

GOVERNMENT FINANCING IN THE ASSOCIATED STATES

BY

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INTRODUCTION

My definition of the term Associated States for purposes of this paper comprehends Antigua, Dominica, St. Kitts-Nevis-Anguilla, St. Lucia, Montserrat and St. Vincent. Though several reasons can be cited for including Grenada in the analysis of the finances of the Associated States (not the least of which is the fact that it is functionally related with the other Associated States via institutions such as the East Caribbean Common Market (ECCM) and the West Indies Shipping Association (WISA) Council) the fact that Grenada is now a politically independent State was considered to be one compelling reason why it was diplomatically improper to include it in this study.

My approach to the analysis of the government finances of the Associated States deals with the problem under four major rubrics. First, I attempt a brief overview of the public finances of the Associated States. Secondly, I discuss the budgetary gap and approaches to the control of recurrent expenditure. Thirdly, I attempt to examine what I consider to be the major issues in tax reform and the potential for accelerating the growth of revenue. Finally, I discuss certain regional fiscal issues of importance to the Associated States.

OVERVIEW

In many ways the Associated States represent a modern miracle of survival in coming through the current period of serious world inflation. Those of us who are more closely associated with the financial position of the more developed territories, all of which have one or more major exports which have been favourably affected by world inflation, cannot really comprehend fully the nature of the financial stringency, and the political and economic pressures which have been caused by the recent world monetary and financial crises in these smaller states. Moreover, even a close examination of the statistical data available fails to give a complete picture since they cannot document either the real changes in the quality of life or the psychological and political turmoil which has been part and parcel of the everyday experiences of the governments and people of the area. Without losing sight of the fundamental goal of objectivity which is expected to govern all scientific research, I shall where convenient attempt to create an awareness of these political and other pressures in so far as they are of relevance to an understanding of the motivations behind fiscal policy.

Economic Activity and Public Finances

As in most other economies, the public finances of the Associated States both help to determine and in their turn are determined by the real level and value of economic activity. The reasons are not far to seek and do not require any abstruse reasoning. Most taxes are based on the value of capital assets or on the value of net income and transactions taking place in the economy. Consequently, as the levels of these parameters fluctuate, so does the level of government revenue. Going one step further, fluctuations in the level of revenue tend to influence, though they do not determine finally, the level of public expenditure, whereas expenditure in turn is one of the determinants of the level of income and economic activity. These relationships persist whether one conceives of a Keynesian-type or a Seers Petroleum-type model of income determination. Our investigation of the government finances of the Associated States must necessarily begin therefore with a look at the performance of these economies in the areas of trade and economic activity in recent years.

It is probably symptomatic of the present poor state of the finances of the Associated States that they publish little economic statistics, and that the only continuous series of GDP estimates available appears to be those published by the Office of the Economic Commission for Latin America (ECLA) in Port-of-Spain, Trinidad. Reference to those data indicates that aggregate Gross Domestic Products at Current Factor Costs for the six Associated States referred to rose from \$255.9 million (EC) in 1970 to \$392.9 million in 1974. This represented an overall increase of about 53.5 per cent over the four-year period, or an average annual growth of 11.4 per cent (Table 1). As would be expected, the increases in GDP for the different states were very disparate, ranging from a low overall increase of 38.7 per cent for the four-year period for Antigua, to a high of 88.8 per cent for St. Kitts for the same period. There was also considerable variation in the growth of GDP from year to year in addition to the differences between states. The growth registered from 1970 to 1971 by the entire group was about 10.4 per cent, it fell to just over 8 per cent for the next two years, and then increased abruptly to well over 18 per cent for the year 1974 over 1973 (Table 1).

Even with the disparities in growth rates among states and the fluctuations over time, the economic performance of the Associated States would have been creditable had it not reflected to the very substantial degree that it does the effects of price inflation in the region. In the absence of a proper economic deflator there is little choice but to refer to the retail price index. Since the base year for the retail price index varies from one state to the other, the changes in the index over the period 1970-1975 have been converted into percentage price changes in order to facilitate comparability. For the ECCM region as a whole prices increased by an average of 14.4 per cent per annum as compared with the 11.4 per cent for GDP at Current Factor Cost. (Tables 5 and 6). This of course suggests a significant fall in real GDP over the period, since the rate of increase in prices was noticeably higher than that of current GDP, though the Index of Retail Prices is not the appropriate deflator for GDP. To a large extent the annual fluctuations in the Index of Retail Prices were also mirrored in

TABLE 1 ASSOCIATED STATES: GDP, DOMESTIC EXPORTS AND IMPORTS
(1970-1974)

	1970	1971	1972	1973	1974	% Increase 1974 1970
	GDP at Current Factor Costs (\$M) ¹					
Antigua	75.1	80.5	84.2	89.9	104.0	38.67
Montserrat	11.9	14.1	15.5	17.3	20.0	68.06
St. Kitts	30.3	35.7	43.0	48.3	57.2	88.78
St. Vincent	39.7	42.7	45.0	49.7	57.9	45.84
St. Lucia	60.7	66.3	73.3	74.3	97.4	60.46
Dominica	38.2	43.2	45.1	51.9	56.4	47.64
Total	255.9	282.5	306.1	331.4	392.9	53.54
% increase over preceeding year		+10.39	+8.35	+8.27	+18.56	
Average increase per annum =		11.39				

¹ ECLA Estimates

the fluctuations in the growth of GDP: 7.2 per cent for prices between 1970 and 1971 when GDP rose by 10.4 per cent; 5.2 per cent and 12.5 per cent respectively for prices in 1971-72 and 1972-73 when the corresponding GDP changes were 8.4 per cent and 8.3 per cent and 29.6 per cent for prices in 1973-74 when GDP grew by 18.6 per cent. Though GDP figures are not available for 1975 it would not be surprising if the real output position deteriorated further in view of the further 16.3 per cent increase in prices between 1974 and 1975 (Tables 5 and 17).

Two peculiar facts appear to emerge from the data in Table 6: first is that St. Kitts, which was noted earlier as experiencing the most spectacular increase in GDP during the period, also was favoured with the minimum increase in the Index of Retail Prices, about 48 per cent for the whole 5-year period; second is that St. Lucia which is normally considered to possess one of the stronger and more diversified economies of the group, and which enjoyed a not insignificant increase in GDP over the period of about 60 per cent, witnessed the highest increase in prices which rose by about 78 per cent between 1970 and 1974, and by about 110 per cent by the end of 1975.

Looking at the record of the Associated States from the point of view of international trade, one sees domestic exports rising from the 1970 level of \$55.8 million to \$137.3 million in 1974, an increase of over 146 per cent. The average annual increase in value of exports was of the order of 25.4 per cent for the 4-year period (Table 3). This growth in value, however, was largely dictated by prices, particularly the prices of bananas, sugar and citrus which increased several-fold during the period, and in some cases was accompanied by actual declines in volume exported. For example, in Dominica, though the value of exports increased over the period by an attractive 76 per cent and the quantity of exports increased for nearly all the minor export items, the volume of bananas exported fell by some 25 per cent, and this item alone accounts for over 60 per cent of the total value of exports of that state. It is obvious from Table 3 that the performance of the export sector in both St. Lucia and Antigua was far from that described for Dominica, while in St. Vincent and Montserrat the situation was clearly much worse. In fact in the case of Montserrat, the value of exports in 1974 was the same as that in 1970 indicating a decline in real volume since some price increases must have occurred over this inflationary period.

