I, which has been largely concerned with theoretical analysis. In Part II, we turn to applied economics with special reference to the Egyptian case.
PART TWO.
CHAPTER VI.
Egypt, like other developing countries, seeks to raise its average per capita income, and to equalize the distribution of income among different sections of the population. The aim of the Government is to double the national income between 1960 and 1970 and, in order to achieve this, an ambitious development plan has been put into operation. Taxation is one of the sources of the finance necessary for investment purposes.

Before examining the role which sales taxes can play in achieving these objectives, it is necessary to describe the important features of the Egyptian economy and their relationship to equity and revenue from taxation. This preliminary chapter is designed to indicate the important features of the economy. The following points will be discussed:

1. the existing distribution of income in Egypt, according to its industrial origin, factor shares, and personal shares;
2. the level of consumption as well as its pattern;
3. the role of the public sector in the economy;
4. the types of taxes used and their revenue productivity.

I. THE DISTRIBUTION OF NATIONAL INCOME IN EGYPT:

The distribution of national income in Egypt is a reflection of the types of wealth prevailing in the economy and the types of occupations which different people follow. The inequality of distribution is the result

---

(1) Average per capita money income in Egypt was £.E.40 in 1954 and reached £.E.50 in 1950. The figures are derived from National Income and Population Statistics for these years. It should be noted that figures given in this part all refer to Egyptian Pounds. An Egyptian Pound approximates One Pound Sterling. (1 Egyptian Pound = 20/6 shillings Sterling).
of the inequality in the distribution of wealth and the inequality in the opportunities open to different individuals. However, to indicate the extent of the country's potential taxable capacity and the extent of the inequality in the distribution of income, it is important to see how the national income in Egypt is distributed among different sectors, factors, and income groups: later this will enable us to advocate the sectors to be used and the types of taxes to be used to secure equity and revenue productivity through the economic policy of the government.

(A) The Distribution of Income by Industrial Origin:

The following table (Table 7) gives a break-down of the net national product by industrial origin for the year 1954. As there are no figures available for the labour force in Egypt for the year 1954, figures for the nearest available year, 1957/1958, will be taken.
Table 7.

Distribution of the Egyptian Net National Product (at Factor Cost) and Labour Force by Industrial Origin, 1954.

<table>
<thead>
<tr>
<th></th>
<th>Net National Product (Factor Cost)</th>
<th>Labour Force</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value terms at current prices £m.</td>
<td>Number, 000</td>
</tr>
<tr>
<td>A: Agricultural Sector</td>
<td>310.2</td>
<td>3.929</td>
</tr>
<tr>
<td>B: Industrial Sector</td>
<td>130.6</td>
<td>0.764</td>
</tr>
<tr>
<td>C: Services Sector</td>
<td>298.3</td>
<td>2.198</td>
</tr>
<tr>
<td>D: Government Sector</td>
<td>91.8</td>
<td></td>
</tr>
<tr>
<td>(including income originating from Public Undertakings)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>E: Net Domestic Product</td>
<td>880.6</td>
<td></td>
</tr>
<tr>
<td>- Net Factor Income from the Rest of the World</td>
<td>13.1</td>
<td></td>
</tr>
<tr>
<td>E: Net National Product at Factor Cost</td>
<td>867.5</td>
<td></td>
</tr>
<tr>
<td>Unclassified</td>
<td>0.130</td>
<td></td>
</tr>
<tr>
<td>Total Labour Force</td>
<td>7,290</td>
<td>100.0</td>
</tr>
</tbody>
</table>


(1) The labour force comprises all those who are employed or seeking employment: it therefore includes the involuntarily unemployed. It should be noted that the working population is 77% of total population. That is, 18.1 m. people who are mentally and physically fit between the ages of 6 and 65 are considered eligible for work.
The figures in the above table indicate that Egypt depends largely on
the agricultural sector as the main source of income and employment. It
contributed just over one-third of national income while it employed 56 per
cent of the labour force. It is not surprising then to find that the services
sector, in such an agricultural economy, came second in importance and contrib-
uted only one-third of income and employment. Because of this the indus-
trial sector only contributed one-sixth of the national income and employed
only 11 per cent of the labour force.

The net result is that the major part of the national income in Egypt
is generated by the agricultural and services sectors. They contributed
70 per cent of the national income and nearly 80 per cent of the total labour
force.

(B) National Income by Factor Shares:

The distribution of national income by factor shares is another
important indicator of the extent of the inequality of income, since most of
the income of the lower income group is derived from wages, while a large
proportion of the upper income groups is from property, i.e., rent, profits
and interest. Moreover, it gives the policy-maker an idea about the size
of the different shares in the national product and helps him direct policy
towards the desired sectors. Finally, it is a good indicator of the types
of taxes that can be used most effectively to secure equity and revenue
productivity. The following table (Table 8) shows the way in which national
income was distributed among different factors of production in different
sectors of the economy in 1954:
Table 8.
Distribution of Egyptian National Income By Factor Shares in 1954.

<table>
<thead>
<tr>
<th>A: Income Originating in the Agricultural Sector:</th>
<th>% to total income generated in the respective sector</th>
<th>% to total National Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Rent of land</td>
<td>34.8</td>
<td>12.6</td>
</tr>
<tr>
<td>2. Wages and Salaries</td>
<td>19.6</td>
<td>7.1</td>
</tr>
<tr>
<td>3. Profits and Interest</td>
<td>46.6</td>
<td>16.5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B: Income Originating in the Non-Agricultural Sector:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Rent of Buildings</td>
</tr>
<tr>
<td>2. Wages and Salaries</td>
</tr>
<tr>
<td>3. Profits and Interest</td>
</tr>
</tbody>
</table>

| C: Government Income                                | 16.7                                                | 100.7                     |


These figures show that rent alone represented one-fifth of the national income in 1954. The largest part of rent is derived from land - which accounted for 60 per cent of total rent - while rent from buildings accounted for the rest.

Wages and salaries, on the other hand, accounted for just over one-quarter of total national income and go largely to the non-agricultural
sector which accounted for 73 per cent of total wages and salaries. It is surprising to find that the smaller number of people employed in the non-agricultural sector - 45 per cent - received such a large percentage.

Finally, profits and interest represented the largest share in the national product; the non-agricultural sector received 55 per cent of the total while the agricultural sector accounted for the rest.

If we follow the classification in the above table, i.e., according to factor shares in the two groups (agricultural and non-agricultural), we find that the factors of production engaged in the agricultural sector received a large part (a third) of the national product in 1954. The distribution of this share among different factors of production indicates that income in the form of profits and interest is the largest proportion, representing nearly 46 per cent of the total income received in this sector, or one-sixth of total national product. This income goes to farmers who are normally large landlords.

Rent, on the other hand, represents the second large item in the agricultural sector, accounting for 35 per cent of the total in this sector, or one-seventh of national income. This shows that in spite of the Land Reform Act which put a limitation on the amount of rent paid by farmers so as to avoid exploitation by landlords, rent is still a big item in the income generated in the agricultural sector.\(^1\) Consequently, 81 per cent of the total income generated in this sector goes to the higher income groups.

Finally, wages and salaries do not play a very significant part as a source of income and represent just under one-fifth of the income generated.

\(^1\) The Land Reform Act of 1952 fixed the rent paid by farmers at 7 times the amount of land tax.
in the agricultural sector, or 7 per cent of the total national income. This is probably due to the fact that the average wage in the agricultural sector is far below the average wage in other sectors and is nearly at subsistence level. Consequently, although the agricultural sector employs little over one half of the labour force, the low wages paid to these workers tend to depress their share relative to the share of other factors. (1)

In contrast to this is the non-agricultural sector. Profits and interest, although still the main source of income, accounted for only 43 per cent. It is likely that most of this will be derived from services, rather than industry, since services are much more important in the economy. Although the number employed were considerably smaller than in the agricultural sector, wages and salaries occupied a much more important position. This is probably due to two factors: firstly, the high wages paid in services and industry; and secondly, the extremely high salaries of members of the boards of limited liability companies, who are often on the boards of several companies: this leads to inequality of income derived from employment. (2)

Finally, income from the rent of buildings was not very significant as a source of income in this sector. It accounted for only 17 per cent of total income derived from the non-agricultural sector, or 8 per cent of national income.

(1) For example, in January 1954, the average wage of an agricultural worker was £1.2 per week and the average duration of employment was 26 weeks per year. Industrial workers and workers in the services sector get between £2 and £7 per week and are fairly continuously employed. For greater details see: Statistical Department, Statistical Yearbook 1955, Cairo 1956.

(2) For example, it was found that one person was a director of 41 companies, and his salary and fees reached £132,000 a year. For other examples, see: Gamal Said, The Egyptian Economy, Cairo 1951, pp.250-261. To limit the number of directorships which an individual may hold, Company Law 26/1954 limited the number of directorships per person to six, with the exception of those who own 10% of the capital.
(C) **The Distribution of Personal Income among Individuals:**

Of more importance as an indicator of the inequality in income distribution, is the distribution of personal income among individuals. This gives a rough indicator of the potential taxable capacity of the country, in addition to information as to the extent of income inequality. For Egypt, the statistics available for 1955 show that the distribution of personal income in that year was as follows:

**Table 9. Distribution of Egyptian Personal Income in 1954.**

<table>
<thead>
<tr>
<th>Income Group</th>
<th>No. of population millions</th>
<th>% of total population</th>
<th>Total Income Received</th>
<th>% to national income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to £25</td>
<td>15.0</td>
<td>68.0</td>
<td>190</td>
<td>21.1</td>
</tr>
<tr>
<td>Over £25 to £50</td>
<td>5.0</td>
<td>22.7</td>
<td>185</td>
<td>20.6</td>
</tr>
<tr>
<td>Over £50 to £100</td>
<td>1.0</td>
<td>4.7</td>
<td>75</td>
<td>8.3</td>
</tr>
<tr>
<td>Over £100 to £500</td>
<td>0.5</td>
<td>2.3</td>
<td>150</td>
<td>16.7</td>
</tr>
<tr>
<td>Over £500</td>
<td>0.5</td>
<td>2.3</td>
<td>300</td>
<td>33.3</td>
</tr>
<tr>
<td>Total</td>
<td>22.0</td>
<td>100.0</td>
<td>900</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Average per capita income in this year in money terms was £40.


Figures in the above table (Table 9) indicate the extent of inequality in the distribution of income and the potential taxable capacity of the country. The majority of the population (i.e. 95 per cent) received an

(1) It should be noted that Table 9 gives the distribution of income by individual income recipients, and not by families. It merely shows the share in national income of a given proportion of population within a given average income bracket. Distribution data provided by the tax authorities, on the other hand, may include incomes of individuals, of families, and of individuals of the same family, since the law requires that every income earner within a given family should file a separate return.
Diagram 2.

The Distribution of Personal Income Before Tax in Egypt, 1955.
income under £100 a year (which is the minimum exemption limit of the Egyptian income tax). At the other end of the scale, only 2.3 per cent of the population received 34 per cent of personal income.

Diagram 2 is derived from Table 9 and offers a visual representation of its significant features, in particular the extent of the inequality of income in Egypt. The two axes are the percentage of income received (vertical), and the percentage of population receiving that income (horizontal). The diagonal line represents the line of equality. The curve is the familiar Lorenz Curve.

There are no detailed figures about the distribution of personal income for persons whose income is above £500 a year. However, a rough estimate for persons whose income is above £1000 a year can be illustrated by surtax returns for 1957 as presented in the following table:

Table 10. Number of Persons in Egypt in Different Income Groups (above £1000) in 1957.

<table>
<thead>
<tr>
<th>Income Group</th>
<th>No. of taxpayers</th>
<th>Income Group</th>
<th>No. of taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td>£1000 - 1500</td>
<td>8968</td>
<td>£15,001 - 20,000</td>
<td>76</td>
</tr>
<tr>
<td>1501 - 2500</td>
<td>6147</td>
<td>20,001 - 30,000</td>
<td>48</td>
</tr>
<tr>
<td>2501 - 3500</td>
<td>2445</td>
<td>30,001 - 40,000</td>
<td>13</td>
</tr>
<tr>
<td>3501 - 5000</td>
<td>1408</td>
<td>40,001 - 50,000</td>
<td>3</td>
</tr>
<tr>
<td>5001 - 10,000</td>
<td>951</td>
<td>50,001 and over</td>
<td>5</td>
</tr>
<tr>
<td>10,001 - 15,000</td>
<td>245</td>
<td>Total Number</td>
<td>20309 (1)</td>
</tr>
</tbody>
</table>

Source: Ministry of Treasury, Taxation Department, Statistical Division, Cairo, (Unpublished Material).

(1) For footnote, see previous page.
The above figures indicate that only a small number of people receive income above £1000 a year. These represented 0.8 per cent of the total population in 1957. Moreover, the larger proportion of people in this group (i.e., 93.4 per cent) receive income only up to £5000 a year. However, these figures should not be taken to represent the number of people who receive income above £1000 a year. This is because income groups in the above table, as classified by the Taxation Department, are given according to tax returns where the tax base is assessed under different schedules of taxes. This means that they do not include agricultural profits which are exempt from income tax - as will be explained later. In addition, the income assessed by the Taxation Department under certain schedules, is not in fact the actual income earned in the year but represents an arbitrary method of assessing income: this will also be explained later. The result of all these defects is that the number of people whose income is above £1000 a year is underestimated, if reliance is placed on surtax returns. Unfortunately, there is no way in which it is possible to indicate the extent of this underestimation since the full data necessary to reach this conclusion are lacking. However, for the sake of comparison, we will double the figure reached by the Taxation Department, to take account of the underestimation of the number of people in the income group above £1000, and consider these to be the number of taxpayers for the year 1955. Comparing this with persons having income above £500 a year (from Table 9), we find that the number of taxpayers whose income exceeds £1000, according to the above assumption, represent only 8 per cent of persons in this group. This means that the large proportion of persons in the top income brackets are concentrated in the range between £500 and £1000 a year.
II. CONSUMPTION EXPENDITURE AND ITS COMPOSITION:

Personal consumption expenditure takes, on the average, or at the margin, a high proportion of the national product. Different estimates have been made and it was found that people spend, on the average, between 75 per cent and 85 per cent of the national income, (1) while the increase in expenditure on consumption which accompanies the increase in income was estimated at 0.9. (2) This was mainly the result of the low per capita income and the influence of the 'demonstration effect' on different income groups. This was especially noticeable among the high income groups where the liquidation of wealth to finance consumption expenditure was noticeable. (3)

Moreover, the increase in income was normally reflected in high rates of increase in consumption expenditures. Available statistics show that the rate of increase in private consumption expenditure between 1950 and 1956 was 40 per cent, and at the same time, national income increased by 30 per cent. (4)

The pattern of consumption expenditure is, in part, a reflection of the level, as well as the distribution, of income among different income groups. The only figures available are for the pattern of consumption expenditure for the country as a whole. There are few indicators of the consumption patterns of the higher income groups.

(1) U.N.: The Development of Manufacturing Industry in Egypt, Israel and Turkey, New York, 1958, p.22.


The following table (Table 11), illustrates the grouping of consumption expenditures for the year 1954, the latest available source of information.

**Table 11.**

<table>
<thead>
<tr>
<th>Composition of the Egyptian Consumption Expenditure, 1954.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>(1) Expenditure on Food, Drink and Tobacco</strong></td>
</tr>
<tr>
<td>(a) Expenditure on Wholly agricultural Products</td>
</tr>
<tr>
<td>(b) Expenditure on manufactured Food</td>
</tr>
<tr>
<td>(c) Tea, coffee and Cocoa</td>
</tr>
<tr>
<td>(d) Drink</td>
</tr>
<tr>
<td>(e) Tobacco</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
<tr>
<td>(2) Clothing</td>
</tr>
<tr>
<td>(3) Medicine and soap</td>
</tr>
<tr>
<td>(4) Fuel and Light</td>
</tr>
<tr>
<td>(5) Furniture and other consumers' durable</td>
</tr>
<tr>
<td>(6) Rent</td>
</tr>
<tr>
<td>(7) Expenditure on other services</td>
</tr>
<tr>
<td><strong>This represents 83% of National Product</strong></td>
</tr>
<tr>
<td>(8) Out of total consumption imports accounted for</td>
</tr>
<tr>
<td>(a) Food ready for consumption</td>
</tr>
<tr>
<td>(b) Non-food items including Kerozene</td>
</tr>
</tbody>
</table>

Source:  

(1) The figures of imports of food items ready for consumption were exceptionally low in this year because the imports of wheat fell from £21.3 in 1953 to £0.3 in 1954, then rose in later years. It reached £20.2 in 1959/60.
It is apparent from the figures in the above table that items included in Group (1) represented the major items of consumption expenditure in Egypt. It represented nearly 60 per cent of the total.

The composition of this item shows that expenditure on manufactured food, drink and tobacco was a significant part of expenditure, representing 64 per cent of total expenditure on these items. This is nearly twice the expenditure on the consumption of wholly agricultural products. Expenditure on services, including rent, represented the second major item of consumption accounting for just over one-fifth of total consumption expenditure, followed by clothing, consumer durables, fuel and light, and medicine and soap.

The pattern of the consumption expenditure of the higher income groups cannot be separated from these figures. However, certain estimates have been made by the National Planning Commission for the year 1954, relating to expenditure on items they considered as 'luxuries' (without specifying the items included in it). According to this estimate, it was found that the level of expenditure on these items represented about 28 per cent of national income, and 34 per cent of total consumption expenditure. Moreover, it was found that while national income was 70 per cent higher than in 1945, the increase in expenditure on 'luxury' items was 103 per cent over the same period.\(^{(1)}\)

This affords an indication of the high taxable capacity represented by the higher income groups, as well as the rapid increase in expenditure on 'luxury' items. Furthermore, such a high level of consumption expenditure on 'luxury' items depended in part, at least, on an increase in imports. In 1954 the level

of imports of consumer goods, mainly 'luxury' items, was £44m. This can be illustrated by comparing imports of consumer durables with total imports: the rates increased from 11.7 per cent for the average of the years 1948 - 1950, to 16.6 per cent in 1956, i.e., a 42 per cent increase over the period. (1)

Such an increase is a real one since the total value of imports showed an increase in 1956 relative to the average of 1948-1950. (2)

The above discussion considers the important features of the Egyptian economy as related to equity and revenue productivity. To complete this description it is necessary, for the purpose of this thesis to consider the role occupied in the economy by the public sector. In particular, how did it finance its expenditure. Against this background we can appraise the types of taxes used.

III. THE SIZE OF THE PUBLIC SECTOR IN THE EGYPTIAN ECONOMY:

The size of the public sector in an economy indicates not only how a government spends its revenue, especially where some of these expenditures contribute to a reduction in the inequality in the distribution of income, but also indicates the amount of revenue required. Consequently, the size of the public sector reflects, in part, the tax burden which will be imposed on the community. In addition, it is an indicator of the influence which the public sector can have on the functioning of the economy.


(2) The average value of imports, for the years 1948-1950, was £175 and for 1956 was £186, i.e., an increase of 6%. See: U.N.: Yearbook of International Trade Statistics, 1956, Vol.1., (Egypt).
In Egypt, the public sector, as a percentage of national income, is large, and its size has increased considerably since before World War II. The following table (Table 12) shows a comparison of the size of the public sector in the years 1937/38 and 1959/60, according to its economic classification:

Table 12.

Government Expenditures in Egypt according to an economic Classification, Selected Years.

<table>
<thead>
<tr>
<th></th>
<th>1937/1938</th>
<th></th>
<th>1959/60</th>
<th></th>
</tr>
</thead>
</table>
|                      | % to total| % to Nat- | % to total| % to Nat-
|                      | Govt. Expen-| ional | Govt. Expend. | ional |
| (1) Current Expenditure on Goods and Services | 53.0 | 11.5 | 40.0 | 15.9 |
| (2) Transfer Payments | 11.5 | 2.5 | 4.4 | 1.7 |
| (3) Capital Expenditure(1) | 35.5 | 7.7 | 55.6 | 22.2 |
| **GRAND TOTAL** | **100.0** | **21.7** | **100.0** | **39.8** |


The above table shows that the public sector is quite large, especially in 1959/60, when it represented two-fifths of national income, as compared with nearly one-fifth in 1937/38. The figures also indicate a change in the composition of expenditure in the public sector. While current expenditure on goods and services ranked first, and capital expenditure was second, in 1937/38, this pattern was reversed in 1959/60. As a percentage

(1) For the composition of capital expenditure, see Appendix E.
of national income, capital expenditures trebled over the period, compared with a rise of only 38% in current expenditure on goods and services. Transfer payments, on the other hand, declined by 32% over the same period - mainly owing to the decline in the percentage of expenditure on servicing the public debt, even although price subsidies and other social service expenditures were introduced after 1938.

It is instructive to see how the government financed these expenditures in the two periods. The following table (Table 13) indicates the contribution of different government receipts to the finance expenditure in the years 1937/38 and 1959/60.

Table 13.

The Contribution of Different Types of Government Receipts in Egypt, Selected Years.

<table>
<thead>
<tr>
<th></th>
<th>1937/1938</th>
<th>1959/1960</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% to total Govt. Receipts</td>
<td>% to total Tax Receipts</td>
</tr>
<tr>
<td>(1) Taxes on Persons</td>
<td>15.9</td>
<td>23.3</td>
</tr>
<tr>
<td>(2) Taxes on Commodities</td>
<td>51.9</td>
<td>76.7</td>
</tr>
<tr>
<td>Total Taxes</td>
<td>67.8</td>
<td>100.0</td>
</tr>
<tr>
<td>(3) Other Govt. Receipts (Profits from Public Undertakings and Commercial Activities)</td>
<td>32.2</td>
<td>7.2</td>
</tr>
<tr>
<td>(4) GRAND TOTAL</td>
<td>100.0</td>
<td>22.3</td>
</tr>
</tbody>
</table>

Comparing Tables 12 and 13, it is apparent that in 1937/38 government receipts were little more than enough to finance government expenditure. By 1959/1960, the situation was reversed and government receipts financed only two-thirds of government expenditure. The rest was financed by borrowing from the banks and from companies. The latter took the form of forced borrowing, for example, in 1959, out of dividends legally restricted to 20 per cent, 5 per cent of the net profits after paying the fixed dividend, was taken by the state in the form of loans.

Furthermore, comparing government receipts in 1937/38 with 1959/60, (Table 13), it is clear that the percentage of total tax receipts to total government receipts declined by nearly 19 per cent over the period. The same trend is also observed if we look at taxes as a percentage of national income, although the extent of the decline was very much less (it declined by 2.6 per cent over the same period).

Other forms of government receipts, e.g., profits from public undertakings and commercial activities, increased rapidly over this period: by about 40 per cent as a percentage of total government receipts, and by 68 per cent as a percentage of national income. The reasons for the decline of the percentage of tax receipts will be left for a separate treatment.

In the meantime we must examine the types of taxes used in Egypt and their role in the revenue structure of the country so that we may ascertain a preliminary idea of their effectiveness in securing equity.
IV. TYPES OF TAXES

Different types of taxes are used to produce the necessary revenue for the government and to reduce the extent of apparent inequality of wealth and income. According to the 1959 tax structure, the tax system in Egypt is composed of the following taxes:

(A) **Taxes on Persons** which include (i) Land and Building Taxes;

(ii) An Income Tax; (iii) Surtax; (iv) Death Duties.

(i) **Land and Building Taxes**: They are one of the older methods of taxation used in Egypt. Their tax base is the annual rental value of buildings and land. This is fixed for several years ahead. (It is 8 years for buildings and 10 years in the case of land). The estimation of the rental value of buildings takes into consideration, among other things, the rent paid by tenants. This means that the Rent Restriction Act for buildings built before 1944 is taken into account. It should be noted that rental value is a net value determined on the basis of gross value minus 20% of the gross value so as to cover costs of repair and depreciation.

The rate of tax applied is 10 per cent on the net rental value. In addition a supplementary tax of 20 per cent of the buildings tax (called Gaffir tax) is added as a contribution from the owners to the central government for services such as the policing of property.

The estimation of the rental value of land, on the other hand, takes into consideration the degree of fertility of land, the ease or difficulty of irrigation, and similar factors. The rates applied are 14 per cent on the rental value of land.
(ii) **Income Tax**: The Income Tax is the most recent tax to be introduced into the Egyptian system. It was introduced in 1939 and is levied according to the source of income from which the taxpayer derives his income.

These Schedules are:

(a) **The Income Tax on Income derived from Personal Moveable Property**: This includes income in the form of dividends and interest from securities (stocks and shares), and from debts, deposits and guarantees. The tax is collected at source, mostly from companies. Capital gains realized by the owners of these securities are not liable to income tax, unless the transactions are undertaken by professional dealers. In this latter case, the profits realized are liable to income tax according to schedule (b).

    The rates applied are proportional (17 per cent in 1959), and have no exemption limit.

(b) **The Income Tax on Commercial and Industrial Profits**: This includes all profits realized by industrial or commercial undertakings whether they are individuals, partnerships or companies. Any capital gains realized by the owners by selling part of their assets are included in the tax base and are therefore liable to the tax. This means that the tax base includes the actual profits realized from the business of the taxpayer plus any realized capital gains.
However, due to the difficulties of administration and the accumulation of a large number of arrears, different laws were introduced where the tax base deviated from the actual profits realized. For example, the profits realized and assessed for the year 1947 are taken to be the tax base for the years from 1948 to 1954, and the 1955 profits were taken to represent the profits for the years until 1958, for taxpayers with no reliable records.

The rates of the tax applied are proportional and are fixed at 17 per cent, but with an exemption limit of £100 for unmarried persons. The exemption limit is given only when income does not exceed double the exemption limit.

(c) Taxes on Income from Wages and Salaries: These are levied on income derived from labour and are collected at source. The rates are very low compared with other schedules which means that income from labour is treated more favourably than other types of income. Moreover, they possess a slight degree of progression since the statutory rates vary from 2% to a limit of 9% when income exceeds £1200 a year. The exemption limit is £100 a year for an unmarried person and is limited to those cases where income does not exceed double the exemption limit.

However, in 1957, another tax, in addition to the above tax was levied at highly progressive rates on income derived from salaries and from fees of directors of limited liability companies. The rates vary from that of 10 per cent on income exceeding £2000 but less than £3000 to up to 80 per cent on income above £20,000 a year. The aim of this tax, as was stated, was to reduce the extent of inequality of income derived from work.
(d) **Taxes on Income Derived from Professional Earnings:** This includes all income derived from professions such as medicine, law, accountancy, etc. This tax (in 1959) was a type of a poll levied according to the number of years since graduation.\(^{(1)}\)

This applies only to those persons whose average income in the years 1951-1954 was less than £1000 a year, or who prefer this method of tax assessment rather than on their actual income. Others, whose average income in the years 1951-1954 was above £1000 a year, or who preferred the actual method of tax assessment rather than a poll tax, are taxed at a proportional rate of 11 per cent on their net income.

The exemptions in this group are of two types: firstly, for work during the first five years after graduation; and secondly, for those who prefer actual method of tax assessment there is the ordinary exemption limit given under other schedules.

(iii) **Surtax:** On top of the above taxes on income, there is a surtax on all sources of income except those derived from agricultural profits. The tax base is composed of the income as assessed under different taxes

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\(^{(1)}\) The poll tax on professional earnings was as follows: £15 for persons 5-10 years after graduation, £30 for those 10-15 years after graduation, £50 for those 15-20 years after graduation, and £80 for those 20 years or more after graduation.
on income and includes income from rent of land and buildings.\(^{(1)}\)

The minimum exemption limit of that tax is £1000 a year and the rates are progressive, ranging from 8 per cent on the first £500 after the exemption limit to 80 per cent on income above £50,000 a year. In short, surtax represents double taxation for people whose income is above £1000 a year.

(iv) Death Duties: Death duties are levied at two stages in Egypt: firstly, there are death duties on the whole value of wealth left by the deceased if it exceeds £5000. The rates are progressive, ranging from 5 per cent on the first £5000 above the exemption limit to 40 per cent on wealth in excess of £100,000; and secondly there are death duties on the share of each heir depending on his (or her) relationship to the deceased. For near relatives, the rate is 5 per cent on the first £5000 and 12 per cent on a share that exceeds £50,000. These rates double or treble as the closeness of relationship between the heir and the deceased becomes less. There is an exemption limit of £500 for each heir, but this applies only if the share of the heir does not exceed £4000. It is not applicable if the share exceeds £4000.

\(^{(1)}\) The income from rent of land and buildings is estimated on the basis of the rental value of land and buildings as assessed for land and buildings taxes. In the case of buildings 20 per cent of this value is deducted to meet costs of maintenance and repairs. In addition, owner-occupied accommodation is excluded from the rental value and consequently from the base of surtax.
(B) **Taxes on Commodities:**

This group includes different types of taxes in Egypt. The most important of these are: import duties, excise duties, export taxes, and taxes on certain types of expenditures on services.

(i) **Import Duties:** This tax is levied on goods imported whether they are consumers' goods or producers' goods (although the rates are different - as will be explained later). The tax base is a mixture between the physical quantity, or weight, and the value of the commodities. Consequently the rates applied are a mixture of specific and ad valorem rates. In fact import duties take many forms in Egypt, and not just a single tax. At present import duties have the following forms:

(a) Import duties levied at specific rates vary according to the type of commodity imported, i.e., whether it is a consumers' or producers' good, and whether the consumption goods are luxuries or not. At present, producers' goods and basic food items are exempted from this duty, while luxury commodities are liable to higher charges.

(b) In addition to the above duties, imports are liable to an ad valorem levy of 8 per cent of the value, although this is reduced to 1 per cent on producers' goods and imports of basic food items.

(c) Luxury items as indicated by the Custom's classification are liable to an additional luxury duty, in addition to the above levies - and this varies with the degree of 'luxury' of the commodities.
(d) Imports became liable to a statistical tax of 1 per cent ad valorem as from 1956. This in fact represents an increase in the rate of import duties, but under a new name.

(e) Quay dues at one-tenth of import duties are paid on all imports.

(ii) **Export Taxes:** This tax is levied on the export of cotton and rice. The rates are specific and vary according to the conditions in the world market for these commodities.

(iii) **Excise Duties:** They are levied on a few goods produced in the home market. Any imports of these commodities are also liable to excise duties in addition to import duties. Moreover, certain commodities (coffee is one) are liable to excise duty although they are not produced in the home market. The rates are specific and vary according to the degree of 'luxury' of the commodities. In fact an additional levy is put on alcoholic drinks since they are thought to be a 'great luxury'. It should be noted that for revenue purposes most of the commodities liable to excise duties have a low price elasticity of demand.

Finally, another type of tax which is the same as the excise duty is the levy put on the process of ginning cotton. This process is chosen as a convenient point of tax collection. The tax base is the number of bales of cotton and the rates are therefore specific.

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(1) Commodities liable to excise duty are: Sugar, Petrol, White spirit, Alcoholic Drinks, Beer, Coffee, Cement, Playing Cards, Wine, Lighters and Matches.
(iv) **Taxes on Expenditure on Certain Services:** In Egypt, expenditure on services is not, in principle, liable to taxation. However, there are certain exceptions to this rule. The most important are:

(a) **Taxes on the Transfer of Money Abroad for Travellers:** This tax is levied on all transfers of money abroad for travelling. The tax base is the amount of money which a traveller transfers outside the country. The tax is levied at a proportional rate of 37.5 per cent of the amount transferred and is collected by the banks who deal with the foreign exchange transfer.

(b) **Entertainment Duties:** This tax is levied on the price of tickets for places of amusement. The rates of the tax vary with the price of tickets from low rates on cheaper tickets to higher rates on dearer ones.

(c) **A Tax on Rent Expenditure:** In 1956 a tax was introduced having the form of a defence tax on all sources of income including expenditure on the rent from land and buildings. The rate of the tax is 3.5 per cent of the annual rent of land and falls on the tenants, or the owner occupier. In the latter case the rent is the estimated rental value of land.

