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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

JAMAICA

**PROJECT PAPER**

REVENUE BOARD ASSISTANCE

AID/LAC/P-142

Project Number: 532-0095
Loan Number: 532-V-023

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

# PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: — DOCUMENT CODE: 3

2. COUNTRY/ENTITY: JAMAICA

3. PROJECT NUMBER: 532-0095

4. BUREAU/OFFICE: LAC 05

5. PROJECT TITLE (maximum 40 characters): Revenue Board Assistance

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 05 DD 18 YY 86

7. ESTIMATED DATE OF OBLIGATION (Under "B." below, enter 1, 2, 3, or 4): A. Initial FY 83 — B. Quarter 3 — C. Final FY 84

8. COSTS ($000 OR EQUIVALENT $1 = ) See Block 16

| A. FUNDING SOURCE | FIRST FY B. FX | FIRST FY C. L/C | FIRST FY D. Total | LIFE OF PROJECT E. FX | LIFE OF PROJECT F. L/C | LIFE OF PROJECT G. Total |
|---|---|---|---|---|---|---|
| AID Appropriated Total | | | | | | |
| (Grant) | ( ) | ( ) | ( ) | ( ) | ( ) | ( ) |
| (Loan) | ( 1,500 ) | ( ) | ( 1,500 ) | ( 3,554 ) | ( ) | ( 3,554 ) |
| Other U.S. 1. | | | | | | |
| Other U.S. 2. | | | | | | |
| Host Country | | | 240 | | 1,458 | 1,458 |
| Other Donor(s) | | | | | | |
| TOTALS | 1,500 | | | 3,554 | 1,458 | 5,012 |

9. SCHEDULE OF AID FUNDING ($000)

| A. APPROPRIATION | B. PRIMARY PURPOSE CODE | C. PRIMARY TECH. CODE 1. Grant | C. PRIMARY TECH. CODE 2. Loan | D. OBLIGATIONS TO DATE 1. Grant | D. OBLIGATIONS TO DATE 2. Loan | E. AMOUNT APPROVED THIS ACTION 1. Grant | E. AMOUNT APPROVED THIS ACTION 2. Loan | F. LIFE OF PROJECT 1. Grant | F. LIFE OF PROJECT 2. Loan |
|---|---|---|---|---|---|---|---|---|---|
| (1) EHR | 650 | | 710 | | | | 3,554 | | 3,554 |
| (2) EHR | 660 | | | | | | | | |
| (3) | | | | | | | | | |
| (4) | | | | | | | | | |
| TOTALS | | | | | | | 3,554 | | 3,554 |

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

| A. Code | | | | | | | |
|---|---|---|---|---|---|---|---|
| B. Amount | | | | | | | |

13. PROJECT PURPOSE (maximum 480 characters)

To provide technical assistance to the Government of Jamaica in its effort: (a) to redesign Jamaica's tax structure along lines that fit the Government's objective of achieving stable economic growth through a private sector led, export oriented, development program; (b) to improve the administration of the tax system; and (c) to initiate the implementation of the systems and to develop the long term implementation plan designed in (a) and (b) above.

14. SCHEDULED EVALUATIONS: Interim MM 01 YY 85, MM 07 YY 85 — Final MM 01 YY 86

15. SOURCE/ORIGIN OF GOODS AND SERVICES: ☐ 000 ☐ 941 ☐ Local ☐ Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

* Because of Jamaica's parallel foreign exchange rate, U.S.$1=J$2.72 for U.S. dollar financed local costs. The official rate of U.S.$1=J$1.78 is used for converting the GOJ contribution into U.S. dollar equivalents.

17. APPROVED BY — Signature: [signature] — Title: Director, USAID/J — Date Signed: MM 05 DD 13 YY 83

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

REVENUE BOARD ASSISTANCE

TABLE OF CONTENTS

TO : L. P. Reade, A.I.D. Director

SUBJECT: JAMAICA - REVENUE POARD ASSISTANCE SUMMARY AND RECOMMENDATION MEMORANDUM

1. BORROWER: The GOVERNMENT OF Jamaica (GOJ)

2. Implementing Entity: The BOARD OF REVENUE, Ministry of Finance

3. LOAN AMOUNT: $3.554 Million (Three Million Five Hundred and Fifty Four Thousand U.S. Dollars)

Purpose: To help the GOJ design and introduce a revised Jamaican tax system that will support the GOJ's economic recovery program, and the structural adjustments through which these program goals are pursued.

5. Project Description: To provide technical assistance to the Government of Jamaica in its effort to:

   a) redesign Jamaica's tax structure along lines that fit the Government's objective of achieving stable economic growth through a private sector led, export oriented, development program;

   b) improve the administration of the tax system; and

   c) initiate the implementation of the systems and to develop the long-term implementation plan designed in (a) and (b) above.

6. Total Project Cost: $5.012 million.

7. Application: The GOJ's application for the loan is included in Annex B.

8. Statutory Requirements: All statutory criteria have been met. See Annex E.

9. Environmental: The Initial Environmental Examination was a negative determination. See Annex D.

10. Recommendation: That a Loan of $3.554 million be authorized to the GOJ on terms and conditions described in the following Project Authorization.

FROM: Project Committees:

USAID/Jamaica

Dennis Darby, OPPD/PDD, Project Officer
Robert Friedline, OPPD
Samuel Skogstad, AID/ECON
Jack Hjelt, RHUD
Gerardo Berrios, CONT
Dan Rathbun, OPED

Mission Executive Committee

Frank Morris, Deputy Director
William Jones, OPPD/PDD
Charles Warren, CONT
Talbot Penner, OPED
Robert Friedline, OPPD
Samuel Skogstad, AID/ECON

Regional Legal Advisor

Theodore Carter

DRAFTER: DDarby, OPPD/PDD; mr 4/29/83

# PROJECT AUTHORIZATION

NAME OF COUNTRY : JAMAICA

NAME OF PROJECT : REVENUE BOARD ASSISTANCE

NUMBER OF PROJECT: 532-0095

NUMBER OF LOAN : 532-V-023

1. Pursuant to Section 105 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Board of Revenue Assistance Project for Jamaica, involving planned obligations of not to exceed Three Million Five Hundred and Fifty Four Thousand United States Dollars ($3,554,000) in loan funds over a three year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the Project.

2. The Project consists of the provision of technical assistance to the Government of Jamaica and will include assistance to enable (1) redesign of the tax structure of Jamaica along lines that fit the Borrower's objectives of achieving stable economic growth through a private sector-led export oriented development program; and improvements in the administration of the tax system and (2) initial implementation of the redesign and improvements.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions as A.I.D. may deem appropriate.

   a. Interest Rate and Terms of Repayment

   The Cooperating Country shall repay the Loan to A.I.D. in U.S. dollars within twenty (20) years from the date of first disbursement of the Loan, including a grace period of not to exceed ten (10) years. The Cooperating Country shall pay to A.I.D. in U.S. dollars interest from the date of first disbursement of the Loan at the rate of (i) two percent (2%) per annum during the first ten (10) years, and (ii) three percent (3%) per annum thereafter on the outstanding balance of the loan and on any due and unpaid interest accrued thereon.

b. Source and Origin of Commodities, Nationality of Services

Commodities financed by A.I.D. under the Project shall have their source and origin in countries included in A.I.D. Geographic Code 941 or Jamaica, except as A.I.D. may otherwise agree in writing. Except for ocean shipping; the suppliers of commodities or services shall have countries included in A.I.D. Geographic Code 941 or Jamaica as their place of nationality, except as A.I.D. may otherwise agree in writing.

