Chapter 8

THE ROLE OF TAXATION IN ECONOMIC DEVELOPMENT

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1. FISCAL ASPECTS OF DEVELOPMENT POLICY

1. Problems of taxation, in connection with economic development, are generally discussed from two different points of view, which involve very different, and often conflicting, considerations: the point of view of incentives and the point of view of resources. Those who believe that it is the lack of adequate incentives which is mainly responsible for insufficient growth and investment are mainly concerned with improving the tax system from an incentive point of view through the granting of additional concessions of various kinds, with less regard to the unfavourable effects on the public revenue. Those who believe that insufficient growth and investment is mainly a consequence of a lack of resources, are chiefly concerned with increasing the resources available for investment through additional taxation even at the cost of worsening its disincentive effects.

2. In my opinion a great deal of the prevailing concern with incentives is misplaced — except in particular cases, such as in the matter of tax concessions granted to foreigners which may increase the inflow of capital from abroad 1 — it is limitation of resources, and not inadequate incentives, which limits the pace of economic development. Indeed the importance of public revenue from the point of view of accelerated economic development could hardly be exaggerated. Irrespective of the prevailing ideology or the political colour of particular governments, the economic and cultural development of a country requires the efficient and steadily expanding provision of a whole host of non-revenue-yielding services — education, health, communications systems, etc., commonly known as ‘infrastructure’ — which require to be financed out of government revenue. In addition, taxation (or other compulsory levies) provides

1 But see below, para. 13.

E. A. G. Robinson (ed.), Problems in Economic Development
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the most appropriate instrument for increasing savings for capital formation out of domestic sources.\(^1\)

3. The only feature that is common to most ‘under-developed’ countries is the shortage of revenue which makes it impossible for them to provide essential public services on the required scale. The common assumption is that these countries are unable to lift themselves out of their predicament because of their very poverty. No doubt the ‘taxation potential’ of a poor country — the proportion of its gross national product that can be diverted to public purposes without setting up intolerable political and social pressures — is generally lower, and in many cases appreciably lower, than that of a rich country. But more important, in my view, is the low ‘coefficient of utilization’ of that potential — due to bad tax laws, bad tax administration, or both — which in turn is only partly to be explained by lack of knowledge, understanding or of administrative competence — it is also the result of resistance by powerful pressure groups who block the way to effective tax reform. Accelerated development in all such cases is predominantly a political issue: expert advice can point the way, but overcoming resistance to more effective policies for mobilizing resources must depend on the collective will, operating through political institutions.

4. The inadequacy of public revenue has two important consequences. It forces undue economies precisely in those fields of public expenditure (like health and education) which are more easily sacrificed in the short run, but are the most important from the point of view of long-run development. It also yields persistent budgetary deficits which force the monetary authorities to follow highly restrictive credit policies (to protect the balance of payments and to limit the pace of inflation) which in turn has highly undesirable effects on the pace of economic growth, without fully compensating for the effects of the weakness in the state of public finances on the stability of the currency.

5. Many under-developed countries suffer, not only from lack of revenue, but also from an irrational scale of priorities in the allocation of public funds. Too much may be spent on the (real or fancied) needs of defence, or for ostentatious purposes of various kinds — such as public buildings and ornaments, lavish diplomatic

\(^1\) The only alternative is inflation, which by comparison is a clumsy and ineffective instrument for mobilizing resources, since a large part of the ‘enforced’ reduction in the consumption of the mass of the population, brought about by the rise in prices in relation to incomes, is wasted in the increased luxury consumption of the profit-earning classes. Also, it is difficult to conceive of inflation as more than a temporary instrument for mobilizing resources: once wages rise in consequence of the rise in prices, the rate of price-inflation is accelerated, without securing any further savings.

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