In the case of buildings, the tax is 2.5 per cent of the rent and falls on the tenants or owner occupiers of houses built before 1944 (that is, those who benefit from Rent Restriction Act). The tax is collected by the owner of the houses. In the case of houses built after 1944, the tax falls on the owners of these houses.
Finally, although we are dealing with taxes collected by the central government, it seems necessary to add that the tenants or owner occupiers of houses pay a tax on the rent paid, (or the estimated rent in the case of owner occupier), to the local government, varying between 2½ and 3½ per cent according to the towns in which the houses are located. This tax is collected by the owner and paid by the tenants to the government.

The above description covers the types of taxes used in Egypt, the tax base, and the rates of each tax. The question is to see how far these taxes were responsible for supplying the government with revenue.

V. THE REVENUE STRUCTURE OF TAXES BETWEEN 1938 AND 1959

The description given about the types of taxes used in Egypt might give the impression that taxes on persons play an important part in the revenue structure of the country. This is especially important, when such a description gives the idea that there is a fairly highly developed system of income tax which can be relied upon to obtain additional sources of revenue.

Figures about the revenue productivity of different types of taxes, however, do not seem to support the validity of this conclusion. This can be shown by examining the revenue importance of different types of taxes between the years 1938 and 1959, leaving the reasons for the failure of taxes on person in general, and the income tax in particular, to occupy a central position in the revenue structure for consideration in the following chapter. The year 1938 is chosen because it was the year just before the
introduction of the income tax and figures are available. The year 1959, on the other hand, represents the last year for which detailed figures are available.

It should be noticed that figures about the revenue derived from different types of taxes, as they are available in the statistics of Egypt, cannot be relied upon to give an idea about the trend of different types of tax revenue in relation to the development of the economy and to the expansion of national income. This is due firstly, to the types of taxes involved altering from time to time during the period; and, secondly, to the rates of tax varying; and thirdly, to the efficiency of collection varying in different years.

Therefore to have a reasonable degree of comparison between the revenue of different taxes in the selected years, certain modifications have been introduced whenever this has been found possible. This took the form of excluding those taxes which were temporary or which were introduced in later years in order to have the same types of taxes in both years of comparison.

It is not possible, however, to isolate the effect of the third factor on the degree of reliability of tax revenue between different years, viz., the fact that figures of revenue are for taxes collected and not for taxes due. The efficiency of tax collection has varied greatly at different times and there has always been a considerable backlog of taxes. This applies

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1) For example, the income tax was not stable over the period as the excess profit tax was operating from 1940 to 1949, before being abolished in 1950. Surtax was introduced in 1949 and was levied on returns of income for the year 1949 thus accruing in 1950. Finally different forms of taxes which were introduced later in 1956 and 1957 appear in 1959 figures, but not for years before 1956 (a defence tax and an additional tax on the salaries of managers of limited liability companies).
especially to the income tax. An alteration in the tax figures for a year may often, therefore, include an unknown element of acceleration or deceleration in administrative efficiency. This is especially true since 1956 when a penal rate of interest on arrears was imposed which naturally resulted in an increase in the revenue collected from the income tax in the following years. (1) This defect is not noticeable under taxes on commodities as these are by their nature collected more rapidly without administrative lag.

Figures in Table 14 indicate that taxes on commodities supplied the treasury with the major part of total tax receipts in both 1938 and 1959. They supplied nearly three times the revenue derived from taxes on persons in 1938. By 1959, though the revenue from both groups of taxes increased in absolute amount, the percentage contribution of taxes on commodities declined in importance while that of taxes on persons increased correspondingly. This was due to the rapid rate of increase in the revenue collected from taxes on persons resulting from the introduction of the income tax. As a result of this, revenue from taxes on commodities was only twice as much as the revenue from taxes on persons by 1959. The failure of revenue from taxes on commodities to increase at the same rate as that from taxes on persons is mainly responsible for their decline in the importance of total government receipts. But it should not be forgotten that in spite of this rate of growth, the income tax has not fulfilled the expectations of those who visualized it as the core of the tax system.

It is necessary, therefore, to analyse the behaviour of the individual taxes to explain this situation.

(1) According to Law 275/1956, taxpayers whose tax liability is fixed, who have delayed in paying income tax, are liable to a penal rate of interest of 6 per cent on these arrears from the supposed day of payment (one month after the assessment of the tax is made to the taxpayers).
### Table 14. The Relative Importance of Different Types of Egyptian Taxes to Total Tax Receipts and to National Income, 1938 and 1959.

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Type</th>
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<th>1939</th>
<th>1958</th>
<th>1959</th>
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<td></td>
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<td>28.27</td>
<td>32.75</td>
<td>38.64</td>
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<td><strong>Grand Total</strong></td>
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<td>14.47</td>
<td>16.75</td>
<td>19.00</td>
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<td></td>
<td><strong>Others</strong></td>
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<td>22.76</td>
<td>17.60</td>
<td>17.94</td>
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<td>2.36</td>
<td>2.36</td>
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<td><strong>Excises</strong></td>
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<td>8.54</td>
<td>8.54</td>
<td>8.54</td>
</tr>
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<td>1.66</td>
<td>1.66</td>
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<td><strong>Export Duties</strong></td>
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<td><strong>Import Duties</strong></td>
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<td><strong>Tobacco Tax</strong></td>
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<tr>
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<td><strong>Land and Building</strong></td>
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<td><strong>Export Duties</strong></td>
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<tr>
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<td><strong>Import Duties</strong></td>
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<tr>
<td></td>
<td><strong>Tobacco Tax</strong></td>
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<td></td>
<td><strong>Excises</strong></td>
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<td><strong>Land and Building</strong></td>
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<tr>
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<tr>
<td></td>
<td><strong>Import Duties</strong></td>
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<td><strong>Tobacco Tax</strong></td>
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<td><strong>Excises</strong></td>
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<tr>
<td></td>
<td><strong>Land and Building</strong></td>
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<td></td>
<td><strong>Income Tax</strong></td>
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<tr>
<td></td>
<td><strong>Export Duties</strong></td>
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<td>0.00</td>
<td>0.00</td>
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<tr>
<td></td>
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<td></td>
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<td><strong>Income Tax</strong></td>
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<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
</tbody>
</table>

**Source:** Compiled from data concerning tax collection from the Taxation Department after making the necessary modifications for the income tax mentioned in the text. The collection of revenue from taxes on commodities is taken from the Custom Department Collection, 5/61, Cairo, (unpublished materials). National Income Figures are from H.P.C. Data.

Note: Figures are rounded to nearest thousand. 

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1. **Table 14. The Relative Importance of Different Types of Egyptian Taxes to Total Tax Receipts and to National Income, 1938 and 1959.**
(A) Taxes on Persons:

Table 14 indicates the total revenue derived from taxes on persons in the years 1938 and 1959. In addition it shows the difference made by the introduction of the income tax to the revenue structure after being in operation for twenty years.

Comparing the contribution of revenue from taxes on persons in 1938 to that of 1959, it is apparent that it increased in 1959 in absolute terms by nine times its level in 1938, and as a percentage of total tax receipts by nearly 37 per cent. As a percentage of national income the increase was not so fast, being only about 14 per cent higher than 1938. The failure of the revenue from taxes on persons to match the growth of national income since 1939 can be attributed to two main reasons.

Firstly, in the case of land and building taxes, the rigidity in the tax base, (the estimated rental value is fixed for long periods), is naturally reflected in a stability in revenue receipts from this base. Therefore in a period of expansion of economic activity, revenue from land and buildings taxes tends to decline as a percentage of taxation in general and national income in particular.

Secondly, revenue from the income tax failed to rise fast enough to outweigh the reduction in the revenue from land and building taxes so that it never came to occupy the central position which its sponsors sought for it. Income tax revenue represented 16.3 per cent of total tax receipts, while as a percentage of national income it was 2.1 per cent in 1959. It is surprising that after two decades in operation, the income tax which was intended to be a major source of revenue to the treasury which would largely replace taxes on commodities, provided such a small contribution - far less than is provided by a tax on one specific commodity, namely tobacco.
Finally, the slow rate of increase in the revenue derived from the income tax can be shown clearly by comparing the revenue derived from the income tax in the year 1946 when the tax assumed its present form with the 1959 revenue; and the figures for 1954 with 1959, before and after the inclusion of surtax.

Table 15 indicates that though revenue from the income tax increased in absolute terms by 2.5 times its 1946 value, expressed as a percentage of total tax receipts or national income it was nearly constant. In other words, income tax revenue was keeping pace with the growth of other types of tax receipts and national income over this period. During this period, however, the rate of income tax rose from 12 per cent to 17 per cent in 1959, and the efficiency of collection increased and arrears were reduced after the imposition of 6 per cent penal rate of interest on overdue tax.

If some allowance is made for these changes, it seems that the expected revenue from an income tax at a constant rate and with weak collection would not have kept pace with the rise in total tax receipts or national income. The alternative suggestion would be that there is an inflexibility in the revenue derived from the income tax as a percentage of national income, which reflects changes in the income tax law.

Comparing 1954 and 1959, on the other hand, where the rate of income tax was the same in both years, it is seen that though revenue from the income tax (excluding surtax revenue) increased by nearly 50 per cent in absolute terms over this period, as a percentage of total tax receipts, it was less in 1954 than in 1959, while as a percentage of national income it
<table>
<thead>
<tr>
<th>Year</th>
<th>Income Tax</th>
<th>Surtax</th>
<th>Total</th>
<th>Income Tax</th>
<th>Surtax</th>
<th>Total</th>
<th>Income Tax</th>
<th>Surtax</th>
<th>Total</th>
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</thead>
<tbody>
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<td>1946</td>
<td>1028</td>
<td>924</td>
<td>2052</td>
<td>1028</td>
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<td>1305</td>
<td>1297</td>
<td>2602</td>
<td>1305</td>
<td>1297</td>
<td>2602</td>
</tr>
</tbody>
</table>

Relative Importance of Income Tax Receipts

\[
\frac{\text{Income Tax}}{\text{Total}} \times 100\%
\]

<table>
<thead>
<tr>
<th>Year</th>
<th>Income Tax</th>
<th>Surtax</th>
<th>Total</th>
<th>Income Tax</th>
<th>Surtax</th>
<th>Total</th>
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<th>Surtax</th>
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<tr>
<td>1946</td>
<td>1028</td>
<td>924</td>
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<td>1305</td>
<td>1297</td>
<td>2602</td>
<td>1305</td>
<td>1297</td>
<td>2602</td>
</tr>
</tbody>
</table>

\[
\frac{\text{Income Tax}}{\text{Total}} \times 100\%
\]

Source:
Compiled from: (1) Figures about Tax Receipts derived from: Taxation Department.

Statistical Division (unpublished materials) after making the modification proposed before.

By M. Hoggar, Cairo, Sept. 1959, and M.P.C. The measurement of Taxable Capacity.

(2) Figures about National Income are derived from: M.P.C. The Measurement of Taxable Capacity.

National Income, 1949, 1954, and 1959, as a percentage of Total

Source: Compiled from: (1) Figures about Tax Receipts derived from: Taxation Department.

Statistical Division (unpublished materials) after making the modification proposed before.

By M. Hoggar, Cairo, Sept. 1959, and M.P.C. The measurement of Taxable Capacity.

(2) Figures about National Income are derived from: M.P.C. The Measurement of Taxable Capacity.

Relative Importance of Income Tax Receipts

\[
\frac{\text{Income Tax}}{\text{Total}} \times 100\%
\]
was nearly the same in both years.\(^1\)

If surtax receipts are now included in the figures for income tax receipts the situation remains basically the same. Revenue from this source still fails to keep pace with total tax receipts, and as a percentage of national income remains relatively stable. Since the rate of income tax was the same in both years, this stability was probably a truer indicator that the receipts were following the expansion of national income than was the case in 1946/1954. But it is still true that between 1954 and 1959 there was a further increase in efficiency of collection, especially after the imposition of the penal rate of interest on overdue taxes.\(^2\)

If this factor is taken into consideration, income tax still appears to possess some inflexibility as a source of raising revenue. This would account for the failure of the income tax to occupy the central position planned for it in the fiscal system. This inflexibility can be attributed to the effects of government policy which will be examined in the next chapter.

Thus, it is apparent from the above description of revenue from taxes on persons that the income tax in Egypt did not play its planned significant role in the revenue structure of the country. Its contribution is still very small, while its rate of growth is low. Therefore it would be difficult to rely on it as a major source of revenue. The reasons for this conclusion will be left for separate discussion in the subsequent chapter.

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(1) If we compare income tax revenue between 1946 and 1954, we find that income tax revenue as a percentage of total tax receipts fell in 1954 relative to its percentage in 1946. This is probably due to the rapid expansion in revenue derived from income taxes relative to other types of taxes, i.e., sales taxes. The rate of growth of the latter types of taxes was very slow during the war and in the period immediately following the war because of the shortage of commodities available in international trade.

(2) This can be illustrated by the fact that yield from interest on arrears of tax dropped from £13,289 in 1957 to £6306 in 1959. Figures are from Taxation Department, Tax collection, (unpublished figures).
(B) Taxes on Commodities:

Taxes on commodities supplied the treasury with the major part of tax revenue in 1938 and 1959. Their contribution was over two-thirds of total tax receipts in both years. This can be seen in Table 14 which was introduced above.

Comparing the contribution of taxes on commodities in 1959 with that in 1938, it is apparent that it increased in absolute terms nearly six times. As a percentage of total tax receipts, the revenue from taxes on commodities fell by about 10 per cent (from 76 per cent to 68 per cent) and as a percentage of national income, it fell by about 22 per cent (from 11.4 per cent to 8.8 per cent).

(C) Sales Taxes:

Sales taxes(1) comprise the major part of tax revenue. Table 14 above summarizes the importance of different types of taxes included in this group and indicates the change which occurred in their relative importance in the period 1938 to 1959. For the purpose of giving a fair impression about the significance of different types of taxes, tobacco taxes are presented as a separate item. This is because the tobacco tax is collected with import duties by the Custom Department without any differentiation between revenue from excises and that from import duties.

Figures in Table 14 indicate that revenue from sales taxes provided over three-fifths of tax revenue in both 1938 and 1959. In absolute figures sales tax revenue in 1959 was about four times as high as the 1938 figures. As a percentage of total tax receipts or of national income, it declined in importance in 1959 relative to 1938. It declined from just under three-quarters of total tax receipts (10.5 per cent of national income) in 1938 to just

(1) Sales taxes are classified in Part I so as to include: (a) Import duties; (b) Excise duties, and (c) Wholesale and Retail sales taxes. In Egypt the first two apply at present.
under two-thirds of total tax receipts (7.8 per cent of national income) in 1959.

The break up of the figures for total sales taxes shows the main types of taxes in this group which were responsible for the decline in the importance of sales taxes. (1)

The salient feature is that import duties increased slowly in absolute terms compared with revenue from other types of sales taxes in the two periods. The former nearly doubled, while the latter increased between four and five times. Moreover, the figures show that import duties were the major source of revenue in 1938, whereas by 1959 they had declined to second in importance. There are no detailed figures for the revenue derived from different imports in the two years which would indicate those groups which are responsible for the low rate of increase in revenue derived from import duties. The only figures available are for the year 1959/1960. Although a comparison between the 1959/60 figures and the 1938 figures is not possible, it will be useful to show the important items of imports which are responsible for a large part of revenue from import duties. (2) It is clear that most of the revenue derived from import duties is derived, as would be expected, from imports of consumer items. Imports of consumers' goods accounted for 40 per cent of the total value of imports, while it accounted for 73 per cent of the revenue from import duties.

The break-down of this figure shows that tobacco alone (representing just under 3 per cent of the value of total imports) produced about half of the total

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(1) See also Table 14.

(2) See also Appendix F.
revenue from import duties. In addition, the tobacco tax occupied the leading position in 1959 as a revenue producer, whereas in 1939 it was second in importance. Other types of imports responsible for the revenue import duties are: food items, which produced 13 per cent of import duty revenues; manufactured products, which produced 8 per cent; and, drink, which produced 5 per cent.

Imports of producers' goods (capital goods and raw materials) on the other hand, though responsible for two-thirds of the value of total imports produced little over one-quarter of the total revenue from import duties. This represents a high contribution from items which are liable to nominal rates of import duty according to the tax code. The exaggeration of the revenue derived from this category, however, is due to the fact that figures of imports of producers' goods include some consumer durables such as cars, which are liable to high rates of import duties. Unfortunately, the figures are not detailed enough to allow the isolation of this item so as to show the extent of the tax on producers' goods as compared with consumers' goods.

From the above description, it is apparent that import duty revenues are mainly derived from imports of consumers' goods where the rates vary from one group of commodities to another. The average rate of duty can be calculated and it reaches 10 per cent while it is 50 per cent on fruits. The average rate of import duties on manufactured consumer goods appears to be 55 per cent. Finally, tobacco seems to be the most important item of imports which produce the largest part of import duty revenues.
The importance of excises in the revenue structure of Egypt is relatively less than that of import duties and the tobacco tax. They came third in importance and retained their position relative to the two other taxes in both 1938 and 1959. They increased a little as a percentage of total tax receipts. There are no detailed figures to show the contribution of different types of commodities liable to excises to the total revenue collected from this tax. The only available figures are for 1954. These figures are not likely to differ greatly from figures for 1959 so far as they affect the relative importance of different commodities. Sugar and petrol together supplied the bulk of the revenue from excises, accounting for 85 per cent of the whole excise revenue. Sugar alone supplied just over one-half of the total revenue from excises, while petrol supplied a little over one-third of the total. The other items were not very significant as a source of revenue from excises. Among these items were cement, lubricating oil, coffee, beer and wine, which together contributed 11 per cent of total excise revenue.

VI. CONCLUSION.

It is apparent from the above description of the importance of different types of government receipts that Egypt depends largely on taxation as a major source of revenue, though its importance declined in 1959 relative to 1938. Taxes on commodities in general, and sales taxes in particular, represented the major part of tax receipts in both years, though

(1) See also Appendix G.
their importance weakened in 1959 relative to 1938. Finally taxes on persons have remained a relatively unimportant source of revenue even after the introduction of the income tax in 1939. The decline in the importance of tax receipts in relation to total government receipts and to national income is mainly due to the fall in importance of import duties and the failure of other types of sales taxes to expand fast enough to counterbalance this reduction. Furthermore, the newly introduced income tax, which was planned to become a major provider of revenue in Egypt, was partly responsible for the decline in the contribution of tax revenue in relation to total government receipts and to national income. As indicated above, its revenue increased very slowly and it failed to reach the central position planned for it.

Since the new economic policy of Egypt aims at:

(1) doubling the national income within the next ten years, and
(2) reducing the extent of inequality in the distribution of income,

the question to be asked is: Given the objective of equity, would more reliance on income or sales taxes provide the treasury with the necessary revenue, at minimum cost, to finance development plans with minimum interference to the objective of a rapid rate of economic growth.

The answer to this question requires that the change which occurred in government policy after 1952 should be taken into consideration as one of the constraints operating in the economy. Egypt cannot now be considered a laissez-faire economy, as previously it tended to be. A free-enterprise type economy led to stagnation and the rise in the national income was
insufficient to outweigh population growth. This encouraged the government to play an active part in economic activity and to follow a policy of "co-operative socialism" in order to secure a progressive economy. This new policy may have an influence on the type of taxation.

Taking the new economic policy of the government into consideration, and assuming the existing distribution of income and consumption expenditure, we shall agree that sales taxes are likely to be a more suitable method of raising the required amount of revenue while at the same time ensuring an equitable distribution of income. Further, sales taxes appear to be more conducive to a rapid rate of economic growth than income taxes.

Our examination of the advantages of sales taxes relative to income taxes will centre around the following points:

(1) the extent to which sales taxes can succeed in raising an increasing amount of revenue so as to allow the government to undertake types of investment not undertaken by private investors;

(2) the degree of success of sales taxes as compared with income taxes in securing equity, and

(3) the extent to which sales taxes, as compared with income taxes, affect the functioning of the economy in a way which promotes economic growth.
CHAPTER VII.
CHAPTER VII

A COMPARISON OF THE REVENUE PRODUCTIVITY OF SALES TAXES AND INCOME TAXES IN EGYPT

In this chapter, it is intended to show that sales taxes are more efficient than income taxes for raising the necessary government revenue, given the Egyptian Government's economic policy. We shall proceed as follows:

I. A brief summary of the structure of tax revenues in 1938 and 1959;
II. an outline of the government's recent economic policy as a factor limiting the choice of the types of taxes which may be used for raising revenue;
III. a demonstration of the effects of this policy on the revenue structure;
IV. an explanation of why sales taxes are more efficient than income taxes in increasing the amount of revenue.

I. THE STRUCTURE OF TAX REVENUE IN 1938 AND 1959:

The description given in Chapter VI of the types of taxes used and their relative revenue importance, has shown that Egypt still depends on taxes on commodities as a major source of revenue, though their importance was less in 1959 than in 1938. Income tax, on the other hand, was still a relatively unimportant source of revenue in the tax structure of Egypt as it represented just over one-quarter of the revenue derived from sales taxes in 1959.

It might be argued that the need for more revenue in Egypt might be satisfied by placing more reliance on an income tax. An income tax, being new to the system, does not seem to have exhausted its potential capacity for raising revenue, although it never attained the position planned for
it when it was first introduced. Sales taxes, on the other hand, have long featured in the system and are now declining in importance due to the changes occurring in the structure of the economy, so that it might not be possible to put further reliance on them. Therefore, from the revenue point of view, it would seem that dependence on the newly operating income tax would be more appropriate to raise the required increase in revenue at little cost.

However, to enforce such a proposal requires a drastic expansion in the coverage of the income tax to include those activities which are not yet taxed or not properly taxed. In addition, the enforcement of the tax has to be made more efficient in order to collect the proper tax at the proper time. This does not seem to be possible in the short period (5 years) to which this analysis is restricted. This is due to government policy which makes it difficult, if not impossible, to expand the tax coverage in the short-run, especially if we take into consideration the administrative feasibility at present. Moreover, this proposal implies that sales taxes have exhausted themselves as a revenue producer and that the marginal cost of raising additional revenue will be high within the changing structure of the economy. This is not clearly so, since the decline in the revenue importance of sales taxes is not due to defects in them or to their inadequacy in raising additional revenue at little cost, but rather to the failure of the policy-makers to exploit them properly. To explain such a conclusion requires an examination of the economic policy of Egypt so that we may see its effect on the revenue productivity of income and sales taxes. This is a first step towards selecting the appropriate types of taxes to be used to raise the required revenue at minimum cost.
II. THE OBJECTIVES OF GOVERNMENT ECONOMIC POLICY:

Egypt's economic policy aims at a 'socialist, co-operative system' where the government will control a large part of the country's economic activities in order to:

1. secure a rapid rate of economic growth;
2. abolish the private monopolistic exploitation formerly prevailing, and
3. reduce the extent of inequality in the distribution of wealth and income.

To achieve these objectives the government nationalized many of the commercial, financial and industrial undertakings and assumed an active role in the field of investment in an effort to fill the gap left by the private sector. A Five Year Development Programme was laid down. The government's share of the total investment provided for in this programme is about 81 per cent of the total in the first year, while the remaining part (19 per cent) is left to the private sector. In an effort to secure the internal resources necessary for investment, it is planned that private

(1) There are no available figures about the existing size of the public sector in Egypt. It is also difficult to obtain an approximate estimate because ownership in the public sector is undertaken through many public institutions formerly privately owned, for example, the Industrial Bank, the Mist'Bank, and their shares in different companies. Moreover, the 'Economic Organization' is the central organization which embarks on different investment in different fields. This makes it difficult to account for the different forms of public ownership under these different institutions. ('Economic Organization' is fully owned by the Government. It is entitled to promote investment in all fields of economic activity, especially those where private initiative is lacking.)

consumption should rise by only 4-8 per cent in the first year in response
to an increase in national income of 9 per cent, reaching 24 per cent in the
fifth year in response to an increase in national income of 40 per cent. (1)

Moreover, the government encouraged the co-operative movement in all
fields of economic activity, especially in the agricultural sector, so as to
avoid exploitation by lenders financing businesses and middlemen marketing
their products. To this end co-operative profits, dividend and discounts
are exempted from the income-tax.

How far was this economic policy responsible for the change in the
revenue structure described in chapter VI? To answer this question, it is
necessary to examine in some detail its effect on different sources of revenue.

III. THE INFLUENCE OF THE NEW ECONOMIC POLICY ON THE REVENUE STRUCTURE:

(A) Receipts from Public Undertakings:

One important effect of the new economic policy relates to the profits
of public undertakings. As mentioned earlier, the revenue derived from
this source increased from 32 per cent to 40 per cent of total government
receipts between the years 1938 and 1959. The nationalization of a large
part of the private sector and the large contribution of the public sector
to investment in the last few years meant that together with new investment,
profits from these undertakings are added to government receipts consequently
producing an increase in the percentage contribution of profits from public
undertakings to total government receipts. (2)

(1) N.P.C.: The Details of the First Year of the Development Plan in Egypt,
(2) See also appendix H: this shows the rate of increase in revenue derived from
public undertakings compared with the rate of increase in national income and
other tax receipts. It is also apparent that the rate of increase of revenue
derived from public undertakings is very much higher than national income
or tax receipts. This trend is likely to continue as long as the govern¬
ment share of total investment remains high.
(B) **Tax Revenues:**

The government's economic policy was also reflected in the revenue derived from different types of taxes. It led to the decline in the percentage of tax receipts to total government receipts and to national income, although its effect varied from one tax to another. To explain how government economic policy contributed to the decline in tax revenue, it is necessary to examine the influence of this policy on the factors affecting the revenue productivity of taxation. This centres around:

1. **(a) the coverage of a tax,** and,
2. **(b) the influence of administrative factors.**

Since income and sales taxes are the two competing sources of revenue with which this study is concerned, the analysis proceeds by examining the effects of government policy on these two factors under income and sales taxes.

(i) **The Income Tax:**

One of the main reasons for the low share of tax receipts in Egypt is the low level and the low rate of increase of revenue from the income tax. This can be illustrated more clearly with respect to the two important factors which affect revenue productivity that are mentioned above, i.e., the tax coverage and the influence of administration.

(a) **Income Tax Coverage:** One of the important features of a productive type of tax is that it should have a wide coverage over a large part of the national income. Unfortunately, the Egyptian income-tax does not seem to possess this feature. In the first place, the government continued to exclude agricultural profits from income

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(1) **It should be noted that the tax-rates on different income groups is one of the factors responsible for the revenue productivity of the tax. But in this analysis, the rates are taken to be fixed by the policy-maker and the problem then is to compare the revenue productivity of different taxes under this assumption.**
and surtax for no economic or social reasons. The amount of agricultural profits is quite large, having been estimated at 17 per cent of the national income in 1954. It is surprising to find a country like Egypt, seeking additional revenue, yet restricting its income tax coverage by excluding a large part of national income from income tax liability. The main reasons for the exclusion of these profits from tax-liability are: firstly, the political power of the landlords which is used to block any tax reform; and secondly, the difficulties of administering such a tax.

The net result of the exclusion of this part of the national income is the low level of revenue derived from the income tax. In addition, from a purely economic point of view, it is difficult to understand why a country like Egypt, trying to diversify the economy towards industrialization should plan its tax policy in a manner amounting to subsidizing taxpayers receiving their income from the agricultural sector rather than those receiving their income from the non-agricultural (especially industrial) sector. This will be discussed in chapter IX.

(1) For example, the number of taxpayers receiving their income from agricultural profits (and who are far above the exemption limit of the income tax) was approximately 36,000, i.e., 7 per cent of total taxpayers liable to income tax in 1954, and 16 per cent of total taxpayers whose income is above the exemption limit. This estimate is made on the assumption that the net profits per feddan were £25 in 1953 (from the National Bank of Egypt's estimate). The number of landowners who own 20 feddans or more were taken to represent people who receive their income from agricultural profits. The net result of this calculation is that a person with 20 feddans gets a net income of £500 a year. Figures are derived from: Statistical Department, Statistical Yearbook, 1958, Cairo, 1959; National Bank of Egypt, Economic Bulletin, No.3., 1953, p.237. See also Table 8, Chapter VI.
Secondly, the encouragement of co-operative societies as one of the main features of the economic system, together with the government policy of exempting co-operative profits, dividends and discounts, is responsible in part for the low level as well as the rate of growth of revenue from the income tax. Co-operative societies produce income in the form of profits, dividends, and discounts to their shareholders in the same way as any other form of undertaking. The size of this income increases with the level of economic activity in general and the rate of growth in the number of these societies in particular. There are no figures to indicate the share of income which accrues from the co-operative movement (in the form of profits, dividends and discounts) and which escapes income tax completely. The only available figures refer to the number of these societies within the Egyptian economy. These figures indicate that co-operative societies expanded very rapidly in the last 10 years, increasing by 130 per cent over the period from 1948 to 1959.\footnote{The number of co-operative societies in Egypt increased from 2,009 societies in 1948 to 4,596 in 1959. See Statistical Department, \textit{Statistical Yearbook, 1955}, Cairo, 1956; and, \textit{The U.A.R. Yearbook 1960}, Cairo, 1960, p.442.} It seems reasonable to take such an increase as an indicator of the increase in the capital invested and income received by shareholders in these societies. Since these types of income are exempted from income tax, this must bear some responsibility for the low level as well as the low rate of growth of revenue from the income tax. In fact, it may be plausible to consider this factor to be one of the reasons for the
stability of revenue from the personal income tax (in absolute terms) over the last few years. (1)

Thirdly, certain economic aims encouraged the government to restrict the income tax coverage without taking into consideration the extent of the benefits which may accrue from this restriction to the economy as a whole. The desire to encourage the investment needed for securing a rapid rate of growth of aggregate income prompted the government to exempt profits of certain new investments from income tax, for a period varying from 5 to 7 years. This resulted in a loss of revenue which could have been collected had this exemption not been used. But such a loss could be justified if the net effect of exemption was successful in securing the desired encouragement to private investors. However, this does not seem to be the case in Egypt, since most of the investment the government seeks to encourage is either undertaken directly by itself, or initiated by itself with the co-operation of

(1) Revenue collected from the personal income tax refers to income tax revenue derived from different schedules on individuals and partnerships, plus revenue derived from surtax, minus the revenue derived from company profits. According to this definition, the revenue from the personal income tax was as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>£.m.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953/1954</td>
<td>11.5</td>
</tr>
<tr>
<td>1954/1955</td>
<td>11.2</td>
</tr>
<tr>
<td>1955/1956</td>
<td>12.8</td>
</tr>
<tr>
<td>1956/1957</td>
<td>18.2</td>
</tr>
<tr>
<td>1957/1958</td>
<td>19.0</td>
</tr>
<tr>
<td>1958/1959</td>
<td>19.1</td>
</tr>
</tbody>
</table>

It is apparent from these figures that income tax revenue was stable over the first three years, increased sharply in 1956/1957, and then continued to be stable. The sharp rise since 1956 is due to the imposition of the Defence Tax at the end of 1956, and the additional tax on salaries of the directors of limited liability companies. Furthermore, the imposition of a penal rate of interest on arrears in 1957 led to an increase in the efficiency of tax collection. Figures are derived from: Taxation Department, Statistical Division, (Unpublished Figures).
the private sector.\(^1\) In this case, no real purpose is served by the exemption of profits for a limited period since the government does not need fiscal methods to encourage investment. Moreover, the private investors who benefited from this concession are those who do not require these concessions to undertake new investment or expand old ones. The use of protective import duties and the lower rate of tariffs on imports of producers' goods seems to be a more powerful tool giving greater stimulus to private investors. It secures them a demand for their product and reduces the cost of their investment.

The net result of these concessions was that the benefit from them was largely reaped by the existing investors who expanded their activities, not because of the tax stimulus, but because of the success of their product in the market and their willingness to risk their capital in projects whose past experience indicated their success. In these cases, the exemption of profits for a limited period represented a waste of government revenue without achieving any real gain. This revenue could have been used for furthering investment in other fields which would encourage private investment, i.e., those which are complementary to private investment.