TABLE 2 ASSOCIATED STATES: LOCAL CURRENT REVENUE AS A
PERCENTAGE OF GDP (1970-1974)

	Percentages				
	1970	1971	1972	1973	1974
Antigua	26.8	26.8	27.2	26.5	23.5
Montserrat	25.2	22.7	23.2	24.9	25.0
St. Kitts	30.7	27.7	23.5	26.3	32.7
St. Vincent	25.7	27.61	26.9	26.8	33.0
St. Lucia	27.2	29.9	29.7	32.0	27.9
Dominica	27.0	27.5	27.9	25.0	22.5
Total Local Revenue as % of GDP	27.1	27.7	27.1	27.5	27.2
Total Expenditure as % of GDP	28.2	29.3	28.8	30.4	29.9

Turning to imports, it may be somewhat surprising that Table 4 suggests that the growth in value was moderate by comparison with that for exports, and that in spite of a dramatic increase of over 32 per cent in the aggregate for the year 1973-74 alone. The overall increase over the 4-year period was 72 per cent representing an average annual growth of about 15 per cent for the group as a whole. The available evidence suggests that this growth in value, even moreso than in the case of exports, was the result of increases in the prices of imports, accompanied by both reductions in volume

TABLE 3 ASSOCIATED STATES: DOMESTIC EXPORTS (\$M)

	1970	1971	1972	1973	1974	% Increase 1974 1970
Antigua	21.8	32.2 ¹	34.6 ¹	50.4	59.0	170.64
Montserrat	0.3	0.3	0.1	0.1	0.3	0.0
St. Kitts	7.7	7.6	11.4	14.3	16.0*	107.79
St. Vincent	6.5	5.4	6.0	9.0	11.0*	69.23
St. Lucia	8.1	9.2	13.7	15.0	30.9	281.48
Dominica	11.4	12.0	13.0	16.2	20.1	76.32
Total	55.8	66.5	78.8	105.0	137.3	146.06
% increase over preceding year		+19.18	+18.50	+33.25	+30.76	
Average increase per annum =		25.42				

*Rough estimates used here in the absence of published data

¹Total Exports -- Domestic plus Foreign

Sources: 1) UN-ECLA - *Economic Activity - Caribbean Community Countries 1974 and 1975*;

2) Caribbean Community Secretariat, *A Digest of Trade Statistics of Caribbean Community Member States, 1976*.

as well as shifts from higher valued to lower valued commodities. It is interesting to note that Montserrat and Antigua, the two members of the group which are most dependent on tourism, were the two economies with the highest increase in the value of imports. It is worth investigating to what extent (a) the existence of a tourist industry (invisible exports) enabled them to sustain the value of imports through the earnings in foreign exchange from that source; (b) the implied weakness of the agriculture sector prevented a switch to local products in the case of essential food imports and therefore made it more difficult to contain the growth of imports; or (c) the importation of high-priced inputs, such as crude oil in the case of Antigua, was essential for the maintenance of exports.

Government Revenue, Expenditure and Purchasing Power

While it is of some importance to examine the absolute levels of revenue and expenditure in any analysis of the public finances of the Associated States, the economic and financial crises of recent years make it imperative to examine these figures in greater depth if one is to get a more precise idea of the financial position of the governments. We noted earlier that one is forced to the conclusion that real output declined for the group as a whole since the growth in value of GDP was significantly

TABLE 4 ASSOCIATED STATES: IMPORTS (\$M)

	1970	1971	1972	1973	1974	% Increase 1974 1970
Antigua	72.6	86.8	91.0	94.5	143.8	98.07
Montserrat	8.8	8.6	12.1	12.1	16.0	81.82
St. Kitts	23.4	30.5	30.6	36.1	40.0*	70.94
St. Vincent	30.5	36.0	35.2	38.5	50.9	66.89
St. Lucia	54.6	69.0	68.7	74.2	91.1	66.85
Dominica	31.3	33.0	32.9	32.3	38.9	24.28
Total	221.2	263.9	270.5	287.7	380.7	72.1
% increase over preceding year		+19.30	+2.50	+6.36	+32.33	
Average increase per annum =		15.12				

*Rough estimates used here in the absence of published data.

Sources: 1) UN-ECLA - *Economic Activity - Caribbean Community Countries 1974 and 1975*; 2) Caribbean Community Secretariat, *A Digest of Trade Statistics of Caribbean Community Member States, 1976*.

less than the rate of increase in retail prices. This means that if Government was to maintain its real level of purchasing power over goods and services, an increasing share of GDP should have been made available to it. It is apparent, however, that though total revenue (including grants) for the group grew by over 11 per cent per annum (Table 11) this was not sufficient to extract from the hard pressed economies any larger share of total output for use in the public sector, since GDP grew by an almost identical rate. Table 2 reveals that Local Current Revenue (excluding all grants) was barely able to maintain its relation to GDP at 27 per cent, and this was in spite of the fact that this particular period 1970-1974 was one which witnessed a fairly considerable amount of new legislative activity in the field of taxation. Of particular importance was the introduction and increases of the consumption tax in all the territories and the sugar levy in St. Kitts in 1974.

From certain points of view it is sometimes argued that the measure of Government's command over resources is more precisely indicated by the level of expenditure, since this reflects the resources actually purchased by the public sector out of

current output in so far as it represents expenditure on goods and services. The picture of the public finances improves somewhat when we examine expenditure data, but certainly not to such an extent as to make one optimistic about the situation. As a percentage of GDP total recurrent expenditure increased slightly from 28.8 per cent for the triennium 1970-1972 to 29.7 per cent for the triennium 1972-1974 (See Table 2). This was inevitable since while GDP grew by 11.4 per cent per annum, Government Expenditure rose at an average rate of 14.7 per cent which was in fact slightly faster than the 14.4 per cent at which prices grew.

In the attempt to get a more precise idea of the implications of these disparities in growth rates the indices for 1970 to 1975 in Table 5 were transformed to a common base year 1970 and used as a deflator of the Government current revenue data in Table 13. The result was the constant 1970 dollars estimates of recurrent expenditure presented in Table 15. These indicate that in the case of Dominica, Antigua and St. Vincent the real value of public expenditure actually fell between 1970 and 1975, whereas in St. Kitts real expenditure rose at an annual rate of over 11 per cent (Table 16). This was not surprising for that state since it not only experienced, as noted earlier, the least increase in prices, but also enjoyed an attractive growth of revenue of 14.5 per cent (Table 11) and was able to maintain the highest rate of growth of expenditure of all the states (21.9 per cent shown in Table 14).

TABLE 5 ASSOCIATED STATES — INDEXES OF RETAIL PRICES*
(1970-1975)

	1970	1971	1972	1973	1974	1975
Antigua (Jan. 1969 = 100)	108.0	117.3	127.8	144.9	180.9	201.7
Montserrat (Mar. 1974 = 100)	64.5	75.4	76.8	84.3	100.0	125.4
St. Kitts (1964 = 100)	135.3	133.0	141.4	155.9	200.2	221.6
St. Vincent (Mar. 1964 = 100)	132.6	141.2	144.9	168.5	228.4	260.8
St. Lucia (Apr. 1964 = 100)	132.9	144.0	155.4	176.3	236.6	278.6
Dominica (Apr. 1964 = 100)	130.0	136.0	140.7	157.6	214.8	254.1

*Indexes are averages of monthly figures except as indicated below:

- 1) For Antigua (1969-73) price index is an average of January and July, 1974 Index is an average of January, April, July and October.
 - 2) Indexes for Montserrat relate to March in 1973 and 1974, April in 1972 and June in 1970 and 1971. Indexes base April 1964 = 100 linked to Index March 1974 = 100 at 1974.
- Source: UN-ECLA — *Economic Activity, Caribbean Community Countries, 1974 and 1975.*

TABLE 6 ASSOCIATED STATES — PERCENTAGE CHANGE IN INDICES OF
RETAIL PRICES (1970-1975)

	1971	1972	1973	1974	1975	Average	1974	1975
	1970	1971	1972	1973	1974	Annual % Increase	1970	1970
Antigua	8.6	9.0	13.4	24.8	11.5	13.5	67.5	86.8
Montserrat	16.9	1.9	9.8	18.6	25.4	14.5	55.0	94.4
St. Kitts	-1.7	6.3	10.3	28.4	10.7	10.8	48.0	63.8
St. Vincent	6.5	2.6	16.3	35.5	14.2	15.0	72.2	96.7
St. Lucia	8.4	7.9	13.4	34.2	17.8	16.3	78.0	109.6
Dominica	4.6	3.5	12.0	36.3	18.3	14.9	65.2	95.5

TABLE 7 ASSOCIATED STATES: INDICES OF RETAIL PRICES (1970-1975)

	1970 = 100*					
	1970	1971	1972	1973	1974	1975
Antigua	100.0	108.6	118.2	134.2	167.5	186.8
Montserrat	100.0	116.9	119.1	130.7	155.0	194.4
St. Kitts	100.0	98.3	104.5	115.2	148.0	163.8
St. Vincent	100.0	106.5	109.3	127.1	172.2	196.7
St. Lucia	100.0	108.4	116.9	132.7	178.0	209.6
Dominica	100.0	104.6	108.2	121.2	165.2	195.5

*Calculated from Table 5.