Ocean shipping financed by A.I.D. under the Project shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the Cooperating Country and countries included in A.I.D. Geographic Code 941.

c. Conditions Precedent to Initial Disbursement

Prior to any disbursement or the issuance of any commitment documents under the Project Agreement, the Cooperating Country shall furnish in form and substance satisfactory to A.I.D.:

1. An opinion of counsel acceptable to A.I.D. that this Agreement has been duly authorized and/or ratified by, and executed on behalf of, the Borrower, and that it constitutes a valid and legally binding obligation of the borrower in accordance with all of its terms;

2. A statement of the name of the person who is to act as the official authorized representative of the Borrower in connection with the Project Agreement, and of any additional represeentives, together with a specimen signature of each person specified in such statements;

3. Evidence that a Senior Revenue Board Tax Official has been appointed as full-time Project Manager by the Revenue Board, to oversee the implementation phase of the project; and

4. Evidence that the Revenue Board has assigned a permanent employee as a counterpart to each person financed by A.I.D. to render technical assistance to the Revenue Board.

d. Condition Precedent to Disbursement for Training

Prior to any disbursement, or to the issuance of any commitment document under the Project Agreement for training, the Borrower shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., a comprehensive training plan covering the entire Project activity.

e. Condition Precedent to Disbursement for Training Outside Jamaica

Prior to any disbursement or the issuance of any commitment documents under the Project Agreement for training outside of Jamaica, the Cooperating Country shall, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., evidence that a system of bonding or some other method acceptable to A.I.D. has been implemented to ensure that participant trainees will return to their posts for a period of time not less than twice the length of time spent in training.

f. Covenant

The Borrower shall covenant that, unless A.I.D. otherwise agrees in writing, it will:

1. provide adequate budget allocations for project implementation in a timely manner consistent with implementation schedule developed by the Revenue Board; and

2. continue the mandate to regulate the tax system given to the Revenue Board under the terms of the Revenue Board Act.

MISSION DIRECTOR

13 May 1983

DATE

# I. PROJECT SUMMARY DESCRIPTION

## A. Description of the Project

The purpose of the Revenue Board Assistance Project is to provide technical assistance to help the Government of Jamaica (GOJ) to: a) redesign Jamaica's tax structure along lines that fit the GOJ's objective of achieving stable economic growth through a private sector led, export oriented, development program; b) improve the administration of the tax system; and c) initiate implementation of the activities designed to achieve a) and b) above.

Working through the newly created Revenue Board, this technical assistance project will have two components--tax policy and tax administration--and be conducted in two stages--design and implementation. In the first stage, the emphasis of the policy component will be on formal evaluation of the existing tax system vis-a-vis the express objectives of the GOJ's economic recovery program and the design of adjustments to current deficiencies discovered. Preliminary evidence collected during the design phase of this project suggests that the existing system has certain characteristics that discourage saving, encourage capital flight, subsidize relatively capital intensive production methods at the expense of employment, encourage imports, and discourage work-effort and economically viable production for the domestic market. While there are other characteristics of the system that mitigate some of these effects, it appears, on balance, that the tax system is an impediment to achievement of attainable levels of production, export and employment.

Studies will be conducted on each of the elements of the tax system, with the objective of quantifying the implicationms of each for revenue generation and distribution of the tax burden among social groups, and determining the structure and level of economic activity. Alternative tax strategies will then be designed, from which an alternative program of taxes can be presented to support, rather than hinder, the achievement of the growth, equity, and efficiency goals of the GOJ.

The emphasis of the tax administration component, in its initial stage, will be on those elements of tax administration that are common to a tax system in general, i.e., independent of the structure of the system. These include training (almost exclusively) in such areas as income accounting, middle-level management, and taxpayer enrollment. The more structure-specific elements of assistance in administration will be deferred until the GOJ has selected the policy and structural reforms to be adopted.

The first stage of the project will end with the preparation of a Governmental "White Paper" on taxation. This paper will rely upon the technical analyses prepared by the technical assistance team, and will include draft legislation reflecting Governmental proposals for comprehensive tax reform.

Stage Two of the project is the implementation stage. Advisors from the resident technical assistance team will work with their Jamaican counterparts in the Revenue Board to initiate the implementation of the structural changes adopted by the GOJ, e.g., preparation of regulations, assistance in organizing for the efficient management of the system, preparation of forms, and planning and scheduling the indicated systems adjustments. The technical assistance team that will implement the project will consist of a group of highly specialized taxation experts headed by Professor Roy Bahl of the Maxwell School at Syracuse University. Professor Bahl has assembled this "blue ribbon" team of internationally renowned experts, and will manage the team under a direct A.I.D. contract.

B. Conclusions of the Feasibility Analyses

The substance of the Revenue Board Assistance project is the provision of specialized technical assistance to: diagnose in detail the malfunctions in Jamaica's tax system; prescribe a carefully designed program of remedies, within a severly constrained time period; and help apply the therapy required to make the prescription effective. The benefits to be derived from the project cannot be quantified until the series of analytical studies contemplated under the project are carried out during the "problem diagnosis" stage of project implementation. Consequently, an *a priori* cost/benefit analysis is neither feasible nor appropriate. For this reason, a "Least Cost" justification has been adopted as the analytical basis for the economic analysis of the project.

The structure of this argument is simple. The GOJ is committed to a restructuring of its tax structure, based on a wide variety of anecdotal evidence that the present structure is not in harmony with governmental policy. This evidence was confirmed by a GOJ-invited design team of world-renowned experts, including Roy Bahl, Charles McClure, Daniel Holland, Richard Bird, Oliver Oldman, and Kenneth Stacey. In addition, this expert team confirmed that tax policy and implementation inefficiencies are having a direct and significant negative effect on Jamaica's economic recovery and development. Beyond this, the GOJ has made a political commitment to significantly adjust the tax system on or about April 1, 1983. Thus, if A.I.D. is to play a significant role, it must employ experts, such as those mentioned above, who can function effectively within such constraints. Syracuse University has put together a team of uniquely qualified experts from among the very limited number of such individuals available world-wide. They represent a "Least Cost" alternative because, realistically, there is no alternative method for achieving the desired goal within the quality standards and time limits stipulated.

It is incidental, but welcome, that Syracuse University was judged to be the institution best capable of assembling and directing the work of this team of experts from a wide variety of educational institutions. This is, in part, due to its past performance on A.I.D. contracts, its relatively low over-head, and Professor Bahl's experience with, and knowledge of, the requirements of directing the specific set of expert services required to perform the task at hand.

The Board of Revenue is the governmental agency through which the project will be administered. The high level of capability of the Board's Commissioners, combined with the support being expressed for the project from the Prime Minister and his staff, outweighs certain organizational and jurisdictional weaknesses that will influence the project.

The Board was created in 1981, with centralized authority over all units of the revenue system. This important step has created a structure which, when fully staffed, and when fully operative in a clearly defined domain, should bring a significant gain in efficiency to the Jamaican revenue system. A subsidiary benefit of operating through this agency will be the development and strengthening of an important public sector institution.

C. Summary Budget

See Table 1 on page 4.

D. Resolution of PID Issues

1. Tax Administration

The principal issue arising during A.I.D./Washington review of the Project Identification Document (PID) concerned the Tax Administration component of the project. The LAC Bureau felt that the administration component was given excessive weight in Implementation Stage One, given that the project was intended to create substantial changes in the existing tax structure. USAID/J concurred in this view, and the major emphasis has been shifted to the tax policy component. Further, it was felt that the emphasis in the PID upon collecting more revenue from the existing structure was inordinately heavy. Since the existing structure was deemed to be an inhibitor of economic growth, more rigid enforcement of that system seemed to imply more severely inhibited growth. This issue poses a fundamental dilemma. A.I.D. has supported the IMF and IBRD view that immediate action is required to reduce the magnitude of the GOJ's budget deficit, for the sake of stabilization objectives. Yet, as noted above, more disciplined administration of the existing tax system could adversely affect growth. The resolution of this issue, as reflected in this Project Paper (PP), is to concentrate stage one tax administration assistance on training in fundamental and general tax administration disciplines, rather than on such applications as enforcement and collection.

TABLE 1.

## SUMMARY BUDGET: BY ACTIVITY

(US$ 000)

| | SYRACUSE | GOJ | TOTAL |
|---|---|---|---|
| Project Management | 790,478 | 26,095 | 816,573 |
| Income Taxes | 261,968 | 40,414 | 302,382 |
| Indirect Taxes | 259,508 | 36,949 | 296,457 |
| Industrial Policy | 87,087 | 20,900 | 107,987 |
| Wealth and Housing Taxation | 325,927 | 54,576 | 380,503 |
| Bauxite and Alumina | 37,608 | 3,932 | 41,540 |
| Special Projects | 296,998 | 194,816 | 491,815 |
| Resident Advisor | 456,657 | 81,050 | 537,707 |
| Income Tax Advisor | 447,843 | 82,615 | 530,458 |
| Customs Advisor | 317,476 | 58,869 | 376,345 |
| Kingston Office | 222,014 | 469,016 | 691,030 |
| Counterpart Costs | - | 88,764 | 88,764 |
| Training | 50,000 | 300,000 | 350,000 |
| TOTAL | 3,553,564 | 1,457,996 | 5,011,560 |

2. Customs

At the PID review, the view was expressed that customs is such a complicated area that assistance in customs administration should be deferred pending a comprehensive review of customs and related areas. USAID/J has pointed out that an extremely important and topical element of the current emphasis on the project has evolved around a GOJ request for assistance in the area of customs administration. It is widely recognized that customs administration is made more difficult because of efforts to avoid restrictions occasioned by the perennial disequilibrium in the market for foreign exchange. However, whether the law is thought to be imperfect or not, it is, nevertheless, the law of a sovereign, democratic state. Consequently, it is USAID/J's view, as reflected in this PP, that some form of technical assistance in the customs area is essential to retain the enthusiasm of the GOJ for the project as a whole. As with the other elements of administration, however, the customs administration assistance proposed in the Project Paper is at an appreciably lower level than was proposed in the PID, and will focus on the preparation of a plan for longer term implementation.