(b) **Administrative Factors**: Administrative considerations, as influenced by government policy, also played a part in reducing the coverage of the income tax in Egypt. Like the tax coverage they contributed to the low level as well as the low rate of growth of

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\(^1\) The latter case took the form of selling equity shares to the general public in those types of investment initiated by the government, and the securement of a minimum rate of return on capital invested.
revenue from the income tax. This can be illustrated by the government's action in determining the size of the exemption limit. In Egypt, the exemption limit is fixed at a higher level, in relation to the average income per head, than that prevailing in more developed countries. If this limit was based on the minimum requirement of an individual there would be no objection to it. But this is simply not the case since the exemption limit is influenced, in part, by the administrative capacity of the country. It is not possible, therefore, within the existing administrative capacity to reduce the exemption limit in the short-period. In fact, government policy in recent years has raised the exemption limit to an even higher level. Reliance on

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(1) For example, the exemption limit in 1957 was around four times as much as the average income per head in Egypt, compared with only twice as much as the average income per head in the U.S.A. or the U.K.

(2) In July 1960, the exemption limit had been increased by nearly 70 per cent of its level in 1959. This was justified by the rise in the cost of living which occurred since the exemption limit was first introduced in 1938. No attention was paid to the fact that such an exemption limit was already high. Within the average per capita income in 1959, (which is £50 a year), a person with an income around £200 a year, (which represents the new exemption limit), can be considered relatively well-off compared with the majority of the population. There are neither economic nor social reasons for not taxing people whose income falls within this group. On the contrary, revenue productivity, equity, and the desire to reduce consumption favour taxing persons falling within this group. This is especially so since people in this group mostly live in towns and cities where they get more of the benefits from government expenditure on social services compared to the very low and the very high income groups.
such a high exemption limit tended to reduce the number of people liable to income tax to only 1 per cent of the population in 1957. (1) With the existing proportional rates of the different schedules of the income tax there is little hope that reliance on these taxes could bring in any significant amount of revenue. Even if we take into consideration the use of progressive rates levied under surtax, this is not likely to make any important contribution to the revenue productivity of the income tax. The number of people in this group represents only 0.08 per cent of total population, and only 0.3 per cent of the total number of those liable to income tax. (2) Their contribution to the tax revenue, on the other hand, was 18 per cent of total income tax receipts or 3 per cent of total tax revenue. (3) The conclusion to be drawn, therefore, is that the government policy of fixing the exemption limit was partly responsible for the small coverage of income taxes in Egypt and the low contribution of the income tax to total tax receipts.

Moreover, the difficulties of administering the income tax and the consequent widespread evasion resulted in a large number of arrears. (4)

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(1) The number of income taxpayers above the exemption limit in 1957 was 254,000 out of the total population of 24 millions.

(2) Figures are derived from: Ministry of Treasury, Taxation Department, Statistical Division, (Unpublished Figures).

(3) Surtax provided the Treasury with £5.4 million in 1957 out of total income tax revenue of £27.5 million and total tax receipts of £165.7 million in that year. Figures are derived from: Ministry of Treasury, op. cit. (Unpublished Figures); and U.N. Statistical Yearbook, 1960, New York, 1961.

(4) See also Appendix I for the arrears figures.
The pressing need for revenue encouraged the government to enact a law by which the profits for one year were ipso facto taken to be the profits for several years to follow for those taxpayers with no reliable records. Experience has shown that this law was not an emergency measure designed to end arrears once and for all. The rapid rise in the accumulation of arrears stimulated the government to renew this arbitrary measure for other years. This means that income-tax revenue ceased to be related to the level of economic activity, i.e. income-tax revenue ceased to follow the rate of growth of national income but became fixed in relation to the level of income in the base year. Therefore, the use of these measures may be responsible for encouraging taxpayers benefiting from these regulations not to keep records so as to evade the tax on their income.

(1) A rough estimate of the percentage of total income taxpayers affected by this law was 94 per cent in 1958.

(2) The Laws 240/1952 and 587/1954 considered profits assessed for 1947 to be profits for the years up to 1954. The Law 102/1958 considered 1955 profits to be up to 1958 for taxpayers whose income was below £500 a year.

(3) The extent of tax evasion can be illustrated by the following example based on these assumptions: (a) the number of people receiving income above £500 per annum taken to be equal to those who provide all income-tax revenue. Their number in 1954 was half a million, and they received an income of £300 million in that year; (b) the percentage of income received from agricultural profits and rent represented 37 per cent in that year. Deducted from income this leaves the net income liable to schedule income tax at £189 million; (c) all taxes collected in 1955 (£21.9 million) are assumed to be paid by people receiving their income from receipts liable to schedule tax.

On these assumptions the average tax rate was found to be 11.5 per cent compared with a weighted average rate of income tax (excluding surtax) of 16 per cent. This means that actual tax collection is far below real tax liability, i.e., evasion is about 28 per cent. If allowance is made for the fact that progressive rates are included in tax revenues, and some of the taxes collected belong to previous years, the extent of evasion will be much higher. Source of the above figures: N.P.C.: The Measurement of Taxable Capacity in Egypt, Memorandum 344, Cairo; September 1959; and Ministry of Treasury, Taxation Department, Statistical Division; for figures of tax revenue, (Unpublished figures).
Finally, certain income groups tended to change the tax base of their income from the actual income earned in each year to some arbitrary base. This can be demonstrated by the way in which professional earnings are treated under the income-tax law. Taxpayers in this group are exempted from the tax for the first five years after graduation. Furthermore, taxpayers whose income was below an average of £1,000 a year (in 1951 - 1954) were given the option of paying the tax according to their actual income or paying a poll tax varying with the number of years since graduation, taking into consideration the five years exemption. This provision caused income tax to lose some of its potential revenue due to the exemption of income earned in the first five years. In addition, it gave the income tax some degree of inflexibility as a method of raising revenue since the relationship between the tax paid and the actual income received is distorted as a result of the arbitrary methods of tax assessment. (1)

All the above factors indicate that the policy of the Egyptian government was responsible for the small coverage of the income-tax, either through the types and size of income to be included in the tax base, or through the pressing need for revenue within the administrative capacity of the country. This resulted in a low level and a low rate of growth of revenue from the income-tax.

(1) In fact, revenue from the taxation of professional income was never above £0.3 million a year, although the number of taxpayers has exceeded 16,000 since 1950. Nearly all taxpayers in this group receive income above the exemption limit.
(ii) The Sales Tax:

The dependence of Egypt on sales taxes in general and on import duties in particular, as a major source of revenue in the pre-war period, was largely due to the structure of the economy. The agricultural sector was large, while the industrial sector was comparatively very small. This encouraged dependence on imports of manufactured goods. However, the change in the structure of the economy, influenced by government economic policy and the desire of the government to secure other objectives, contributed to the low rate of growth in sales tax revenue and consequently to the decline in the percentage of tax receipts to national income. The main reasons for this decline are largely attributable to the effects of government policy on the coverage of sales taxes, while administrative considerations were of small importance in this case.

In the first place, attempts to diversify the economy led to the expansion of the industrial sector and consequently to the reduction of the imports of certain types of manufactured goods. This policy went a stage further when the government aimed at reducing the pressure on the balance of payments by giving preference to the establishment of import-competing industries. To this end, the rates of import duties on import-competing products were raised to a higher level, while the

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(1) The agricultural sector contributed about 50 per cent of the national product in 1939; the industrial sector 8 per cent. By 1959 the corresponding percentages were 33 per cent and 26 per cent respectively. Figures are compiled from: Issawi, C., Egypt at Mid-Century, Oxford University Press 1954, (for 1939); and N.P.C.: The Five Year Development Plan 1960/1961 - 1964/1965, Cairo, July 1960, (for 1959).

(2) and (3) For example, figures show that imports of consumers' goods were higher in 1948 than in 1954. If 1948=100, the quantum index of imports declined to 83 in 1954. This was mainly due to the expansion of the industrial sector which began to produce import-competing products.
rates applicable to capital goods were reduced to a nominal rate (1 per cent instead of 8 per cent). Finally, the desire to free large amounts of foreign exchange to finance imports of capital goods led the government to restrict imports of luxury goods, or at least their rate of increase.

In addition, excises have not expanded their coverage to include commodities now produced within the country and formerly taxed as imports, especially those having a high income elasticity of demand. As a result, the coverage of excises remained much the same in the post-war period as when they were first imposed during the thirties on a few products with a low price elasticity of demand.

Moreover, the government policy of reducing the inequality in the distribution of income included the exemption of basic food items from import duties in order to reduce the burden of taxation imposed on the lower income groups. This was coupled with a rise in the rates of import duties on those commodities consumed by the higher income group. The net effect of these measures is to slow down the rate of increase in the revenue productivity of import duties.

Finally, the use of specific rates of import duties as basic rates tended to slow down the rate of increase in revenue. Specific duties always lag behind a change in prices. However, the importance of this factor is reduced in part by the use of an additional ad valorem levy on 'luxury' commodities.

Each of the above factors played some part in the slow rate of increase of revenue from sales taxes (in absolute terms), and consequently in the decline in the importance of the whole group of sales taxes, and more especially import duties.
IV. THE EFFECTIVENESS OF SALES TAXES AND INCOME TAXES AS MAJOR SOURCES OF REVENUE.

The pressing need to finance necessary development programmes requires the imposition of the tax whose marginal social cost is lowest. In terms of revenue productivity, this criterion recommends those taxes which produce a higher amount of revenue at little cost to the taxpayers and to the community. This means that, given the degree of tax progression, a tax with wider coverage and ease of administration is preferable to another with a smaller coverage. Within the existing institutional framework and government economic policy, sales taxes on different consumers' goods and services seem to possess the requirements necessary for a productive source of revenue at little cost.

(A) The Coverage of Sales Taxes Compared with the Income Tax.

Within the existing circumstances of Egypt the use of sales taxes will ensure a wider coverage than under an income-tax. It will include expenditure from those sources which are excluded from the income-tax base. The most important of these are: agricultural profits; capital gains; expenditure from income below but near the exemption limit; and expenditure out of the dividends and discounts of co-operative societies.

Agricultural profits and capital gains accrue largely to big landlords who normally reside in big cities where the comforts of life are available. (1) This means that the expenditure of people in this group is largely within the monetary sector. In addition, the influence of

(1) As mentioned before, the amount of agricultural profits represent 17 per cent of national income in 1954. The importance of capital gains, on the other hand, is difficult to assess. Evidence suggests that they are a source of income for some people. These gains arise because the demand for land and buildings is stimulated by population growth and the effect of development programmes that create real gains for their owners who are able to derive income from the regular realization of part of these gains. See: The Permanent Council for Production in Egypt, Cairo, 1955, p.12.
the 'demonstration effect' tends to reduce the price elasticity of demand for many of the commodities they purchase. All these factors tend to facilitate the taxation of people in this group by sales taxes imposed on their expenditure.

Even people with high incomes within the non-monetary sector will find it difficult to escape sales taxes completely. Part of their expenditures are on commodities produced or distributed within the monetary sector and hence taxable at the point of import or the manufacturers' level. Since barter exchange is largely concentrated at the retail level, the imposition of sales taxes at the stage of manufacturer and the point of import will ensure that the expenditure of people in this group will be liable to sales taxes.

Expenditures out of money income by people near the exemption limit, or out of income received in the form of dividends or discounts from co-operative societies, will also be liable to sales taxes. Since Egyptian expenditure is closely related to the change in income, any increase in the level of economic activity will be quickly reflected in an increase in the revenue productivity of sales taxes.

But the question which remains is how to reach the consumption expenditure of taxpayers in an administratively easy way?

There are certainly few difficulties in taxing a large part of consumers' expenditure. This is because most consumer expenditures are on manufactured products produced largely by the public sector. Even food items are to a large extent manufactured products. For example, expenditure on manufactured food items was 75 per cent of total expenditure on food in 1959/1960. This facilitates the collection of sales taxes
from producers of these items. Purely agricultural food items, by way of contrast, represent a small proportion of expenditure on food and many of these items are imported. The latter element amounted to 23 per cent of purely agricultural food items in 1959/1960.\(^{(1)}\)

Finally, the use of co-operative societies as a means of marketing agricultural products facilitates the taxation of non-imported agricultural products. Moreover, the use of co-operative societies to market agricultural products will reduce the size of the non-monetary sector. Farmers selling their products through these societies secure a higher return on their products as they avoid the exploitation of middlemen and money lenders. In addition, it avoids the waste in agricultural products resulting from the lack of marketing facilities. All these factors help to widen the coverage of sales taxes and are therefore conducive to a higher amount of revenue.

It is true that home consumed products will escape sales taxes completely. But this applies equally to the income tax. Moreover, most of the home consumed products are basic food items consumed largely by the lower income groups. As will be suggested later, those commodities considered to be basic can be exempted from sales taxes as a form of exemption limit. This means that the extent of revenue loss due to this factor will be small.

Income tax, on the other hand, does not possess such a wide coverage. As mentioned earlier, its coverage is smaller due to the

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\(^{(1)}\) A comparison between figures of imports of food items in 1959/1960 with those in 1954 presented in chapter VI should be interpreted with care. This is because imports of wheat in 1954 were abnormally low and thus affected imports of food items. The figures of the preceding and succeeding years represent more normal figures.
exclusion of certain types of income (agricultural profits, capital gains, etc.). It has been shown that within the short period it is not possible to tax these types of income. Problems of valuing and assessing agriculture income present special difficulties, especially when the administrative capacity of the country is taken into account.

It may be argued that if the exclusion of agricultural profits is the factor causing the income-tax to be deficient then, within the framework of government policy of relying on co-operative societies to market agricultural products, it should be possible to tax these profits. The income of farmers is easily known as it is simply the result of multiplying the price paid and the quantity purchased by the societies.

However, producers in the agricultural sector might be tempted not to market their products through co-operative societies so as to avoid the payment of income-tax, thus conflicting with the avowed policy of encouraging these societies. And, since farmers might find it more advantageous to barter their products, or sell through the medium of middlemen or money lenders whose power might increase in consequence, any such action might discourage the expansion of the monetary sector. Naturally, this will be reflected in the revenue productivity of the income-tax, especially if we take into consideration the difficulties inherent in collecting taxes on income that does not admit of easy assessment.

(B) The Ease of Administration

Sales taxes in Egypt are a quicker device for producing revenue than the income-tax. This is because of the ease of administration
within the existing capacity. Sales taxes are collected at a point chosen in the expenditure circuit, i.e., the import point or at the manufacturers' level. The latter provides easy collection, especially in recent years, since a large part of the industrial, financial and commercial undertakings are under public control.

Furthermore, as the demand for different goods and services is rising at a faster rate than the increase in income, the rate of increase in revenue from sales taxes is likely to be higher than under an income-tax. But the time horizon in which such a rapid rate of increase in consumption expenditure can continue is limited to the very short period. Over a long period of time, the rate of increase in consumption cannot increase above a 100 per cent rate of increase in income, assuming reasonable average and marginal propensities to consume. There will come a time when the desire of consumers to increase their consumption very quickly to satisfy newly created wants will fade as a result of the rise in the standard of living which accompanies the rise in income. These factors will be reflected in the revenue productivity of sales taxes.

This should not be taken as an indication that the yield of sales taxes will decline as a result of the slowing down in the rate of increase of consumption expenditure in the short-period. The wider coverage of

(1) Available statistics show that the rate of increase in private consumption expenditure was 40 per cent higher in 1956 than in 1950 compared with a rate of increase of national income of 30 per cent over the same period. On the other hand, the rate of increase of expenditure on items considered as 'luxuries' was 103 per cent in 1954 relative to 1945, while the rate of increase in national income was 70 per cent. For details See: U.N.: Economic Development in the Middle East 1956/1957, p.73 and N.P.C.: The Measurement of Taxable Capacity in Egypt, Memorandum 344, Cairo, Sept. 1959, by Hogear, M.
sales taxes will result in a higher amount of revenue than an income-tax having a smaller coverage. In addition, the ease of administering sales taxes within existing conditions means that the tax will be properly enforced compared to an income tax.\(^1\) This is especially important when we take into consideration the fact that ease of administration was responsible in part for the shorter lag between the expenditure of consumers and the collection of sales taxes revenue. Compared with the income tax, revenue from sales taxes can be levied quickly and efficiently.

Under an income-tax, it may be true that after a period the rate of growth of national income may equal or exceed the rate of growth of consumption expenditure. But from the revenue point of view this is not sufficient since any such advantage may be outweighed by the concomitant disadvantages of the income-tax (smaller tax coverage, larger number of arrears, and greater tax evasion).

In the longer run, the attraction of the income-tax as a source of revenue is that the increase in income will be reflected in a large increase in revenue, especially when the tax is progressive. This is especially important when the coverage of the tax will be widened to include other sources of income and administrative efficiency will increase to enforce the tax properly.

As will be suggested later,\(^2\) it may be argued that the exemption of basic necessities and the use of discriminatory rates may weaken the

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\(^1\) The average cost of collection of sales taxes during the period 1940-1958 was 0.7 per cent, compared with an average rate of 2.8 per cent under the income tax. (See also Appendix J and K.)

\(^2\) Basic necessities will be exempted from sales taxes due to the difficulties in administering social dividends as will be explained in chapter VIII.
revenue productivity of sales taxes. This is not likely to be the case in Egypt. The exemption of basic necessities, it is true, will have an effect on the revenue productivity of sales taxes. But the use of highly discriminatory rates can play an important role in outweighing the loss of revenue due to exemptions. There is thus little danger that the use of progressive rates will discourage the level of demand for these commodities to any significant extent. The low price elasticity of demand resulting from the 'demonstration effect' tends to modify the effect of these taxes in reducing consumption expenditure. Moreover, the limitation of substitution between highly taxed and lightly taxed or exempted commodities due to the widespread gap in the standard of living between the higher and lower income groups, (1) tends to limit further the extent of potential changes in consumption patterns. This is especially important when we take into consideration the fact that the higher income groups consider commodities consumed by the lower income group as inferior goods. This will also be a factor limiting the reduction in the revenue due to the shift of consumers' expenditure towards lightly taxed commodities.

But this should not be taken to mean that higher rates of sales taxes will not affect consumers expenditure at all. The influence on the rate of increase of consumption expenditure is likely to be more noticeable than the influence on the level of consumption. Through the income-effect, sales taxes will absorb part of the increase in income and thus tend to restrict the rate of increase in demand. In addition, the imposition of progressive sales taxes is likely to discriminate against present consumption and thus encourage future consumption. The net result is

that the rate of increase of consumption expenditure will be slowed down with consequent effects on the rate of increase of revenue from sales taxes. But, as explained earlier, the slow rate of increase in consumption expenditure need not weaken the reliance on sales taxes as a source of revenue in the short-run. (1)

(C) Empirical Evidence:

It was shown previously that sales taxes supplied the Treasury with a considerable though declining percentage of revenue. This decline is attributable to the accidental factors mentioned above rather than to any inherent defect in sales taxes. The analysis has shown that the present revenue of sales taxes is derived from only a part of their potential coverage. For instance, attention was drawn to the failure of the excises to tax home produced commodities formerly imported. Moreover, expenditure on services is largely exempted from sales taxes. The important expenditures thus untaxed are: rent, public utilities, personal services, hotels and restaurants.

The use of sales taxes will, therefore, ensure the effective enforcement of the tax on different wealth and income groups, and consequently will be more successful in providing a large amount of revenue. An example, based on the performance of the economy in the past, can be given here to illustrate the success of sales taxes as a source of revenue.

(1) Because of the wider coverage, administrative ease, and the progressive rate structure. It should also be remembered that the government's need for revenue is for finance of development programmes. Therefore, even if we accept that sales taxes encourage more savings and are thus likely to be less productive of revenue, this is not necessarily disadvantageous. The increase in private saving may provide the resource necessary for development programmes through private rather than the public sector. This will reduce the need for public saving.
The example takes the form of a rough estimate of the potential revenue productivity of sales taxes when their coverage is expanded to include expenditure on different goods and services for the year 1954. This year was chosen because data are readily available. Unfortunately, available figures are total figures for different groups of commodities without the details of expenditure of different income groups. Nor are there any figures for expenditure on commodities liable to excises. However, use will be made of the available figures for total expenditures on those items considered as 'luxuries' in Egypt.

This estimate is based on the following assumptions:

(1) The figures of the value of imports of consumers' goods in 1954 will be considered to constitute imports of 'luxuries'. The total of this figure was £.E. 44 million in 1954.

(2) Expenditure on excised consumers' commodities will be estimated to be equal to the value of imports of consumers' goods in this year, and will be considered also as 'luxury' items. Their value then will be £.E. 44 million.

(3) The difference between total consumption expenditure in 1954 (which was £.E. 709.4 million) and expenditure on items considered as 'luxury' (including imports and excised commodities according to assumptions 1 and 2) will leave the rest to be those expenditures on basic and non-luxury items. From this net figure, 40 per cent of total consumption expenditure will be deducted to represent commodities considered as basic necessities and therefore exempted from the tax. This item is £.E. 283.7 million.
(4) The rates to be applied on 'luxuries' will be an average of 30 per cent while 'non-luxuries' will be liable to 10 per cent. 'Luxury' imports in Egypt in 1954 were liable to an additional ad valorem levy, (in addition to specific and ad valorem rates applied), of not less than 30 per cent, while it rises to 100 per cent on some other commodities. Imports of purely agricultural products paid on the average 12.8 per cent, manufactured food items paid an average of 32.5 per cent, and other manufactured imports paid an average of 55 per cent.

On these assumptions the revenue productivity of sales taxes will be arrived at taking total expenditure on private consumption to be £.E. 709.4 million, (1) and the expenditure on 'luxury' items to be £.E. 241 million. (2) From expenditure on 'luxuries', the estimated sum of expenditure on excises and the value of imports of consumers' goods will be deducted to reach a net figure for the non-taxed expenditure on 'luxuries'. This gives the net taxable expenditure liable to a 30 per cent rate.

Expenditure on 'non-luxury' items will be arrived at by deducting 'luxury' expenditure from total private consumption expenditure. In addition expenditure on basic items will be deducted from this figure. The net figure will represent the net tax base which will be liable to a 10 per cent tax rate.


The following is the net result of this calculation:

(1) Total Expenditure on 'luxuries' in 1954 £ 241.0 m.
   (a) Value of imports of consumers' goods £ 44.0
   (b) Expenditure on excised commodities £ 44.0 88.0

(2) Net Tax Base liable to 30% rate £ 153.0

(3) Total Private Consumption Expenditure in 1954 £ 709.4
   - Less Expenditure on 'Luxuries' £ 241.0 468.4

   40% of the total consumption expenditure representing basic necessities 283.7

(4) Net Tax Base Liable to 10% rate 184.7

   Tax Liability on (2) £ 153 x 30% £ 45.9
   Tax Liability on (4) £ 184.7 x 10% £ 18.5

   Total Additional Revenue to Existing Sales Taxes £ 64.4

It is apparent from these calculations that, within the assumptions given above, sales taxes' revenue was around £E. 64 million, i.e. 7.8 per cent of national income in 1954. This compares with revenue from the personal income tax of £E. 11.5 million, which suggests how successful sales taxes can be in raising revenue for the treasury of Egypt.

One objection to the imposition of sales taxes on home produced commodities is that it may defeat its own purpose by discouraging investment through its effect on demand. That is not likely to be the case in Egypt, as is shown in detail in chapter VIII.
V. CONCLUSIONS

The above discussion has shown that the income tax in general and sales taxes in particular were responsible for the low level as well as the low rate of growth in tax revenue. This led to the decline in the percentage of total tax receipts to total government receipts and to national income in 1959 relative to 1938.

It may be argued that since the income tax is new in the Egyptian tax structure, and its contribution is still small, it might be advisable to improve the existing system of income taxes by expanding their coverage and enforcing them properly on different taxpayers. However, within the short-period it is difficult, if not impossible, to lay great reliance on income taxes. The difficulties of imposing an income tax on the excluded sources, especially income in the form of agricultural profits received by big landlords, stems from the political power of landlords. The existing administrative conditions also make it difficult to enforce a tax on this group at any reasonable cost of collection. (1)

Moreover, since the introduction of the income tax law in 1939, profits, dividends and discounts of co-operative societies have been exempted from income tax. This was based on the assumption that these societies represent a co-operation between different individuals to serve the interest of each other so that they do not operate on a profit basis. But such an exemption is based on a misconception of the income received by the shareholders of these societies. It ignores the fact that discounts and dividends distributed

(1) At present the average cost of collection of the income tax revenue during the period 1940 - 1956 was 2.8 per cent compared with an average of 0.7 per cent under sales taxes. If agricultural profits are included in income as a tax base, the cost of collection will rise to a higher level since their assessment requires more skill and effort than other types of income, especially when some parts are within the non-monetary sector.
to shareholders are a disguised form of profits that are really like any other profits realized by a limited liability company. Therefore, from the revenue point of view, profits, discounts and dividends are a source of income to the shareholders of co-operative societies like any other dividend received. There is a presumption, therefore, that they should be subject to income tax. Yet, this might defeat the government objective of encouraging the establishment of these societies, and thus their exemption from income tax may be necessary.

In the short-run, the reliance on sales taxes, within the present economic policy of Egypt, will be more effective in reaching different wealth and income groups. This will enable the tax system to supply the treasury with an increasing amount of revenue to help in financing development plans. However, in the long-run, the attraction of sales taxes may be less because of the difficulty in varying the rates on services, and the differentiation in the treatment of 'luxuries' and 'necessities'. Moreover, the rate of increase in consumption will slow down as the standard of living rises, and thus will not be higher than that of increase in income. Finally the increase in savings which accompany the increase in income will be another factor tending to reduce the efficiency of sales taxes as a major source of revenue. However, this is not the place to discuss the long-run alternative though this problem will be briefly discussed in the concluding chapter.

The next chapter is devoted to showing that the success of sales taxes as a major source of revenue cannot be outweighed on the ground of the regressiveness in its incidence. On the contrary, it will be shown that sales taxes can be made as progressive as income taxes, and consequently as equitable.
CHAPTER VIII.
CHAPTER VIII

THE EQUITY OF SALES AND INCOME TAXES IN EGYPT

Equity is one of the main objectives of tax policy in Egypt. To demonstrate the degree of equity obtained within the existing system of taxation, it is necessary first to see the extent to which taxes levied in Egypt conform to the most commonly accepted principle concerning the distribution of the tax burden, i.e., the principle of 'ability to pay'.

I. THE BASIS OF EQUITY IN THE EGYPTIAN TAX STRUCTURE:

It is generally considered by taxpayers in Egypt that the tax system is designed to secure equity through the principle of 'ability to pay'. An examination of the taxes used in Egypt and the way in which they are levied gives the impression that equity as prescribed by this principle is not secured. This conclusion can be justified by reference to different taxes which rely on two basic measures of taxable capacity interpreted under this principle. The most important of these taxes in Egypt are the income tax and the sales tax. (1)

(A) Income Tax: The income tax is basically a tax levied according to the source of income with little regard to the personal circumstances of different taxpayers. In this respect, income tax fails in the basic requirement of the principle of 'ability to pay', i.e., the equal treatment of equals. Different people receiving the same income may be taxed differently merely because they receive their income from

(1) As mentioned earlier, the tax system in Egypt is characterised by continuous change. It will be impossible to study it properly without limiting the discussion to a certain period. Since available statistics and changes are available up to the year 1959, this study will be limited to the structure of income and sales taxes as they were in 1959.
different sources. On the other hand, inconsistency in applying the exemption limit tends to produce inequality in the treatment of individuals with the same income but different personal circumstances. This can be clearly demonstrated in the following examples:

(i) Schedule income tax excludes from the tax base agricultural profits which accrue largely to wealthy landlords. It is strange to find a tax system in an agricultural economy excluding agricultural profits from income tax in spite of their importance as a source of income. (1) This situation is due to difficulties of administration and the political power of the landlords which is used to block such tax reforms.

The net result is that the equal treatment of equals (a necessary condition for securing equity), among different taxpayers receiving their income from the agricultural and non-agricultural sector, is neglected.

(ii) The treatment of capital gains does not follow a consistent pattern under the schedule income tax. Capital gains realized by selling one of the assets of an industrial undertaking are included in the tax base, while capital gains realized by an individual selling his land or buildings are not liable to income tax so long as the sale is not made by a professional dealer. This means that people receiving part of all of their income from this latter source are not liable to tax, whereas others who receive their income from other sources are.

(iii) The tax rates within each schedule are uniform, but the rates for different schedules vary a great deal. For example, while income derived from moveable property and profits from

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(1) The percentage contribution of agricultural profits to national product reached 17 per cent in 1954. See table 8 in Chapter VI.
industrial undertakings are liable to 17 per cent, income received in the form of rents from buildings is liable to 12 per cent, and in the form of rents from land to 14 per cent. This means that people receiving the same amount of income but from different sources are not paying the same amount of tax.

(iv) The family circumstances of different taxpayers are not generally recognized except within very narrow limits. Exemption limits and allowances are granted only on incomes worth not more than double the total value of the exemption limit and allowances. When income exceeds this limit, no exemption limit and allowances are given. This means that people receiving an income above double their exemption limit and allowances, are not treated equally, because people receiving the same amount of income, but eligible for different allowances, are treated the same.

(v) Because of the difficulties of administering an income tax and the resultant accumulation of a large number of arrears, the legal income tax base was changed from the actual income earned in the current year to the amount received in some earlier year. (1)

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(1) According to the Laws 240/1952, 587/1954, and 206/1955, the profits assessed for 1947, for taxpayers falling under the commercial and industrial schedule, were considered as profits for each of the years from 1948 to 1954 for taxpayers having no reliable records. This was designed to end arrears. In 1955, it was found that arrears were still accumulating. Thus another law was enacted (302/1950) which stipulated that 1955 profits were to be taken as a basis for profits in the years from 1956 to 1958 if 1955 profits were less than £500 a year. As a result of this law, 93.5% of schedule income taxpayers on industrial and commercial undertakings are assessed on an arbitrary basis.
The use of this arbitrary administrative simplification completely disregards the taxable capacity of taxpayers in any particular year. Receivers of equal incomes in any given year may be taxed differently according to the extent of the discrepancy in their profits in an earlier year.

These examples indicate that schedule income tax as applied in Egypt departs from the principle of taxing people according to their 'ability to pay'.

Furthermore, ease of tax collection rather than the desire to secure equity has been the purpose of many of the provisions in the tax code. There is often a conflict between these two considerations because the ease of tax collection does not necessarily mean that equity will be secured and vice versa. Administrative feasibility usually requires some sacrifice of equity. It has been sacrificed to such an extent in the Egyptian case that the income tax can no longer be regarded as securing equity according to the principle of 'ability to pay'.

The above defects have been magnified in some cases and mitigated in others by the introduction of the surtax in 1949. This tax applies to those taxpayers whose income from all sources exceeds £1,000 a year.

Since the surtax base is composed of income falling under all schedules, net of the schedule income tax paid, this means in effect that the tax retains all the shortcomings which caused the schedule income tax to depart from the principle of 'ability to pay'. Agricultural profits and exempted types of capital gains are still excluded, and the arbitrary methods of assessing income apply to the surtax base as well.
In other cases, surtax tends to equalise the distribution of the tax burden and enhance the application of the principle of 'ability to pay'. The inconsistencies in rates under the income tax schedules alone are reduced, since the surtax paid on income falling under an income tax schedule with low rates will be greater than that on income falling under a schedule with high rates.

Moreover, the circumstances of different taxpayers are taken into account under the surtax thus overcoming to some extent the neglect of this factor under schedule income tax. Unfortunately, the application of the surtax is limited to those whose income is above £1000 per year, while individuals whose income is below £1000 a year still suffer the inequities of the income tax schedules.

Thus, it seems fair to say that the introduction of surtax, though a step towards the application of the principle of 'ability to pay' with respect to income, still falls short of an adequate approximation to that principle.

(B) Sales Taxes: Sales taxes in Egypt are composed of import duties and excises. An examination of the principle upon which these taxes are levied indicates that they do not conform to the principle of 'ability to pay' based on consumption expenditure.