Sources of Revenue and the Potential for Balancing the Recurrent Budget

Even though the data in Table 12 covers as short a period as 1971 to 1975, it is still possible to discern a clearly declining trend in revenue based on international trade concomitant with an increase in the share of revenue derived from income and property, and consumption and production. Though in fact the major item of present tax on consumption and production is really a supplement to the customs tariff imposed in order to restore revenue lost with the elimination of duty on certain items originating within the Caribbean Community, this tax is intended also to be levied on any domestic production of the same items as well in order to avoid discrimination against regional imports. It is probably true that few if any of the states attempt to collect this

tax on the relevant domestically produced products consumed locally, both because the established tax-collection machinery is the Customs Department which is organised largely to collect taxes on imports, and because as a matter of policy the Governments prefer to confer an advantage on local production. The share of total revenue deriving from consumption and production increased from 14.5 per cent in 1971 to 19.6 per cent in 1975, but this can be accounted for entirely by the increases in rates of consumption tax and in the number of imported items covered in the base of the tax.

Though there has been a very marginal increase in the share of total revenue contributed by taxes on income and property, this area of direct taxation in general represents the one in which there exists the greatest unexploited potential for increasing revenue, though it is beyond doubt also the revenue source likely to give rise to greatest political controversy when attempts are made to increase taxes. In the past the high-income groups and property owners have used their influence on Government policy to protect their interests in the crudest ways imaginable by securing exemptions from tax on land, winning concessions for special categories of income, and ensuring the existence of loopholes in the tax system which would facilitate the effective reduction of nominal rates. There also appears in some states to be such widespread evasion of income tax that the government itself appears reluctant to tackle the problem through the introduction of administrative reforms and considers it preferable

TABLE 8 ASSOCIATED STATES: GOVERNMENT RECURRENT REVENUE
(1970-1975)

	(\$'000)					
	1970	1971	1972	1973	1974	1975
	Rev. Est					Est.
	Va: Local Current Revenue					
Antigua	20,112	21,626	22,918	23,848	24,392	30,064
Montserrat	3,023	3,200	3,610	4,301	4,961	5,262
St. Kitts	9,289	9,945	10,071	12,678	18,654	21,988
St. Vincent	10,218	11,783	12,137	13,288	19,056 ¹	21,335 ²
St. Lucia	16,466	19,778	21,806	23,838	27,199	28,756
Dominica	10,288	11,943	12,567	13,011 ³	12,675	13,788
Total	69,396	78,275	83,109	90,964	106,937	121,193

Source: Country Estimates

¹ Approved Estimates

² Figures refer to Fiscal Year 1975-76

³ Provisional

TABLE 9 ASSOCIATED STATES: CURRENT ACCOUNT GRANTS

	1970	1971	1972	1973	1974	1975
Antigua ³	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Montserrat	1,016	1,827	895	1,219	1,338	1,952
St. Kitts	2,151	2,414	2,539	2,799	1,924	1
St. Vincent	336	1,320	1,000	1,200	720 ¹	2,560 ²
St. Lucia	191	215	372	306	238	301
Dominica	1,411	1,201	758	120	126	4,000
Total	5,105	6,977	5,564	5,644	4,346	9,314

Source: Country Estimates

¹ Approved Estimates

² Figures refer to Fiscal Year 1975-76

³ Grant figures not available for Antigua

to abolish the tax altogether. To quote from the White Paper issued by the Antigua Labour Party on Total Abolition of Income Tax and Projected Compensatory Revenue:

The Antigua Labour Party is convinced that the weight of income tax obligation is carried by a constant hard-core wage and salary earners, many of whom can ill afford to carry the burden, while at the same time there exists a privileged entrepreneurial group which succeed in emancipating itself from the obligation of income tax through its tax evasion techniques. The Antigua Labour Party considers it more equitable to set everybody free from the income tax burden and discover other productive means and methods to collect \$5.7 million.

It is clear that very few Governments of the Associated States would feel confident enough to campaign on a platform including a proposal for radical tax reform instead of tax abolition, nor would any of them wish to risk the possible results of a confrontation with the emancipated group referred to. Yet this political fear of adopting radical policies which would bring fiscal strength to the precarious finances leaves the Governments little choice but to continue their dependence on British and other external budgetary aid. It also effectively undermines the confidence with which they can contemplate the prospect of approaching political independence from the United Kingdom. In the particular case of Dominica for example the state had to resort to budgetary aid again in 1975 after being financially independent for some time. Perhaps fortunately, however, the political pressures for drastic fiscal and financial reforms are becoming more obviously and audibly present as the tolerance hitherto exercised by public servants and other public sector employees has reached its

TABLE 10 ASSOCIATED STATES: GOVERNMENT RECURRENT REVENUE
(1970-1975)

(\$'000)

	Vc: Total Current Revenue and Grants					
	1970	1971	1972	1973	1974 Rev. Est	1975 Est
Antigua	20,112	21,626	22,918	23,848	24,392	30,064
Montserrat	4,039	5,027	4,505	5,520	6,299	7,214
St. Kitts	11,440	12,359	12,610	15,477	20,578	21,989
St. Vincent	10,554	13,103	13,137	14,488	19,776	23,895
St. Lucia	16,657	19,993	22,178	24,144	27,437	29,057
Dominica	11,699	13,144	13,325	13,131	12,801	18,288
Total	74,471	82,252	88,673	96,608	111,283	130,507

Source: Country Estimates

TABLE 11 ASSOCIATED STATES: GROWTH IN CURRENT REVENUE
(1970-1975)

	Percentages					
	1971	1972	1973	1974	1975	Average Annual Growth
	1970	1971	1972	1973	1974	
Antigua	7.5	6.0	4.1	2.3	23.3	8.6
Montserrat	24.5	-10.4	22.5	14.1	14.5	13.0
St. Kitts	8.0	2.0	22.7	33.0	6.9	14.5
St. Vincent	24.2	0.3	10.3	36.5	20.8	18.4
St. Lucia	20.0	10.9	8.9	13.6	5.9	11.9
Dominica	12.4	1.4	-1.5	-2.5	7.7	3.5
Total Associated States	14.4	4.0	8.9	15.2	13.2	11.1

limits and they refuse to postpone satisfaction of their demands in several states. Unlike in the case of imported supplies by the public sector which can be postponed while efficiency in the public sector is allowed to deteriorate, it is not apparent that there is considerable room for manoeuvre in situations such as the Government faces

in St. Lucia. At the same time the magnitude of resources required to enable the Government to satisfy the new demands must force it to come squarely to grips with the need to make full use of the fiscal system as a means of resource mobilization.

Income and Property Tax Reforms

Now that the economic and financial crisis of the early 1970s has evolved into a political crisis of major proportions in some states, there is evidence that several of the Governments of the Associated States are displaying the political willingness to introduce at least some of the kinds of fiscal policy reforms which would improve their finances, but which are also dictated by considerations of equity and justice in the distribution of burdens and benefits in the community. Let us look briefly at some of the areas to which attention is being turned:

Residential Property Taxation: Except in the case of Montserrat which in recent years has undertaken drastic revision of its provisions for taxation of both income and property, and has now become one of the few states in the Eastern Caribbean with a significant share of its revenue coming from property, nearly all the other states are only now in the process of undertaking sweeping re-examination of their taxation of real estate. Not only are the annual rateable values (ARV) used as a basis for taxing residential and commercial properties hopelessly out of line with actual market values, but the rates of tax of the order of 5 per cent of the same undervalued ARV are also low by comparison with practice elsewhere, where such taxes are expected to make a worthwhile contribution to revenue.

Land Taxation: The practice here ranges from a specific tax imposed on acreage without any relation to value in use or productive capacity to the extreme case of Dominica where nearly all land and particularly agricultural land is exempt from taxation. An attempt in the 1975-1976 Budget to impose a penalty tax on idle land to force the holders of valuable agricultural tracts (particularly the absentee landlords) to develop their land was effectively opposed, and alternative measures attempting to tax land in general have so far failed. The full implications of the situation can be realized only when one learns that all agricultural income is also exempt from tax in Dominica, a country receiving budgetary aid from the U.K. No serious approach to an improvement of the fiscal and financial situation can afford to ignore these issues.