3. Tax Policy

A.I.D./W suggested that USAID/J consider removing the tax administration component entirely in order to allocate more of the project's budget to the policy component. As indicated in PID issue 1. above, the relative magnitude of the components have been adjusted in favor of tax policy. USAID/J does not consider it necessary, however, to abandon administrative assistance entirely. The opportunity for the project to have a profound, positive influence on the GOJ's lagging structural adjustment process is considered high, as argued in the FY 1985 CDSS for Jamaica and in this PP. However, it is also important to note that policy and administration are so intimately related that this opportunity would likely be lost if administration were totally removed.

4. Technical Assistance

The Development Assistance Executive Committee expressed concern that a three or four man team, each with specialized expertise, would not be able to function as an integrated unit. The operational proposal put forward by Syracuse, through Professor Bahl, describes in detail the process through which the individual experts can and will function as a true team. It was also suggested that alternatives to the U.S. Internal Revenue Service (IRS) be explored in order to gain greater expertise in the tax policy area. Alternative modes have been explored. The Senior Advisor on Administration feels that the IRS is the source that is most likely to have the combination of expertise required. Nevertheless, the reduction in magnitude of the administration component, and changes in timing and emphasis made during PP design, may not be acceptable to the

IRS because that element of the PID was primarily a reflection of IRS views. In this event, alternative, identified sources of tax administration technical assistance will be employed.

## E. PROJECT COMMITTEE

USAID/Jamaica

Dennis Darby,OPPD/ PDD Project Officer
Robert Friedline, OPPD
Sam Skogstad, AID/Econ
Geraldo Berrios, CONT
Jack Hjelt, RHUD
Dan Rathbun, OPED
Wes Hawley, CO

Consultants

Dr. Roy Bahl, Professor of Economics and Director, Metropolitan Studies Program, Syracuse University

Dr. Oliver Oldman, Professor of Law and Director, International Tax Program, Harvard University

Dr. Daniel Holland, Professor of Finance, Sloan School of Management, Massachusetts Institute of Technology

Dr. Charles McClure, The Hoover Institute, Stanford University

Mr. Kenneth Stacey, Retired Customs Official, British Customs Service

AID/Washington

Paul O'Farrell, PFC

# II. DETAILED PROJECT DESCRIPTION

## A. Background

### 1. Economic and Political Environment

After a period of steady growth in the 1960s and early 1970s, the Jamaican economy fell into a sustained decline. Between 1973 and 1980, real per capita GDP declined 20 percent, the unemployment rate reached 27 percent, foreign exchange reserves were exhausted, and perennial budget deficits, coupled with inflationary finance, left the economy in a state of near financial collapse.

A substantial contributing factor to these depressed economic conditions was the GOJ development policy, which greatly expanded the role of the public sector in the economy and protected domestic industry in order to promote import substitution. The strategy of growth through import substitution, with a concentration on the manufacturing sector in so small a nation, was destined to fail. The combination of increased governmental regulation of the economy and protectionist policies penalized exporters and private sector initiative, and led to an increasingly inefficient allocation of domestic resources. In the agricultural sector, government policies provided disincentives for exports and, in fact, incentives for imports, which further shortened the supply of foreign exchange for building productive capacity.

The opposition Jamaica Labor Party won an overwhelming parliamentary majority in the 1980 elections and a mandate to deregulate the economy, stimulate private sector initiative, and switch to an export promotion growth strategy. The new Seaga Government embarked upon a three-year economic recovery program, the cornerstones of which were disciplined fiscal management, mobilization of foreign assistance, and major adjustments in the structure of the economy. The structural adjustments were to be achieved by significantly increasing reliance on private market mechanisms, relative to government regulation and centralized planning, and replacing the heavily protectionist import-substitution development strategy with a strategy of promoting export-oriented, market-efficient, domestic production.

In 1981, the economic recovery program made impressive progress. Foreign exchange resources flowed into Jamaica through foreign assistance, commercial lending, and private transfers. Arrears on commercial external debt service payments were eliminated, and the overall budget deficit declined from 14 percent of GDP to 12 percent. Domestic monetary expansion was reduced to levels consistent with the goals of the recovery program. Some structural impediments to private markets, e.g., price controls, were eased.

In 1982, however, the world market for bauxite and alumina, Jamaica's principal foreign exchange earners, contracted far beyond expectations. Export earnings and government revenue associated with bauxite and alumina fell far short of the projected levels upon which the recovery program was based. The government was confronted with a serious fiscal problem, as the exacerbated foreign exchange shortage and severe revenue shortfalls reduced resources available to fund government activities in support of the economic recovery program at projected levels. Because of the importance of these activities to the economic recovery, and the intransigence of recurrent expenditures (primarily wages and salaries), there was little prospect for curtailing public expenditures. On the revenue side, there was little that could be done in a short period. Administrative improvements undertaken in 1981 had already increased collections, leaving little room for further extensive gains from that source. Moreover, the government held the view that the tax system was in need of major adjustments to make it compatible with the efficiency and equity goals of the economic program generally. That consideration, and the pro-cyclical implications of tax increases at a time when exogenous expenditures were depressed, precluded significant discretionary actions to increase tax revenue. Inevitably, therefore, the budget deficit failed to realize the further reduction that had been programmed for 1982.

One consequence of the unexpected shortfall of resources in 1982 was that it illuminated the importance of comprehensive tax reform to the success of the structural adjustment program and, indeed, the entire economic recovery program. It became clear that the conflict between the need for revenue and the need to correct the disincentive effects of the existing tax system was not susceptible to a satisfactory resolution until the structure and administration of the tax system as a whole had been subjected to a comprehensive review and reform.

Prime Minister Seaga is committed to implementing such reform and has elevated this to a position of top priority on his policy agenda. Through the Board of Revenue, A.I.D. has been asked to provide technical assistance and support to: (a) undertake the comprehensive review of existing tax policy and administration; (b) develop, in conjunction with the Government of Jamaica, a proposed tax system design; (c) provide training for its administration; and (d) assist in the implementation of the system that emerges from the process. The Board of Revenue Assistance Project responds to that request.

2. The Government Sector

The central government budgetary position has been weak since the mid-1970s. A current account deficit has existed for many years. Although there is some debate about how to measure the size of the overall budget deficit, it is near 15 percent of GDP and approximately 80 percent is financed by donor assistance. A program of expenditure reductions and/or tax increases is necessary to fill, at least, the current account gap. Barring a substantial acceleration of economic growth that similarly boosts revenues, discretionary fiscal adjustments by the GOJ will almost certainly be called for.

The level of taxation in Jamaica is high for a country of its income level, at nearly 29 percent of GDP in 1981/82. Even if one ignores all bauxite taxation on grounds that it does not impose any domestic burden (certainly an unrealistic assumption), the tax burden is 15 percent.

The composition of the tax structure has changed markedly during the past decade, but the changes have occurred on an ad hoc basis more than by design. The most recent example of this ad hoc approach is found in the Prime Minister's May 5, 1983, budget message. In order to close a financing gap of US$60 million in the FY83-84 budget, the following measures were adopted:

1) an increase in the tax on cigartettes of J46¢ per package;

2) a new transfer tax on overtime sales;

3) a new tax profits of life insurance companies; and

4) a 1% education tax on payrolls.

The imposition of a substantial production levy in 1974 made the bauxite tax a major component of the tax structure. With the declining fortunes of the bauxite sector, this relative importance has fallen. Otherwise, the drift has been toward an increase in income taxation, in large part because of a combination of high rates, a high rate of inflation, and indexing of neither rates nor brackets. The property tax has declined in relative importance, as there was a long delay in revising the valuation roll and rates have not been increased. Indirect taxes -- customs, excise, sales, and consumption duties -- have not increased in relative importance, in part because many of the taxes were levied on a specific, rather than an ad valorem basis.