Generally speaking, the coverage of sales taxes in Egypt is not wide enough to include all expenditure on goods and services. Consequently, expenditures, though accepted as a tax base, cannot be regarded as

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(1) According to surtax returns in 1957, the number of taxpayers whose income was above £1000 a year was 20,309, i.e., 4% of total income taxpayers.
representing the taxable capacity of different taxpayers. In fact, the policy followed in determining the tax coverage appears to be inconsistent.

On the one hand, the government policy of encouraging industrialization tends to reduce the general coverage of sales taxes because imports of consumers' non-durable goods have declined,\(^1\) while the excise coverage has not been extended to the domestically produced commodities which have replaced these imports. It is surprising to notice that the coverage of excise duties has not increased since their introduction in the thirties.\(^2\)

As a result of these two factors, the composition of consumption expenditure between taxed and non-taxed expenditure, rather than its level or rate of increase, has changed towards more expenditure on non-taxed commodities with consequent effects on the coverage of sales taxes. This may be attributed to the conviction that taxes on expenditure are regressive, yet as we have seen and will be seen again later, sales taxes may be more equitable than income tax.

The need for revenue, however, induced the government to widen the coverage of sales taxes in other directions. Expenditure on services such as travel abroad was taxed, and a tax on rent paid by tenants benefiting from the Rent Restriction Act of 1944 was levied. This latter tax is paid by the owners of houses built after 1944.

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\(^1\) The percentage value of imports of consumers' non-durable goods declined from an average of 22.9% in the years 1948-1950 to 9% in 1959. The value of imports during this period increased from an average of £175m to £186 m. Imports of consumers' durable goods increased slowly over this period. The net result is that the total value of imports of consumers' goods rose from £58 m. in 1948 to reach £70 m. in 1950, (i.e., rate of increase of 11% per annum), then reaching £73 m. in 1959, (i.e. rate of increase of 0.4% per annum). This gives an idea of the decline in the coverage of sales taxes in the direction of consumers' non-durables. For details see: N.P.C. Statistics on International Trade, Production, National Income, and Capital Formation, No. 86, 1959, and Ministry of the Treasury, The Budget Reports 1959/60, 1960/61.

\(^2\) Commodities produced in Egypt and subject to excise duties are: Alcoholic drinks, petrol, beer, sugar, cement, coffee, matches, playing cards.
From these two factors, it is apparent that sales taxes do not secure equity even if expenditure rather than income is taken as the measure of taxable capacity. Not all types of consumers' expenditure is liable to the tax, nor is there any consistent liability on those expenditures subject to the tax. Consequently, different people may have an equal expenditure, but pay different amounts of tax depending on whether the commodities purchased are imported or home produced. Moreover, the tax levied on rent is restricted to a certain class of tenant to the exclusion of others. It may be argued that tenants of houses built before 1944 enjoy the benefit of the low rent protected by the Rent Act and are therefore in a favourable position compared with others who pay a larger rent for houses built after this date. Therefore on grounds of equity, tenants protected by the Rent Act have a higher taxable capacity than those who pay a higher rent in new houses. However, this argument is invalid as taxable capacity must be measured in respect to expenditure on different goods and services rather than on rent alone. Moreover, the high rents paid by the other category of tenants, not being a tax but representing the value of the flat, has no relation to the capacity of a tax on expenditure. Thus consistency in applying the principle of equity to a tax on expenditure on different goods and services requires the taxation of all expenditures on rent without discrimination. If it is desired, for social reasons, to discriminate in favour of a certain class of tenants, this desire must be weighed against the sacrifice of equity.

Finally, in fairness to sales taxes now existing in Egypt, it should be pointed out that they possess the other conditions necessary to secure
equity, i.e., an exemption limit and progressive rates. The exemption limit of sales taxes in Egypt is applicable by exempting from import duties certain basic commodities such as maize, meat and canned fish, which are consumed by the majority of the population. Excise duties, on the other hand, apply to few commodities with a relatively high income elasticity of demand such as sugar, petrol, coffee and alcoholic drinks.\(^{(1)}\) Therefore, expenditure on basic necessities is hardly affected by sales taxes.

The progressive structure is achieved by applying high rates on imports with a high income elasticity of demand and lower rates on goods with a lower income elasticity of demand. In addition, since 1949, an ad valorem rate has been levied on 'luxury' commodities which have a high income elasticity of demand.

Excise duties follow the same pattern, but the additional tax on 'luxury' goods is imposed on alcoholic drinks only and at specific rates. However, most of the commodities liable to excises, especially alcoholic drinks, though having a fairly high income elasticity of demand, (also tobacco, sugar, coffee), tend to have a low price elasticity of demand and are chosen for excise tax liability solely for revenue purposes.

In conclusion, the tax system as it exists at present in Egypt, represented by income and sales taxes, cannot be considered as satisfying the basic requirements of the principle of 'ability to pay'. In fact, the tax system in Egypt reflects a desire for ease of collection, rather than the pursuit of equity. Since the objectives of administrative feasibility and equity are frequently in conflict, the Egyptian tax structure diverges widely from the usual conception of an equitable revenue system.

\(^{(1)}\) It should be noted that some of these commodities liable to excises are used for the production of other commodities, but this is likely to be on a small scale, i.e., sugar and petrol.
As the principle of 'ability to pay' can be applied to either income or expenditure as a tax base, the question remains as to what interpretation best fits the circumstances prevailing in Egypt.

II. INTERPRETATION OF THE 'ABILITY TO PAY' PRINCIPLE IN EGYPT:

The principle of 'ability to pay', as interpreted in the literature, requires that income is the required measure of taxable capacity. However, it was contended earlier that within the conditions of less developed countries, expenditure rather than income is an appropriate measure of taxable capacity.\(^{(1)}\) The circumstances and conditions prevailing in the Egyptian economy as well as the social standards accepted by the majority of population would support this conclusion. Different reasons can be cited in its support.

In the first place, Egypt is characterized by a high rate of increase in consumption expenditure which accompanies the rate of increase in income. As we demonstrated in Chapter VI, while the national income increased by 30 per cent between 1956 and 1950, the rate of increase in consumption expenditure was much higher, reaching 40 per cent over the same period. Moreover, statistics available show that expenditure on certain items considered as 'luxuries', (without specifying the items included), also increased at a faster rate than that of income.\(^{(2)}\) This gives the impression that the rate of increase in consumption expenditure in Egypt was much higher than the rate of increase of income.

\(^{(1)}\) See Part I, Chapter IV.

\(^{(2)}\) For example, while national income increased by 70 per cent between 1954 and 1945, expenditure on items considered to be 'luxuries' by the National Planning Commission increased by 103 per cent. For details See: N.P.C. The Measurement of Taxable Capacity in Egypt, by M. Hogear, Memorandum 344, Cairo, Sept, 1959,
Since such a rapid rate of increase in expenditure on goods and services imposes a burden on the community by reducing its ability to increase production and income in future periods, and as the reduction in the rate of increase of these expenditures imposes a sacrifice on consumers, equity requires the distribution of the burden involved in this sacrifice according to the rate at which each individual withdraws from the common pool.

Secondly, in an economy characterized by a high propensity to consume such as that of Egypt, the choice of consumption expenditure as a tax base seems to reflect the real taxable capacity of taxpayers better than income. Expenditure in this case takes into consideration the spending power inherent in wealth and other means of increasing the satisfaction of taxpayers. Egyptian evidence suggests that liquidation of wealth, especially by property owners, plays an important part in financing consumption expenditure. Moreover, where real capital gains are a source of income resulting from development programmes and the rapid increase in population, the choice of expenditure as a tax base ensures that expenditure out of these sources of income will fall into the tax base.

Thirdly, in Egypt, with the majority of the people living near the subsistence level and only a few enjoying a high standard of living, the consensus of opinion is that equity should be based on the command over resources so as to close the wide gap in the standard of living of the higher and lower income groups. Income, if considered to be the measure of relative standards of living, seems to be merely an illusion, as it is only one of the relevant factors. Ownership of wealth is another factor which influences the

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standard of living, and which is ignored under a tax based on income. As expenditure is financed not only out of income but also out of the liquidation of capital and the realization of capital gains (which is not considered as income in Egypt in most cases), therefore, the choice of a tax based on expenditure is more appropriate as a measure of the standard of living of different income groups. A tax based on expenditure would seem to secure equity as interpreted by the majority of the population.

Finally, the problems of enforcement, within the existing distribution of national income, give preference to a tax based on expenditure rather than a tax based on income. These problems will be illustrated in the following section by illustrating difficulties of administering a tax on income within this distribution; we then see how a tax on expenditure overcomes some of these difficulties.

III. THE COMPOSITION OF NATIONAL INCOME AS A FACTOR FAVOURING EXPENDITURE AS A TAX BASE

It has been shown earlier that income generated in the agricultural sector represented 36 per cent of total national income in 1954. (1) Difficulties arise in assessing the income received by the factors of production in this sector, either because people do not know their income, or because they tend to conceal it for tax purposes. By far the most important sources of income in the agricultural sector are profits and interest, and these categories of income are the most difficult to assess. (2) Because of the administrative difficulties in taxing people in this sector, and the political power of the landlords, these profits which are an important proportion of national income escape a tax on income completely.

(1) See Table 8, Chapter VI.

(2) Agricultural profits and interest represented 47 per cent of total income generated in the agricultural sector and 17 per cent of total national income in 1954. See details in Chapter VI.
Similar difficulties arise with respect to the other sources of income from agriculture: rent, wages and salaries. Income from rent is treated arbitrarily through a land tax based on the estimated rental value. The taxes on wages and salaries, difficult to collect when income exceeds the exemption limit, are further complicated by the difficulty in determining whether particular incomes exceed the exemption limit.

The difficulties of administering an income tax are not limited to the agricultural sector in Egypt, but extend also to the non-agricultural sector. The only incomes which are effectively taxed by an income tax in the latter sector are wages and salaries from which the tax is deducted at source. This form of income, though important, represents less than half (about 40 per cent) of income in this sector and less than one-fifth (about 19 per cent) of total national income. The significant share (i.e., 43 per cent of non-agricultural income and 20 per cent of national income) goes to profits and interest. As explained before, these profits are largely derived from the service industries, (small retailers, traders, etc), and to a smaller extent from the industrial sector. The taxation of this income represents the most troublesome problem to the Taxation Department in Egypt. These problems arise from the limitations of the existing tax administration in the face of low tax morality and the inadequate records. This resulted in the accumulation of a large number of arrears. To end these arrears, the government introduced certain arbitrary laws which bore no relation to any conception of equity. As a result of these laws nearly 94 per cent of total income taxpayers in 1958 were assessed on an arbitrary basis without considerations of equity.

(1) Compiled from figures about the number of taxpayers under the industrial and commercial schedule for 1958 as they are grouped under groups A, B, C, and D, where Group A means taxpayers whose profits are above £1000, Group B, between £500 and £1000, Group C, between the exemption limit and £500, Group D, below the exemption limit. Source: Taxation Department, Statistical Division, Cairo, (Unpublished material).
In summary, out of national income generated in 1954, 17 per cent was completely exempted from income tax because of administrative and political problems, while another 20 per cent was not fully taxed because of the use of arbitrary rules and the discrepancy between the actual profits earned and those which were taxed. The only share of income which is effectively taxed in Egypt is that which accrues to wage and salary earners in the non-agricultural sector. If this is the case, and if ease of collection rather than equity is the prime consideration, then equity cannot easily be secured. There is no way in which it is feasible to avoid the above mentioned defects in the short run as it takes a long time to develop an administration capable of efficiently handling a difficult system of tax collection. Moreover, in Egypt where tax morality is low and illiteracy is widespread, the effective enforcement of the income tax would require high collection cost, which may not be justified in terms of the extra revenue received.\(^1\)

It remains to be seen how far a tax based on expenditures on different goods and services can avoid these difficulties and succeed in collecting the taxable capacity of taxpayers who manage to escape a tax on income. The most important group in this respect are receivers of profits.

In the case of income received in the agricultural sector in the form of profits and interest, the use of a tax on expenditure is likely to provide a more effective type of tax than a tax on income because it avoids most of the administrative difficulties of taxing the spending power of people in this group. Large landlords usually reside in cities where the facilities of living and social activities (which characterize their life) are well developed.

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\(^1\) The average cost of income tax collection, with the existing high rate of evasion during the period 1940 to 1958 was 2.8%, while that of sales taxes was 0.7%. See Appendices J and K.
Thus their expenditure is normally within the monetary sector and can, therefore, be reached by a tax on expenditure.

Furthermore, the pattern of expenditure of the higher income groups (who are largely property owners in Egypt) is different from that of the lower income groups. (1) There are no available statistics about the pattern of expenditure of different income groups in Egypt. But available evidence suggests that the lower income groups spend a large part of their income on food, shelter and clothes. The upper and middle income groups, on the other hand, are inclined more towards manufactured goods and services and less towards food items. Even expenditure on food items tends to move upwards in quality. This has been confirmed by the U.N. report on Egypt where it was found that "as in the past the increase in income from agriculture continues to be spent on the purchase of land or on the construction of buildings or on luxury products." (2)

If this represents in a broad way the consumption expenditure of the lower and higher income groups in Egypt, it would seem that people receiving their income in the form of agricultural profits (and in the form of profits which cannot be easily and properly assessed under an income tax) can be reached more effectively and easily by a tax on expenditure rather than by a tax on income.

In the first place, manufactured products are either imported or produced in the home market. In the case of imports, there is general agreement that imports are controlled effectively for tax purposes through the few outlets of the country so that evasion from import duties is very difficult if not impossible.

(1) Issaur, Charles, *Egypt at Mid-Century*, Oxford University Press, 1954, pp.84-89

The importance of imports of manufactured consumer durables (cars, electrical appliances, etc) is still significant, but the imports of manufactured consumer non-durables is not very significant now because of the growing importance of domestic industry. (1)

However, this should not be taken to mean that the effectiveness of a tax on expenditure on manufactured consumer goods is reduced because of the difficulty of enforcing the tax on commodities produced within the country. Industrial activity is closely controlled by the public sector and this simplifies the collection of taxes on commodities home produced by a few large firms. Any danger that excises on home produced commodities will put domestic production at a disadvantage relative to imports is avoided by levying excises on imports in addition to import duties. This means that the competitive advantage of home produced commodities remains.

Expenditure on food items is not likely to raise any serious problems for a tax on expenditure in Egypt. This is because a very high proportion of expenditure on food items is on manufactured products. (2) Imports of manufactured food items are not a significant part of the total of manufactured food items.

(1) For example, figures show that imports of manufactured consumer non-durables declined for 23 per cent in the years 1948-1950 to 9 per cent in 1956 (averages), while that of consumer durables increased from 11 per cent in 1948-1950 to 17 per cent in 1956. For details, see: U.N.: The Economic Development of Manufacturing Industry in Egypt, Turkey and Israel, New York, 1953.

(2) Figures available for 1959/1960 show that expenditure on manufactured food items amounted to £374 million out of total expenditure on food items of £504 m., i.e., 74 per cent of total food expenditure on manufactured products. See N.P.C.: The Details of the First Year of Development Plan 1960/1961, Cairo, July 1960, p.96.
food items consumed, e.g., in 1959/1960 they amounted to only £24 million, or 6.5 per cent of total expenditure on manufactured food items in Egypt. Here again, since manufactured food items are largely produced domestically, the existing government control over a large part of industrial activity will facilitate the collection of a tax on such commodities.

Consumption expenditure on wholly agricultural food items does not appear to raise any difficult problems in this respect either. This is because a large part of expenditure on these items is on imported commodities. Thus the ease of taxing imports will facilitate the taxation of part of expenditure in this category.

On the other hand, co-operative societies exist in every Egyptian village to help farmers with loans, improvements in productivity, and marketing, and can be used as points of tax collection. Sales by these societies to wholesalers (or wholesale prices when sales are made to others, i.e., retailers or consumers) can be made the tax base, thus avoiding many of the complications associated with the taxation of agricultural products. Co-operative societies are relatively large institutions with good records and are subject to government control. It is true that under this system, farm output consumed on the farm


(2) Imports of wholly agricultural products are a significant part of total expenditure on this item. They amounted to £30 million out of a total expenditure of £130 million in 1959/1960, i.e., 23 per cent of expenditure on wholly agricultural products. Figures are derived from: N.P.C. The Details of the First Year of Development Plan in Egypt, 1960/1961, Cairo, July 1960, pp. 99-102.
will escape sales taxes, but this is not a defect which is avoided by an income tax. In any event, most of the home consumed commodities are likely to be of a basic character and exempted from sales taxes. Thus equity will not be injured in any significant way.

Finally, the taxation of expenditure on services is not likely to raise any serious problems either. In 1954 (the only year for which figures are available), expenditures on services represent 23 per cent of total expenditure. Some of these expenditures are already taxed. The following table (Table 16) illustrates expenditure on services relative to total expenditure on consumption for the year 1954, as preliminary data to explain the relative ease of taxing different types of expenditure in Egypt.

Table 16. Expenditure on Major Service Items as a Percentage of Total Consumption Expenditure in Egypt, 1954.

<table>
<thead>
<tr>
<th>Rent</th>
<th>Transport</th>
<th>Other Services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>9.6</td>
<td>4.9</td>
<td>8.1</td>
<td>22.6</td>
</tr>
</tbody>
</table>


(1) It should be noted that there is no inconsistency between the percentage of expenditure on services to total expenditure on consumption and the percentage of income received from the services industry sector as given in Chapter VI, Table 7. (the former appear appear to be too low). This is because consumption expenditure is at market prices while income received is at factor cost. Since expenditure on services represents only a small proportion of total expenditure on consumption, and is restricted in its liability to taxes while expenditure on consumer goods is larger in size and liable to higher rates of sales taxes, therefore, the percentage of expenditure on services to income at factor cost will be lower than the percentage of expenditure on goods produced to income at factor cost.
It is apparent from the above figures that rent constitutes the highest single item of expenditure on services, representing about 43 per cent of the total. Experience has shown that it is feasible to tax rent paid by tenants. In Alexandria tenants have been taxed on rent for many years and in 1956 this tax was generalized on a national scale in the form of a defence tax. This tax falls on the tenants of houses built before 1944, while the statutory taxpayer was the owner of houses built after 1944. In fact, as mentioned before, this seems to be inequitable since it does not equalize the treatment of equals either among tenants or owners. To ensure equity requires that the tax should be modified so that expenditures on rent by different consumers be liable to tax at consistent rates. Under the present system the owner can be made responsible for collecting the tax. In the case of the owner occupier of a house (or a flat) the tax can be levied on the rental value of the house which can be regarded as the rent assumed to be paid by the owner to himself (imputed rent). In this case the tax will be paid by the owner in addition to the building tax which is supposed to be levied on income from rent, while the former is paid on his expenditure on rent.

Expenditure on public transport (railway, buses, etc.) represents one-fifth of the total expenditure on services in Egypt. The taxation of these expenditures does not present any difficult problems since railways and buses are under public ownership. This makes it easy to collect the tax from a few large firms. It should be noted that in some cases the price of transport (i.e. railway tickets) is subject to a tax designed to finance certain social objectives. This charge could be enlarged and extended to buses etc., without giving rise to extra problems, since these undertakings are monopolistic and hence easily controlled.
Similarly, private cars can be taxed through excises on petrol and through licences which could be made to vary with the horse-power or weight of the car. The existing machinery of taxing these activities will remain unchanged and therefore no additional strain need be put on the administration. The same system can also be applied to taxis, and the increase in cost resulting from the tax will be reflected in the price of taxi services.

There are no detailed break-down for the item 'other types of expenditure', which represents about 36 per cent of the total. Presumably this category is composed of expenditure on public utilities, (gas, electricity, telephone, travel abroad and other personal services). Few difficulties may be expected to arise in taxing the services of public utilities since they are public monopolies which can be made responsible for the tax on behalf of the government.

The transfer of money abroad for travel is liable to a tax at a proportional rate of 37 per cent, and can be checked by the licences which are given for imports. This feature would prevent the difficulties encountered in differentiating between the imports of services and capital goods.

For expenditures on other types of personal services such as hairdressing, hotels and restaurants, the difficulties of assessment and collection of sales taxes can be reduced greatly by differentiating between these services according to the nature of their business. Most hotels and restaurants, for example, are located in big cities. These are likely to be large firms which can be chosen as a point of tax collection by way of the bill presented to each consumer. When the number of rooms is small or the number of workers in these services does not exceed a certain figure, sales taxes can be incorporated with a licence tax. This will mean that sales taxes lean more towards the ease of tax collection than the strict interpretation of equity. But the ease of
administration which results from applying this rule is not likely to injure equity in any serious way. People using such small sized services are likely to be within a certain income group. Since the tax will be a cost element which will be reflected in prices to consumers, the tax will be shifted forward and paid by consumers of these services. This will ensure that consumers within this group pay nearly the same amount of tax on their expenditure on these services.

In conclusion, a tax based on expenditure on different goods and services is likely to be more effective in reaching the taxable capacity of taxpayers whether the spending power is derived from income, wealth, or other sources of spending power not included under income for income tax purposes. Moreover, it will reduce the difficulties which prevent the effective taxation of profits in the agricultural and non-agricultural sectors, and other sources of income which cannot be taxed because of administrative difficulties.

Finally, the political power of the higher income groups is likely to be reduced under a system of sales taxes. This is partly because a sales tax is incorporated in the price of commodities in a way which does not interfere with the personal affairs of the taxpayer. In addition, there is feeling that the consumer can avoid the tax by not buying the commodity and this tends to reduce the resistance to sales taxes. Finally, within the existing capacity for administration, the cost of collection of sales taxes would be low compared to an income tax. The figures for the average cost of tax collection of income tax in the period 1940-1958 was 2.8 per cent, while that for sales taxes was 0.7 per cent.\(^1\) It should be noted that the present income tax system is characterized by the existence of a large number of arrears, and any serious

\(^1\) See Appendices J and K.
attempt to end these arrears is likely to raise the cost of collection to an even higher level. On the other hand, sales taxes do not present those difficulties and any expansion in sales tax coverage to include non-taxed commodities is not likely to raise the cost of tax collection by any significant amount. This is especially true since much of the tax will be collected either by the existing machinery or through public undertakings. Therefore, from the point of view of cost of collection, equity can be secured at little cost.

There is hardly need to mention here that a tax on total expenditure as in Kalder's model, cannot be applied in the short period to which the analysis is limited, because administration is inefficient, illiteracy is prevalent, and tax morality is low. If it is difficult to administer an income tax it will be more difficult to administer an expenditure tax in the short run. It may have some place, however, in the long run.

For a tax to secure equity, the ease of reaching the taxable capacity of different taxpayers through the chosen tax base must be supplemented by other features. The most important of these are provision for exemption limits and allowances, and progressive rates.

IV. EXEMPTION LIMITS AND ALLOWANCES:

We explained in Part I that exemption limits and allowances present a serious problem for most forms of taxation. This is because of the difficulty of arriving at an exact measure of minimum requirements. Under the Egyptian income tax, taxpayers are given a fixed exemption limit and allowances varying with individual circumstances. The size of this exemption limit and the allowances is determined by what the policy maker feels is reasonable within the social, political and economic conditions of the country.
It might be argued that a similar provision could be made for a sales tax through a social dividend given to each taxpayer according to his individual circumstances, the amount depending upon the cost of basic necessities. (1) But conditions in Egypt are such that administrative problems encountered may be beyond the present capability of the state. In the first place, the personal expenditure of different individuals must be known in order to determine the amount of tax on total expenditure if that is to be used as the basis of the social dividend. It is difficult to get information about the patterns of expenditure of different individuals. They are likely to vary from one person to another, and hence it becomes difficult to arrive at the social dividend even for people within a given income group, especially when those individuals are located in cities and rural sectors.

Secondly, the income of different individuals may have to be known in order to decide whether, in view of their family circumstances, taxpayers are eligible for the exemption limits and allowances.

All these problems will be difficult for the existing administration to handle in an efficient and inexpensive way. It would be more practicable to exclude basic necessities from liability to sales taxes. This does not avoid all the difficulties, however, since there are a number of other important considerations. In the first place, it is difficult, if not impossible, to secure a definition of basic necessities. Necessities are merely certain goods considered as basic to the majority of the population in a given time and place. The best way to overcome this ambiguity is to specify the commodities regarded as basic within the present conditions of Egypt. This can be done with little difficulty because of the widespread gap in the standard of living between

(1) This was suggested in Part I.
the higher and lower income groups. In addition, the results of various sample surveys undertaken to investigate the pattern of consumption of different classes of people, especially in the agricultural sector, are of great help in this regard. Border-line cases which are difficult to assign to one category or the other, are not likely to be numerous in Egypt and these can be dealt with by certain arbitrary rules which have to be made to facilitate the administration of such provisions.

There is no need to fear that the exclusion of certain types of expenditures from sales tax coverage will run against our concept of equity (a tax on the rate of 'withdrawals' from the common stock of goods and services). Basic commodities are likely to be those commodities which have a very low income and a very low price elasticity of demand. A change in income is, therefore, not likely to have any significant effect on expenditure on these items. Hence there is little likelihood of conflict between the granting of an exemption limit by excluding expenditure on basic necessities from the tax base and the concept of equity as defined earlier.

It may be argued that the exemption of basic necessities might induce a shift of expenditure from the taxed to exempted commodities, thus conflicting with the equity of sales taxes. The extent of this influence will be limited since basic necessities are food items consumed largely by the poor. It is unlikely that the higher income groups will shift part of their expenditure to these items, especially when the rich regard such commodities as inferior goods. In addition, prestige considerations tend to influence the consumption patterns of the higher income groups towards 'luxury' and away from basic items. The effect on spending patterns of exempting basic necessities may therefore be negligible.

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(1) This will also have an effect on optimal resource allocation as discussed in Chapter IX.
V. THE APPLICATION OF PROGRESSIVE RATES:

The use of progressive rates in a system of sales taxes on goods and services is not likely to meet serious obstacles in Egypt. As mentioned earlier, progressive rates are already applied to imports, though in a rather rough and cumbersome way, and revenue excises are levied on certain items with little regard to equity.

However, if the tax system is to be unified and its coverage expanded to include a wider range of expenditure (previously non-taxed), careful planning will be necessary to ensure consistency of rates. This will entail a survey of the pattern of consumption expenditure of different income groups to establish scales of rates consistent with the degree of income elasticity of demand. This is difficult to achieve in practice due to the difficulties of calculating the exact income elasticity of demand for different commodities. In addition, reliance on a sample survey of the pattern of expenditure of different consumers may give misleading results, since consumption expenditure of different consumers may vary a great deal depending on tastes, habits and traditions, even if income is the same. However, these difficulties could be reduced by taking a wider sample survey of the pattern of expenditure of different fixed income groups to represent different sectors of the population (rural and urban population, small cities and large cities, etc.)

In this case, variations in the pattern of expenditure of different income groups will reflect the changes which occur as we move up the income scale. Therefore, the scale

(1) A survey has been carried out in Egypt on a wider scale among a large section of the population to determine the pattern of expenditure of different income groups. The results are not yet available. These results could be relied upon for limiting commodities considered basic and deciding the scale of tax progression according to the pattern of expenditure and the change in it among different income groups.
of tax progression will be based on a fairly approximate degree of income
elasticity of demand. This is not likely to injure the equity of a tax based
on expenditure on different goods and services, since there is not an optimum
rate of tax progression which it is desired to achieve and which can be secured
by any other tax.

Finally, the elasticity of substitution is limited in Egypt by the wide-
spread gap between the consumption level of the upper and lower income groups. (1)
Surveys have indicated that the higher income group consume commodities in a
different range and quality from the lower income groups. Consumer durables
are purchased only by the upper income groups. In the field of manufactured
goods such as clothes, furniture etc., the lower income groups cannot afford
to buy any significant quantities even of the lowest quality, since most of the
income of this group is spent on food. Even in the case of food, the quality
as well as the type of commodities differ greatly between income groups. (2)
These factors will tend to facilitate the application of progressive rates and
limit the extent of substitution.

The rates applied should be levied on an ad valorem, rather than on a
specific basis. This will tend to equalize the treatment of equals according
to their expenditure rather than according to the weight or quantity of
different commodities consumed. Moreover, ad valorem rates will avoid certain
complications which exist in the present system where a mixture of specific and
ad valorem rates are applied.

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(1) Issaur, Charles, Egypt At Mid-Century, Oxford University Press, 1954, p.85
(2) For example, in a survey made in Egypt by the Rockefeller Foundation in 1948,
of 1071 families in the agricultural sector, 12 per cent of the sample sub-
sisted primarily on bread and cheese; another 56 per cent add to this milk
and vegetables occasionally; 25 per cent eat bread, cheese, plus milk,
vegetable and meat occasionally, and only 6 per cent eat vegetables and meat
regularly. For details see: Issaur, Charles, op.cit. p.88.
Decisions on the rate of tax progression could be made by the policy maker within the existing economic, social and political conditions prevailing in Egypt. Given the scale of tax progression, the rates will vary according to the approximation to the income elasticity of demand suggested earlier. The application of progressive rates will not introduce any serious administrative problems, provided the taxed goods and services are properly classified according to their income elasticity of demand as defined above. This procedure is already roughly followed in the existing system of import duties where commodities are grouped according to the degree to which they are considered 'luxuries', rather than strictly according to the pattern of expenditure of different income groups and the changes which occur as we move up the income scale. To facilitate the application and therefore the administration of progressive rates after widening the coverage of sales taxes, a careful classification of different commodities under different rates is necessary. This is fairly easy to apply since the manufacturers' level in Egypt concentrates on a few products so that it would be possible to differentiate.

It may be argued that progressive sales taxes will encourage consumers to reduce their expenditures on highly taxed commodities or shift their expenditure to more lightly taxed or exempted goods, thus causing an increase in the inequality of wealth.

However, this argument should not be given too great a weight as circumstances prevailing in Egypt tend to modify the effect of highly progressive taxes on consumption expenditure.

In the first place, the influence of the 'demonstration effect' and the desire for prestige, noticeable in Egypt, tend to reduce the price elasticity of demand for highly taxed commodities. This is shown by the statistics of imports of consumer durables in general and cars in particular.
The percentage value of imports of consumer durables to the total value of imports increased from 11 per cent on the average between 1948-1950 to 17 per cent in 1956.\(^1\) Rates of import duties on these items were raised rapidly since 1949 when an additional luxury levy was added and its rates were increased several times.\(^2\) It should be noticed that this increase in the percentage of imports of consumer durables was a real increase as the total value of imports in 1956 was higher than the average of 1948-1950.\(^3\)

The effect of high rates of duties on imports of consumer durables can be illustrated more clearly by showing the effect of the duty on the imports of private cars in Egypt in the period 1948 to 1959. Unfortunately, the statistics available do not provide for a complete comparison over this period as the method of computing the figures has changed. The number of cars is available since 1953, while the weight of imports of cars was available before 1953. Therefore, in the face of these difficulties, some comparison will be made by making use of both weight and value measures for the period from 1948 to 1953, and then the number of private cars from 1953 to 1959. This will give an idea of the effect of the change in the rates of import duties on imports.

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\(^1\) U.N., The Development of Manufacturing Industry in Egypt, Israel and Turkey, New York, 1958.

\(^2\) The rates of import duties before 1949 were as follows: (a) £0.1 per Kg. of the weight; (b) 8% of the value of the car f.o.b. In April 1949 a luxury tax was introduced whose rate was 10%. This rate was increased to 30% in May 1954, 65% in 1957, 85% in 1958, and 100% in 1959.