Allowances, Deductions and Exemptions under the Income Tax: It is difficult to estimate the effect of these in reducing the base of the income tax since in many cases, particularly where exemptions are involved, no report is made of the exempt income, and the records do not permit us to discover what the base would have been had the exempt income been included. For instance, someone appears to have convinced all the Governments that if all interest earned on deposits in banks in the Associated States were exempt from tax, there would be a tremendous influx of capital from outside the region leading to a significant alteration in the economic situation. All the policy is certain to have achieved is some added relief from income tax of those local persons sufficiently well off to be able to hold large amounts of idle cash in local banks.

An interesting case discovered in the St. Vincent law is the absence of any upper limit on the amount of income which could be deducted in respect of premiums paid on life insurance as long as this did not exceed a certain proportion of assessed income. The records reveal that in the year 1974 eight persons in the \$50,000 and over income category had insurance deductions exceeding \$32,000. Compare this with a limit of \$800 per person in affluent Trinidad and Tobago.

In the case of mortgage interest in respect of an owner-occupied property, the Associated States are consistent with practice elsewhere in the Caribbean when no limit is imposed on the quantum of this payment which can be claimed as a deduction from income. In a situation of serious financial stringency, one may seriously question whether the rich ought to be completely free to benefit from a subsidy without limit to luxury housing, or for that matter be free to finance consumption expenditure at the cost of the revenue by borrowing on their residential property. Still with housing, the refusal of St. Vincent to permit deduction of rates and taxes and maintenance of residential property and at the same time excluding Annual Rateable Value from income for tax purposes may well be worthy of general consideration since the net result of this package is usually a reduction of taxable income. It is obvious that in the case of lower income groups their ability to benefit from these generous exemptions, deductions and allowances is restricted by the limited amount of resources available to them for saving and acquisition of these assets such as bank deposits, houses and insurance. Equity therefore suggests that reasonable limits be imposed on the ability of the rich to benefit from these.

Taxation of Non-Residents: The income tax provisions in several of the Associated States distinguishes between non-residents who are, (a) British subjects who are given most of the allowances enjoyed by residents as well as the benefit of the rate schedule which bestows preferred treatment on incomes facing an average rate of tax less than the prevailing company rate; and (b) non-British subjects who are often taxed at the company rate and are denied all allowances. This favourable treatment of British subjects understandable, though not defensible, in a pure colonial setting, is hardly appropriate to the present and prospective political status of the Associated States. Without going into the arguments in support of this view now, there really is no justification for similar treatment of residents and non-residents under the tax system, nor can there be any rationale for unilateral discrimination among non-residents on the basis of their nationality.

Administratively too, since non-residents are outside the jurisdiction of the courts or other mechanisms of enforcement, it is considered infeasible to rely on the tax return and assessment as a collection device. Here too there is a basis for differentiating between the tax treatment of residents and non-residents, as the mechanism which is considered more efficient here is a withholding tax on the gross income at the time of payment or credit to the account of the non-resident. The responsibilities and liabilities normally attached to the recipient of the income in the case of a resident taxpayer are now imposed upon the payer of the income under the withholding tax. Naturally since the tax is imposed upon the gross income a relatively low rate is applied, which, when costs are taken into account, would approximate the prevailing tax rate on net income.

The standard provision in the tax laws of the Associated States also tends to enforce collection of the tax on non-residents (or perhaps to avoid reduction in the tax on residents through deduction of payments to non-residents) by insisting that where the payment to a non-resident is being claimed as a deduction by a taxpayer tax must be withheld and paid over to the tax authorities if the deduction is to be allowed. By implication, if no deduction was being claimed, it was not necessary to withhold tax from the income accruing to the non-resident. The withholding tax device suggested above imposes the burden universally on all payments of income to non-residents, irrespective of the treatment of these payments in the accounts of local taxpayers.

The Corporation Tax: The final area of need for tax policy innovation with which I propose to deal in this part of my paper concerns the tax treatment of corporate income. Here too an essential element of the rationale for change is the difference in proposed treatment of resident and non-resident companies and resident and non-resident shareholders. Whereas under the present system the company is treated as if it were the personification of its shareholders, and the entire amount of the tax paid at the company level is imputed to the shareholders who can claim credit for it when the dividend paid out of that income is reported by the shareholder for tax purposes, the proposed change would impose a tax on the profits of the company as a legal person, and a separate and distinct tax on the dividends paid to shareholders out of the same profits. Government is free, however, as was done in Trinidad and Tobago in 1966, to bestow benefits on local shareholders such as the Dividend Income Allowance, which would restore in effect their eligibility to credit for tax paid by the company on its profits, while leaving dividends paid to non-resident shareholders to bear the full brunt of the additional (withholding) tax. This means that even if the prior position of local shareholders is completely restored, non-resident shareholders who would normally attempt to reduce their tax burden or obtain a refund by filing a return and claiming credit, would not only be ineligible for further credit but would have to pay additional tax.

An additional source of revenue which is usually facilitated by the use of the corporation tax device is the treatment of non-resident corporations (branch plants) as if they were full-fledged corporate enterprises. In addition to the corporate tax imposed upon the share of profits allocable to the branch, additional withholding tax can also be imposed upon the profits after tax as if such profits were a distribution of dividends made to the parent company by a subsidiary. This interesting device leaves us indebted to the Canadians whose commercial and financial relations with their affluent southern neighbour puts them in very much the same situation as the Associated States vis-à-vis capital exporting countries.

I have so far been attempting to show that though the fiscal performance of the Associated States in recent years has not been entirely without credit to these dependent and open economies, there remains a tremendous amount of untapped fiscal capacity which can be exploited to improve their financial position, if only they could find the political will and determination to do so. Unfortunately, it is hazardous to

TABLE 12 ASSOCIATED STATES - PERCENTAGE COMPOSITION OF GOVERNMENT LOCAL CURRENT REVENUE (1971-1975)

	Total Local Current Revenue		Percentage Composition (%) Tax Revenue				
	\$'000	Income and Property	Consumption and Production	Inter-National Trade	Other	Total Tax Revenue	Non-Tax Revenue
1971 - Antigua	21,626	22.5	15.9	24.5	-	62.9	37.1
Montserrat	3,200	25.8	24.5	26.0	-	76.3	23.7
St. Kitts	9,945	17.8	15.0	29.9	-	62.6	37.4
St. Vincent	11,783	21.9	8.9	46.5	1.6	78.9	21.1
St. Lucia	19,778	24.0	13.9	50.2	0.9	89.1	10.9
Dominica	11,943	21.3	15.6	45.3	0.8	83.0	17.0
Total:	78,275	22.1	14.5	38.2	0.6	75.5	24.5
1972 - Antigua	22,918	21.7	15.8	24.3	-	61.7	38.3
Montserrat	3,610	29.8	22.7	25.8	-	78.3	21.7
St. Kitts	10,071	17.6	18.3	32.4	-	68.3	31.7
St. Vincent	12,137	23.8	14.7	41.7	1.8	82.2	17.8
St. Lucia	21,806	24.0	15.5	48.4	0.7	88.6	11.4
Dominica	12,567	22.9	22.9	35.9	0.5	82.2	17.8
Total:	83,109	22.6	17.8	36.0	0.5	76.4	23.6
1973 - Antigua	23,848	24.3	18.8	28.0	-	71.1	28.9
Montserrat	4,301	24.8	21.2	21.6	-	67.6	32.4
St. Kitts	12,678	18.2	23.1	24.6	-	65.7	34.3
St. Vincent	13,287	21.8	14.8	41.7	1.6	79.9	20.1
St. Lucia	23,838	25.0	16.4	46.8	1.3	89.5	10.5
Dominica	13,011	26.2	27.3	30.3	0.7	84.4	15.6
Total:	90,963	23.6	19.5	34.5	0.7	78.2	21.8

TABLE 12 (Contd.)