## 3. Statement of the Problem

Jamaica has critical fiscal problems. On the one hand, the government is being pressed to raise taxes in order to reduce a large and continuing budget deficit. On the other hand, it acknowledges a need to reduce the tax burden in order to stimulate production and employment in the private sector. This dilemma is a result of the piecemeal approach to tax structure reform during the past two decades. In fact, the Jamaican tax system has been allowed to drift through periods of fast and slow economic growth, high and low rates of inflation, and, more recently, through a change in economic policy from import substitution in a highly regulated economy toward export expansion in a more market-oriented economy. Scant attention has been paid to the restructuring that was necessary to fit changing economic policy and conditions.

The consequences of this drift are more far-reaching than the budgetary deficits which have emerged, or the political problems of raising tax rates in a depressed economy. In particular, the tax system does not support the GOJ's development policy of basing economic growth on private sector initiative and export promotion. Tax practices have distorted relative prices to the point of providing a serious constraint to economic growth. With respect to the latter, it seems clear that the tax system has lowered the price of capital relative to labor, and the price of imports relative to exports, even though the unemployment rate is currently around 27 percent and the shortage of foreign exchange is perhaps the major obstacle to growth. On the management level, the quality of tax administration has deteriorated to a point where an unacceptably small proportion of the tax base is being assessed. Furthermore, inequities in the system provide strong incentives for tax evasion and avoidance, e.g., those employees who are covered under withholding attempting to avoid the high marginal personal income tax rates by seeking loopholes, while those outside withholding underdeclare their income.

The time has come to carry out a comprehensive reform of the Jamaican tax structure. The tax system needs to be adjusted to promote market oriented development, to reduce its inequitable burden, and to improve its coverage of the real economic base of the country.

B. Goal of the Project

The goal of this project is to promote recovery and sustained broadbased growth in the Jamaican economy. This project contributes to the goal by specifically addressing the key macro-economic problem of fiscal reform. It is recognized that this goal statement may be quite broad in comparison with goal statements of most A.I.D. projects. However, as noted in the CDSS and in other policy analyses of the Jamaican economy, the inability of the tax structure to finance current expenditures and debt service, or support current development policy, shares direct responsibility for the present poor performance of the economy. The GOJ's program of structural adjustment -- the principal focus of major donor assistance -- will not achieve its full potential unless this key tax reform component of the program is instituted concommitant with adjustments in the market for foreign exchange, removal of price controls, and the government's divestment program. Hence, the project's goals must be stated as, and measured against, broad macro-economic changes.

In striving to achieve this goal, an improvement in the fairness and efficiency of the tax system can also be realized. It should be noted that either or both of these objectives could, in most LDCs, be the principal justification for this type of project. However, in the case of Jamaica, improvements in equity or tax administration are not the sole motivations. A key motivation is to reform the policy and administration of the tax structure so that it measureably supports, not hinders, development policies and structural adjustments designed to change the course of the Jamaican economy and establish it as a model of broad based growth and stability based on active, free, and competitive markets.

C. Purpose of the Project

The purpose of this project is to design and introduce a Jamaican tax system that supports the Government's economic recovery program, as well as the structural adjustments through which this program is pursued. This requires that four criteria be met by tax reform.

1. The tax system needs to be restructured so that it will make a maximum contribution to the development of the economy. There are many areas where the present system needs reform. It is commonly asserted that taxes are so high that they discourage work effort; that they provide disincentives for saving and investment; that they discourage repatriation of funds held abroad by Jamaicans, and discourage investment in the economy by foreigners; and that they subsidize imports at the expense of exports. In combination, the present environment of exchange market disequilibrium, quantitative import restrictions, tariffs and tariff exemptions, and industrial incentives make production for the limited local market much more attractive than production for export, especially beyond the CARICOM market. Finally, the tax system induces a variety of distortions in relative prices that have unfavorable effects on the allocation of resources. The government's goal of increased reliance on free market forces as determinants of production and consumption decisions requires a restructuring of the tax system to reduce these distortions.

2. There is a need for fiscal stabilization. The tax system must raise an amount of revenue adequate to cover expenditure requirements. It is not the responsibility or mandate of this project to identify the proper level of public expenditure in Jamaica; that is a decision which belongs to the GOJ. However, the revenue yield and elasticity implications of alternative tax structure changes must be identified, and their implications understood. Only in this way can the implications for non-tax financing requirements be anticipated, and their implications for monetary and credit policy be incorporated into development planning.

3. A comprehensive tax reform should provide a fair and equitable tax structure. The rules of taxation should be clearly stated and understandable by the taxpayer, and the administration of the tax should treat all taxpayers impartially. Under every tax, all those who are equally circumstanced with respect to the base of that tax should pay the same amount of tax. The present income tax, for example, under which the self-employed can easily avoid thr payment of income taxes, violates the maxim of horizontal equity. Considering the reformed tax structure as a whole, its burden should be distributed in a pattern consistent with the GOJ's long-term concern with the distribution of income and wealth.

4. Any tax system should be administrable in an efficient and fair manner. This goal should be pursued for both the current and revised tax structures. Since, like many developing countries, Jamaica is short of skilled administrative manpower, training will be a key component to the achievement of this objective, especially in the short run. Additionally, however, the design of the revised tax structure must recognize the goal of administrability within the context of a developing country, with its human resource constraints, limited computerization possibilities and lack of resources. While these criteria lay out the primary purpose of comprehensive tax reform, clearly there can be conflicts among them. For example, certain aspects of comprehensive reform aimed at stimulating economic growth by removing distortions and heavy tax burdens may result in sacrifices of tax yield and vertical equity.

Other reforms reinforce one another; for example, simplifying the tax system to improve its administration may lead to an increase in revenue. Consequently, a key requirement of the project in meeting its purpose is to articulate the areas of conflict and identify the implications of proposed solutions so that the GOJ can make an informed judgement on the economic and social consequences of its public finance choices.

## D. Project Activities and Outputs

The reform of the Jamaican tax system will require intensive study of each major component of the system (see below), and an integration of the individual findings and recommendations so as to produce proposals for comprehensive tax reform. In addition, the project will assist the GOJ in the implementation of the tax reform program it adopts.

1. Analysis of income taxation.

2. Analysis of tax incentives.

3. Analysis of foreign trade and domestic indirect taxation.

4. Analysis of wealth taxation.

5. Analysis of the taxation of bauxite and alumina.

6. Other special studies on:
   a. the distribution of tax burdens,
   b. the elasticity of the tax system,
   c. impacts on low income families,
   d. computerization and tax administration.

7. Alternative proposals for comprehensive tax reform, integrating the findings and recommendations of the analyses carried out under Tasks 1 through 6.

8. A reorganization of the structure and procedures of tax administration, including the preparation of a long term implementation plan.

9. Training of a core group of managers and administrators.

A summary follows of the analytical approach, key issues, and possible directions of recommendations of the analyses to be carried out to achieve outputs 1 through 9. A more comprehensive treatment of these outputs is contained in Annex A. It should be emphasized at the outset that the objective here is <u>comprehensive</u> tax reform. Though these tasks have been separated, the planned analyses will be carefully integrated (see <u>Management Plan</u>).

<u>Output 1: Income Taxation</u>

The major income tax concerns in Jamaica have to do with company and personal income tax structure and administration.

a. <u>Personal Income Tax</u>

<u>Background</u>

Receipts from personal income tax declined in real terms from $126 million in fiscal year 1978 to $110 million in fiscal 1981 (both years' revenues are in 1977 dollars), despite a brisk rate of inflation during the period. This performance points up the malaise of the personal income tax. Taxpayers have found legal and, more likely, illegal ways of protecting themselves from "bracket creep". However, the success of taxpayers in avoiding income tax is uneven. Persons of equal circumstance with respect to economic income are paying widely varying amounts of income tax. In particular, the income tax has really been a levy on the employed; the self-employed have been the beneficiaries of unsalutory neglect.

## Plan of Study

This task will attack the problem of the income tax by developing two alternative "models" for GOJ consideration, each a version of a broad-based tax. Each will be evaluated with respect to the distribution of the tax burden, economic effects, and administrability. Particularly important in evaluating these two models is the relation between the personal income tax and the corporate income tax.