\(^3\) The average value of imports in the years 1948-1950 was £175 million, increasing to £186 million in 1956. Figures are taken from U.N.: Yearbook of International Trade Statistics, 1956, Vol I, (Egypt).
Table 17.
Imports of Private Cars,
Egypt 1948-1959

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<tbody>
<tr>
<td>Weight (thousand Metric tons)</td>
<td>8.4</td>
<td>10.8</td>
<td>9.3</td>
<td>11.1</td>
<td>5.5</td>
<td>2.2</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Value (£m)</td>
<td>3.1</td>
<td>4.4</td>
<td>3.69</td>
<td>4.8</td>
<td>2.5</td>
<td>1.1</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Number</td>
<td>1992</td>
<td>3092</td>
<td>5722</td>
<td>1913</td>
<td>1049</td>
<td>3215</td>
<td>5151</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rates of Duty</td>
<td>10%</td>
<td>30%</td>
<td>1%</td>
<td>65%</td>
<td>85%</td>
<td>100%</td>
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</table>


Figures in the above table indicate that though 'luxury' duties were levied on imports of cars (as measured by weight and value), imports continued to rise with little interruption reaching a peak in 1951. They then began to decline in 1952 and 1953. Though the rates of duties were raised in 1949, imports also continued to rise with little interruption reflecting in part the responsiveness of imports of cars to the rise in national income. The decline in imports of cars in 1952 and 1953, however, cannot be considered to be a result of the decline in income in 1952. This is because the effect of the decline in income on the level of imports will be apparent in a later period rather than in the period of the decline. There is always a time lag
between the earning and the expenditure of income. The decline in the imports of cars in 1952 is, therefore, the result of government restriction on imports of cars as a result of the drain on the foreign exchange reserves which followed the decline in cotton prices.\(^1\) It was found that import restriction was more powerful than raising import duties to curtail imports of cars.\(^2\)

Let us consider the years from 1953 to 1959. It is apparent that the number of cars imported in 1954 compared to 1953 rose by nearly 60 per cent, though 'luxury' duty on cars increased by 200 per cent (from 10 per cent to 30 per cent). The rise in car imports continued to increase sharply in 1955 (increase of 80 per cent of 1954 level) in spite of the effect of the high rates. This gives the impression that the demand for cars (as measured by the number of cars imported) is insensitive to the change in prices due to the high rate of tax.

It may be argued that the increase in imports of cars in 1954 and 1955 may be due to:

(1) the "pent up" demand for cars which was unsatisfied during the period of restriction from 1952 to 1953, and

(2) the lagged effect of the rise in import duties on the demand for cars - cars already contracted for imports cannot be reduced promptly.

The first explanation seems to be plausible and it may be responsible for part of the rise in demand for cars. But such a rapid rise in demand for cars cannot be explained only by this factor. If the price elasticity of demand for cars is high, it would have reduced drastically the imports of cars as a result of a slight rise in prices. But in our case, the prices rose by the

\(^1\) A similar effect followed the foreign exchange crisis after the Suez episode.

amount of the tax, i.e., an increase of 20 per cent of the value of the car, while imports rose sharply (increased by 55 per cent). This means that cars are somewhat insensitive to changes in prices.

The second explanation does not seem to fit the facts, especially if we look to car imports after a lagged period, say 1958 or 1959. While 'luxury' duty increased by 110 per cent in 1957 compared with 1954 (from 30 per cent to 65 per cent), imports of cars rose by 200 per cent in 1958 compared with 1957, and by 60 per cent in 1959 compared with 1958. Even this ignores the increase in import duty rates which occurred in 1958 and 1959.

From these figures it would seem that the demand for cars is less sensitive to change in prices which rose sharply following the rise in import duties.

A further reason why taxes on expenditure will not seriously increase the degree of wealth inequality is that progressive tax rates will absorb a large part of the purchasing power of the higher income groups, thereby reducing their real disposable income. This will modify the rate of increase in the inequality of wealth. However, it should be pointed out that a modification in wealth inequality does not necessarily imply that an increase in this inequality is to be condemned. It should be remembered that an increase in the inequality of wealth which stimulates the productive capacity of the economy, and the rate of increase in aggregate income has certain advantages. Nor can it be implied from this discussion that within the existing administrative conditions of Egypt, income tax will be more efficient in reducing the rate of increase in wealth inequality. In fact income tax is likely to increase wealth inequality at a higher rate than sales taxes because of the exclusion of certain types of income

(1) See also Part I.
from the tax base on the one hand, and the widespread evasion on the other hand. These defects of income tax are difficult to avoid within the short period. Therefore, if it is desirable to reduce the extent of inequality of wealth as a social objective, a more effective way to accomplish this end is to impose death duties, in addition to sales taxes. Sales taxes on consumers' goods will limit the consumer's spending during his life-time, contrary to income tax. In this case, a consumer under sales taxes cannot escape the tax altogether.

VI. SALES TAXES ADVOCATED IN EGYPT:

In Egypt, at present, sales taxes take the form of import duties and excises levied at the manufacturers' level. The question here is to see whether there is any need to change the present method or point of tax collection when expanding the tax coverage.

The existing points of tax collection do not seem to require modification since they have many administrative advantages.

Firstly, imports can be checked effectively since the number of outlets in Egypt are very few. The experience of the existing administration will be of great assistance especially when the present classification of commodities is modified and an ad valorem rate is applied.

Taxes on home produced commodities are efficiently collected at the manufacturers' level at present. The preference for collecting the tax at the manufacturers' level in Egypt, is because a large proportion of industrial activity is in the public sector. This point of tax collection will ease the administration and collection of taxes particularly when they are levied at discriminatory rates and when certain commodities considered to be basic necessities are exempted.
For the same reason, the cost of tax collection will be reduced. Moreover, the government enforcement of retail prices without tax pyramidine will be more effective when these undertakings are under public ownership.

Nor are there difficulties in taxing agricultural products as mentioned above, when co-operative societies, whose responsibility it is to market agricultural products for farmers, are chosen as the tax collection point.\(^{(1)}\)

Finally, the collection of sales taxes on expenditure on services which vary from one type of service to another can be made through the existing machinery with little additional cost.

With respect to the rates of sales taxes to be applied, it is suggested that simplification as well as equity considerations require the use of ad valorem rates only. This will mean that in the short period, with which we are concerned, equity will be secured between different people making the same expenditure on the same goods and services. Moreover, it will relieve the administration of the use of two tax bases for tax assessment and thus reduce the cost of collection.

In the long run, the limitations of sales taxes as an equitable method of taxation become more important. As the standard of living rises, difficulties arise in distinguishing between commodities considered as 'necessities' and those considered as 'luxuries'. Furthermore, the rise in income will be accompanied by a smaller rise in consumption while saving increases, especially in the higher income groups. Finally, the modification in the rates of sales taxes on services

\(^{(1)}\) There are no figures about the percentage of farm output marketed through the co-operative societies. But according to the policy of the government in the agricultural sector ..."The marketing apparatus is being re-organised and controlled to enhance production and to have it marketed through agricultural co-operative societies..." See: The U.A.R. Yearbook 1960, Cairo, 1961, Government Printing Office.
required to suit the new standard of living will be difficult to make. These factors will tend to reduce the effect of sales taxes as an equitable type of tax by comparison to income tax. This is not the place to discuss the better alternative in the long run, though this problem will be briefly discussed in the concluding chapter.

VII. CONCLUSIONS:

Within the short period, sales taxes, once their coverage has been expanded to include consumers' expenditure on a variety of goods and services, seem to be a more equitable method of securing equity than an income tax within the existing conditions of Egypt. This is because sales taxes are likely to be more effective in reaching the taxable capacity of different wealth and income groups, particularly those which are difficult to tax under the existing system of income tax because of administrative and political obstacles. In practice any ideal tax unless properly enforced, tends to be inequitable in incidence because of the exclusion or evasion of certain sources of income. Thus the ease and efficiency with which sales taxes can be administered make these taxes the more desirable method of securing equity. Finally, it is fairly easy under a sales taxes system to introduce the conditions necessary to secure equity, i.e., exemption limits and allowances and rates of tax progression.

Equity is but one of the criteria upon which a tax system should be assessed. Other factors such as the need to secure a rapid rate of economic growth should be taken into consideration by the policy maker. However, if the tax system is to be unified and its coverage expanded to include a wider range of expenditure (previously non-taxed), careful planning will be necessary to ensure consistency in securing the government's objectives without serious conflict among them.
The following chapter will therefore examine, firstly, the efficiency of Egypt's present tax system in promoting the government's economic objectives, and secondly, the effects of the suggested modifications in the existing sales taxes in furthering these objectives.
CHAPTER IX.
CHAPTER IX

THE ECONOMIC EFFICIENCY OF SALES AND INCOME TAXES IN EGYPT.

Government policy in Egypt aims at doubling the national income within the next ten years. The plan (1) designed to achieve this target depends on several assumptions, the most important of which are:

(i) the government will play an active part in the field of investment in order to promote a rapid rate of growth of aggregate income. To this end public investment will represent a major part of total investment. For example, public investment constituted four-fifths of total investment in the first year of the plan;

(ii) the capital/output ratio is taken to be around $3:1$. This means that within the assumed rate of increase in national income, there is a need to increase the rate of saving and mobilize it to finance the required rate of investment; (2)

(iii) the prices of different goods and services are assumed to be stabilized at the 1959/1960 price-level during the period of the plan.

Saving could be increased in the short run through the use of various methods such as foreign loans and grants, forced savings through inflation, and compulsory saving through taxation. It is difficult to secure enough foreign


(2) The estimated investment required to reach a target 8 per cent increase in national income per annum in the first five years was 26 per cent of national income in 1959/60. If we exclude the part to be financed by foreign loans (i.e., 9 per cent of national income 1959/60) the required rate of saving is about 17 per cent. This compares with present savings of 11 per cent in 1959/1960. These figures are compiled from National Bank of Egypt, Economic Bulletin No. 2., 1960, pp.81 - 85.
loans and grants to finance a large part of the plan because of the limit on the available supply in the world for the needs of every country. On the other hand, inflationary finance cannot be relied on to a great extent because of the dangerous effects on the economy and its performance, quite apart from the limitations of the capital market and the desire of the plan to secure price stability. Therefore, reliance has to be put on taxation\(^1\) to secure a large part of the saving necessary for the finance of the required investment. The question which then emerges is: Which taxes can best be relied upon to maintain the objectives of the plan?

The purpose of this chapter is to demonstrate that sales taxes are most likely to secure the above objectives. The analysis will proceed as follows:

(I) the effects of the existing sales and income taxes on the supply of effort in relation to the requirements of a rapid rate of growth;

(II) the effects of the existing sales and income taxes towards reducing private consumption expenditure and consequently providing the resources necessary for investment;

(III) the success of sales taxes relative to income tax as tools of stabilization, and,

(IV) the effects which the modification of the existing sales taxes, as in the proposed model in Part I, will have on the functioning of the economy in securing the required rapid rate of growth of aggregate income.

\(^1\) This is recognized in the plan where it is estimated that total savings in 1960/1961 will fall short of investment and an inflationary gap is anticipated at around £51 million in 1960/1961 at 1959/60 prices. It was realized that private savings are difficult to increase in the short run so that reliance has to be put on taxes and social security contributions to limit disposable income in the private sector. See N.P.C., The Details of the First Five Years of Development Plan in Egypt 1960/1961, Cairo, 1960, p.210.
I. THE SUPPLY OF EFFORT: (1)  

It is difficult to compare the effect on the supply of effort of the existing sales and income taxes used in Egypt. There are many reasons for this. The first is the difficulty of finding figures of expenditures on different goods and services by different income groups in order to assess the burden of the tax on each group and incentive effects relative to income tax.  

The second difficulty is that it is not possible to assess exactly the effect of different types of taxes on the supply of effort without conducting an empirical study into the reaction of different individuals to different types of taxes. Unfortunately no such investigation has yet been carried out in Egypt. Therefore, the only alternative is to assess the possible effects of sales and income taxes on the supply of effort on the basis of the theoretical analysis in Part I and the circumstances prevailing in the Egyptian economy.  

Within a system of sales taxes such as the one described in Chapter V, there is not likely to be any significant effect on the supply of effort. This is because most of the labour force is unskilled with expenditure mostly on food items of a basic character. These commodities are excluded from the existing sales tax coverage. Only a few home produced commodities, such as sugar, coffee and alcoholic drinks, are liable to excise duties. These do not play any important role in the expenditure patterns of people in this group. Therefore sales taxes are not likely to have any disincentive effect on people in this group.  

The expenditure of skilled workers and technicians is not likely to be on those commodities liable to high rates of sales tax. A large part of their expenditure is on food items, with a smaller part on lightly taxed items, especially those produced in the home market and liable to excises. The liability of only a small part of their expenditure to low tax rates will mean the tax
burden of sales taxes will be insignificant in its effects on the supply of effort. Moreover, even such a small tax burden will hardly be noticed since the tax is incorporated in the prices of the taxed commodities and paid in small amounts.

Finally, people receiving their income from managerial and professional posts are those with high expenditures on commodities with a high income elasticity of demand. Some part of these expenditures is liable to high rates of sales taxes. However, the degree of tax progression is reduced because of the shrinkage of sales tax coverage resulting from the replacement of imports by home produced commodities not liable to excises. Even with the existing high rates of sales tax, there do not seem to be disincentive effects on the supply of effort. This is probably due to the fact that sales taxes are neutral in their effects on the money price of leisure and work, which is one of the factors influencing the work-leisure choice of people in this group. Moreover, the rise in the standard of living which accompanies the increase in income tends to influence consumption expenditure towards new commodities which are complementary to leisure and are mostly desired for prestige purposes. Both these factors are responsible for the tendency of people in this group to work rather than increase their leisure in order to obtain the highly taxed commodities. Finally, there is the fact that sales taxes are paid voluntarily in the sense that they leave the option to buy or not to buy the taxed commodities to the taxpayer. They are also paid in small amounts on each commodity. This tends to reduce the disincentive effects which the high rates of sales taxes might otherwise have had.

Income tax, on the other hand, is not likely to have a disincentive effect on the supply of effort, especially if the income earned is below double the exemption limit. This is because the rates applied within this limit are very
low, varying from 2 per cent on the first £120 a year after the exemption limit, and 3 per cent on the second £180 a year. Such a low rate does not seem to have any significant effect on incentives.

However, income tax, even at this low rate, may have a disincentive effect on the supply of effort when income just exceeds double the exemption limit. In addition, it may discourage the mobility of labour from the agricultural to the industrial sector. The increase in earnings to over double the exemption limit raises the marginal rate of tax to a very high level (from 2 per cent on an income of £200 a year, to 31 per cent on income in the range of £200 - £210 a year).\(^1\) Skilled workers' income seems to be around this point where income just exceeds double the exemption limit. This might be a powerful influence inducing these workers to reduce their effort.

The movement of labour from the agricultural to the industrial sector which is necessary for promoting economic growth seems to be impeded in part by income tax, especially when income just exceeds double the exemption limit. Family attachments of workers oblige them to send part of their wages to their families. Therefore, the margin left over to them after these payments to their families and to the tax authority may not be enough to attract them to leave the agricultural sector and their families in the first place. It is therefore not surprising to find that Egypt suffers from a shortage of skilled labour which may be due in part to the income tax structure. In addition, it is peculiar to find the income tax designed in a way which runs contrary to a rapid rate of growth by reducing the incentives of skilled workers and technicians.

Income tax on the salaries of people in managerial and professional posts is not high enough to have any significant effect on work incentives. Though the

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\(^1\) In this example, the exemption limit is considered to be £100 a year for a single person. See Appendix L.
rates of income tax on this group are progressive, they do not anywhere exceed 9 per cent. But when surtax is added to schedule income tax, the rates of tax on earned income rise to higher levels, in some cases to higher than those applied to other sources of income.\(^1\) The net result of these high rates is that income received from employment is discriminated against, and other sorts of discrimination are also noticeable. Income tax on salaries in Egypt is deducted at source (i.e., in the same way as P.A.Y.E.). This means that the income tax on people in this group will be more effectively enforced compared to other sources of income. There are no opportunities for people in this group to reduce their income tax liability by the various methods open to other sources of income to avoid or evade the tax, for example, expense accounts, or concealment of part of income. Such an effective enforcement of the tax on income from employment for highly paid executives and managerial posts, in addition to the high rates of income tax, is dangerous within the government objectives of a rapid rate of economic growth. The high rates of income tax are likely to discourage work incentives of people in this group. In addition, they may discourage the supply of top executives and managers whose income falls within this range since the net income received will be less than that received from other sources. The net effect is that Egypt might suffer from a shortage in the supply of entrepreneurship.

However, the discrimination against earned income is increased even more for top executives who are members of the board of directors in limited liability

\(^1\) For example, as can be seen in Appendix M, when income is in the range between £10,000 and £20,000, the marginal rate of schedule income and surtax reaches around 46 per cent. This compared with a marginal rate of 40 per cent on income from rent of buildings and 41 per cent on rent of land. Not only is the discriminatory treatment in favour of earned income lost, but it is in fact penalized relative to other sources of income in the higher income levels.
companies. People within this group are singled out for a separate progressive tax on their salaries.\(^{(1)}\) The effect of adding this tax to other income tax on their salaries is that the marginal rate of the tax rises from about 16 per cent when income is increased from £1000 to £2000, to about 126 per cent when income increases from £10,000 to £20,000.\(^{(2)}\) There is no social or economic justification for discrimination against this class. On the contrary, economic reasoning would require favourable treatment to encourage additional supply. Instead, the application of such discriminatory rates should be applied to those people whose contribution to the national product is very small, and whose claim on output is high, i.e., rentiers.

Even if such a tax can be justified on the grounds of equity as is implied by the law imposing this tax (i.e. reducing inequality in the distribution of income), it would seem that such a tax hits hard at the wrong type of inequality. Instead of reducing the inequality of income derived from inherited wealth (which is favoured by income tax treatment in Egypt), this law punishes that type of inequality resulting from superior quality, talent and skill, which are necessary to secure a rapid rate of economic growth, i.e., entrepreneurship. It is strange to find a bottleneck in entrepreneurship with tax laws that tend to discourage rather than encourage the supply of this important function. Therefore, this additional tax on the salaries of director is definitely likely to affect the supply of effort of people in this group. More important, it will discourage the supply of new enterprise.

\(^{(1)}\) See Chapter VI for the rates of this tax.

\(^{(2)}\) See Appendix N.
II. **SAVING AND INVESTMENT:** (1)

Egypt is characterized by a high level of consumption expenditure.(1) In addition, the rate of increase in consumption expenditure was much higher than that of the rate of increase in income,(2) with the result that little is left over for savings. Available evidence estimates that the level of savings in Egypt was about 10 per cent of national income in 1956.(3) Savings, it seems, were made solely by persons and companies until 1958, when the government began to contribute to the community's total savings instead of dissaving as in the past.

The way in which these savings were used among different types of investment gives the impression that they were not favourable to a rapid rate of economic growth. This is because most of these savings are invested in financing stocks in trade and services, in addition to investment in real estate.(4)

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(1) See Chapter VI.

(2) See Chapter VI.


(4) For example, it was found that 50 per cent of the savings in Egypt are directed towards investment in real estate, especially of a luxury kind. This led the government to divert part of its investment to buildings for middle and low income groups. In addition, during the years 1951-1953, while total investment in industry and services was £28 million, investment in services alone accounted for £22·6 million, i.e., 80 per cent of the total. For details, See: Harbison, F. and Ibrahim, A., Human Resources for Egyptian Enterprise, New York, 1958, p.33.; National Bank of Egypt, **Economic Bulletin** No.2., 1956, p.109; Republic of Egypt, The Permanent Council for Production, Cairo, 1955, p.13.
These types of investment are characterized by little addition to the productive capacity of the economy and they thus contributed little to the rate of growth of real income of the country. For example, investment in buildings was largely directed towards luxury types whose inputs were largely imported. This tended to reduce the size of the domestic multiplier, and added little to the productive capacity of the economy.

Finally, an important part of the country's liquidity was dissipated by increased hoards of gold, jewelleries, cash, etc. The extent of these accumulated hoards was estimated to be about 10 per cent of national income in recent years.

It seems therefore that the present tax system in Egypt was responsible in a large part for the high level of consumption as well as for its high rate of increase, and consequently a low level of saving. In addition, it was responsible for the present pattern of investment. This can be demonstrated by examining the effects of sales and income taxes on consumption and the inducement to invest.

(A) Consumption Expenditure:

In an economy motivated by high consumption expenditure, the need to reduce the rate of increase on consumption expenditure in the short run requires an effective tax policy. Tax policy in Egypt has failed in this respect. In the first place, sales taxes are in a weak position to have a positive influence on private consumption expenditure. The tax coverage was originally limited to imported commodities and to a few commodities produced in the home market. The

(1) It was found that investment in residential building in the first year of the plan would require nearly one quarter of its cost in foreign exchange to finance imported materials. See: N.F.C.; The Details of the First Year of Development Plan in Egypt 1960/1961, Cairo, July 1960.

(2) Gamel Said; Some Aspects of Industrialization in Egypt with Special Reference to Problems of Finance, Cairo, 1958, p.24.
chosen commodities have not changed since the taxes were introduced in the thirties. The expansion in the industrial sector tended to reduce the coverage of sales taxes even further as it reduced the reliance on imports which were liable to import duties.\(^1\) Thus, the effect of the tax in absorbing purchasing power from consumers, and discouraging them through a rise in prices that reduced the rate of increase in consumption expenditure, has weakened as the coverage of the tax contracted.

Moreover, the rates of sales taxes were basically specific and normally lagged behind the rise in prices. This means that the tax rates were reduced instead of being increased when compared to the prices of commodities following the inflation.

All these factors seem to be responsible in part for the failure to limit the rate of increase in consumption expenditure which accompanied the rate of increase in aggregate income.\(^2\) If it was desired to reduce the rate of increase in consumption expenditure, sales taxes coverage should have expanded and the rates used should have been raised to a higher level in order to put present consumption at a disadvantage relative to future consumption.

Income tax was in no better position. The coverage of this tax is very small. The number of people liable represented only 2 per cent of the population in 1958. This means that the income tax system is restricted to a very small number of consumers. The most important factors responsible for this small coverage are the exclusion of agricultural incomes, and the high exemptions.

\(^1\) For example, the quantum index of imports fell from 100 in 1948 (basic year = 100) to 83 in 1954. For details see: M.P.C., Statistics on International Trade, Production, National Income and Capital Formation, Memorandum 66, Cairo, 1959.

\(^2\) The rate of increase in consumption expenditure was at a faster rate than that of income. See Chapter VI.
given to different sources of income. It should be noted that people who receive a large part of agricultural income are large landlords or members of the middle class. Those people tend to have a high marginal propensity to consume as they are influenced by the 'demonstration effect' and the desire for appearance. This means that by leaving their income untouched by taxation, or at most lightly taxed (as in the case of income from rent), this tax did not take active steps to encourage people in this group to restrict their consumption expenditure.\(^2\) The high exemption limit on the other hand, resulted in the exclusion of a large number of people who are relatively well-off within the per capita income environment in Egypt. This means that the spending power available to these people is higher than would have been the case had they paid their proper share in taxes.

Finally, government encouragement to the co-operative movement meant that the increase in the purchasing power of shareholders in the form of dividends and discounts is not liable to income tax. Consequently the increase in their consumption expenditure out of this source is not checked by income tax.

It is not surprising to find, therefore, that the tax system did not check the rapid rate of increase in consumption expenditure and increase savings. Instead of modifying the types of taxes used by extending their coverage and promoting a proper enforcement, the government neglected this aspect by not taxing the high spenders in the community in some cases, and taxing them at a lower rate in others.

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(1) The exemption limit expressed as a multiple of income per head was about 4 times in 1954. Professional persons were exempted from income tax for the first five years after graduation.

(2) In different reports this fact was stressed. For example, the U.N. Report on Egypt found that "the increase in income from the agricultural sector continued to be spent either on the purchase of land or the construction of buildings or on luxury products." U.N.: Economic Development in the Middle East, 1945 - 1954, p.40.
(B) **The Inducement to Invest:**

In a country like Egypt, where there is a tendency towards investments which add little to the productive capacity of the economy (trade and services, etc), the required tax system should be more than neutral in its effect on different types of investment. More important is that it should discriminate in favor of investments necessary for increasing the productive capacity of the economy, i.e., machinery, plant, building, vehicles etc. In Egypt the existing tax system seems to discriminate against those types of investment which promote a rapid rate of economic growth. This can be demonstrated by examining the effect of sales and income taxes on investment. It is difficult to reach any definite conclusions as investment is influenced by many variables in the economy, of which taxation is only one.

Sales taxes as they exist in Egypt follow an inconsistent pattern in relation to their effect on the inducement to invest in general. They are used in some cases to encourage private investors, while they discourage them in other cases. This latter effect has been reduced in recent years.

On the one hand, sales taxes in the form of import duties are used to protect home produced commodities from foreign competition in the form of imported substitutes. Such discrimination in the use of sales taxes gives home industries and private investors protection against foreign competition and consequently a secure market for their products. In fact, it is not too much to contend that the main reason for the expansion in the industrial sector was due to the existence of protective duties. Its size was quite negligible before the thirties, when import duties were not used in a protective form. Since then the size of the industrial sector expanded to 8 per cent of national product in 1939, and

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27 per cent in 1959. (1)

On the other hand, import duties tend to discourage the inducement to invest especially in those types of investment which are needed to increase the productive capacity of the economy, i.e., industrial investment. This is because import duties are imposed on imports of capital goods and raw materials. Such a state of affairs tended to discriminate against investment using a large proportion of imported capital equipment. Since industrial investment is largely capital intensive and is designed to provide products at a competitive price compared to substitutes, the imposition of import duties on capital goods and raw materials tended to reduce the competitive advantage of these industries. This tended to reduce the incentives given to private investors. Import duties tend to raise the supply price and consequently the cost of production of a particular investment project, by at least the amount of the tax. Given the prices of the product of a particular investment project, the increase in the cost of investment and the raw materials imported tended to reduce the marginal efficiency of capital. The rise in prices resulting from high costs of production might reduce the demand for the product. In addition, the rise in the supply price in relation to the demand price tended to reduce the incentive to invest in other direction. Moreover, when the cost of investment is high as a result of the inclusion of the tax on capital goods, the amount of investment which could be undertaken out of a given savings becomes small, assuming the marginal efficiency of capital is not affected by the tax. This is especially true when an investment project is indivisible and the rate of import duties is high (as was the case before 1954 where the rates varied from 6 - 10 per cent) and

the cost of borrowing is high.\(^{(1)}\) In this case the discrimination against private investors in the industrial field is very great. The extent of this factor is more apparent too when we take into consideration the fact that high costs of capital investment require a high return to attract capital in the first place. When the cost of a particular investment increases, the risk of losing capital invested is great and private capital can be attracted only if persuaded by a high rate of return to cover the increased risk of putting a larger amount of capital in one project.

Furthermore, the imposition of sales taxes on capital goods and raw materials\(^{(2)}\) imported tends to add to the high cost of home produced commodities and thus puts home producers at a disadvantage in the export market. This was especially evident in the textile industry where the high cost of production resulting largely from high import duties on capital goods tended to reduce the competitive advantage of the export of textiles in relation to Indian and Japanese competition. This is one of the reasons which in recent years (since 1954) have led the government to reduce import duties on capital goods and raw materials to nominal rates (1 per cent ad valorem) in order to increase the competitive advantage of the cotton industry. This was with the aim of diversifying the country's exports by reducing the reliance on the export of raw cotton. On the other hand, the imposition of sales taxes on capital goods and raw materials imported reduced the competitive advantage of home produced commodities in relation

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\(^{(1)}\) Electricity and transport are good examples. The high cost of investment due to high import duties on capital goods and raw materials, in addition to the high cost of borrowing, limited the capacity of these industries to expand and to replace depreciated assets at a price necessary to secure a market. This led in the end to the nationalization of these industries as a measure to relieve the pressure of demand by undertaking further investment. The rates of duties on capital goods were reduced to 1 per cent after 1954.

\(^{(2)}\) Raw materials were also liable to a 7 per cent ad valorem rate, but were reduced to 1 per cent in recent years.
to imported goods. This may have been responsible for the slow rate of expansion in investment in some industries though imports were increasing (i.e., woollen industry, sugar industry, etc.). All these factors indicate how the imposition of sales taxes on producers' goods probably contributed to the slow growth of industrial investment in Egypt.

Therefore, it is not surprising to find in all these cases that private investors in Egypt tended to favour those types of investment which yielded a high and quick return in the short run with little capital used, in order to avoid the depressing effect of sales taxes on the profits from industrial investment using a large proportion of capital. This might explain in part the slow rate of growth of aggregate income. The diversion of resources towards those types of investment which add little to the productive capacity of the economy means that the secondary effects arising from these investments on income and employment are small. Since the rate of growth of income is slow, the accelerator is not likely to be powerful enough to provide a greater stimulus to further rapid increase in national income. To encourage a rapid rate of growth of aggregate income would require therefore the removal of import duties on producers' goods to stimulate private investors to invest in capacity creating types of investment.

It may be argued that the fear of losing revenue derived from imports of producers' goods may have encouraged the government to keep such taxes at low rates. However, this does not seem to be a valid reason for keeping such a tax. Even if we accept the view that revenue productivity is an important objective, the loss of revenue is not likely to be significant. The rates of duty on producers' goods are nowadays very low, (reaching 1 per cent), and this is not likely to affect the revenue productivity of import duties to any significant extent. Import duty revenues on producers' goods were £25 million out of a total of £94 million in 1959/1960. A considerable part of this revenue is likely
to be derived from import duties on certain consumer goods such as cars which are liable to higher rates. This will tend to reduce the importance of revenue derived from producers' goods.

Moreover, in recent years most of the investment undertaken in Egypt has been public investment. Therefore the inclusion of the tax as part of government expenditure on investment on the one hand, and as a part of revenue when it is collected on the other hand, represents double counting. They will be cancelled out without gain or loss to the treasury. If this part of revenue is deducted from the revenue from import duties on producer goods, the loss of revenue which is expected to occur is that resulting from private investment. This part is very small as the share of private investment in total investment is very small.\(^1\) However, even this small loss of revenue is likely to be outweighed by the possible increase in private investment, income, expenditure, and consequently government revenue after a lag. Moreover, any increase in private investment following the exemption of producers' goods from import duties will relieve the government from undertaking some investment projects, thus reducing its burden.

In conclusion, the existing system of sales tax is likely to be partly responsible for encouraging private investment through the use of protective duties. However, such a system is probably responsible for the discouragement

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\(^1\) The following is an estimate of the expected real loss to the Treasury from the exemption of producers' goods from sales tax. We assume that revenue from import duties on cars and other durables included in the imports of capital goods is £5 million. This leaves a net revenue on producers' goods of £20 m. Since the government is the major investor, this revenue will be divided between public and private investment, according to the proportions of each as in 1960/1961 plan, which are: \(^4/5\) public and \(^1/5\) private. This means that the real loss of revenue to the Treasury on the basis of this assumption will be £4 million. This is not a significant amount of revenue, and can be compensated by other taxes or a rise in rates.
of private investment, especially that which would stimulate a rapid rate of growth of aggregate income because of the effect of the tax on producers' goods. Consequently, from the point of view of economic efficiency, it would be more appropriate to abolish the discouragement to industrial investment by removing import duties on producers' goods.

Schedule income tax in Egypt is levied at proportional rates varying according to the nature of the source of income. In addition, the rates of income tax on different schedules are not the same on all the returns from different types of investment. For example, returns from land and buildings are favoured under income tax treatment relative to industrial investment.\(^{(1)}\)

The discrimination in favour of income from rent in comparison to income derived from industrial investment is apparent though it is smaller than the discrimination in favour of agricultural profits. The difference in the rates is 3 per cent in favour of income from rent. This difference is increasing with the process of inflation which proceeds since the assessment of the tax extends over a long period (10 years).

Moreover, if we add to this advantage the fact that the important part of income received from the agricultural sector, i.e., agricultural profits,\(^{(2)}\) is completely exempted from income tax, then the discrimination in favour of agricultural income becomes very significant. It is peculiar to find in Egypt,

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\(^{(1)}\) Appendix 0 shows the rates of income tax applied to different sources of income and the rates of land and building taxes in order to show how far the tax system favours certain types of income relative to others. The figures indicate that the tax system in Egypt discriminates in favour of income from land and buildings. Income received from the agricultural sector is composed of two important parts: (1) income from rent, and (2) agricultural profits and interest.