1974 - Antigua	24,392	25.3	22.3	27.1	-	74.6	25.4
Montserrat	4,961	31.0	25.3	19.7	-	76.0	24.0
St. Kitts	18,654	15.4	14.0	40.8	-	70.2	29.8
St. Vincent	19,056	23.2	17.0	40.3	2.2	82.7	17.3
St. Lucia	27,199	26.4	17.5	39.5	0.9	84.3	15.7
Dominica	12,675	26.4	26.0	27.4	1.1	81.5	18.5
Total:	106,933	23.8	19.2	34.6	0.8	78.6	21.3
1975 - Antigua	30,064	23.3	19.7	26.0	-	69.0	31.0
Montserrat	5,262	36.0	23.7	19.4	-	79.1	20.9
St. Kitts	21,988	13.5	10.6	46.7	-	70.8	29.2
St. Vincent	21,335	22.3	16.7	35.0	7.2	81.2	18.8
St. Lucia	28,756	29.2	23.4	41.8	1.0	95.5	4.5
Dominica	13,788	24.1	28.3	25.1	4.0	81.5	18.5
Total:	121,193	23.4	19.6	34.8	2.0	79.7	20.4

TABLE 13 ASSOCIATED STATES: GOVERNMENT CURRENT EXPENDITURE
1970-1975

	\$'000					
	1970	1971	1972	1973	1974	1975
					Rev. Est.	Est.
Antigua	21,004	21,226	22,646	23,764	28,378	36,753
Montserrat	3,773	4,186	4,385	5,154	7,304	8,539
St. Kitts	9,339	13,562	13,579	15,507	18,419	24,151
St. Vincent	12,763	14,524	15,890	17,438	19,776 ¹	23,894 ²
St. Lucia	13,968	15,936	18,373	21,501	27,695	31,192
Dominica	11,398	13,254	13,181	17,583 ³	15,916	18,233
Total	72,245	82,688	88,054	100,947	117,488	142,762

¹ Approved Estimates² Figure refers to Fiscal year 1975-76³ Provisional

Source: Country Estimates

TABLE 14 ASSOCIATED STATES: GOVERNMENT CURRENT EXPENDITURE IN
REAL TERMS (1970-1975)

	\$'000					
	1970	1971	1972	1973	1974	1975
Antigua	21,004	19,545	19,143	17,708	16,942	19,675
Montserrat	3,773	3,581	3,683	3,943	4,711	4,392
St. Kitts	9,339	13,797	12,994	13,461	12,445	14,744
St. Vincent	12,763	13,638	14,538	13,720	11,484	12,148
St. Lucia	13,968	14,701	15,717	16,203	15,559	14,882
Dominica	11,398	12,671	12,182	14,507	9,634	9,326
Total Associated States	72,245	77,933	78,256	79,542	70,776	75,167

make the inference that if these states were to experience an acceleration in their revenue growth, this would lead to an elimination of the deficit on current account, since such an inference would be based on the presumption that expenditure levels are given and are not significantly influenced by the mere fact of availability of revenue. In fact current levels of deficit, though held at an absolute minimum through postponement of wage and salary revisions for public servants, and deferment of purchases

of goods and services wherever possible, are yet not reflective of the true financial position. In many cases large amounts remain outstanding on bills payable by the Governments, and since there is no data reflecting accrued commitments, these are in no way indicated in the expenditure accounts. Even after all these competing demands for additional revenue are provided for, there is little doubt that the Governments of the Associated States would wish to increase their contribution to social welfare by improvements and expansion of public services if the means are available. But of their very nature such services tend to place heavy commitments on future recurrent budgets, and so the cycle of a deficit-ridden budget commences once again.

TABLE 15 ASSOCIATED STATES: GROWTH IN CURRENT EXPENDITURE

	1971	1972	1973	1974	1975	Average Annual Growth
	1970	1971	1972	1973	1974	
Antigua	1.1	6.7	4.9	19.4	29.5	12.3
Montserrat	10.9	4.8	17.5	41.7	16.9	18.4
St. Kitts	45.2	0.1	14.2	18.8	31.1	21.9
St. Vincent	13.8	9.4	9.7	13.4	20.8	13.4
St. Lucia	14.1	15.3	17.0	28.8	12.6	17.6
Dominica	16.3	-0.6	33.4	-9.5	14.6	10.8
Total Associated States	14.5	6.5	14.6	16.4	21.5	14.7

TABLE 16 ASSOCIATED STATES: REAL GROWTH IN CURRENT EXPENDITURE
1970 DOLLARS (1970-1975)

	1971	1972	1973	1974	1975	1975 1970	Average Annual
	1970	1971	1972	1973	1974		
Antigua	-6.9	-2.1	-7.5	-4.3	16.1	-6.3	-0.9
Montserrat	-5.1	2.8	7.1	19.5	-6.8	16.4	3.5
St. Kitts	47.7	-5.8	3.6	-7.5	18.5	57.9	11.3
St. Vincent	6.9	6.6	5.6	-16.3	5.8	-4.8	-0.5
St. Lucia	5.2	5.9	3.1	-4.0	-4.4	6.5	1.4
Dominica	11.2	-3.9	19.1	-33.6	-3.2	-18.2	-2.1
Total Associated States	7.9	0.4	1.6	-11.0	6.2	4.0	1.0

TABLE 17 ASSOCIATED STATES: PERCENTAGE GROWTH RATES OF REVENUE, EXPENDITURE AND OTHER AGGREGATES FOR THE ASSOCIATED STATES 1970-1975

	1971 1970	1972 1971	1973 1972	1974 1973	1975 1974	Mean Annual Rate
Aggregate Revenue and Grants	10.4	7.8	8.9	15.2	17.3	11.9
Aggregate Expenditure	14.3	6.5	14.6	16.4	21.5	14.7
Aggregate GDP	10.4	8.4	8.3	18.6	n.a.	11.4
Aggregate Domestic Exports	19.2	18.5	33.3	30.8	n.a.	25.4
Aggregate Imports	19.3	2.5	6.4	32.3	n.a.	15.1
Mean Percentage Change in Retail Prices	7.2	5.2	12.5	29.6	16.3	14.4

Expenditure Control and the Budgetary Deficit

When therefore one examines the possibilities for reduction or elimination of the current budget deficit in the Associated States an important element of any new fiscal and financial discipline must be the control of recurrent expenditure. The typical public accounting officer conceives of this control as comprising auditing, cost control, financial management and general attempts to restrict the annual increments in the budgets of departments and spending agencies. They completely ignore the fact that many commitments to incur recurrent expenditure derive from the nature of the capital expenditures undertaken many years previously, as well as from certain built-in factors inherent in the nature of the contracts through which the public service operates. For example, Governments do not always display an awareness of the fact that each decision to build a school or hospital could place on the recurrent budget an annual commitment to spend up to 50 per cent of the capital cost for its operation and maintenance, and this is not an expenditure which it is in any way possible to shirk at any time in the future. Secondly, in most countries nearly all public sector employees, even where they are covered by periodically negotiated salary agreements, are employed on an incremental scale which provides for an automatic annual increase in compensation. The only forms of expenditure control which can obviate these increases in recurrent expenditure would involve decisions not to employ or to undertake the capital expenditure involved. Both the employment strategy and the capital investment strategy of Government therefore must necessarily come under scrutiny in any attempt to regulate recurrent spending.

In assessing the potential for control of expenditure, due recognition has also to be given to what might broadly be called the politics of Government spending. Particularly in periods of serious economic depression, it must be very nearly impossible for any government which has to face the polls at a later date to ignore unemployment

TABLE 18 ST. VINCENT - DISTRIBUTION OF INCOME REPORTED FOR INCOME TAX YEAR 1974 BY SOURCES AND OCCUPATIONAL CLASSES FOR INDIVIDUALS (\$'000).