> Alternative one would replace the present income tax with an expenditure tax. Like the income tax, the expenditure tax could be progressive. Moreover, in determining the tax base, it would involve much the same kind of reporting as under the income tax.

The difference between an income tax and an expenditure tax lies solely in its treatment of savings. Under the income tax, savings are included in the tax base; under the expenditure tax, they are excluded. Therefore, to go from the present so-called income tax to an expenditure tax would not be so drastic a step in terms of its administration. However, compared to an income tax, the expenditure tax would have the advantages of simplicity, administrability and allocational efficiency. It would be inferior to the income tax, however, on distributional grounds. There is a tradeoff, therefore, between these two sets of considerations. And, it will be an objective of the study to develop a sense of what is involved in this tradeoff in the specific context in Jamaica.

> The alternative to the present tax in Jamaica is a pure income tax model. This would involve developing a tax base that more accurately measures real economic income.

The two models would be compared to the present tax with respect to resource allocation, distribution of the tax burden, and administrability. No matter what the choice -- an expenditure tax, a purer income tax, or an improved version of the present personal income tax, special attention must be given the self-employed who are "hard to tax".

To explore both alternative models and develop the evidence relevant to choosing among the three alternatives represented by these two and the current tax, a sample derived from tax returns will have to be developed. It will then be possible to compare the distribution of the tax burden for the two alternatives and the present income tax <u>vis a vis</u> a number of assumptions about the revenue required from the tax. For each alternative, as well as for the present personal income tax, the analysis will evaluate the appropriate relation between that tax and the company tax. With respect to bringing the self-employed into the tax system, the analyses would report the experience in other countries with the "hard to tax".

## b. Taxation of Companies

### Background

Resident companies are taxed on their worldwide income, and non-resident companies are taxed on income originating in Jamaica. Tax rates are 35 percent on agricultural companies and 45 percent on non-agricultural companies. Intercorporate dividends are taxed at 37.5 percent. Business expenses incurred in earning income are generally deductible. Members of groups of affiliated companies are treated as separate entities for tax purposes. Inventories are valued at the lower of cost or market value. For the purpose of calculating cost, first-in first-out (FIFO) is acceptable, and annual depreciation allowances are generally based on a declining balance method applied to the historical cost of assets.

### Plan of Study

The taxation of company income can be appraised under either of two models: taxation of income, or taxation of consumption. Moreover, under the income tax model the goal can be integration of the company and personal taxes, or a classical (separate) system. The choice between these objectives has potentially important implications in terms of distributional equity; neutrality of resource allocation; effects on saving, investment, and development; and the simplicity of tax administration and compliance.

Under the present system, the treatment of capital consumption allowances raises a number of related concerns that deserve further investigation. First, some of the depreciation allowances may be less generous than required to approximate loss of economic value. Moreover, to the extent that depreciation allowed for tax purposes differs significantly from economic depreciation, investment choices may be distorted.

Second, failure to allow tax-free recovery of investment introduces an element of distortion with regard to the choice between long and short-lived assets.

The Jamaican Income Tax Act contains a number of standard provisions intended to prevent understatement of income and underpayment of tax through various kinds of manipulation. However, only three percent of company returns were audited in 1980-81. Given what appears to be a low level of administrative capability, one must investigate the extent to which these statutory safeguards really work as intended.

The interaction between personal and company taxes deserves attention at several levels. The most obvious of these is the present provision for partial relief from double taxation of dividends. This provision is intended to encourage equity finance and increase the flow of savings available for that purpose. However, since early 1982 all interest on bank deposits of individuals has been legally exempt from taxation. Consequently, the salutory effect of the partial dividend exemption is more than offset by the total exemption on interest income. In addition to the obvious stimulus for legitimate saving via banks and other savings institutions, which by itself should encourage the use of debt relative to equity finance, this exemption opens the door to massive tax avoidance via tax arbitrage. An entrepreneur, who might otherwise consider using his own capital to finance his investment, can reduce his tax liability by depositing funds in a bank account, using the account as collateral, and borrowing from the bank.

The lack of a capital gains tax is commonly seen as a problem, primarily in the taxation of individuals. In fact, it also has important ramifications in the area of company taxation and its relation to the taxation of individuals.

The analysis will also examine the present system of partial dividend relief, in comparison with i) a classical system, ii) complete relief from double taxation of dividends, and iii) complete integration. An integration of company and individual taxes, while attractive in many respects, could not be proposed lightly. Thus, one aspect of the research must be a thorough investigation of the administrative simplification it would allow, the reduction in economic distortions it would entail, and the difference in tax burden it would bring about. A particularly important question is whether the administrative advantages could be realized without sacrifice of a graduated rate structure. Any such analysis would, of course, need to consider carefully the implications of the large role played by multinational firms and firms subject to tax holidays.

## Output 2: Taxation and Investment Incentives

### Background

Public policy in Jamaica is used deliberately in a myriad of ways to influence private investment decisions. In addition to providing incentives to influence the level of investment, Jamaican policy addresses the kinds of economic activity undertaken, the choice of locations, and the markets for which production is undertaken.

Taxation is a major element of the policy set directed to these choices. Tax incentives are provided through income tax holidays, special investment allowances, preferential depreciation rules, customs exemptions, and exemptions of certain dividends paid by qualifying companies. In addition to tax incentives, selected domestic economic activities are shielded from foreign competition by quantitative restrictions and customs duties on imports of rival goods. Finally, some activities, particularly non-traditional exports, benefit from exemptions from certain administrative regulations governing access to foreign exchange and import permits.

The examples of investment incentives set forth above represent deliberate efforts by the Government of Jamaica to influence the level of investment. Other elements of public policy, directed toward other objectives, appear to have effects that weaken the influence of the incentives. Foreign exchange market disequilibrium, for example, constitutes a disincentive to investment in economically viable import substitution, as do price controls on goods now primarily or largely imported. Moreover, policies that exempt capital goods from customs duties may encourage selection of relatively capital intensive production technologies and, therefore, cost the economy some additional employment generation.

In general, a tax incentive should satisfy the following economic and administrative criteria:

1. It should induce increases in production and employment in the intended directions;

2. Its principal indirect effects, such as effects on the method of production, as well as on the level, should be understood and evaluated;

3. It should be administratively simple and easily monitored, to minimize the chances of incentives being passed through from eligible to ineligible activities; and

4. It should be sufficiently modest so that it does not permit survival of activities that cannot become economically viable in the absence of subsidies.

Many of the incentives available in Jamaica fail to satisfy one or more of the foregoing criteria. This project will assess existing incentives against these criteria.

Plan of Study

Studies will be conducted to determine the effectiveness and administrative manageability of the system of incentives now in place. In addition, the implications of policies not directly targeted on the preferred activities will be evaluated in order to determine the overall incentive or disincentive effects of public policy. In particular, a comprehensive review of the foreign trade and payments regime will be undertaken.

The questions to be answered are straightforward. Is there evidence that the Jamaican economy has responded to various incentives, in terms of overall growth or structural changes? Have tax incentives been a net cost to the GOJ in terms of revenue sacrifice? What have been the distributional impacts of incentive policies? What would be the implications of removing incentives? In answering these questions, alternative proposals will be advanced from which a modified incentive system design can be selected. The system selected will dictate the legislative, regulatory, and training requirements for the implementation and operation of the system.

Output 3: Foreign Trade and Domestic Indirect Taxes

Background

The system of indirect taxation in Jamaica has four major components: customs, excise duty, consumption duty, and retail sales tax. In recent years, consumption duties (mainly levied on liquor, cigarettes and oil) have grown to account for more than half of the revenues from indirect taxes. The Retail Sales Tax is levied on a small number of luxury-type commodities (automobiles, air conditioners, stereos, TVs, etc.,) at varying rates.

There are three general problems with the current structure.

-- The base of indirect taxation is too narrow.

-- The system has a built-in cascade effect that may distort resource allocation.

-- Administration is weak, leading to widespread evasion and the accumulation of arrears.

Plan of Study

This study will take three forms. First, there will be a careful study of the suitability of a general sales tax in a country like Jamaica in general, and in Jamaica specifically, with particular attentionm given to the level and form such a tax might take. In addition, however, it will be particularly important to study the excise commodities which produce the major part of the revenue under the present system, and which in all likelihood will continue to do so for some years to come. It is, therefore, important that there be special studies of the traditional sumptuary taxes on alcohol and tobacco, as well as those on petroleum products and motor vehicles. The first two of these products are, perhaps, more important for their distributive implications than for their resource allocation implications, but the third group needs to be examined closely in terms of efficiency and resource allocation effects. In all likelihood, it will be appropriate to retain particular forms of special taxes on these groups of products, even if a general sales tax is put into effect.