\(^{(2)}\) Agricultural profits and interest in Egypt represented 47 per cent of total income generated in the agricultural sector in 1954. See Chapter VI.
where the policy is to diversify the economy by increasing the size of the industrial sector and reducing the reliance on the agricultural sector, a tax policy which works in an opposite direction. It gives what amounts to a subsidy to investors in the agricultural sector, without having any regard to the harmful effect of such a subsidy on investment and its allocation.

Income received from rent of buildings - the second traditional type of investment in Egypt - is also favoured in tax treatment. The tax is levied on the estimated rental value which is fixed for a long period. This gives taxpayers receiving income from the rent of buildings an advantage relative to other sources of income assessed on the actual income of taxpayers, especially in an inflationary period. The tax rate has suffered a continuous decline following the rise in prices, which means in effect a low real tax rate compared with other sources of income during the period of the assessment of the tax (8 years in Egypt). Moreover, income received from the rent of buildings is liable to nearly three quarters of the rates applicable to income from industrial investment. This gave an encouragement to investment in buildings which has been a popular attraction, especially after the Land Reform Act in 1952.\(^{(1)}\)

Finally, schedule income tax favours the traditional types of investment in another important way. Income as defined in the Egyptian tax law generally excludes irregular receipts. But for certain types of irregular receipts and under certain schedules there are exceptions to this rule. The most obvious example is the treatment of capital gains. For example, any realized capital

\(^{(1)}\) The Land Reform Act was enacted in 1952 and restricted the amount of land owned to 200 feddan (1 feddan = 1 acre) with certain exceptions which extend this limit to a maximum of 300 feddan. This law, while restricting the purchase of land by the higher income groups, did not encourage the flow of capital to industry. Instead capital flowed towards buildings. For details see: National Bank of Egypt, *Economic Bulletin*, No. 2., 1956, p.109.
gains from the selling of one the assets of an industrial undertaking are included in the tax base. This is not followed under other schedules. Capital gains realized from selling agricultural land and buildings are not liable to income tax. Since agricultural land and buildings are continuously rising in value (in real terms), due to the effect of development programmes, and the rise in population is at a faster rate than the supply of land and buildings, capital gains realized from this source are real and represent an important part of income of those who invest in them. The exemption of these profits from taxation, therefore, represents another powerful discrimination in favour of the traditional types of investment which are usually used to finance the consumption expenditure of the higher income groups.

It is not surprising then to find that a large proportion of investment in Egypt is directed towards real estate. Even in recent years investment in buildings has occupied a central position in the composition of the private investment. (1) Most of these investments are on luxury buildings with a large import content rather than on houses for the middle and lower income groups. High import content for luxury buildings have caused the increase in leakage from the income stream towards those uses which add little to the productive capacity of the economy. This has tended to reduce the size of the multiplier and thus contributed to the low rate of growth of aggregate income. In short, we can say that schedule income tax in Egypt encouraged rather than discouraged

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(1) In the first year of the development plan, it is estimated that 60 per cent of investment in residential buildings will be undertaken by the private sector. This represents 38 per cent of total private investment in 1960/61. Most of these investments are in luxury projects. This is why the government contributed 40 per cent of investment in residential building to provide houses for low and middle income groups. For more details, See: N.P.C.: The Details of the First Year of Development Programme in Egypt, 1960/1961, Cairo, 1960, p.13.
the diversion of resources towards those channels which run counter to the
government policy of securing a rapid rate of growth of aggregate income.
A contrary policy is therefore required to help in diverting resources towards
those types of investment which are necessary for securing the objectives of a
rapid rate of economic growth. This requires a tax policy designed to:

(i) limit the rate of increase of private consumption expenditure in order
to free resources for use in capital formation;

(ii) remove all obstacles to and discrimination against industrial invest-
ment and other types of investment necessary for a rapid rate of economic growth.
In addition, the tax policy should discriminate against the traditional types of
investment in order to discourage the extensive use of resources in those fields
which add little to the productive capacity of the economy.

Income tax is difficult to adapt as a means to these ends in the short run.\(^{(1)}\)
To secure both these two objectives, therefore, requires the expansion of the
tax coverage of sales taxes to include all expenditures on different goods and
services. The rates applied must vary according to the income elasticity of
demand for different commodities.

Schedule income taxes have to be abolished and reliance must be placed on
surtax (by reducing its exemption limit), and the degree of tax progression must
be adapted to the rate of progression of sales taxes. This is only a step
towards adapting taxpayers to more direct forms of taxes in the form of an expendi-
ture tax in the long run.

\(^{(1)}\) See Chapters VII and X.
III. **Stabilization**: (1)

The Egyptian economy is basically agricultural and depends largely on one commodity for its exports, i.e., cotton. Cotton exports represented 85 per cent of the country's total exports and 13 per cent of its national income in 1954. (1) As the prices of cotton are not under the control of Egypt, but depend largely on world prices, it is generally considered that fluctuations in the value of exports will be a main force leading to the instability of the economy. Thus the role of taxation is to provide a device to reduce the extent of this instability. It is desirable, therefore, to compare the effects of the existing types of sales and income taxes in this context.

However, before starting such a discussion, we need first to show that the extent of the effects of the external sector on the Egyptian economy has been greatly exaggerated. (2)

Diagram 3 shows the relationship between the price index of total export, exports of cotton and national income, taking 1936=100. It is apparent that the relationship between national income and cotton prices does not support any significant positive correlation. The national income was rising in most of the years where the prices of cotton were falling, e.g. the years 1952, 1953 and 1955. This shows that the economy was not susceptible to fluctuations in national income following fluctuations in cotton prices, as is usually considered to be the case. It is true that national income declined very slowly in the years 1950 and 1952. But such a decline cannot be attributed to the decline in the price of cotton as

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(1) Compiled from figures of exports of cotton and National Income in 1954.

(2) Figures are not complete for a long enough period to show the effect of fluctuation in the prices of cotton on national income. National income figures are not available in the period before the Second World War. The only figures which exist cannot be relied upon to give a complete relationship between fluctuation in the prices of cotton and national income, but they can at least give a rough indication of the extent of this fluctuation in relation to national income in one cycle, i.e., Korean Boom.

Source: See Appendix P
Diagram 4.

The Trend of Income and Sales Taxes in Egypt, 1946-1956
(£.E.m.)

Sales Taxes Revenue

Income Tax Revenue

The Trend of National Income in Egypt 1945-1956
(£.E.m.)

National Income
such. Other factors are likely to be responsible for such a decline. The most important of these was the political and economic instability which led to the destruction of some parts of the country's wealth, especially in 1952. It is difficult, therefore, to attribute the decline in national income in this year to the decline in cotton prices. The explanation for the insignificant correlation between cotton prices and national income in the period examined (1945-1955) can be explained in terms of the structure of the Egyptian economy.

In Egypt, the agricultural sector is by far the largest sector in terms of income or employment. It contributed a little over one-third of national income while it employed about half the labour force in 1954. A short run fluctuation in the prices of cotton, does not induce a change in the supply of cotton or induce fluctuations in employment. This is probably what happened in Egypt in these years where the prices of cotton declined while the index of national income (1938=100) showed a rise. A rise in agricultural production compensated for the decline in the prices and left national income expanding. (1)

The industrial sector, on the other hand, is small, accounting for about 15 per cent of national income in 1954. The elasticity of supply in this sector is very low, especially in the short run while most of the commodities produced in Egypt at that time were consumers' goods whose elasticity of demand is low. Therefore the effects of fluctuations in the value of exports were reflected in the price level, (2) balance of payment difficulties, and the standard of living of the farmers.

(1) In fact the production of cotton increased over this period. It increased from 235,000 tons in 1945 to 261,000 in 1950, to 363,000 in 1951, and to 447,000 tons in 1952. M.P.C., The Central Statistical Office, Statistical Data for the Egyptian Region, Cairo, April 1959. Table 24.

(2) For example, the cost of living in Egypt rose from 282 in December 1949 to 328 in December 1951, and then to 383 in December 1954. National Bank of Egypt, Economic Bulletin, No. 2, 1956, p. 209.
However, with the process of industrialization, the industrial sector began to expand rapidly, reaching about 27 per cent in 1959, while the percentage of cotton exports to national income declined to 9 per cent. Even with such a relatively small percentage the effect of the fluctuation in the prices of cotton may result in a serious fluctuation in income and employment. The industrial sector now comprises an important part of the economy. Within the short period, the problem requires an effective device to reduce the extent of these harmful effects, especially where adverse accelerator effects are present, as is the case when the industrial sector is expanding. In addition, with the introduction of the development plan with its high rate of spending, there is a possibility that inflationary tendencies might develop. The question, therefore, is to compare how far the existing types of sales and income taxes can succeed in reducing the instability of the economy in the face of inflationary and deflationary tendencies.

It is difficult to make such a comparison for Egypt as the coverage of both taxes are too defective to measure. In addition, the period under discussion (1945 - 1956) was characterized by continuous change in the rates of tax. However, certain generalizations about the flexibility of both taxes can be made.

Sales taxes, though defective in coverage, appear to have more flexibility in relation to national income than income tax, taking figures of national income and tax revenue in absolute terms. Diagram 4 shows that revenue from sales taxes follows national income more closely than does revenue from income tax.

If we look at the percentage change in revenue compared with the percentage change in national income, the results are different. Diagrams 5 - 7 and Table 18
The Percentage Change in National Income Compared with the Percentage Change in Sales Taxes Revenue in Egypt 1947 - 1956.
Diagram 6. The Percentage Change in National Income Compared with the Percentage Change in Import Duties Revenue in Egypt 1947-1956.
show clearly the behaviour of revenue from sales taxes in relation to the change in national income. The percentage change of sales taxes' revenue was following the rate of change in income though it was more apparent after a lag. This is understandable because of the delay in reducing or increasing imports following the fluctuation in national income. There is always a lag between contracting imports and their delivery. In addition, consumption expenditure is 'sticky' in a downward direction and this makes it difficult to reduce consumption following a decline in income.

The percentage change in income tax revenue, on the other hand, does not seem to follow any consistent pattern. It fluctuates in a random way, following the fluctuation in national income in some cases, while it is far from following the change in national income in other cases. Diagram 8 and Table 18 show the percentage change in income tax revenue compared with the percentage change in the national income. While the percentage change in national income was positive in 1948 and 1947, the percentage change in income tax revenue in 1947 was negative. This is a strange movement of income tax, especially in those years where high progressive excess profit tax was in force (which was abolished in 1950). Moreover, while the figures in Table 18 show a very flexible income tax revenue following the change in national income in 1948, this was not the case in the years after 1948. The wide gap between the percentage of change in income tax revenue which accompanied the percentage change in income in 1948, declined in later years until the movement was reversed in 1950. Finally, while the percentage change of national income was negative only in 1952, the percentage change in income tax revenue was positive in 1952, but became negative in 1953 and 1954. This gives the impression that income tax is flexible but only after a lag. However, this is difficult to justify in Table 18, or by relying on the structure of the income tax system prevailing in Egypt.
### THE PERCENTAGE CHANGE IN NATIONAL INCOME, SALES TAXES REVENUE, IMPORT DUTIES, EXCISES, TOBACCO TAX, AND INCOME TAX... EGYPT.

Table 18.  

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>National Income</td>
<td>8.6</td>
<td>7.9</td>
<td>15.6</td>
<td>8.5</td>
<td>9.0</td>
<td>-13.0</td>
<td>4.3</td>
<td>11.3</td>
<td>6.5</td>
<td>19.9</td>
</tr>
<tr>
<td>Sales Taxes</td>
<td>21.0</td>
<td>18.0</td>
<td>4.0</td>
<td>10.0</td>
<td>18.0</td>
<td>2.0</td>
<td>8.0</td>
<td>4.5</td>
<td>10.0</td>
<td>1.5</td>
</tr>
<tr>
<td>Import Duties</td>
<td>42.0</td>
<td>27.0</td>
<td>-7.0</td>
<td>20.0</td>
<td>6.0</td>
<td>-7.0</td>
<td>-12.9</td>
<td>4.4</td>
<td>15.5</td>
<td>-10.6</td>
</tr>
<tr>
<td>Excises</td>
<td>13.0</td>
<td>20.6</td>
<td>25.0</td>
<td>-15.0</td>
<td>40.9</td>
<td>-</td>
<td>-22.0</td>
<td>21.0</td>
<td>18.0</td>
<td>11.0</td>
</tr>
<tr>
<td>Tobacco Tax</td>
<td>10.1</td>
<td>9.5</td>
<td>5.0</td>
<td>10.8</td>
<td>20.1</td>
<td>-</td>
<td>5.0</td>
<td>0.8</td>
<td>-0.4</td>
<td>6.1</td>
</tr>
<tr>
<td>Income Tax</td>
<td>-10.9</td>
<td>16.0</td>
<td>17.0</td>
<td>0.6</td>
<td>22.8</td>
<td>14.6</td>
<td>-10.2</td>
<td>-10.0</td>
<td>9.3</td>
<td>12.6</td>
</tr>
</tbody>
</table>

**Source:** Compiled from U.N., Statistical Yearbooks 1951, 1954 and 1958, Statistical Department, Cairo, 2 - 5/61 for Details of Sales Taxes.

1. **Note:** The revenue is compiled on the basis of calendar year.
In the first case, though the percentage change in national income became positive in 1953, the percentage change in income tax revenue was still negative in 1954. In addition, the percentage change in income tax revenue which accompanied the percentage change in national income in the years 1955 and 1956, was not following a consistent pattern. The percentage change in income tax revenue was lower than the percentage change in national income in 1955, and higher in 1956 (still assuming a one year lag). Though the structure of the rates followed, and the coverage of the tax in both years was the same, there was inconsistency in the behaviour of income tax revenue in relation to the change in national income.

In the second case, neither the structure nor the way in which income tax is levied would support the conclusion that income tax is flexible in its revenue in relation to a change in national income. Various reasons can be given to explain this conclusion:

(i) the coverage of income tax in Egypt does not include agricultural profits. Since fluctuation in money national income was largely due to fluctuation in cotton prices in the period under discussion, it would seem that a considerable part of the effect of these fluctuations accrues to the income generated in the agricultural sector. It is true that secondary effects of these fluctuations will be reflected in other parts of the economy which are liable to income tax. But the exclusion of the main factor responsible for the wide fluctuation would tend to reduce any flexibility of income tax;

(ii) the administrative efficiency of income tax is still very weak. It is true that it has improved relative to its level in the period from 1940 - 1945, yet the administrative machinery is still incapable of collecting the tax liability at appropriate times. There are large numbers of arrears which extend to five years on the average. This tends to reduce the flexibility of income tax in
the face of fluctuation in national income. This can be illustrated by the following example. A large proportion of excess profit tax revenue (which was levied to absorb windfall gains during the War and abolished in 1950) was collected after it was abolished in 1950, when war-time profits had disappeared.\(^{(1)}\) Out of a total excess profit tax revenue of £52 million collected in the period from 1941 to 1958, a sum of £15 million was collected after the tax was abolished, i.e., 28 per cent of total excess profit tax revenue was collected after its abolition.\(^{(2)}\) This high percentage of delay in collecting tax receipts tended to weaken the use of the tax as an anti-deflationary or inflationary device. On the contrary, it might disturb the economy even further if the tax were to be collected in a recession period.

Moreover, the use of arbitrary ways of assessing income tax for certain groups of taxpayers to end arrears must result in a certain degree of rigidity in the revenue from income tax.\(^{(3)}\) The choice of the income in one year (1947) as a basis for the profits to 1954 meant that income tax was isolated from the changes which occurred in economic activity in the period from 1948 to 1954. This tended to reduce the flexibility of income tax rather than increase it, and this is contrary to the changes which occurred in some years.

Therefore the above reasons do not support the conclusion that income tax could have been a flexible source of revenue changing with the rate of change in national income. But there was some flexibility in some years. The problem

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\(^{(1)}\) It was unfortunate to abolish excess profits tax in 1950 at a time when stabilization was badly needed. The Korean Boom with its effects on windfall profits and the price level required the application rather than the abolition of this tax.

\(^{(2)}\) Source: Compiled from: Ministry of the Treasury; Taxation Department, Statistical Division, Figures for Income Tax Receipts, (Unpublished material).

\(^{(3)}\) See Chapter VI.
is how to explain the consistency of these fluctuations with the fluctuations in national income. Various reasons can be given, the most important of which are:

(i) the proceeds of income tax revenue which appear in the statistics are for tax collection rather than for tax accruals for the profits or income realized in the preceding year. Because of the administrative inefficiency surrounding income tax and the large accumulation of tax arrears, the revenue collected from income tax does not belong to the preceding year, but to many years (perhaps as many as five). The fluctuations in revenue will therefore reflect in part a change in the administrative efficiency in collecting arrears;

(ii) the rates of income tax were increased several times in this period (i.e., from 12 per cent to 14 per cent in 1950, to 16 per cent in 1951, and to 17 per cent in 1952). Surtax rates increased similarly. These changes in rates may be responsible for the wide fluctuations in income tax revenue in the years 1951 and 1952 which accompanied a smaller fluctuation in income. In addition, when the rates became "normal" in the system, income tax revenue settled to its "normal" trend, and this might be the case of a negative rate of increase in income tax revenue in the years 1953 and 1954.

Consequently, we can say that though both taxes fluctuated with the rate of change in national income, the fluctuation in sales tax revenues can be considered as real and reflecting to a large extent the change in national income more than income tax. Various reasons can be cited for this state of affairs.

In the first place, though sales tax coverage was limited, the nature of the sales tax levy made them quicker in absorbing purchasing power from consumers. These taxes are levied at the point of import and at the manufacturers' level. They are largely self-collected as the commodities pass through the point of tax
collection. Since the increase in income in Egypt is accompanied by a high rate of increase in consumption expenditure, the revenue from sales taxes will be more representative of the change in national income than will the revenue from income tax.

Secondly, the commodities liable to excise taxes (i.e., tobacco, sugar, petrol, coffee) are characterized by a relative high income elasticity of demand and this was reflected in fluctuations in the revenue from these taxes following fluctuations in national income. This can be seen clearly from Diagram 7.

Finally, the relatively efficient method of collecting sales taxes without problems of arrears, reduced the lag between the earning of income and the collection of the tax. This means that sales taxes were able to absorb part of the purchasing power of the consumers more quickly and at more appropriate times than could income tax.

In conclusion, within the existing circumstances of Egypt, where the coverage of income tax is very small, and the tax administration is inefficient, it is difficult to rely on income tax as a device to stabilize the economy. It takes a long time to develop a tax machinery capable of handling income tax efficiently with a larger number of taxpayers. Since an efficient tax administration is an important condition of using tax as a tool of stabilization in order to collect the right amount of tax at the appropriate time, it would appear that income tax cannot be relied upon within the short period. It seems more suitable to rely on other taxes which are within the administrative capacity of Egypt. But to be effective, their coverage has to be expanded to include all expenditure on different consumer goods and services, and a proper rate structure has to be devised along the lines suggested in Chapter VII.
The above discussion gave a detailed analysis of the efficiency of the existing sales and income taxes in promoting a rapid rate of growth of aggregate income. Under both taxes many defects have been mentioned. But most of the defects under income tax cannot be overcome within a short period of time. It takes a long time to develop a proper income tax system which can be fully enforced on a large proportion of the population. This will be explained in some detail in Chapter X. The defects under sales taxes can be more quickly adapted to render these taxes more capable of being used within the short period to reach the objectives of the government at reasonable cost, compared with income tax.

The question now is to see what effect the expansion of sales taxes coverage (to include other non-taxed goods and services at progressive rates) will have on the proper functioning of the economy compared with a hypothetical income tax of equal incidence on different income groups. This comparison will be between practical forms of sales and income taxes within the existing political, social and administrative conditions of Egypt. We will begin first by examining the effect of sales and income taxes on the supply of effort, then see how far they are favourable to savings and investment in Egypt.

IV. THE SUPPLY OF EFFORT: (2)

The circumstances at present prevailing in Egypt are not very different from those prevailing in most less developed countries. Therefore, the general conclusion reached in Chapter V is applicable to Egypt. This conclusion supports the view that sales taxes are likely to have less disincentive effects on the supply of effort than income tax. The most important reasons for the advantage of sales taxes over income tax of equal yield on different income groups are:
(i) With the rising standard of living which accompanies development programmes due to the rise in income, commodities with a higher income elasticity of demand are likely to be considered complementary to leisure. This tends to encourage rather than discourage the incentive to work.

(ii) Sales tax is incorporated in the prices of the taxed commodities and thus may be unnoticed by consumers. This is especially true when the tax is paid in small amounts on each purchase and the burden is thus lightly felt, especially when illiteracy is prevalent.

(iii) Sales taxes leave the monetary rewards of work unaffected, and therefore will not be a factor hindering the mobility of labour from the agricultural to the industrial sector, or from unskilled to skilled jobs, as might be the case under income tax.

For Egypt, there are some special points which need to be added. In our examination of the way in which the exemption limit should be granted, we proposed that the exemption limit should take the form of the exemption of some commodities of a basic character to the majority of people. Such exemption will reduce the burden of the tax and thus tend to reduce any possible disincentive effects which the tax might have. In addition, it will prevent the condemnation of sales taxes on the ground that they might lead to inflationary pressures by raising the cost of living. Most of the expenditures of people in the low income groups are on commodities considered basic. Therefore, the effect of sales taxes on the cost of living will be negligible.

Furthermore, sales taxes with expanded coverage will be more widespread in coverage than income tax. The latter tax is restricted to about 2 per cent of the population due to the exclusion of certain sources of spending power and the high exemption limit. The fact that part of the expenditure of people in this group, especially on non-basic commodities, will be liable to sales taxes,
means that the same amount will be collected from a wider coverage. This means that the incidence of the tax on different income groups is likely to be lower than under income tax. A low progressive tax structure will have a smaller disincentive effect. This means that sales taxes are likely to have less disincentive effects compared with an income tax raising the same amount of revenue.

V. SAVING AND INVESTMENT: (2)

One of the important conditions for the success of development programmes in Egypt is success in reducing the rate of increase of consumption expenditure which accompanies the rate of increase in national income to free resources for their use in capital formation. (1) To fulfil this objective in the short run, reliance has to be made on those types of taxes which are more effective in reaching the spending power of a large part of the population. In Egypt this can be accomplished in a more appropriate way through sales taxes. Sales taxes, as explained before, are likely to reach the spending power of a larger proportion of the population. (2) Given the assumption of equal yield, both taxes are likely to reduce the proportion of consumption and saving in the same way through the income effect. It is through the substitution effect that sales taxes are likely to have the advantages. This is because of the discrimination of sales taxes against present consumption. Therefore, sales taxes are more likely to increase personal saving than an income tax. (3)

(1) The plan estimated that the rate of increase in consumption expenditure has to be limited to a rise of 4.8 per cent in response to a rise of income of 9 per cent in the first year, and to reach 24 per cent in the fifth year in response to an increase in income of 40 per cent. See N.P.C. The Details of the First Year of Development Plan in Egypt 1960/1961, Cairo, July 1960.

(2) See Chapter VII.

(3) See Chapter V.
Personal savings are only one form of the community's total savings. It is important to encourage other forms of saving. Sales taxes may be effective in encouraging private saving, but may react on other forms of saving in such a way as to lead to a possible reduction in the community's total savings. Therefore, it would be more appropriate to view the net effect of sales taxes on savings as compared with income tax. Apart from personal savings, the most important forms of savings are company savings and government savings.

It is difficult to reach any definite conclusion as to the effect of sales taxes compared to income tax on company saving. The motives for saving are in this case quite different from those of persons and depend in part on different company policies towards the proportion of profits to be distributed to shareholders, the desire for company growth, and the market conditions affecting these policies. However, certain general conclusions can be reached by making some assumptions about the behaviour of these companies in Egypt. The most important of these are:

(i) companies aim at maximizing their profits in the long run rather than the short run, (1)

(ii) companies distribute a fixed percentage of their profits after tax each year, (2)

(iii) the familiar assumption made in this thesis that sales taxes are shifted in full to consumers while income tax is paid by the statutory taxpayer.

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(1) This is a reasonable assumption to make about Egypt. Most of the companies in Egypt are interested in growth and securing a position in the market rather than short run maximization of profits. This is influenced by the fact that the market is dominated by oligopolistic firms where the exploitation of full market opportunities is difficult. Secondly, the government watching of prices of different products to stabilize the economy may put a limit on the extent to which these companies can exploit market opportunities to raise prices to a maximum. Finally, most of the companies are now under public control, and this puts a limit on the extent to which they can exploit market opportunities to maximize short-run profits.

(2) A law was enacted in 1958 fixing the distribution of profits of companies to shareholders to 20 per cent above those distributed in 1958.
Applying these assumptions to the Egyptian case, it is likely that sales taxes will be more favourable than income tax to corporate saving. To reach such a conclusion, it is necessary to know something about conditions of demand and supply.

The present position in Egypt is that there is an excess demand in relation to the existing supply especially for the goods produced in the home market. This is because of the low rate of increase in the elasticity of supply in the existing productive capacity of the economy, aggravated in part by the limitation on imports. Demand on the other hand is expanding more rapidly than the expansion in the supply. Available evidence suggests that the existing supply falls short of the demand for most consumer goods.\(^{(1)}\) Therefore, within these conditions and taking the above assumptions into consideration, the use of sales taxes is not likely to affect the demand for the taxed commodities to the extent of impairing their profitability. Sales taxes are likely to absorb part of the excess demand for the taxed commodities. Consequently the profitability of the companies producing these commodities will not be affected. The net price of a commodity will be the same before and after the tax, since the tax is assumed to be shifted forwards while demand is not affected by the tax. As sales taxes do not affect the profits realized by these companies, while the amount of the

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\(^{(1)}\) We mentioned before in Chapter VI that the rate at which consumption is increasing is higher than that of the increase in income. Here, it is important to give examples of the presence of excess demand in Egypt among some of the consumer goods produced in the home market. The production of refrigerators was 8,000 units in 1956, and some were exported to neighbouring countries. The minimum requirement of the country was found to be 9,000 units while this is likely to increase as income rises. Washing machine production was 600 units in 1956 while annual consumption was estimated to be 2500 units. See: N.P.C.: The Consumers' Durable Goods Industry in Egypt, Memorandum 39, by A. Gazareen, Cairo 1957.
distributed profits is assumed to be fixed, the use of sales taxes will result in an increase in company saving. Income tax, on the other hand, tends to take part of these profits in taxes,\(^1\) and thus reduce the amount of undistributed profits which these companies can retain. Moreover, these taxes may encourage waste in expense accounts, since these will be subsidized in part by the treasury.

Government savings are not likely to be affected by sales taxes under the assumptions followed in this discussion, i.e., a given amount of revenue will be raised by either income or sales taxes.\(^2\) Within these assumptions, government savings will remain the same under both taxes, given government expenditure.

Therefore within the circumstances prevailing in Egypt, the net effect of sales taxes is that they are likely to encourage the community's total savings more than under income tax.

But the increase in savings is not enough to promote a rapid rate of growth of aggregate income. These savings have to be channelled towards investment, especially those types of investment which increase the productive capacity of the economy. Different measures can be taken to secure this end:

\(^{1}\) It is true that the reduction in the amount of retained profits of companies by income tax will only change the form of saving without changing the community's total saving, assuming government current expenditure to be unchanged in both cases. But when the effect of this tax induces companies to increase dividends which go to consumers or lead to a waste in expenditure by companies, this is likely to decrease total saving rather than leave it unchanged. What happened in practice was a mixture of both these cases.

\(^{2}\) Even if we relax this assumption, government saving might be increased rather than decreased. The wide coverage of sales taxes to include different consumers who escape income tax or who evade such tax will not evade sales taxes levied on their expenditure on different goods and services which are not of a basic character. In addition, the efficiency of administering sales taxes compared with income tax will ensure that the proper amount of revenue is collected from different income groups. Both these factors will ensure a higher revenue productivity relative to income tax. This conclusion rests on the assumption of equal incidence on different income groups without limitation of the amount of revenue to be collected. It is true that some of the revenue will be lost because consumers may reduce their expenditure on taxed commodities. But when the tax rate is less than 100 per cent of the price of the commodities, the decline in government revenue will be more than outweighed by the increase in private savings.
Firstly, the existing rate of interest on government borrowing is very low, varying between \(\frac{2}{3}\) per cent to \(\frac{3}{4}\) per cent.\(^{(1)}\) It is not likely that people who save will be attracted towards government securities as a form of investment. If these rates of interest are raised to a reasonable level to match other rates of interest prevailing in the private sector, there is some likelihood that this will attract savers to invest their money in government securities since the opportunity cost of holding their money in liquid forms (especially hoards) will be high. Moreover, the rise in the rates of interest is likely to reduce the relative attractiveness of investment in other fields whose present rates of return are very much higher than the present rate of interest on government bonds.

It might be argued that a high rate of interest on government bonds might induce a rise in the rate of interest in the private sector and this might adversely affect the inducement to invest. This is not likely to be the case in Egypt. This is because the rise in the rate of interest on government bonds is only an attempt to bridge some of the gap between the rate of interest on government bonds and on private loans. It is true that this is likely to be reflected in some rise in the rate of interest on private loans. But this rise is likely to be small. Within such a small rise, the investment demand schedule is not very sensitive. Moreover, even if such a rise in the rate of interest is likely to discourage private investment, this is not likely to be of any significant importance in Egypt where over four-fifths of investment is undertaken by the public sector. This means that public investment is not likely to be discouraged by the high rate of interest.

Secondly, the government by encouraging savings institutions and other forms of contractual savings will mobilize other parts of the community's savings. Most

Most of the financial institutions and insurance companies in Egypt are in the hands of the government. This will be an important step towards diverting these savings towards the types of investment planned by the government.

Thirdly, the government can give some guarantee for private investment in those types of investment desired by the government, such as a minimum rate of return on capital. This guarantee is likely to attract some part of the savings of people anxious to secure a minimum income. Finally, the government can expand its existing policy of joining with private investors in desirable forms of investment as specified in the development plan. This may take the form of government bonds at fixed interest rates which secure investors against the loss of their capital. In addition, the government can encourage investment in equity shares, since government co-operation may give some security against the risk of losing capital. In this way the government will provide investors with a wider range of choice between safe and risky types of investment, while leaving the ultimate choice to private investors.

These are the measures which would help to divert the community's savings towards investment, especially in those fields which accord with government plans. The accomplishment of these measures (i.e., the increase in the community's savings and their diversion to different types of investment) would mean that a considerable part of the development plan might be achieved. It should be recalled that the plan depends in large part on the public sector for embarking on different investment projects. The size of public investment is large, and it will continue to occupy this high position during the period of the plan (5 years).

However, this should not be taken to mean that we ignore here the disincentive effect of sales taxes on the inducement to invest in the private sector which will be sacrificed because of its small proportion. (1)

(1) See Chapter V.
But though sales taxes may be favourable to the inducement to invest in some ways, they may discourage the inducement to invest in other ways. The most important of these are:

(i) the use of highly progressive sales taxes may reduce the demand for the taxed products in a way which would discourage investment in these fields;

(ii) the use of discriminatory sales taxes with the exemption of basic necessities may divert demand from the highly taxed to the lightly taxed or exempted commodities. This would mean a diversion of resources from one field to another which may run counter to government policy.

However, there is no reason to suppose that sales taxes are likely to influence investment through the above two channels in any significant way. In the first place, as explained earlier in this chapter, Egypt is characterized by the presence of excess demand for the highly taxed commodities which are produced in the home market. Further, an additional reason for the insignificant effects of high rates of sales taxes on demand for consumers' goods is that the price elasticity of demand for highly taxed commodities is not high. (1)

Secondly, there is no reason to suppose that the imposition of sales taxes at discriminatory rates, and the exemption of basic necessities, will influence consumers' demand in a way which may affect the allocation of resources between different investment projects undesirably. (This is because of the 'demonstration effect', prestige consumption, and low elasticity of substitution).