	Agriculture and Fisheries	Trade	Professions	Employment	Investment	Total
35 Number of Assessments	115	1,116	46	3,499	105	4,481
1 Government Salaries, Wages, Pensions	50.6	204.1	59.6	5,379.6	13.5	5,707.4
2 Other Salaries, Wages, Pensions	6.6	799.9	43.6	5,925.9	36.2	6,812.2
3 Agriculture Profits (St. Vincent)	203.9	295.8	4.1	52.9	3.5	587.2
4 Income from Property (St. Vincent)	3.3	289.3	16.3	136.9	87.2	635.0
5 Profession or Vocation	-	194.1	286.3	156.6	-	637.0
6 Trade or Business	22.1	3,455.3	9.9	296.2	0.9	3,784.4
7 Investments (St. Vincent)	4.8	737.5	6.6	167.3	136.3	1,052.5
8 Investments + Pensions (Abroad)	5.5	309.6	1.8	169.5	132.5	618.9
9 Any Other Income	0.4	136.4	-	56.9	6.8	200.5
10 Total Income	324.2	6,522.0	430.2	12,341.8	436.9	20,035.1
11 Less Annual Payments	2.0	21.6	-	115.3	1.7	140.6
12 Less Allimony	-	20.0	-	7.4	3.0	30.4
13 Less Widows + Orphans Pensions	0.1	12.7	0.1	205.0	0.1	218.0
14 Less Losses	-	101.1	3.1	28.2	1.2	133.6
15 Net Total Income	322.1	6,366.6	427.0	11,985.9	410.9	19,512.5

and privation among potential political supporters without initiating some 'special works' programme which would bring a *measure of welfare* and ensure survival through hard times, even if the resources are hard to come by. In the classical case of Western-type free-enterprise economics, this was handled domestically as well as internationally through the location of defence related projects. It is probably fitting that in our situation the orientation is in the direction of creating *civil amenities*. Whether or not we like our form of democracy this must clearly be regarded as one of the costs of maintaining it.

PROSPECTS FOR THE PUBLIC FINANCES

Prospects and Problems of Tax Structure Development

This area of speculation is a very difficult and treacherous road for any analyst of the economics of the Associated States. I say this for two important reasons. First because there are likely to be serious problems of flexibility in increasing revenue from the major traditional source which is international trade because of the sub-regional commitment to a Common External Tariff in the ECCM (Eastern Caribbean Common Market), and a further commitment for harmonization of the ECCM Tariff with the Common External Tariff of the Caribbean Common Market. Secondly, because while in larger states the growth of industrial and commercial output and of income in general appears to facilitate the dependence on income tax as a source of revenue, in the case of these small states the ease with which personal contact and influence can be and has been employed poses serious questions as to whether higher or even existing rates of personal income tax can be successfully collected. In no less than two of the Associated States (Dominica and St. Kitts) legislation has been passed which in effect transfers direct control of the administration of the income tax from the Comptroller or Commissioner of Inland Revenue to the Minister of Finance, an elected member of the administration. In at least one other state, Antigua, the personal income tax was abolished by the end of the year 1976 precisely on the ground that it was being administered in an inequitable manner and penalised the working class to the advantage of the business community.

These problems associated with the income tax and the customs tariff suggest a possibly increased role for a wide variety of internal levies, quasi-taxes and service charges more or less of a *hidden nature* and with an impact largely on consumption. It is difficult to envisage any serious movement towards an increased reliance on taxes based on *productive assets or real estate* since such a trend would encounter the same obstacles deriving from political influence as would the income tax. This was clearly demonstrated in the *hysterical response* of landowners to the imposition of a differentiated tax on used and unused land in Dominica in 1975, though the *mechanics of the device* employed in this case was not without its defects.

Of course the income tax itself as applied in most of the Associated States is not without very serious defects and is in much need of wide-ranging reforms. There is no doubt that a considerable amount of the resistance and opposition to this tax derives from the fact that the *failure* of the Governments to undertake a restructuring of the rates and allowances to bring them more in line with present levels of income and

TABLE 19 ST. VINCENT - DISTRIBUTION OF ALLOWANCES CLAIMED, TAXABLE INCOME AND TAX PAYMENTS BY SOURCES AND OCCUPATIONAL CLASSES OF INDIVIDUALS FOR INCOME TAX YEAR 1974 (\$'000).

	Agriculture and Fisheries	Trade	Professions	Employment	Investments	Total
35 Number of Assessments	115	1,116	46	3,449	105	4,881
10 Total Income	324.2	6,522.0	430.2	12,341.8	416.9	20,035.1
15 Net Total Income	322.1	6,366.5	427.0	11,986.0	410.9	19,512.5
16 Earned Income Relief	27.9	311.7	16.8	868.0	7.0	1,231.4
17 Personal Allowances	86.8	716.0	32.0	2,760.6	46.6	3,552.9
18 Wife Allowance	45.2	334.8	13.2	575.0	14.2	482.4
19 Children's Allowances	55.4	362.2	16.0	1,058.8	9.5	1,510.9
20-21 Housekeeper + Dependent Allowance	0.6	10.6	0.6	21.3	-	33.1
22 Life Assurance Allowance	1.9	190.3	9.2	382.6	6.1	590.1
23 Total Allowable Deductions	217.8	1,926.5	87.8	5,576.3	83.4	7,891.8
24 Taxable Income	104.3	4,440.0	339.1	6,409.7	327.5	11,620.6
25 Income Tax Charged	11.1	1,144.6	115.8	1,257.4	72.2	2,601.1
26 Less Tax from Dividends	0.3	150.2	0.3	35.0	13.5	199.3
27 Less Double Tax Relief	-	4.2	-	1.7	0.6	6.5
28 Less PAYE Deductions	5.8	91.1	15.7	718.8	5.9	837.3
29 Income Tax Payable	6.3	922.3	100.2	547.9	61.0	1,637.7
30 Refunds Payable	1.4	23.2	0.5	45.9	8.7	79.7
31 Net Tax Yield	4.9	899.1	99.7	502.0	52.3	1,558.0

conceptions of acceptable burden has caused this tax to be generally regarded as iniquitous and confiscatory by even employed persons of moderate income. Tax avoidance and evasion have almost become demonstrations of civic-mindedness; and the investigator gets the distinct impression that tax-reform is avoided or postponed not only because it would cost a sizeable reduction in revenue which cannot be afforded in the present state of economic depression, but also because it is not an urgent matter since at current levels of evasion and avoidance, no one really faces the nominal rates which appear in the statutes. In short, effective rates of tax are felt to be in line with acceptable burdens in these communities.

An excellent example of the sort of rate structure which one faces in the Associated States is given by the Dominican Rate Schedule set out in Section 25 of its Income Tax Ordinance, No. 28 of 1966 as follows:

For every dollar of the first	\$	500	...	4c
" " " on the next		500	...	6c
" " " " " "		500	...	8c
" " " " " "		500	...	10c
" " " " " "		500	...	14c
" " " " " "		500	...	18c
" " " " " "		500	...	22c
" " " " " "		500	...	26c
" " " " " "		500	...	30c
" " " " " "		500	...	34c
" " " " " "		500	...	38c
" " " " " "		1,500	...	42c
" " " " " "		3,000	...	46c
For every dollar over		10,000	...	50c

A rate schedule such as the above makes a restructuring of the rates difficult to accomplish without loss of revenue both because of the small steps of \$500 employed for the first 11 tiers, and because of the relatively rapid pace at which the marginal rate rises, though it commences at the low rate of 4 per cent, since any rationalization would suggest reduction in the number of tiers, together with increase in the size of each tier. One way of avoiding the revenue loss is by increasing the minimum marginal rate at which the schedule begins. This is also desirable from the point of view of increasing the efficiency of tax administration, since it can be reasonably argued that it is not worth the time and effort it takes to assess income tax to raise only \$4 out of \$100. Minimum marginal rates of income tax of less than 10 per cent can hardly be defended at the present levels of wages and salaries, and there is really no serious reason for retaining such low marginal rates on grounds of equity. For the same reason it can hardly be argued that splitting chargeable income into slices of \$500 with rate differentials of 2 to 4 per cent between slices of chargeable income achieves any greater measure of equity than having slices of \$1,000 with rate differentials of 4 to 8 per cent. In fact, there are various possible rate structures which can be designed with greater simplicity without sacrifice of equity. What is important is that the particular rate structure, working in conjunction with the various allowances and deductions, should achieve a reasonably smooth increase in the effective rate of tax on total

income, taking due account of the differences in circumstances of taxpayers in the various income groups.