With respect to a general sales tax, a question that requires particular examination is the possible broadening of the base to include services. It is not clear, for example, that service taxes of the sort discussed in some of the existing reports on this matter can be easily tied into a manufacturer's level tax. The administrative aspects of maintaining separate excise and customs systems together with a general sales tax, the differing kinds of skills required to administer these types of taxes, and the possibility of administrative improvement over the next few years are all matters that will have to be considered very closely in designing an appropriate indirect tax structure for a country such as Jamaica.

In addition to these general reports, there will be particular studies of:

-- taxes on automobiles and petroleum products;

-- taxes on the traditional sumptuary excise on alcoholic beverages and tobacco;

-- the coordination between excise taxes and more general sales taxes;

-- the resource allocation effects on the foreign trade and indirect tax systems as a whole, both as they now exist and with respect to the various alternatives that might be considered; and

-- the administrative aspects of all existing taxes and possible tax changes, both because of the difference between excise and sales tax administration mentioned above, and because of the extent to which administrative possibilities will limit what can be done, particularly in the general sales tax area.

## Output 4: Wealth Taxes, Housing Taxation and Related Problems

The principal forms of wealth taxation in Jamaica are property taxes, property transfer taxes, and motor vehicle taxes. There is no income tax on capital gains.

### a. The Property Tax

#### Background

Property tax, in principle, should be one of the major sources of revenue in Jamaica. However, this tax has never been an important source of revenue--either earlier, when it was levied on capital value, or since it has been levied on unimproved land value. A major reason for the poor revenue response of property tax lies in the constancy of the assessed values since 1974. With assessments unchanged and nominal rates constant, the tax has remained unproductive for government and become a continually smaller burden for taxpayers. Property tax receipts fell from a modest 5 percent of total tax revenue to an insignificant 2.5 percent over the ten year period between 1974 and 1983.

A new valuation exercise is underway and scheduled for completion in 1983. It will be adopted for property tax bills due April 1984. Ten years between valuations is too long. The departures between market and assessed values that develop over time lead to strong inequities among taxpayers, and destroy the credibility of the tax. With the new valuation, these disparities will have been resolved. The property tax could become a more powerful revenue source. This is a very appropriate time, therefore, to reconsider its role in the revenue structure.

Plan of Study

A major argument for converting the property tax from capital value (the value of land and the improvements thereon) to unimproved land value was that the latter would force idle lands into productive use. Additional grounds for favoring a tax on unimproved land lie in its relative simplicity and lower costs of administration. The Commissioner of Valuation has estimated, very roughly, that it requires at least three times the resources he presently has (with an even higher multiple applied to such skilled and scarce categories of personnel as professionally qualified property valuers) to undertake a valuation on the capital value base of Jamaica's 540,000 parcels. This is an important consideration, but it is not definitive. If there would be substantial benefits in other respects from switching to the capital value base, the additional cost of doing so could be a good investment.

There is concern, however, that a tax on unmimproved value may result in a pattern of burden distribution that does not appropriately reflect "ability to pay". Among the most important issues to be studied here is how the two bases would affect the burden distribution. We intend to treat this question through empirical analysis, i.e., by drawing a sample of parcels.

A number of other issues will be considered: the possibility of a classified property tax, the impact of alternatives to the flat rate structure, the wisdom of allowing supplementary Parish rates, and property tax exemption policy.

Whatever base is chosen, and whatever rate schedule is decided on, the property tax will remain a meagre revenue source unless major administrative difficulties are remedied. These difficulties lie in the areas of up-to-date assessments, collection of arrears, and valuation of special types of property, such as housing under rental restriction laws. Associated with this study will be a careful analysis of the transfer tax and how those taxes interact with the housing sector.

This research is expected to generate the information, administrative procedures, and technical competence that will enable the GOJ to get more revenue from the property tax, design property and transfer taxes more suitable for meeting its economic and social objectives, and keep these taxes on a more current basis. This will make them more reliable, as well as productive revenue measures, without causing distorting effects on the pattern of housing investment.

b. Transfer Tax

All real and personal property tax transfers are subject to taxation, although many are not effectively taxed. The transfer tax, to some degree, seems to substitute for a capital gains tax. It is 5 percent of the gross amount of the transfer, but not to exceed the capital gains on the transferral property. We propose to study the operation of the present transfer tax, its economic potential, and alternative "models" for taxing wealth. While Jamaica is not unique in failing to tax this base, there is no reason in principle why more revenue should not come from wealth. This is particularly the case for Jamaica, since a tax on wealth or wealth transfers could catch those who avoid income tax.

c. Taxes and Housing

This aspect of the study will explore the numerous ways in which the Jamaican tax system interfaces with the housing sector. The three premier examples of this interface are the housing finance trust, the fringe benefit provision of the income tax that allows exclusion of employer provided housing from taxable income, and the property transfer tax. In addition to these, there are other housing related issues that will be explored. For example, how should rent-controlled properties be valued for purposes of the new rent control law?

The study will address two questions. First, how much tax revenue is lost because of these various subsidies to the housing sector? Second, what are the effects of the subsidies on the housing sector? For example, one might explore whether the various subsidies result in Jamaicans consuming higher quantities of housing than households in developing countries of similar incomes. Additionally, one might examine the distribution of the subsidy to see if all income classes benefit equally, or whether one class is benefitting more than another.

The output of the study will be at least two documents. The first would be an examination of the current tax system. Each major interface of the tax system would be identified, described and analyzed to determine the revenue loss and the effect on the housing sector. The second output would be a set of recommendations as to how the tax might be changed to better meet the goals of the government.

## Output 5: Taxation of Bauxite and Alumina

### Background

The bauxite-alumina industry in Jamaica is subject to two different tax regimes: the production levy and the company income tax. The production levy is an ad valorem tax on the mining of bauxite. Since all bauxite is transferred between affiliated firms, no markeet prices are established. The valuation of output is, therefore, based on a reference price for aluminum metal.

The primary objective of tax policy in mining, especially in developing countries acting as hosts to foreign-based multi-nationals, is generally taken to be the extraction of a sizeable fraction of economic rents (that part of profit that exceeds profits attainable on alternative investments). If taxes do not strike only rents, they will adversely affect production and may adversely affect the choice of mining techniques.

It does not appear that the production levy was carefully designed to capture economic rents, rather than impinging on output. It makes no allowance for costs, and its rate falls as the reference price -- and, presumably, rents -- rises.

### Plan of Study

The primary purpose of the study will be to determine how Jamaica should tax the bauxite-alumina industry, considering a) the need for revenue, b) the desire to avoid discouraging local production, and c) prospects for the industry, including the continued development of alternative supplies of bauxite and movements in energy prices.

## Output 6: Special Studies

A number of special issues arise which are essential to the formulation of a comprehensive reform, but do not neatly fall into the categories above. These include tax incidence, the elasticity of the tax system, and the social impacts of the tax system.

### The Incidence of Jamaican Taxes

Who pays Jamaican taxes and will pay them under a reformed tax system? This question lies at the center of evaluating alternative tax proposals. The objective of this analysis is clear: to establish the distribution of burdens across income classes under the present system, and to simulate the change in progressivity/regressivity under alternative changes in structure and/or administration. At the suggestion of the Board of Revenue, we will also attempt to make estimates of the distribution of expenditure benefits. Comparing these with the distribution of tax burdens will produce an idea of the income redistribution which occurs through the tax/expenditure process.

## Elasticity Analysis

Both the World Bank and the International Monetary Fund have called for reforms to improve buoyancy of the Jamaican tax system. While it is not clear that an increase in the effective rate of taxation is in the best interest of the country, it is clear that some estimates need to be made of the change in tax buoyancy resulting from alternative tax structure reforms.

We propose to estimate the income elasticity of Jamaican taxes, on a tax by tax basis, using standard methods of analysis. The partitioning approach will be taken, i.e., rate and base elasticities will be separately estimated and used in developing a forecasting model. At the heart of this work will be estimation of the extent to which administrative improvements, broadening the tax base, changing the rate structure, etc., can work to make the tax system more or less responsive to real and nominal income growth. In addition to the policy planning value of this exercise, the results may also assist the government in improving its own forecasting exercises.