Therefore the use of progressive sales taxes is not likely to affect adversely the inducement to invest to any significant extent in the private sector. It will merely slow down the rate of growth of investment in consumers' goods industries. Such a low rate of increase in consumption goods industry

(1) See Chapter VIII.
investment will allow for a higher rate of increase in investment goods industries planned by the government - whether it is undertaken by the government alone, or in conjunction with the private sector. The net effect will be a combination of those types of investment which secure a rapid rate of increase in aggregate income.

VI STABILIZATION: (2)

Sales taxes may be superior to income taxes as devices for stabilizing the economy because of: (i) their wider coverage; (ii) progressive rates; and (iii) their speed in producing revenue.

In the first place, sales tax coverage in Egypt is wider than that of income tax. Expenditure out of sources not liable to income tax - either because of government policy or the difficulty of administration - are included in the sales tax base. (1) As landlords in Egypt are the very people who are affected by cyclical fluctuations resulting from fluctuations in agricultural products, especially cotton, therefore sales taxes which reach the spending power of people in this group will act more strongly than other taxes which cannot reach them. This is especially true when we remember that people in this group are influenced in their consumption expenditure by the desire for appearance so that they liquidate part of their wealth in order to maintain or increase their consumption expenditures. Moreover, sales taxes' coverage will not be restricted to only 2 per cent of the population as is the case under the existing income tax, but will include a large number of consumers who cannot be reached by income tax. The most important of these are people with incomes below the exemption limit but above the average income per head, and people whose wealth is in the form of hoards. Since people in this group are characterized by high

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(1) See Chapter VII.
propensity to consume, the fact that sales taxes fall on some part of their expenditure means that the tax will be more effective in influencing the consumption expenditure of a large number of consumers, compared with income tax. In the case of hoards, the fact that wealth is held in a liquid form means that people can increase their consumption expenditure without taking into consideration the conditions of the economy. The use of sales taxes on different goods and services means that the tax will reach people who use liquid reserves without being liable under income tax. All these factors tend to give sales taxes a preference over income tax on the ground of wider coverage.

Secondly, the system of sales taxes suggested in this thesis is such that highly progressive rates are applied according to the degree of income elasticity of demand. Within this system, sales tax revenues will fluctuate widely upward and downward with fluctuations of income, especially when the rates used are ad valorem. Such taxes therefore provide some degree of flexibility required in a successful tax system designed to secure stability. Moreover, through the rise and the reduction in the rates, sales taxes are likely to influence the consumption behaviour of consumers, especially when the changes in the rates are considered to be temporary.

Thirdly, within the administrative conditions of Egypt, sales taxes appear to be feasible and are administered at a very low cost compared with income tax. The expansion of the tax coverage as suggested, is not likely to encounter any serious administrative difficulties. These taxes will be effectively enforced with little opportunity to reduce their effects on stabilization by the widespread evasion as under income tax.

Furthermore, the ease of administration of these taxes, in particular the fact that they can be levied without delay, and the nature of these taxes in

(1) See Appendices J and K.
that they are levied at the point of import or manufacture, will ensure that revenues from sales taxes are likely to flow more quickly than income tax. The time lag in the collection of the tax will be shorter and sales taxes will be quicker in absorbing purchasing power from consumers, compared with an income tax.

VII. CONCLUSIONS:

Sales and income taxes are both defective from an efficiency point of view. But the defects under sales taxes can be remedied more quickly and easily. If sales taxes are remedied in the manner advocated, they are likely to be more favourable to a rapid rate of economic growth than a reformed form of income tax.

They are also likely to have less disincentive effects on the supply of effort. Neither do they impede the mobility of labour which may result under income tax.

Moreover, sales taxes are more likely to encourage savings, whether by private companies or the government. The use of proper fiscal, monetary and certain institutional reforms, will encourage the channelling of these savings and their diversion to planned types of investment. This will help to ensure that a large part of the government plan is secured since the major part of investment is planned to be undertaken by the government. Even within the private sector, the effect of sales taxes on the inducement to invest is likely to be more favourable to a rapid rate of economic growth, one of the main objectives of government policy.

Finally, as a tool of stabilization, sales taxes have a wider coverage, flexibility, and speed in producing revenue, relative to income tax.
If all these factors indicate relative advantages for sales taxes on the grounds of their efficiency in helping towards the government's objectives of a rapid rate of economic growth, at a reasonable cost, then there is every reason for supporting more reliance on sales taxes in a modified form and within the short period in Egypt.
CHAPTER X.
CHAPTER X

CONCLUSIONS

The purpose of this concluding chapter is to summarize and evaluate the foregoing discussion, and to make suggestions for the improvement of the Egyptian tax system so as to render it an effective instrument in the hands of the fiscal authority.

I. SUMMARY:

The object of this thesis, as explained in the introductory chapter, is to evaluate how far the reliance of less developed countries in general and in Egypt in particular, on sales taxes as compared with income tax, will be successful in fulfilling the following objectives:

(i) a higher amount of revenue at a minimum cost,
(ii) an equitable distribution of the tax burden, and
(iii) the minimum adverse effects on incentives.

The broad conclusion reached seems to run contrary to the general belief about the efficiency of sales taxes in securing the above objectives, i.e., that sales taxes cannot be considered as an appropriate device for raising a higher amount of revenue in an equitable manner, and at minimum burden, compared with an income tax. On the contrary, our analysis has demonstrated the conclusion that sales taxes, along the lines suggested in this thesis, seem to secure an equitable distribution of the tax burden to at least the same extent as income tax. In addition, they are likely to be more efficient in raising an increasing amount of revenue, with minimum interference with the functioning of the economy in the short period (taken to be between 5 - 7 years). Different factors
contributed to this conclusion, the most important of which are:

(i) the way in which national income originates from different industrial origins, in addition to the way in which it is distributed among factor shares;
(ii) the interpretation given to equity in so far as it fits the conditions and requirements of less developed countries;
(iii) the pattern of consumption, its level and rate of increase;
(iv) wealth as a factor influencing consumption expenditure;
(v) the administrative capacity, degree of tax compliance and literacy in less developed countries.

In judging the Egyptian case against the background of these general factors we find that all of them support the preference of sales taxes over income tax as a means of providing the Egyptian treasury with a higher amount of revenue. They are more equitable than income tax within the short period. In addition, they are likely to have less adverse effects on incentives. The large share of income received in the form of profits, interest and rent, especially in the agricultural sector, the high level as well as the rapid rate of increase in consumption expenditure, (encouraged in part by the liquidation of wealth), especially those termed in Egypt as "luxuries", are important factors influencing this conclusion. In addition, the low capacity of administration within a framework of a high degree of illiteracy and low tax compliance added support for the reliance on sales taxes, compared with income tax, in securing the above mentioned objectives within the short run. The former type of taxes are likely to have wider coverage which enables them to reach
the spending power of different wealth and income groups, while the ease
of administration ensures the effective enforcement of the tax on different
taxpayers.

The conclusion is, therefore, that sales taxes, compared with income tax,
are a more equitable method of taxation in Egypt in relation to the objective
of raising an additional amount of revenue at minimum cost within the short
period. There are obvious advantages in using income as the tax base just
as there are obvious disadvantages in using expenditure. The emphasis that
we have placed on the disadvantages of the income base and the advantage of the
expenditure base arises out of our considered judgement in favour of the
expenditure base. Although many difficulties remain, the argument has been
cast fairly firmly in this unequivocal mould. Academic qualifications,
although not inserted ar regular intervals out of a concern for lucid exposition,
are implicit in some of the more bold statements which would seem, if taken at
face value, to be indicative of misplaced clarity of judgement.

II. EVALUATION:

The advantages of any tax in securing the objectives indicated earlier,
depend upon how efficiently a tax can succeed in reaching the spending power
of different wealth and income groups within the conditions of each country in
a proper way without discrimination. The conditions necessary to secure these
objectives have been discussed in Part I where it has been indicated that this
requires wider coverage and a proper enforcement of the tax. This would ensure
that the required amount of revenue from different wealth and income groups is
absorbed in taxation (as intended by the policy maker). As indicated in Part II
and summarized above, sales taxes seem to possess these qualities within the
circumstances of the Egyptian economy in the short run. If this is the case, then the conclusion is that sales taxes should be preferred to income tax, since the marginal social cost of raising a given amount of revenue by using sales taxes is likely to be lower than by raising it by using income tax. But this conclusion may be objected to on two important grounds:

(A) the defects noticed under income tax (and which led to the preference for sales taxes) are not inherent characteristics of income tax as such, but are mainly defects which result from the way in which income tax is implemented in practice, and which can be remedied;

(B) even if the advantage of sales taxes are recognised within the short period, they are dubious over a longer period where income tax regains its superiority.

These two points merit separate discussion.

(A) Defects of the Egyptian Income Tax.

Discussion concerning sales taxes in Egypt centres around the ease with which these taxes can reach the spending power of different income groups in a more effective way. Income tax, on the other hand, is condemned because of its small coverage, since it excludes a large part of personal income (i.e., agricultural income and capital gains), in addition to its lack of proper enforcement. This tended to weaken the tax as a device to secure revenue, equity, and economic efficiency.

However, it may be argued that if the preference for sales taxes is based on these criticisms, this would mean that the case against income tax (and consequently the advantage of sales taxes) rests on an illusion. This is because the criticism levelled against income tax is mainly directed against
the way in which the tax is levied, rather than against the tax itself. It
would be possible to remedy these defects by expanding the coverage of the
tax and properly administering it. The important question to be answered
then would be: Is it really possible to expand the existing coverage of income
tax and enforce it properly in the short period?

It is doubtful if this would be easy to secure within the short period
as will be explained later. However, even if we assume that it is possible
to expand the tax coverage in Egypt to include the non-taxed sources, i.e.,
aricultural profits, it is still doubtful that income tax will secure its
objectives (i.e., equity, revenue productivity and economic efficiency).
Income tax still neglects other factors having an influence on the taxable
capacity of tax payers, i.e., security or power which possession of wealth
confers on its owner. In addition, income tax does not take into consideration
the possibility of liquidating wealth which enhances the purchasing power of the
higher income groups and which is not uncommon in Egypt. Therefore, the
exclusion of these additional factors from liability to income tax, will not
affect equity only, but possibly also revenue productivity and economic effici-
ency. In Egypt the rate of growth of national income is low and this will
naturally be reflected in a low rate of increase in revenue from income tax
(assuming that all sources of incomes are included). But such a low rate of
growth of national income is normally accompanied by a higher rate of increase
in consumption expenditure. This is mainly due to the movement of some part of
the population from the rural to the urban sector where the propensity to consume
is higher. In addition, the influence of the 'demonstration effect' and the
desire for higher standards of living is great and is encouraged in part by some
liquidation of wealth. All these factors tend to put income tax at a disadvantage
relative to sales taxes in terms of revenue productivity since the rate of increase in consumption expenditure is likely to be higher than that of income within the short period. Furthermore, the other factors which increase the spending power of taxpayers and consequently their taxable capacity (i.e., wealth) are not taken into account by an income tax. Thus equity cannot be secured by an income tax.

It may be argued that if the problem here is that of how to reach the taxable capacity inherent in wealth, this might be better reached through the use of a tax on wealth. This is true, but such an argument ignores the difficulties inherent in determining the taxable capacity inherent in different types of wealth. There is no measure in which it would be possible to reduce the taxable capacity of different types of wealth to one common unit of measurement. Moreover, in a country like Egypt where holding wealth in non-income producing forms (i.e., gold, jewellery and foreign currencies) is not uncommon, it is difficult to trace them and thus they are difficult to tax. In this case, people holding their assets in these forms will be favoured in tax treatment relative to others. This is likely to be reflected in the revenue productivity of such a tax. Furthermore, the imposition of a tax on wealth might encourage wealthy groups to shift their forms of wealth from assets which can easily be traced, to others which are difficult to trace. Such a movement is likely to run against the objective of a rapid rate of growth of aggregate income, since the increase in wealth is in those types which do not add to the productive capacity of the economy.

Capital gains represent another type of problem which reduces the efficiency of income tax in Egypt. This is because capital gains represent an increase in the spending power and consequently the taxable capacity of taxpayers. Thus it
tends to have an effect on equity and revenue productivity of the tax. It is always difficult to decide upon whether certain types of capital gains are to be considered as income or capital. Moreover, capital gains when they are realized, do not belong to the period during which realization occurred, but to the period during which the asset was held. To tax these gains at the time when they are realized might invite taxpayers to vary the dates of realization with their effect on the stability of revenue. On the other hand, to tax them at that time also runs against equity since the income from this source accrued over a long period of time. It is possible of course to spread these gains over the period during which capital gains accrued. But this will complicate the system of administration and lead to some insecurity in the tax burden of taxpayers who realize these gains over a long period of time. Finally, there are great difficulties in assessing the extent of these gains in Egypt since most capital gains result from real estate rather than equity shares. It is difficult to trace the true price of land or buildings in many cases, especially when taxpayers do not reveal the true price. This would present serious difficulties in administering such a tax in an effective way. All these factors tend to make it difficult to tax capital gains in Egypt, with consequent effects on equity among different income groups. In addition, they might influence private investors' decisions to invest in projects which provide a high probability of capital gains, though its yield may be low. If this is the case, then a tax system with wider tax coverage would still encourage a movement of investment towards those traditional types of investment possessing a low multiplier effect.

Finally, the exemption of co-operative profits, dividend and discounts from income tax, tends to reduce the efficiency of income tax in securing revenue and
as a method of securing equity between people receiving dividends from different sources, i.e., companies and co-operative societies. It is theoretically possible to include profits, dividends and discounts of co-operative societies in income as a tax base by changing the present tax law. But this is not feasible in practice in Egypt, especially within the present policy of the government under which the co-operative movement is considered one of the main pillars of the economic policy of the country. The co-operative movement has had tax concessions since the introduction of income tax in 1939 when the government economic policy did not rely so heavily on the co-operative movement for its support. If the policy changes to one of putting a strong reliance on co-operative societies in all fields of economic activity as a device to support its economic policy, it will become very difficult if not impossible for the government to defeat its own purpose and withdraw income tax concessions which have been long in the system. This might give the impression that the government was withdrawing its support from the co-operative movement.

It may be argued that the exemption of profits, dividends and discounts of co-operative societies, though adversely affecting equity and revenue productivity of income tax, is desirable on economic grounds, since it will encourage the co-operative movement required by the government to further economic growth. This does not seem to be a solid argument for discrimination in favour of co-operative societies and their shareholders. Economic growth requires the encouragement of those types of investment characterized by a capacity creating effect. If any discrimination is desired in favour of these types, such discrimination should be given according to the purpose of investment rather than the form which an investment project may take. Two investment
projects may be established to fulfil the same purpose, but one may take
the form of a co-operative society, and the other the form of a company.
Although they would be treated differently under such a system, no purpose
would be served.

Therefore, we conclude that the exemption of co-operative profits, divi-
dends and discounts tends to weaken income tax as a source of revenue and as
a device to secure equity and economic efficiency. There is no possibility of
abolishing this discrimination at least in the short period within the existing
economic policy, which depends on the support and success of the co-operative
movement.

The conclusion which could be drawn from this discussion is that even
if it were possible to expand the coverage of income tax, this tax is still
inferior to sales taxes in securing equity, revenue productivity and economic
efficiency within the short period. Sales taxes do not suffer from the same
defects as income tax since they are levied on consumers' expenditures on goods
and services. These expenditures are influenced by all sources of spending
power whether they are made out of income or capital. As such, it will take
into consideration the influence of those factors which are neglected under
income tax (i.e., wealth, capital gains, dividends and discounts of shareholders
in co-operative societies).

But the truth of the matter is that an expansion of the existing coverage
of income tax within the existing capabilities of tax administration in Egypt is
almost impossible. It is extremely difficult, if not impossible, to assess
income derived from the agricultural sector, as farmers either do not know
exactly what their income is (especially when part or all of it is derived from
the non-monetary sector), or they tend to conceal it. The complication of taxing
agricultural income (and for that matter also capital gains) is increased in Egypt if we take into consideration the existing administrative capacity. As explained in Chapter VII, the administrative capacity of Egypt is very low and is already suffering from a high degree of inefficiency in the already limited areas of income tax. These difficulties are increased by lack of tax compliance on the part of taxpayers with the majority of taxpayers illiterate and record keeping virtually non-existent. The net result of these factors is that only a small proportion of national income (i.e., representing income in the form of wages and salaries in the non-agricultural sector) is effectively taxed by an income tax. Other sources of income are either not taxed or not properly taxed, equity is injured, revenue productivity is weakened, and the tax becomes an instrument influencing the economy in a direction against a rapid rate of growth of aggregate income unintended by the policy-makers.

Therefore, the importance of administrative feasibility as a factor limiting the efficiency of a tax in reaching its objectives should be stressed. In fact, administrative feasibility played an important role in influencing the types of income to be included in income as a tax base, so that the income tax moved away from being a means to secure equity, revenue productivity and economic efficiency. The enforcement of the tax varies with the types of income received, the extent of expenses of production allowed under each source, and the ease or difficulty in which income can be assessed. Such an unintended discrimination in tax administration is also reflected in the effect of the tax on the proper functioning of the economy, since it may influence the supply of different factors of production in a way which may be inimical to a rapid rate of economic growth as demonstrated in Chapter IX. This is especially important when we take into consideration that a small coverage and weak administration would tend to reduce
the revenue productivity of income tax. If a fixed amount of revenue is to be raised within these circumstances, the tax rates have to be raised to a higher level. If this is accepted, then the argument made in Chapter IX concerning an equal yield under both income and sales taxes cannot be accepted. Once this assumption is dropped, then the advantage of sales taxes become more apparent, since the wider coverage of sales taxes will mean that rates will be lower than under income tax. This means that sales taxes will have a less disincentive effect than income tax. Moreover, when sales taxes have wider coverage, (especially by including the consumption expenditure of the middle income groups who are largely consumers and are excluded from income tax coverage), they will tend to reduce consumption expenditure more than an income tax. This will help to divert more resources from the private to the public sector, thus avoiding inflationary pressure.

It is difficult to avoid these defects of income tax and ensure proper enforcement within a short period of time. Administrative efficiency is not a short-run problem, but one which needs a longer period in order to allow time for administrators to get the necessary education and training required to perform the job efficiently. In addition, to increase the compliance of taxpayers is not any easier. This is especially true when the majority of population do not appreciate the benefits which accrue from government expenditure of tax proceeds. It is through education over time that higher compliance can be achieved since education will help taxpayers to keep records and appreciate national responsibilities.

The conclusion, therefore, is that sales taxes, being within the administrative feasibility of Egypt, tend to have a wider coverage and to be properly administered relative to income tax, and would fulfil the objectives in the short period at minimum cost.
(B) Sales Taxes in Egypt in the Long Run:

Doubts arise concerning the advantage of sales taxes over income tax once the limitation of the period of time is extended from the short to a longer period of time. Different problems then surround the application of sales taxes as compared to income tax and these tend to weaken the case for sales taxes. In the first place, once the rate of increase in national income sustains its rate of growth and per capita income rises, the percentage of income spent out of an increase in income is likely to get smaller. The rise in the standard of living and the development of savings habits tend to make consumption expenditure adopt a normal relation to income within the conditions of Egypt. This would mean that the rate of increase in consumption expenditure will lag behind the rate of increase in income with consequent effects on revenue productivity and the possibility of equity. In addition, with the development of the economy and the increase in the share of the industrial sector, the size of the middle income group is likely to increase. This, together with the rise in the standard of living, will make it difficult to distinguish between the commodities which are considered as 'necessities' and those which are considered as 'luxuries'. The line of demarcation between these two groups is not likely to be sharp enough to allow such differentiation. This is especially true when expenditures on services are taken into account, since it will/be possible to enforce the tax properly on different sources of income. All these factors tend to give income tax a superiority over sales taxes in the longer-run. If this is the case, then it is important to invest in such types of tax at present in order to pave the way for their future development.

It is true that income tax is a superior type of tax to sales taxes in the long run, since the advantage of the latter type of taxes over the former will
diminish as explained above. But sales taxes are only one type among many other types of taxes levied on consumption expenditure. It should be recalled that the choice of sales taxes as the suitable type of tax on consumption expenditure (as against a tax on total consumption expenditure as in Kalder's Model), is based on the impossibility of applying an expenditure tax in Egypt. Once it is recognized that in principle the choice is made between a tax on income and a tax on consumption expenditure, and the form which the latter type of tax should take is based on the feasibility of applying the tax in practice in the short run, then a proper comparison in the long run should be made between an income tax and an expenditure tax. If this is accepted, then the advantages of income tax in the long run can also be doubted. The disadvantages which characterized income tax mentioned above remain. The power inherent in wealth is still neglected under income tax, though no doubt it tends to increase the taxable capacity of its owners. Moreover, the problems of capital gains cannot be solved in any easy way and the experience of more advanced countries indicates the difficulty of reaching a satisfactory solution. This is especially true when the sources of capital gains move towards equity shares and other forms of securities as the country develops and the industrial sector expands. In this case the importance of capital gains as a source of income may increase. In addition, any discrimination in the treatment of capital gains will not only run contrary to equity, but also influence the direction of private investment. This may conflict with efficiency in the allocation of the community's savings if they move towards those types which provide a low rate of increase in aggregate income. Finally, the problems of determining net income as separate from gross income represent another important factor influencing revenue productivity, equity,
and the supply of different factors of production. Many definitions of expenses of production are used varying from one source of income to another. This variation in the definitions is reflected in the discrimination in the tax treatment between different sources of income, with its consequent effect on the objectives which it is desired to secure by an income tax. All these factors show apparent defects of income tax which are difficult to remedy even in the long run. Even in more developed countries, long experience with income tax does not seem to be sufficiently satisfactory to make income tax an accepted tool of fiscal policy.

However, these defects are not so apparent under an expenditure tax. The fact that consumption expenditure is chosen as a tax base means that all sources of spending power which influence consumption are taken into account. There is no need to become involved in this context with problems of measuring the taxable capacity inherent in wealth, or in difficulties connected with evaluation if a tax on wealth is thought to be applied. In addition, problems concerning the determination of whether capital gains are real or illusory, and their assessment, are avoided under a tax on consumption expenditure since the behaviour of consumers as reflected in their spending will indicate the way they treat capital gains (i.e., as capital or income). In this case, consumption expenditure will reflect the taxable capacity of different taxpayers in a more efficient way than income tax. This is especially true within the interpretation given to equity in this thesis which requires taxation according to the rate of withdrawal of goods and services from the common pool rather than additions to it. In a country like Egypt, where there is a need for a continuous rise in per capita income to raise the standard of living from its present very low level, capital formation will possess a high importance for a long time to come. This tends to support the interpretation given to equity, even in the long run.
The effect of an expenditure tax, as compared with income tax, on incentives does not seem to be apparent in all cases. However, many discussions in the literature on the expenditure tax have indicated that this tax is likely to be more favourable to incentives. This means that the expenditure tax will be conducive to a more rapid rate of economic growth in the long run. There is neither time nor space to examine here these advantages since they are outside the scope of this study.

The revenue importance of an expenditure tax can also be secured if proper rates of tax are used. However, there is no reason to suppose that the same amount of revenue raised by an income tax would be required by an expenditure tax. Within a full employment situation - which is a realistic assumption for an economy in the long run - taxation is required to regulate the economy against inflationary and deflationary pressures (following the principle of functional finance). If this is accepted, then the fact that an expenditure tax will encourage more saving means that the amount of revenue needed by an expenditure tax is likely to be less than under income tax. This makes it unnecessary to raise the same amount of revenue as that raised by an income tax.

The conclusion that follows from this discussion is that income tax is definitely superior to a system of sales taxes on different goods and services in the long-run. On the other hand, it is likely to be inferior to an expenditure tax on Kalder's model. Therefore, from a long-run point of view an expenditure tax should be preferred.

But as we mentioned before, it is necessary to invest in a highly developed tax system such as an expenditure tax in order to pave the way for its future use.
The 'gestation period' of a new tax is very long before any tax produces its full effects. Since an expenditure tax is a more difficult type of tax than an income tax, and largely uses the same type of detailed information, we suggest that Egypt should retain but modify its income tax system, to work together with sales taxes. This will provide for a type of investment in training the administration for highly developed techniques of personal taxation while getting taxpayers accustomed to these taxes. This is a step towards providing higher tax compliance and an effective enforcement of the tax in the future. This leads to the next problem to be discussed in this concluding chapter, i.e., What recommendations are proposed to harmonize the tax system in Egypt to suit short and long run requirements of a rapid rate of economic growth?

III. RECOMMENDATIONS FOR THE IMPROVEMENT OF THE EGYPTIAN TAX SYSTEM:

The success of any tax system in reaching its objectives (i.e., equity, economic efficiency and revenue productivity) depends not only on the way in which one tax is used separately from the others, but also upon the effect of other types of taxes used in the system. The tax system should be harmonized since the equity and economic efficiency of one tax may be offset by the inequity and inefficiency of others. This may tend to make the tax system as a whole inefficient and inequitable. Moreover, government expenditures are always another aspect of the fiscal system which have an effect on equity and economic efficiency. In this discussion, we assumed government expenditure to be given. Therefore the question which remains to be answered is: how to harmonize the existing tax system in Egypt to avoid the anomalies noticed in the text (Chapters VII to IX) and to combine with the proposed system of sales taxes to achieve short and long run objectives?
We mentioned earlier the necessary modifications if the system of sales taxes is to achieve its objectives in the short run. These modifications can be summarized as follows:

1. Expanding the existing coverage of sales taxes to include consumers' expenditure on non-taxed goods and services, especially those produced in the home market;
2. Devising a tax structure consistent with the degree of income elasticity of demand and degree of tax progression required by the policy maker;
3. Classifying carefully those commodities which are to be considered to be of a basic character within the conditions of Egypt.

The effects of these modifications on equity, revenue productivity and economic efficiency has been discussed in detail in Chapters VII to IX and therefore do not require further analysis. For the rest of the tax system, the modifications suggested to provide more consistency in the tax system as a whole centre around:

A) Raising the rates of land and building taxes to a higher level in order to abolish the discrimination in favour of investment in real estate;
B) Agricultural profits should be subject to the tax;
C) Unifying the existing system of schedule income tax under one tax base subject to one system of exemption limits, allowances and rate structures;
D) Exemption limits and allowances should be raised to £500 for administrative reasons.

These are the modifications in the other parts of the tax system suggested in order to make it work in harmony with the recommended system of sales taxes. The next step is to examine the effect of these modifications on the desired objectives.
Raising the Rate of Land and Building Taxes:

The existing rates of land and building tax are much lower than the rates of the existing income tax. While the rates of land and building taxes vary from 12 to 14 per cent, the rates of income tax on commercial and industrial profits are 17 per cent at present. As we suggested in Chapters VIII and IX, such discrimination not only leads to inequity but is probably also responsible for the existing pattern of investment in Egypt. To remedy these defects, the rates of land and building taxes should be raised to at least the same rate as that applied to income tax. But within a country like Egypt where there is a tendency for savers to use their savings in bidding up the prices of land, or to invest them in luxury building which adds little to the productive capacity of the economy, it would seem that equity has to be sacrificed in part in favour of economic efficiency. Rentiers have to be taxed at higher rates in order to discourage the rate of increase in income received from real estate. This would discourage the diversion of a large part of the community's savings towards these traditional types of investment. In contrast it will discriminate in favour of those types of investment having a capacity creating effect, e.g., industrial investment. There is no fear that higher rates of tax would produce disincentive effects since people in this group are rentiers who are contributing little to the national product, while their claim on output is large.

It may be argued that a high rate of tax on building may have disincentive effects on building activities. In a country like Egypt characterized by a rapid rate of growth and by a rapid movement from rural to urban sectors accompanying industrialization, there is a great need to encourage building activities to avoid housing problems. That this objective is important cannot be doubted, but the existing investment in buildings is largely in luxury buildings.
with high import contents. These types of buildings not only impose a burden on the community in the form of the drain on the foreign exchange they use, but also do not solve the housing problem for the majority of population. This led the government to invest in building activities to solve the housing problems of the low and middle income groups. In fact, just under 50 per cent of investment in residential buildings is to be undertaken by the government in the first year of the development plan 1960/1961. If this is the case, then the government will not be discouraged by the high tax in its investment policy. Its effect will only be apparent on luxury buildings which it is desired to reduce.

Therefore, the increase in the rates of land and building tax, though contrary to equity, yet is important within the existing economic circumstances of Egypt. In addition, the high rates of tax would provide the treasury with a higher amount of revenue.

(B) The Taxation of Agricultural Profits:

The taxation of agricultural profits is an important and necessary step towards abolishing the discrimination made in favour of income received from the agricultural sector in contrast to the industrial field. It is odd for a country like Egypt, trying to change the structure of the economy towards industrialization, to have an income tax policy discriminating against industry. In this case, equity as well as economic efficiency requires the taxation of agricultural profits. The taxation of agricultural profits presents a very difficult problem because of the existing administrative capacity. There is no easy way in which it is possible to assess these profits in an equitable manner. But this should not be taken to mean that because of difficulties of administration, agricultural profits should be left untaxed. A fair approximation
to equity could be attempted within the short period until administrative efficiency and tax compliance is increased. Therefore, we suggest the use of an arbitrary fixed levy per feddan (= one acre of land), varying with the degree of fertility of land, system of irrigation, etc., which is basic information for the assessment of the land tax. The basis for the assessment of this levy is the estimated net profit per feddan periodically made by the Ministry of Agriculture. This information could be used as a basis for assessing the amount of tax per feddan. This levy could be fixed every two years to facilitate the work of administration on the one hand, and to take into consideration the change in profitability due to unknown elements (e.g. crop failure) on the other.

An exemption limit could still be granted under this tax by exempting, say, people who exploit a fixed number of fudans (according to the policy to be followed in granting exemptions) from the tax. The tax is to be assessed on the occupier of land and paid together with the land tax which is normally paid by the occupier and deducted from the rent paid to the owner. As mentioned above, this is an arbitrary method of taxation, but there is no other way in which it is possible to tax these profits more easily or more equitably.

There is no doubt that the imposition of a tax in this form will produce some revenue to the treasury and thus add to the tax revenue. On the other hand, there is no reason to suppose that the imposition of this tax will have a disincentive effect. This is because the tax is levied in a lump sum amount which does not vary with the amount of profits realized. In this case the tax will be like a poll tax in its effect, encouraging the taxpayers to increase their profits to outweigh the loss of income due to the tax, without fearing additional tax liability. In addition, the fact that there are no other
opportunities by which an investor can escape the tax by diverting his investment, will reduce any disincentive effect the tax might have. It is probably true that the tax will have less disincentive effect than income tax in other fields which vary with the amount of income earned.

Therefore, on the whole, a tax on agricultural profits, though it may not secure equity in a strict sense, is an approximation to it, and is better than no tax at all as is the case at present. It will also represent an additional source of revenue with least disincentive effects and without favouring one source of income against another.

(C) The Unification of the Existing Schedule Income Tax:

The unification of the existing system of tax is an important factor contributing to the consistency of income tax in so far as equity and economic efficiency is concerned. The analysis in Chapters VIII and IX has indicated the inconsistencies and anomalies in this direction which were responsible in part for the pattern of investment prevailing in Egypt. In addition it tended to affect equity and the revenue productivity of the tax. To reduce these defects it is necessary to unify all sources of income under one tax base in order to ensure that all sources of income are treated in a non-discriminatory way. In addition, this will facilitate the administration of income tax by abolishing the duplication involved in assessing the tax on any one taxpayer in many different ways and by many different officials, according to the sources of his income. This will cut the waste in administrative costs since all the taxpayer's income will be included under one return and assessed by one official. The net result is that efficiency of administration will increase, and discrimination will be avoided with favourable effects on the revenue productivity, equity and economic efficiency of the tax.
The exemption limits and allowances will be the same for every taxpayer, from whatever source his income is derived. Thus the tax will avoid the discrimination noticed in this direction, when exemption limits and allowances are varied under different schedules. The size of the exemption limits and allowances will be discussed under a separate heading.