One possible rationalization of the rate structure given above may be the following:

Income Range	Chargeable Income Limit	Marginal Rate Applicable	Maximum Tax Due	Mean Rate on Chargeable Income
\$ 0- 1,000	\$ 1,000	8%	\$ 80	8s
1,001- 2,000	2,000	12	200	10
2,001- 3,000	3,000	16	360	12
3,001- 4,000	4,000	24	600	15
4,001- 5,000	5,000	32	920	18.4
5,001- 7,000	7,000	40	1,720	24.6
7,001-10,000	10,000	48	3,160	31.6
10,001-15,000	15,000	56	5,960	39.7
15,001-25,000	25,000	60	11,960	47.8
Over 25,000		60		

The restructuring of the schedule suggested above seeks to avoid the loss of revenue and therefore retains what is obviously a rapid rate of increase in the marginal tax rate. Given the levels of income prevalent in modern times, a rate of 40 per cent on chargeable income between \$5,000 and \$7,000 is indeed quite high, given that nearly all new university graduates with salaries of \$600 (EC) per month or above without family responsibilities will fall into this category. Table 21 shows that based on the incomes and allowances of six hypothetical cases, and using the assumptions as stated in the notes to the model computations, the proposed structure would produce an effective tax rate on total income (before allowances and deductions are taken) that is only .6 of a percentage point higher for a person with gross income of \$8,700 annually, and less than a half of 1 per cent higher for a person with gross income of \$20,000 per annum. In cases 4, 5 and 6, the effective tax rates on total income are increased by 1.92 per cent, 3.1 per cent and 4.46 per cent respectively by the proposed rates over the existing rates. It must be remembered, when looking at these cases, that persons in the upper income brackets do make extensive use of the possible opportunities for avoidance and evasion; thus the allowances and deductions presented are probably minimal in many cases, and the effective tax rate therefore represents a maximum which they are likely to pay.

If one were solely concerned about the introduction of a reasonable rate structure which takes cognisance of the need to attract and retain middle level professionals without regard to prospective losses of revenue resulting from an effective reduction in the rate of income tax the rate schedule would more closely resemble the following:

		%			%
\$ 0 - 1,000	---	10	\$10 - 15,000	---	35
1 - 2,000	---	15	15 - 25,000	---	40
2 - 4,000	---	20	25 - 50,000	---	50
4 - 6,000	---	25	50,000+	---	60
6 - 10,000	---	30			

One cannot fail to note, however, that while this schedule would increase the rate of tax on incomes over \$50,000 to 60 per cent compared with the 50 per cent of the Dominica schedule given earlier, it actually reduces the rate applicable to chargeable incomes between \$3,001 and \$25,000. Unfortunately it also increases the rate applicable to the lowest incomes under \$3,000, and this may be offensive to the egalitarian notions of some purists.

From the point of view of tax structure development, it may be preferable in small societies such as the Associated States to remove or reduce the areas of discretion of the tax authorities by employing more simplified versions of the income tax than those in use in larger societies. Simplification of the mechanism by eliminating the multiplicity of deductions and allowances, and replacing them by a single large allowance based for instance on the proven number of dependents in the taxpayer household, would result in a larger tax base which can then be taxed at a lower rate which can be differentiated into three or four steps. Another alternative would be to use the device of apportioning the gross income without taking any deductions among the adults and adult equivalents in the household, and applying a graduated schedule to the income so apportioned. These approaches would limit the administrative problem of the income tax to that of collection and verification of income only, and would not necessarily do any violence to equity considerations. In the absence of innovations such as these, there is likely to be increasing disenchantment with this form of taxation, and a tendency towards increasing dependence on indirect taxes on domestic production and consumption, with all that this implies for equity of the tax systems, the allocation of resources and the structure of domestic prices of goods and services.

The Potential for Fiscal Harmonization

The Eastern Caribbean Common Market Agreement states as one of its major objectives in Article 2 (a) (i) its aim to promote in Member States harmonious development of economic activities. In Article 3 - Principles, this fundamental aim of harmonization is set forth in more specific detail under the following clauses:

- (b) subject to Article 22, the establishment of common customs tariffs and common commercial policies towards countries and territories, not parties to this agreement;
- (d) the progressive harmonization of investment and development policies including industrial development, treatment of non-resident business establishments and development planning;
- (e) the coordination of currency and financial policies;

(f) the progressive harmonization of taxation policies and incentive legislation in order to promote the equitable distribution of industries among Member States;

(h) a common policy of agricultural development.

The mandate for harmonization is further reiterated in Article 7 - Common Customs Tariff, Article 13 - Development Policies, Article 14 - Monetary Policy, Article 15 - Fiscal Policy, Article 16 - Transport, and Article 17 - Agriculture.

When one compares the expressions of intent to harmonize as opposed to those to cooperate contained in the Treaty of the Caribbean Community and Common Market with those of the ECCM Treaty it does appear that the commitment to the establishment of a true Common Market, with roughly similar prices for inputs and outputs, seemed stronger in the case of the Eastern Caribbean Common Market. The progress towards greater harmonization of their economic systems has been relatively slow since the inauguration of the treaty but then this is an area in which progress is necessarily cautious and carefully deliberated, though other factors such as their dependent political status and the lack of adequate technical expertise and guidance from the ECCM Secretariat may also have contributed to the lethargy. There have been significant areas of advancement, however, which may be noted for the record.

A single trade and industrial representative of the Associated States is located in Montreal and London, and conducts affairs in the interest of all the States. By comparison, while joint missions and cooperation in foreign affairs has received expressions of interest and its absence has been lamented by the more developed countries of CARICOM, particularly as a result of the imposition of the new duty on sugar by the United States, one cannot at this time envisage any movement away from independent diplomatic missions by the MDCs. No doubt one of the factors militating against joint missions and joint representation is the fact that the larger countries can 'afford' the expenditure while the LDCs cannot. Thus small size does have certain things to its credit.

The Associated States have probably also made greater progress than the MDCs in their efforts to harmonize their policy towards the establishment of industry. Some 35 potential regional industries have been allocated among the seven states (including Grenada), and though there have been a few cases of breach of faith by certain states establishing industries allocated to other states, steps are being taken to accelerate the pace of establishment of the allocated industries.

A significant step towards fiscal harmonization, over and above the general CARICOM Agreement on the Harmonization of Incentives, was taken in 1976 when the ECCM States agreed to negotiate a joint Double Taxation Treaty with Canada. The major contribution of such a treaty to fiscal harmonization is not merely that it produces harmony in the basic treatment of foreign income arising within the Associated States and also uniformity of treatment of income accruing to residents of the Associated States from a Canadian source, but it also exerts considerable pressure on governments to adopt the same basic policy underlying the treatment of foreign

TABLE 20 ST. VINCENT - DISTRIBUTION OF TAX PAYERS BY MAXIMUM TAX RATE LIABILITY FOR TAXABLE ACCOUNTING YEAR 1974 FOR INDIVIDUALS

Max Rate	No. of Returns	Taxable Income \$'000	Tax Assessed \$'000	Tax from Dividends \$'000	P.A.Y.E. Tax \$'000	Tax Refunds \$'000	Tax Payable \$'000	Net Tax Yield \$'000	Net Tax Revenue ¹ \$'000
3	1,757	300.2	11.1	3.8	15.1	13.6	5.7	7.9	2.5
4	741	590.3	22.1	2.8	14.5	7.6	12.7	5.2	14.6
6	525	691.0	34.0	3.7	24.3	9.2	15.1	6.0	24.8
8	274	508.8	30.6	4.0	11.9	5.2	19.8	14.6	25.3
10	253	572.5	36.3	3.4	22.9	8.0	18.1	10.0	28.2
14	170	470.9	34.2	2.4	16.5	4.1	19.3	15.2	30.0
18	129	409.9	36.0	0.2	14.1	1.0	22.5	21.5	34.7
23	135	518.2	55.4	6.3	23.3	6.1	31.8	25.6	49.1
28	114	489.0	57.9	2.8	28.6	4.1	30.0	25.9	53.2
33	107	514.9	73.5	3.6	32.4	2.1	38.4	36.2	70.2
38	143	827.6	141.9	3.5	75.3	6.3	69.3	63.0	135.6
44	308	2,388.5	534.8	14.6	241.1	8.3	249.8	286.5	533.8
50	79	889.8	225.8	14.6	86.1	3.0	156.1	153.1	250.8
60	48	662.8	226.1	12.0	81.1	0.3	133.4	133.1	225.8
65	98	2,386.0	1,042.4	121.6	150.5	0.7	770.6	769.6	1,041.2

Notes: ¹ Net Tax Revenue = Total Tax Assessed - Double Taxation Relief - Tax Refund

income. There is abundant evidence of this arising out of the treaty negotiations, and the governments appear receptive to recommendations made for harmonization of certain aspects of underlying policy.