## Impacts on Low-Income Families

Central government tax policies can have important effects on low income taxpayers. These effects, however, are often hidden because the burdens are borne in the form of employment reductions in the informal sector, or in the price of consumer necessities. Currently, we know little about how far "down" the socioeconomic scale the effects of central government tax policies are felt. This research will provide information on that important topic.

The purpose of this research is to identify the effects of alternative tax reforms on low-income taxpayers. The research requires estimation of the current tax burden on these payers and projections of how they would fare under various reform prog[illegible]hnique will be establishing "representative taxpayer families" (rural and urban) and estimating their tax burden on a basis of knowledge about the sources of family income and the distribution of the family budget.

Although estimates of these effects may be made from secondary data, consumer expenditure surveys, etc., these sources will not be as informative as specific household data. Therefore, we propose to carry out a set of in-depth case studies on one hundred low-income Jamaican families. The following stratification might be considered. Of the total case-study families, fifty will be urban families (twenty five will have unemployed households heads, and twenty five will have household heads employed in low-wage labor) and fifty will be rural families (twenty five will have household heads engaged in agricultural labor and twenty five will have household heads engaged in petty trade). The urban families will be selected from an area in Kingston; the rural parish is still under consideration.

The research will have clear practical value in terms of development planning. It will show the kinds of impacts tax policy changes have on poor families. Findings in this regard will have relevance to questions concerning the effects of development on women, since poor households are preponderantly headed by women. Changes which general development theory might predict in times of economic scarcity, such as increased fertility and decreased family investment in childcare, will also be illuminated.

Output 7: Comprehensive Tax Reform Proposals

This output is the synthesis of the analyses and recommendations of the individual studies conducted to produce Outputs 1 through 6. In particular, this product is specifically designed to integrate the proposed changes in each tax instrument so that the comprehensive tax structure is internally consistent and supportive of development policy.

The output will be used to develop a White Paper issued by the government and describing the full reform of the tax structure. The output will include a compendium of analyses to support the White Paper, the package of draft legislation needed to codify the reform, and the organizational structure, procedures and schedule for implementation of the reform.

To assure preparation of an integrated proposal to the government, we have taken a number of steps. First, the team leaders, Professors Bahl, Bird, Holland, McLure and Oldman, will meet on a periodic basis throughout the life of the Project. Second, a meeting of the senior staff in January of 1984 will have as its purpose the integration of the 1983 work, planning the 1984 work program, and preparation of substantive proposals for submission to the GOJ. The proposals will form an agenda from which the GOJ will draw in preparing the major income tax reforms it is committed to present to Parliament in April of 1984. Most important, however, will be two meetings held toward the end of the project. The first, in January 1985, will be designed to prepare an integrated set of recommendations to serve as input to the White Paper. The second, in late 1985, will be to begin preparation of the Final Report of the Project.

**Outputs 8 and 9: Reorganization of the Structure and Procedures of Tax Administration and Training**

The effectiveness of any tax system in achieving its purposes depends upon the effectiveness with which it is administered. Administrative effectiveness, in turn, is dependent upon the design. Tax policy, which supplies the design, and tax administration are, therefore, inextricably interdependent on one level. Nevertheless, there are certain principles of effective tax administration that are common to tax systems in general. All tax systems, for example, require that taxpayers be enrolled, that taxpayer liability be established, and that taxes be collected.

The tax administration and training outputs of this project have two parts, one of which can be embarked upon simultaneously with the policy studies, and one that must await selection by the government of the revised structure it wishes to implement. The first component is heavily weighted toward middle management executive training and initial training for revenue agents. The objective of this first component is to improve the capability of the Board of Revenue to enroll taxpayers, establish liability, collect taxes due, and prepare a long term implementation plan for administering the newly selected tax structure.

Areas of administrative improvements that are required, regardless of the tax system that evolves, abound. Tax accounting, for example, is a highly specialized area of accounting, and there is a serious shortage of personnel with the appropriate training. Such expertise is essential to establishing liability under any form of income, consumption, or expenditure tax, and will be provided under the Project.

Another example relates to the effective use of computer equipment to be acquired by the Board of Revenue through a grant from the European Economic Community. Jamaica's specific software planning has only begun. It is essential that a software firm be identified early so that a consultant can visit Jamaica and determine what will be required to develop such a package. The planning should be undertaken simultaneously with the development of a tax structure. The selection of an appropriate package will depend upon how the data processing function will be organized geographically, i.e., with regional centers or a centralized center. This determination is essentially independent of changes that should or might evolve in tax policy and structure. The present project will assist in developing the relationship with a software firm and providing training for Jamaican counterparts who will eventually manage the system.

Another needed area of tax administration improvement is the design and implementation of a statistical data base system. At present, statistical information collected by the Income Tax Department and published in its annual report is of limited value as a management tool, or for other analyses of tax system performance.

Another issue to be addressed is the organization of the various tax functions. The several revenue collecting functions have recently been consolidated under the Revenue Board. However, the consolidation is too recent to have resolved several issues with respect to the organization of functions under the Revenue Board umbrella. One such issue is the locus of the tax policy analysis office and the economist who will head it. This will depend on the functions that are determined to fall within the scope of the office. The appropriate role of this office and the functions it can perform to best facilitate the continuous monitoring, evaluation, and administration of the tax system must be defined. Once again, this issue is independent of the structure of the system that evolves.

The second component of these outputs is the specific organizational, management and procedural changes which must be undertaken to implement the reforms successfully. Little specific definition can be given to the characteristics of this output at this time without prejudging the analyses of the present structure. However, the achievement of this component can be verified in the evaluation of the project, as seen through the long term implementation plan which will be a project output.

E. Inputs

1. Technical Assistance

The Project requires three kinds of expertise. First, the formulation of a comprehensive tax reform package requires experts in tax policy with a long history of work on such problems in less developed countries. The senior staff proposed for this project fit those requirements admirably. Moreover, all have had experience with public finance analysis in Jamaica: Bahl with the World Bank, Bird with the IMF, Holland with USAID, and McLure with the Ministry of Finance of the GOJ. Finally, they represent an appropriate mixture of expertise on income, indirect, foreign trade and wealth taxes.

The second type of expertise is in the area of legal services; final implementation of any tax reform package will require drafting of legislation, codes and procedures. Professor Oldman will lead this team. His experience in this area, and in LDCs, makes him highly qualified for this task.

The third type of experience necessary for final implementation is an expertise in tax administration. For this project, three types of experience and knowledge are necessary. First, there needs to be a Resident Tax Policy Advisor who has a general appreciation of which improvements in administration are necessary to fit any legal adjustment in the tax structure. While all of the senior staff on this project have extensive experience in this area, and in implementing tax administration reform, a full time resident advisor must be in place to assist in managing and coordinating the changes in each area. Second, because of the importance of the company and individual income tax, there is specific need for a resident income tax advisor who is skilled in procedures for improving income tax assessment and the application of automatic data processing skills in that area. Further, he must be capable of training GOJ officers in these areas. The project intends to seek such assistance from IRS, or elsewhere. Appropriate personnel have been identified. Third, there is need for a resident customs advisor who has experience in day-to-day procedures and can administratively advise the Jamaican government on improving customs assessment and collection. The customs advisor should have experience in training and be capable of carrying out on-the-job and a more organized in-service training program in the customs and excise department. Steps have been taken to identify such an advisor, through the U.S. Customs Service and the British Customs Service. In this connection, we have undertaken a preliminary study of customs and excise administration needs and have identified the specific expertise required.