Finally, it will be possible with a unitary tax system to apply the same rate structure of the tax to different taxpayers without reference to the source of income, as is the practice under the present tax system. This will avoid inconsistencies which result from applying different rates to different sources of income with effects on the equity of the tax and influences on the supply of different factors of production. The tax in this case will ensure that all incomes are treated in the same way, from whatever source they are derived. If it is desired to apply reduced rates to income from employment on equity grounds, as it is usually the case under the existing system, this can still be provided within this system in an easy way and without extending the discrimination to other sources.

(D) The Rise in Exemption Limits and Allowances to £500 a Year:

The administration of income tax suffers from the high burden of assessing the tax on a large number of taxpayers and the difficulties of assessing the tax properly on this number. This led to the accumulation of arrears and increased the burden on administration. Since the purpose of income tax in the short period is to act as a type of investment for the future rather than to achieve a particular and immediate end, we suggest that the exemption limit should be raised to £500 a year. This will mean that the number of taxpayers liable to the existing schedules will be reduced drastically from half a million taxpayers to only about 60,000 according to 1958 figures. If we add to these the number
of taxpayers receiving their income from agricultural profits, estimated to be around 40,000, the total number of taxpayers liable to income tax will be about 100,000. To follow such a system would reduce tremendously the effort needed to assess the tax on a large number of taxpayers whose contribution to the revenue is very small. This will be an important step towards diverting more effort towards ending arrears.

There is no reason to suppose that such a drastic reduction in the number of taxpayers would reduce the revenue from income tax to any significant extent. This is because the large number of taxpayers included in the figures are those who are liable to the industrial and commercial schedule representing 435,000 in 1958. These constitute about 93 per cent of all taxpayers and nearly take the largest part of the effort of administration. Out of those taxpayers 267,000 (i.e., 62% of the total under this schedule) are below the existing exemption limit in Egypt. Moreover, taxpayers in the range between above the exemption limit and £500 were 133,000 in 1958, (i.e., 30 per cent of the taxpayers in this schedule). Taxpayers included in both these two categories nearly take the largest part of the administrative effort. There are no figures available indicating the contribution of different groups of taxpayers to the treasury. Total figures are only available where it can be seen that total revenue from income tax on industrial and commercial undertakings (in the form of individuals and partnerships which constitute the above figures) was £3.8 m. in 1958. It is reasonable to assume that a large part of this revenue is derived from taxpayers whose income is £500 rather than from those whose income is below £500. Even if it is to be assumed that all the revenue is derived from those taxpayers with income less than £500, this would indicate the low revenue productivity of the tax derived from such a large number of taxpayers. It would
not be worthwhile collecting this revenue at such a high effort and cost. Such a waste of effort probably has an effect on the effort spent on taxpayers with income above £500. If the effort is concentrated towards taxing people with income above £500, it is probably true that a better enforcement would be secured and that the loss of revenue resulting from the exemption of taxpayers with income below £500 a year would be outweighed. In addition, the modification in the rates of land and building taxes and the liability of agricultural profits to income tax are all factors contributing to the revenue productivity of income tax, and they are thus likely to produce a net addition to the revenue.

Finally, there is no reason to believe that people with incomes below £500 will be undertaxed relative to those with incomes above this amount. This is because the rates of sales taxes applied will take into consideration the tax burden of the existing types of taxes used in order to secure more equity in the system as a whole.

These are the modifications suggested together with the proposed system of sales taxes. It should be noted that the suggested modifications in other parts of the tax system do not render the purpose of this thesis futile, i.e., how to raise additional amounts of revenue in an equitable manner and with minimum interference with the functioning of the economy. It is true that the remedy to the above defects in the other parts of the tax system may produce additional revenue, a step towards more equity, and a movement towards a more efficient allocation of resources. But, on the other hand, the effect of the suggested reform will be a loss of revenue due to the rise in the exemption limit. In addition, equity is not secured in most cases under this system (e.g. land and building taxes, and agricultural profits). If this is the case, then the main
purpose of his thesis remains unaffected. The defects which are suggested as fit for reform are those whose eradication will ensure consistency and efficiency in the tax system as a whole.

The conclusion, therefore, is that if all the modifications are followed together with sales taxes as suggested in our system, the components of the tax system as a whole will be consistent with each other in securing equity, revenue productivity and economic efficiency, as related to incentives necessary for a rapid rate of economic growth. Even from the long run point of view, investment in income tax will be secured. It will provide a basis for reliance on personal types of taxes in the future. This has to be aided not only by income tax laws as such, but by making compulsory book-keeping, auditing and other requirements for a proper enforcement in the future. In addition, additional requirements as to the types of wealth held, purchases and sales of wealth during a year, gifts, bequests, etc., have to be elicited gradually, in order to accustom taxpayers to supplying this information as a step towards the application of an expenditure tax in the long run.
Appendix A.

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Appendix C.

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<td>6.5</td>
<td>5.9</td>
<td>4.2</td>
<td>4.1</td>
<td>5.5</td>
</tr>
<tr>
<td><strong>More Developed Countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>% of Taxes on Persons:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1) Canada</td>
<td>9.0</td>
<td>9.0</td>
<td>12.0</td>
<td>13.1</td>
<td>13.0</td>
<td>11.2</td>
<td>10.1</td>
<td>11.8</td>
<td>-</td>
<td>11.2</td>
</tr>
<tr>
<td>(2) Sweden</td>
<td>8.0</td>
<td>8.7</td>
<td>11.8</td>
<td>11.6</td>
<td>12.1</td>
<td>11.0</td>
<td>11.6</td>
<td>11.5</td>
<td>-</td>
<td>10.8</td>
</tr>
<tr>
<td>(3) U.K.</td>
<td>17.8</td>
<td>15.6</td>
<td>16.7</td>
<td>15.9</td>
<td>15.7</td>
<td>16.0</td>
<td>14.9</td>
<td>15.0</td>
<td>-</td>
<td>15.9</td>
</tr>
<tr>
<td><strong>% of Taxes on Commodities</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1) Canada</td>
<td>7.0</td>
<td>7.1</td>
<td>8.0</td>
<td>7.7</td>
<td>8.1</td>
<td>7.1</td>
<td>7.1</td>
<td>7.6</td>
<td>-</td>
<td>7.4</td>
</tr>
<tr>
<td>(2) Sweden</td>
<td>7.7</td>
<td>6.9</td>
<td>7.0</td>
<td>7.4</td>
<td>10.8</td>
<td>11.4</td>
<td>11.8</td>
<td>11.4</td>
<td>-</td>
<td>9.3</td>
</tr>
<tr>
<td>(3) U.K.</td>
<td>14.0</td>
<td>13.7</td>
<td>13.6</td>
<td>12.7</td>
<td>13.0</td>
<td>13.2</td>
<td>13.1</td>
<td>12.8</td>
<td>-</td>
<td>13.3</td>
</tr>
</tbody>
</table>

Appendix D.
(See Chapter III.)

Import Duties, Export Taxes and Taxes on Income and Wealth in Ceylon, 1947-1957 (Fiscal Years).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Import Duties</td>
<td>167</td>
<td>177</td>
<td>180</td>
<td>188</td>
<td>245</td>
<td>260</td>
<td>251</td>
<td>244</td>
<td>258</td>
<td>255</td>
<td>265</td>
</tr>
<tr>
<td>Export Tax</td>
<td>83</td>
<td>136</td>
<td>149</td>
<td>167</td>
<td>252</td>
<td>227</td>
<td>193</td>
<td>259</td>
<td>369</td>
<td>316</td>
<td>325</td>
</tr>
<tr>
<td>Taxes on Income and Wealth</td>
<td>96</td>
<td>104</td>
<td>121</td>
<td>133</td>
<td>139</td>
<td>211</td>
<td>238</td>
<td>225</td>
<td>213</td>
<td>319</td>
<td>285</td>
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</tbody>
</table>

Appendix E

(See Chapter VI) The Size and the Composition of Government Expenditure in Egypt in the years 1937/38 and 1959/60.

<table>
<thead>
<tr>
<th></th>
<th>1937/1938</th>
<th></th>
<th></th>
<th>1959/1960</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value in £m.</td>
<td>% to total Govt. Expenditure</td>
<td>% to National Income</td>
<td>Value in £m.</td>
<td>% to total Govt. Expenditure</td>
<td>% to National Income</td>
</tr>
<tr>
<td>(1) Current Expenditures on Goods and Services:</td>
<td>19.2</td>
<td>53.0</td>
<td>11.5</td>
<td>204.5</td>
<td>40.0</td>
<td>15.9</td>
</tr>
<tr>
<td>Defence, salaries, wages, services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) Transfer Payments:</td>
<td>4.2</td>
<td>11.5</td>
<td>2.5</td>
<td>22.7</td>
<td>4.4</td>
<td>1.7</td>
</tr>
<tr>
<td>Service of the debt, Price subsidies and Social Affairs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(3) Capital Expenditure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) In human resources: Health and Education</td>
<td>6.2</td>
<td>17.0</td>
<td>3.7</td>
<td>52.3</td>
<td>10.4</td>
<td>4.2</td>
</tr>
<tr>
<td>(b) Capital Formation including gross expenditure on Annexed Budget and Autonomous Budget</td>
<td>6.7</td>
<td>18.5</td>
<td>4.0</td>
<td>231.6</td>
<td>45.2</td>
<td>16.0</td>
</tr>
<tr>
<td>Total Capital Expenditure</td>
<td>12.9</td>
<td>35.5</td>
<td>7.7</td>
<td>283.9</td>
<td>55.6</td>
<td>22.2</td>
</tr>
<tr>
<td>Grand Total</td>
<td>36.3</td>
<td>100.0</td>
<td>21.7</td>
<td>511.1</td>
<td>100.0</td>
<td>39.8</td>
</tr>
</tbody>
</table>

Appendix F
(See Chapter VI)

The Break-Up of Revenue from Import Duties into the Major Groups of Commodities Imported in Egypt for the year 1960/1961.

<table>
<thead>
<tr>
<th>Imports of Wholly Agricultural Food Items:</th>
<th>Imports of Manufactured Food Items:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Composed of: Wheat £20.2 paid duty of £2.0</td>
<td>Composed of Flour £10.3 paid duty of £4.7m. Canned Food £13.3</td>
</tr>
<tr>
<td>Fruits £2.5 paid duty of £1.2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Drinks</td>
</tr>
<tr>
<td></td>
<td>Coffee</td>
</tr>
<tr>
<td></td>
<td>Tea</td>
</tr>
<tr>
<td></td>
<td>Tobacco</td>
</tr>
<tr>
<td></td>
<td>(1) Total Imports of Food, Drink and Tobacco</td>
</tr>
<tr>
<td></td>
<td>30.3</td>
</tr>
<tr>
<td></td>
<td>24.3</td>
</tr>
<tr>
<td></td>
<td>0.3</td>
</tr>
<tr>
<td></td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td>6.7</td>
</tr>
<tr>
<td></td>
<td>6.4</td>
</tr>
</tbody>
</table>

| | 69.5 | 30.6 | 62.8 | 67.3 |
| | 0.6 | 0.3 | 0.2 | 0.2 |
| | 5.7 | 2.6 | 1.8 | 2.0 |
| | 0.5 | 0.2 | 0.2 | 0.2 |
| | 9.1 | 4.1 | 2.2 | 2.3 |
| | 1.0 | 0.4 | 0.1 | 0.1 |
| | 4.6 | 1.6 | 0.7 | 0.7 |
| | 2.8 | 1.2 | 0.2 | 0.2 |
| | 95.8 | 41.0 | 68.2 | 73.0 |
| | 57.7 | 25.3 | 13.9 | 14.8 |
| | 77.3 | 33.7 | 11.4 | 12.2 |
| | 226.8 | 100.0 | 93.5 | 100.0 |

Appendix G.
(See Chapter VI)

The Break up of the Revenue Received From Excise Duties in Egypt in 1954.

<table>
<thead>
<tr>
<th>Product</th>
<th>Revenue Collected £m.</th>
<th>% to Total Excise Duties' Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Sugar</td>
<td>7.9</td>
<td>47.0</td>
</tr>
<tr>
<td>(2) Petroleum</td>
<td>6.4</td>
<td>38.0</td>
</tr>
<tr>
<td>(3) Lubricating Oil</td>
<td>0.4</td>
<td>2.3</td>
</tr>
<tr>
<td>(4) Cement</td>
<td>0.8</td>
<td>4.7</td>
</tr>
<tr>
<td>(5) Coffee</td>
<td>0.3</td>
<td>2.0</td>
</tr>
<tr>
<td>(6) Wine and Beer</td>
<td>0.3</td>
<td>2.0</td>
</tr>
<tr>
<td>(7) Pure Alcohol</td>
<td>0.2</td>
<td>1.0</td>
</tr>
<tr>
<td>(8) Matches</td>
<td>0.5</td>
<td>3.0</td>
</tr>
<tr>
<td>Total</td>
<td>16.8</td>
<td>100.0</td>
</tr>
</tbody>
</table>


"Egyptian Taxation, The Tax System and its Organization and Administration", Taxation Department, Cairo 1955.
Appendix H.
(See Chapter VII)

Rate of Change of Different Types of Government Receipts in Egypt in Selected Years.

<table>
<thead>
<tr>
<th>Rate of Change of 1959 over 1938</th>
<th>672</th>
<th>833</th>
<th>546</th>
<th>350</th>
<th>-</th>
<th>766</th>
<th>252</th>
<th>633</th>
<th>618</th>
<th>448</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of Change of 1959 over 1946</td>
<td>138</td>
<td>239</td>
<td>156</td>
<td>351</td>
<td>151(1)</td>
<td>229</td>
<td>86</td>
<td>131</td>
<td>166</td>
<td>122</td>
</tr>
<tr>
<td>Rate of Change of 1959 over 1954</td>
<td>50</td>
<td>90</td>
<td>22</td>
<td>32</td>
<td>54(1)</td>
<td>45</td>
<td>11</td>
<td>31</td>
<td>44</td>
<td>28</td>
</tr>
</tbody>
</table>

Compiled from figures of Tax Receipts
(1) excludes surtax receipts
(2) includes surtax receipts
The Percentage of arrears to Total Taxpayers for Surtax-payers.
(situation as surveyed at 31/3/1957)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Number of Taxpayers</th>
<th>Total Number of Taxpayers who are not yet assessed to the Tax</th>
<th>% of Taxpayers not yet assessed to the Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>35618</td>
<td>-</td>
<td>37%</td>
</tr>
<tr>
<td>1952</td>
<td>36069</td>
<td>13315</td>
<td>46%</td>
</tr>
<tr>
<td>1953</td>
<td>36430</td>
<td>17590</td>
<td>48%</td>
</tr>
<tr>
<td>1954</td>
<td>36425</td>
<td>20471</td>
<td>56%</td>
</tr>
<tr>
<td>1955</td>
<td>37456</td>
<td>31492</td>
<td>84%</td>
</tr>
</tbody>
</table>

The Percentage of arrears to Total Taxpayers for Commercial and Industrial Schedule Tax.
(situation as surveyed at 31/3/1957)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Number of Taxpayers</th>
<th>Total Number of Taxpayers who are not yet assessed to the Tax</th>
<th>% of Taxpayers not yet assessed to the Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>376873</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1952</td>
<td>395144</td>
<td>42637</td>
<td>11%</td>
</tr>
<tr>
<td>1953</td>
<td>399056</td>
<td>54627</td>
<td>11%</td>
</tr>
<tr>
<td>1954</td>
<td>397038</td>
<td>61283</td>
<td>15%</td>
</tr>
<tr>
<td>1955</td>
<td>414176</td>
<td>38272</td>
<td>92%</td>
</tr>
</tbody>
</table>

The Percentage of Arrears to Total Taxpayers for Non-Professional Taxpayers.
(situation as surveyed at 31/3/1957)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Number of Taxpayers</th>
<th>Total Number of Taxpayers who are not yet assessed to the Tax</th>
<th>% of the Taxpayers not yet assessed to the Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>20000</td>
<td>-</td>
<td>23%</td>
</tr>
<tr>
<td>1952</td>
<td>20233</td>
<td>4691</td>
<td>23%</td>
</tr>
<tr>
<td>1953</td>
<td>20610</td>
<td>6144</td>
<td>30%</td>
</tr>
<tr>
<td>1954</td>
<td>20927</td>
<td>7782</td>
<td>37%</td>
</tr>
<tr>
<td>1955</td>
<td>20915</td>
<td>15448</td>
<td>74%</td>
</tr>
</tbody>
</table>

Source: Court of Audit for the year 1953/1954, Cairo, 30th December 1957.
Appendix J

(See Chapter VII)

Gross Sales Taxes Collection and Expenditures in Egypt in the years 1940 - 1958

<table>
<thead>
<tr>
<th>Year</th>
<th>Total tax collection (£m.)</th>
<th>Total expenditure (£m.)</th>
<th>Collection per £ expenditure</th>
<th>Cost of collection as a percentage of total tax receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>16.48</td>
<td>0.38</td>
<td>48.6</td>
<td>2.0</td>
</tr>
<tr>
<td>1941</td>
<td>15.90</td>
<td>0.38</td>
<td>94.2</td>
<td>1.3</td>
</tr>
<tr>
<td>1942</td>
<td>20.78</td>
<td>0.30</td>
<td>71.0</td>
<td>1.4</td>
</tr>
<tr>
<td>1943</td>
<td>21.32</td>
<td>0.31</td>
<td>77.7</td>
<td>1.2</td>
</tr>
<tr>
<td>1944</td>
<td>24.08</td>
<td>0.33</td>
<td>79.0</td>
<td>1.1</td>
</tr>
<tr>
<td>1945</td>
<td>29.41</td>
<td>0.37</td>
<td>97.9</td>
<td>1.0</td>
</tr>
<tr>
<td>1946</td>
<td>36.21</td>
<td>0.41</td>
<td>115.2</td>
<td>0.8</td>
</tr>
<tr>
<td>1947</td>
<td>43.47</td>
<td>0.45</td>
<td>135.8</td>
<td>0.7</td>
</tr>
<tr>
<td>1948</td>
<td>47.31</td>
<td>0.55</td>
<td>134.8</td>
<td>0.7</td>
</tr>
<tr>
<td>1949</td>
<td>60.22</td>
<td>0.54</td>
<td>173.3</td>
<td>0.6</td>
</tr>
<tr>
<td>1950</td>
<td>74.14</td>
<td>0.57</td>
<td>163.7</td>
<td>0.6</td>
</tr>
<tr>
<td>1951</td>
<td>93.07</td>
<td>0.54</td>
<td>172.3</td>
<td>0.6</td>
</tr>
<tr>
<td>1952</td>
<td>93.31</td>
<td>0.57</td>
<td>163.7</td>
<td>0.6</td>
</tr>
<tr>
<td>1953</td>
<td>87.72</td>
<td>0.52</td>
<td>162.4</td>
<td>0.6</td>
</tr>
<tr>
<td>1954</td>
<td>99.99</td>
<td>0.48</td>
<td>203.3</td>
<td>0.5</td>
</tr>
<tr>
<td>1955</td>
<td>98.64</td>
<td>0.51</td>
<td>193.8</td>
<td>0.5</td>
</tr>
<tr>
<td>1956</td>
<td>103.03</td>
<td>0.57</td>
<td>180.7</td>
<td>0.5</td>
</tr>
<tr>
<td>1957</td>
<td>87.99</td>
<td>0.58</td>
<td>151.7</td>
<td>0.7</td>
</tr>
<tr>
<td>1958</td>
<td>98.28</td>
<td>0.60</td>
<td>163.8</td>
<td>0.6</td>
</tr>
</tbody>
</table>

AVERAGE 0.7

Source: Compiled from the Budget, Custom Division for different years.
Salaries and wages represent 60% of total cost of tax collection.
### Gross Income Tax Collections and Expenditures in Egypt in the years 1940 - 1958

<table>
<thead>
<tr>
<th>Year</th>
<th>Income Tax Collection m.f.E.</th>
<th>Cost of Income Tax Collection £,000,E.</th>
<th>Collection per £1 expended £.E.</th>
<th>Cost of Tax Collection as a percentage of total Tax Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940</td>
<td>2,736</td>
<td>71,305</td>
<td>39.1</td>
<td>2.5</td>
</tr>
<tr>
<td>1941</td>
<td>2,719</td>
<td>69,250</td>
<td>39.1</td>
<td>2.5</td>
</tr>
<tr>
<td>1942</td>
<td>4,686</td>
<td>87,037</td>
<td>54.4</td>
<td>1.8</td>
</tr>
<tr>
<td>1943</td>
<td>12,440</td>
<td>104,014</td>
<td>49.6</td>
<td>0.8</td>
</tr>
<tr>
<td>1944</td>
<td>15,462</td>
<td>149,248</td>
<td>103.8</td>
<td>0.9</td>
</tr>
<tr>
<td>1945</td>
<td>15,023</td>
<td>210,412</td>
<td>71.4</td>
<td>1.4</td>
</tr>
<tr>
<td>1946</td>
<td>16,329</td>
<td>244,377</td>
<td>66.8</td>
<td>1.4</td>
</tr>
<tr>
<td>1947</td>
<td>15,496</td>
<td>383,850</td>
<td>40.3</td>
<td>2.4</td>
</tr>
<tr>
<td>1948</td>
<td>13,032</td>
<td>449,714</td>
<td>28.9</td>
<td>3.4</td>
</tr>
<tr>
<td>1949</td>
<td>19,848</td>
<td>605,448</td>
<td>32.8</td>
<td>3.1</td>
</tr>
<tr>
<td>1950</td>
<td>18,706</td>
<td>625,716</td>
<td>29.4</td>
<td>3.3</td>
</tr>
<tr>
<td>1951</td>
<td>18,889</td>
<td>635,363</td>
<td>22.1</td>
<td>4.5</td>
</tr>
<tr>
<td>1952</td>
<td>27,412</td>
<td>902,009</td>
<td>30.3</td>
<td>3.2</td>
</tr>
<tr>
<td>1953</td>
<td>28,150</td>
<td>1,006,000</td>
<td>27.9</td>
<td>3.5</td>
</tr>
<tr>
<td>1954</td>
<td>26,157</td>
<td>1,068,000</td>
<td>24.5</td>
<td>4.1</td>
</tr>
<tr>
<td>1955</td>
<td>27,824</td>
<td>1,066,000</td>
<td>26.1</td>
<td>3.8</td>
</tr>
<tr>
<td>1956</td>
<td>31,994</td>
<td>1,201,000</td>
<td>26.6</td>
<td>3.7</td>
</tr>
<tr>
<td>1957</td>
<td>36,291</td>
<td>1,232,000</td>
<td>28.0</td>
<td>3.5</td>
</tr>
<tr>
<td>1958</td>
<td>43,690</td>
<td>1,363,000</td>
<td>32.0</td>
<td>3.1</td>
</tr>
</tbody>
</table>

**AVERAGE**

<table>
<thead>
<tr>
<th>Income Tax Collection m.f.E.</th>
<th>Cost of Income Tax Collection £,000,E.</th>
<th>Collection per £1 expended £.E.</th>
<th>Cost of Tax Collection as a percentage of total Tax Receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AVERAGE</strong></td>
<td></td>
<td><strong>2.8</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Traylor: U.N. Expert in Egypt

Budget for the years 1956-1958

Salaries and wages constitute about 80% of total cost of the collection.
Appendix L.
(See Chapter IX)

### Average and Marginal Rates of Income Tax on Income Derived from Commercial and Industrial Profits in Egypt.

<table>
<thead>
<tr>
<th>Income Level £.E.</th>
<th>Tax Liabilities £.E.</th>
<th>Effective Tax Rates</th>
<th>Marginal Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>200</td>
<td>17</td>
<td>8.5</td>
<td>17</td>
</tr>
<tr>
<td>210</td>
<td>27</td>
<td>12.8</td>
<td>100</td>
</tr>
<tr>
<td>220</td>
<td>37</td>
<td>15.0</td>
<td>100</td>
</tr>
<tr>
<td>230</td>
<td>39.1</td>
<td>17.0</td>
<td>21</td>
</tr>
<tr>
<td>240</td>
<td>40.8</td>
<td>17.0</td>
<td>17.0</td>
</tr>
<tr>
<td>250</td>
<td>42.8</td>
<td>17.0</td>
<td>17.0</td>
</tr>
<tr>
<td>260</td>
<td>44.2</td>
<td>17.0</td>
<td>17.0</td>
</tr>
</tbody>
</table>

### Average and Marginal Rates of Income Tax on Income Derived from Wages and Salaries in Egypt.

<table>
<thead>
<tr>
<th>Income Level £.E.</th>
<th>Tax Liabilities £.E.</th>
<th>Effective Tax Rates</th>
<th>Marginal Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>190</td>
<td>1.80</td>
<td>0.9</td>
<td>-</td>
</tr>
<tr>
<td>200</td>
<td>2.00</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>210</td>
<td>5.10</td>
<td>2.4</td>
<td>31.0</td>
</tr>
<tr>
<td>220</td>
<td>5.4</td>
<td>2.4</td>
<td>3.0</td>
</tr>
<tr>
<td>230</td>
<td>5.7</td>
<td>2.4</td>
<td>3.0</td>
</tr>
<tr>
<td>240</td>
<td>6.0</td>
<td>2.5</td>
<td>3.0</td>
</tr>
<tr>
<td>250</td>
<td>6.3</td>
<td>2.5</td>
<td>3.0</td>
</tr>
<tr>
<td>260</td>
<td>6.6</td>
<td>2.5</td>
<td>3.0</td>
</tr>
</tbody>
</table>
Appendix M.

(See Chapter IX.)

The Average and Marginal Rates of Income Tax By Source of Income (including Surtax) in Egypt.

(Ihypothetical Case) at 1959 rates

<table>
<thead>
<tr>
<th>Income</th>
<th>Tax on Income from Salaries and Wages</th>
<th>Tax on Income from Moveable Property</th>
<th>Tax on Commercial and Industrial Profits</th>
<th>Tax on Land (rent)</th>
<th>Tax on Agricultural Profits</th>
<th>Tax on Rent from Buildings</th>
</tr>
</thead>
<tbody>
<tr>
<td>£ 500</td>
<td>3.1% 17%</td>
<td>17% 17%</td>
<td>17% 17%</td>
<td>14.0% 14.0%</td>
<td>12% 12%</td>
<td></td>
</tr>
<tr>
<td>1000</td>
<td>4.8% 17%</td>
<td>17% 17%</td>
<td>17% 17%</td>
<td>14% 14%</td>
<td>12% 12%</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>10.2% 15.9%</td>
<td>19.7% 22.4%</td>
<td>19.7% 22.4%</td>
<td>16.4% 19.9%</td>
<td>15.1% 18.3%</td>
<td></td>
</tr>
<tr>
<td>3000</td>
<td>12.6% 17.4%</td>
<td>21.3% 24.6%</td>
<td>21.3% 24.6%</td>
<td>18.6% 21.8%</td>
<td>16.8% 20.0%</td>
<td></td>
</tr>
<tr>
<td>5000</td>
<td>15.9% 20.8%</td>
<td>23.2% 26.1%</td>
<td>23.2% 26.1%</td>
<td>21.0% 24.6%</td>
<td>19.0% 22.3%</td>
<td></td>
</tr>
<tr>
<td>10000</td>
<td>24.1% 32.3%</td>
<td>32.3% 41.3%</td>
<td>32.3% 41.3%</td>
<td>27.5% 34.1%</td>
<td>26.0% 33.1%</td>
<td></td>
</tr>
<tr>
<td>20000</td>
<td>34.9% 45.6%</td>
<td>38.2% 44.1%</td>
<td>38.2% 44.1%</td>
<td>34.4% 41.3%</td>
<td>33.2% 40.4%</td>
<td></td>
</tr>
</tbody>
</table>

The Taxes levied are those according to the rates under each schedule and collected by the Central Government only.
Appendix N.

(See Chapter IX)

The Average and Marginal Rates of Income Taxes on Salaries Under Different Levels of Income in Egypt.

<table>
<thead>
<tr>
<th>Income</th>
<th>Income Tax</th>
<th></th>
<th>Income Tax + Surtax</th>
<th></th>
<th>Income Tax + Surtax + Additional Tax</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Average rate</td>
<td>Marginal rate</td>
<td>Average rate</td>
<td>Marginal rate</td>
<td>Average rate</td>
<td>Marginal rate</td>
</tr>
<tr>
<td>£ 1000</td>
<td>4.8</td>
<td>-</td>
<td>4.8</td>
<td>-</td>
<td>4.8</td>
<td>-</td>
</tr>
<tr>
<td>£ 2000</td>
<td>6.5</td>
<td>8.6</td>
<td>10.2</td>
<td>15.9</td>
<td>10.2</td>
<td>15.9</td>
</tr>
<tr>
<td>£ 3000</td>
<td>7.3</td>
<td>9.0</td>
<td>12.6</td>
<td>17.4</td>
<td>15.9</td>
<td>27.4</td>
</tr>
<tr>
<td>£ 5000</td>
<td>8.0</td>
<td>9.0</td>
<td>15.9</td>
<td>20.8</td>
<td>25.9</td>
<td>40.8</td>
</tr>
<tr>
<td>£10000</td>
<td>8.5</td>
<td>9.0</td>
<td>24.1</td>
<td>32.3</td>
<td>51.6</td>
<td>77.3</td>
</tr>
<tr>
<td>£20000</td>
<td>8.7</td>
<td>9.0</td>
<td>34.9</td>
<td>45.6</td>
<td>88.6</td>
<td>125.6</td>
</tr>
</tbody>
</table>

at 1959 rates
<table>
<thead>
<tr>
<th>Income</th>
<th>On Income from Salaries and Wages</th>
<th>On Income from Moveable Property</th>
<th>On Income from Industrial Profits</th>
<th>On Income from Agricultural Profits</th>
<th>On Income from Rent of Buildings</th>
<th>On Income from Rent of Land</th>
</tr>
</thead>
<tbody>
<tr>
<td>£ 500</td>
<td>3.1</td>
<td>17.0</td>
<td>17.0</td>
<td>17.0</td>
<td>12.0</td>
<td>12.0</td>
</tr>
<tr>
<td>1000</td>
<td>4.8</td>
<td>5.8</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2000</td>
<td>6.5</td>
<td>8.6</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3000</td>
<td>7.3</td>
<td>9.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>5000</td>
<td>8.0</td>
<td>9.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>10000</td>
<td>8.5</td>
<td>9.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>20000</td>
<td>8.7</td>
<td>9.0</td>
<td>-</td>
<td>-</td>
<td>Capital gains are exempted</td>
<td>Capital gains are exempted</td>
</tr>
</tbody>
</table>

1. The tax rates are those applied in 1959.
2. The rates are the income tax rates on the schedule, and the land tax rates, and Building Tax rates (including Saffir Tax).
3. Local taxes are excluded from this calculation.
4. Taxes on Income from professions cannot be determined as it depends on the number of years of graduation up to £1000 income a year and then it becomes 11% proportional rate afterwards.
### Appendix P  
(See Chapter IX)

**Movement in the Prices of Total Export, Export of Cotton and in National Income for the Years 1945 - 1955, Egypt**

*(1938 = 100)*

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>National Income</td>
<td>(100)</td>
<td>302</td>
<td>323</td>
<td>351</td>
<td>380</td>
<td>438</td>
<td>500</td>
<td>524</td>
<td>475</td>
<td>480</td>
<td>514</td>
<td>564</td>
</tr>
<tr>
<td>Total Export</td>
<td>(100)</td>
<td>249</td>
<td>256</td>
<td>286</td>
<td>439</td>
<td>392</td>
<td>502</td>
<td>798</td>
<td>608</td>
<td>446</td>
<td>505</td>
<td>495</td>
</tr>
<tr>
<td>Export of Cotton</td>
<td>(100)</td>
<td>284</td>
<td>295</td>
<td>333</td>
<td>538</td>
<td>484</td>
<td>635</td>
<td>1054</td>
<td>766</td>
<td>550</td>
<td>643</td>
<td>634</td>
</tr>
</tbody>
</table>

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