Quite independently of the treaty negotiations, however, the Governments of the Associated States have been undertaking a searching fiscal review though this has been motivated more by the need to find additional revenue than by the need to ensure that their economies possess a fiscal structure which would encourage savings, investment and economic growth. These efforts so far have involved the Commonwealth Fund for Technical Cooperation, the United Nations Multi-Sector Regional Planning Project for the Caribbean Community, and the local expertise of the states concerned. And though a regional approach has not been adopted in the conduct of these reforms, and each government remains free to accept or reject any of the proposals for reform being recommended, the fact that the fundamentals of the approach to reform remain the same from one state to the other imparts a strong harmonizing influence to the exercise. Special mention might also be made here of the appointment to the FCCM Secretariat of a Commonwealth Fund for Technical Cooperation expert in tax law drafting. It is intended to use this expert not only to provide technical support in the drafting of the laws associated with the fiscal reform exercise, but also to undertake a general review of the income tax laws from the point of view of legal draftsmanship, and also examining the feasibility of designing a basic model income tax law for the ECCM with the individual differences in rates and allowances confined to schedules to the Model Ordinance. Such a level of tax harmonization is certainly a very realistic prospect within the Associated States.

Of far greater moment for the evolution of the fiscal and financial administration of the Associated States are the proposals now being considered for the establishment of Common Services in this region covering possibly income taxation, the customs tariff and audit among other areas of governmental administration. It is indisputable that the best possible device for ensuring the attainment of the harmonization objective would be the establishment of a unified service for income tax and customs duties under a central administration, but such a development clearly represents a political challenge such as the Associated States have never faced before. It would mean the transfer to a regional authority and away from direct political control by the individual administration the two major sources of revenue of the states. In the present circumstances many governments would regard this as depriving them of a substantial control over the means to power, and few will wish to move in this direction without considerable deliberation.

Financial and Monetary Policy and Resource Mobilization

One final area of importance to the Government finances of the Associated States remains to be discussed here. It concerns the evolution of the financial and monetary policy and the appropriate institutional framework for better mobilization of the resources available in these economies. It has now become commonplace, (and several states have already moved in this direction) to look for the establishment of an indigenously owned and managed commercial bank, and to facilitate its control of a

TABLE 21 MODEL INCOME TAX COMPUTATIONS - DOMINICA

	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6
Income:						
Earned Income - Self	2,000.00	5,100.00	13,200.00	20,000.00	35,000.00	50,000.00
- Wife	-	1,800.00	4,000.00	6,000.00	-	-
Annual Rateable Value of House ¹	-	1,800.00	3,000.00	4,800.00	7,200.00	9,000.00
TOTAL INCOME	2,000.00	8,700.00	20,200.00	30,800.00	42,200.00	59,000.00
Deductions:						
Earned Income Allowance - self	200.00	480.00	480.00	480.00	480.00	480.00
- wife	-	480.00	480.00	480.00	-	-
Personal allowance - self	800.00	800.00	800.00	800.00	800.00	800.00
- wife	600.00	600.00	600.00	600.00	600.00	600.00
- children ²	700.00	700.00	700.00	700.00	700.00	700.00
- dependent relative	125.00	125.00	125.00	125.00	125.00	125.00
National Provident Fund ³	100.00	180.00	180.00	-	-	-
Life Insurance Allowance	-	-	1,200.00	1,200.00	1,200.00	1,200.00
House Maintenance ⁴	-	1,500.00	2,500.00	4,000.00	6,000.00	7,500.00
House Insurance ⁵	-	150.00	250.00	400.00	600.00	750.00
Mortgage Interest ⁶	-	1,800.00	3,000.00	4,800.00	7,200.00	9,000.00
Real Estate Rates & Taxes ⁷	-	90.00	125.00	240.00	360.00	450.00
Water Rates ⁸	-	36.00	48.00	60.00	60.00	72.00
TOTAL DEDUCTIONS	2,525.00	6,941.00	10,488.00	13,885.00	18,125.00	21,677.00
TOTAL TAXABLE INCOME	-	1,759.00	9,712.00	16,915.00	24,075.00	37,323.00

TABLE 21 (Contd.) MODEL INCOME TAX COMPUTATIONS - DOMINICA

TOTAL TAXES PAID - Present Structure	-	115.90	2,927.52	6,517.50	10,097.50	16,721.50
- Proposed Structure	-	171.08	3,021.76	7,109.00	11,405.00	19,353.80
TAX AS % OF TOTAL INCOME - Present	-	1.33%	14.49%	21.16%	23.93%	28.34%
Proposed	-	1.97%	14.96%	23.08%	27.03%	32.80%

NOTE TO TABLE 21

1. Assumption is: Annual rateable value of house is 6 per cent of the capital value of the house.
2. " " 2 children living at home
3. " " a) Pension contribution is same as N.P.F. contribution for cases 1, 2, 3, and is computed as 5 per cent of income up to a maximum income of \$3,600 per annum and thereafter NPF contribution remains constant at \$180 per annum.
b) Cases 4, 5, 6 are all private self-employed persons and do not make pension contributions.
4. " " House maintenance = 5 per cent p.a. of capital value of house.
5. " " Insurance for fire etc. = 1/2 per cent of 1 per cent of capital value of house.
6. " " Mortgage interest is paid at the rate of 10 per cent p.a. on the original principal for 20 years. The principal of the mortgage is assumed to 60 per cent of the capital value of the house.
7. " " Real estate rates and taxes are 5 per cent of the Annual Rateable value of the house.
8. " " Water rates as \$3 per month for low income groups; \$4 per month for middle income groups; \$5 per month for upper middle income groups and \$6 per month for upper income groups.

sufficiently large share of the market for current finance to enable it to influence commercial bank policy towards the financing of agriculture and small business, and the rate of interest on savings and housing mortgages to name a few areas of concern. It is normally expected too that a publicly owned commercial bank would be banker to statutory bodies and public corporations, though this need not always be to its advantage when they are unable to generate surpluses. Specifically, one would expect such a bank to be the main if not the sole depository for the funds of National Provident Fund and Social Security schemes. Care has to be taken in achieving these objectives, however, since any wholesale withdrawal of funds from the foreign branch banks could cause repercussions which would be destabilising to the financial market and to commerce and industry in general.

In the absence of a national central bank certain rudimentary functions can be performed by a publicly owned commercial bank, such as being general depository for the Consolidated Fund, and lender of a limited scale to Government out of the surplus funds of national insurance. At present in some of the Associated States, these surpluses are being deposited in commercial banks at rates of 3 per cent or less only to be relented to Government at rates as high as 8 per cent or more. Where the depository function just referred to is being exercised, such banks can also increase their resources from the proceeds of deposit requirements imposed on financial institutions and non-bank financial intermediaries, a step which it is now imperative that these Governments should take.

A further step in the direction of improving the mobilization of resources would require the amendment of the legislation relating to life insurance and pension funds investments. While states such as Antigua have legislation regulating the operation of these institutions, there are no local assets requirements imposed. In such small economies with few if any public companies, with shares that are being traded, it cannot be expected that such institutions will be happy to invest their funds in securities issued by Government alone, in a situation where the credit of the Government itself is questionable. One would here look forward to the evolution of a regional arrangement, perhaps with the Eastern Caribbean Currency Authority as its nucleus, which would facilitate the imposition of a regional assets ratio upon investments made by these institutions.

CONCLUSION

In this brief survey I have tried to expose most of the major issues affecting the public finances of the Associated States from a point of view of fiscal policy, administration and politics. It would be presumptuous of me to conclude that should the Governments pursue the recommended policies they would be sure to eliminate their present financial crises. What is beyond doubt is that their fiscal performance would improve tremendously, and they could then make a stronger case for financial assistance from intra and extra-regional sources.