The skills and level of effort of the technical assistance is as follows:

| Position | Level of Effort (Person Months) | Skills and Other Remarks |
|---|---|---|
| Project Coordinator | 18 PM | Senior Public Finance Economist with extensive experience in analysis of LDC tax systems. Also, solid experience in project management, including recruiting and directing other senior advisors, assistant researchers and staff. In addition to overall management of the technical assistance, the Project Coordinator will carry out specific elements of the analysis and integrate the component studies to obtain the comprehensive tax reform package. The Project Coordinator will reside in Syracuse, but make at least quarterly visits to Jamaica. The level of effort represents half time for 36 months. |

| Position | Level of Effort (Person Months) | Skills and Other Remarks |
|---|---|---|
| Senior Policy Analyst (Income Tax) | 8 PM | Senior Public Finance Economist, with specific expertise in income tax policy and administration and their effect on individual and corporate resource allocation decisions. The principal responsibility of this analyst will be to lead the analysis and preparation of Output 1. The entire income tax analysis team (5 persons) will devote 18 PM to the project. The analyst will provide 8 PM of effort. |
| Senior Policy Analyst (Wealth Tax) | 6 PM | Senior Public Finance Economist, with particular expertise in property taxes, inheritance tax and other wealth taxes. Principally responsible for the analysis and preparation of Output 4. The senior analyst will provide 8 PM of effort and other analysts on this team will provide 20 PM. |
| Senior Policy Analyst (Indirect Tax) | 7 PM | Senior Public Finance Economist, with particular expertise in the policy and administration of sales and consumption taxes. Analyst will have principal responsibility to provide Output 3. He will provide 7 PM of effort and will lead a team of 4 analysts who will provide an additional 12.5 PM. |
| Legal and Tax Administration | 5 PM | Senior Legal and Tax Administration Advisor, with experience in drafting legislation and necessary regulations. This team will assist the GOJ in drafting new legislation as might be required by tax reform. |

| Position | Level of Effort (Person Months) | Skills and Other Remarks |
|---|---|---|
| Project Manager -- Resident Advisor | 36 PM | Senior Tax Administration Expert, with broad experience in tax policy and administration. Advisor will represent the technical assistance in Jamaica and provide day-to-day assistance to the GOJ on the reorganiz^tion of the reformed tax system. |
| Resident Income Tax Advisor (Examinations) | 36 PM | Income Tax Administration Expert. Advisor will have special expertise in area of examinations. He will be involved in training and in advising in organization and administrative control. |
| Resident Customs Advisor | 24 PM | Senior Customs Administration Expert, with specific experience in commodity valuation manifest control, port audit, and collection procedures, and training. |

2. Training

An essential ingredient in realizing the objective of the project is the training of Jamaican personnel in the policies, administration, and day-to-day operation of the reformed tax structure. To help insure administrative feasibility, a special effort has been made to integrate the analysis of the tax structure and the formulation of the reform package with tax administration. In each case, the senior policy analysts have been selected partly on the basis of their experience with tax administration in LDCs.

A reform which requires sophisticated and detailed administrative procedures would require extensive training of Jamaican personnel before its benefits could be realized. While this approach could conceivably have long-run benefits, it would certainly delay the benefits of tax reform and could seriously hamper the overall development effort of the GOJ. Consequently, the policy reform package will concentrate on improved tax instruments which can be effectively managed by existing staff skills supplemented, primarily, by in-country training -- both on-the-job and more formalized in-service courses conducted by the resident advisors and core trained staff from the GOJ, with support from the senior policy analysts. In this way, implementation of the reform can proceed without delays endemic in extended absenteeism of personnel sent for long-term training. However, despite the effort to balance the reform with administration, there will be a need to provide some participant training to the various levels of personnel who will manage and operate the system. Regardless of which reform package is announced by the GOJ, there will be a requirement to improve the capacity of the tax administration staff. A portion of this training can start at the outset of this project.

On-the-job training and the organization of in-service training will be carried out by the two resident advisors, who will allocate approximately 50 percent of their time to this task, including informal training through counterpart participation in work tasks. They will be assisted, particularly in in-service training, by the senior policy analysts, who will conduct workshops and seminars at various times during the life of the project.

The resident advisors will assist the Board of Revenue strengthen its training division so that regular in-service classes are held for management, administration, and operations personnel of the departments which are responsible for the various taxes.

While the final curriculum will be developed during the initial stages of the project, training will most likely include the following areas:

a. Participant Training

An IRS team visited Jamaica in 1982 in conjunction with preparation of the PID for this project. The structure of the project has been amended since that time. Nevertheless, the participant training program developed by the IRS team remains relevant in scope, although its magnitude has been reduced. This program is as follows.

| Persons | Training | Cost |
|---|---|---|
| 3 | Senior Executive Training | $ 4,500 |
| 3 | Division Manager's Intax Training | 10,500 |
| 5 | Specialized Management Training | 9,000 |
| 1 | Harvard International Tax Program | 18,000 |
| 1 | Two months in City Assessor's Office in U.S. City | 3,600 |
| 1 | Two months in Rural Assessor's Office in U.S. City | 3,600 |
| | TOTAL | $49,200 |

b. In-Service Training

In-service courses will be offered to staff on a recurrent basis, be presented as short topical sessions (10 to 20 hours), and be scheduled to coincide with the introduction of a reform, new procedure or new form. Initially, the resident advisors would be heavily involved in conducting these in-service courses. However, during the life of the project instructional responsibility will shift to Jamaican personnel of the Board of Revenue.

c. Government Staff Training Institute

Training needs in accounting and auditing, which require longer courses, will be carried out by the two government staff training institutes which now provide these courses. The resident advisors will review the relevant course content and recommend modifications appropriate to the tax reform program.

3. Commodities

The project will procure a micro computer system so that data and reports can be entered in Jamaica and processed and edited both in Jamaica and Syracuse. This will permit floppy disks to be exchanged using the similar facilities located at both places. In addition, a third micro computer unit will be lodged with the USAID/J Economic Officer, who will be providing technical backstopping for the project. While the immediate use of this system will be to carry out the analysis related to outputs 1 through 7, the equipment will be used subsequently by the Board of Revenue in its continuing research and analysis activities.

The project will also procure one sedan and one station wagon to provide logistics support for the project.

4. Cost of Inputs

The overall cost of the project is US$5,011,560, financed by a $3,553,564 U.S. loan contribution and the local currency equivalent of US$1,457,996 provided by the GOJ. The U.S. contribution will be used primarily for costs which cannot be financed by local currency. The Jamaican contribution will cover local costs, such as housing and per diem for all expatriate project staff while in Jamaica, salaries and other costs of all locally hired Jamaican staff, in-country logistics costs, and international travel on Air Jamaica.

Detailed budget estimates are provided in Part III D of this project paper. A summary of costs by object class is provided on the following page. A summary budget by activity is contained in Part I.C, page 4.

Summary Budget by Object
(in U.S. $)

| Item | U.S. | GOJ | Total |
|---|---|---|---|
| Personnel | $1,576,811 | 284,831 | 1,861,642 |
| Travel/Conferences | 134,936 | 204,846 | 339,782 |
| Equipment | 42,600 | 79,831 | 122,431 |
| Allowances* | 419,664 | 196,732 | 615,396 |
| Supplies | 64,974 | 10,112 | 75,086 |
| Training | 50,000 | 300,000 | 350,000 |
| Office Costs | 3,320 | 221,629 | 224,949 |
| Publications | 29,024 | - | 20,024 |
| Indirect Costs | 986,897 | - | 986,897 |
| Contingency | 245,338 | 160,015 | 405,353 |
| Total | $3,553,564 | $1,457,996 | $5,011,560 |

* Includes allowances for furniture, appliances, etc., for resident personnel support.

## III. PROJECT FEASIBILITY ANALYSES

### A. Economic Analysis

The Board of Revenue Project is designed to identify the parameters and introduce one of the key macroeconomic structural adjustments required to redirect the economy of Jamaica toward a market based, export-oriented system. As part of the project design effort, a variety of economic analyses have been carried out to understand the policies and practices of the current tax structure, which may be contrary to the development goals of the country. These project design analyses, provided as Annex A, present a qualitative, a priori basis for proceeding with the project's implementation. In summary, the analyses indicated that a substantial divergence exists between the policies and practices of the current structure and that needed to support the GOJ's development goals. The more noteworthy problems of the current tax structure are that tax policies discourage increased work effort, favor capital over labor, protect inefficient domestic industries, discourage investment in production for export, and fail to encompass the real economic base of the country. Tax assessment and collection practices foster avoidance and serious inequities in payment. The reader is directed to Annex A for a more comprehensive discussion of these and related issues.

The quantification of the economic and financial losses inherent in the present system and the benefits to be realized from a comprehensive tax reform are two of the principal activities of the Project. While preliminary evidence indicates that hundreds of millions of dollars are not now collected, no attempt was made to estimate the potential revenue which could be realized from a comprehensive tax reform. This decision was taken in recognition of the speculative and, perhaps, misleading conclusions which would be associated with an integral rate of return or benefit/cost analysis based on preliminary estimates of benefits gained during project design.

Given its nature, the usual forms of economic analysis of projects are clearly unsuitable. Therefore, the project must be considered from the point of view of cost effectiveness, i.e., the least cost solution to the tax reform problem. In this regard, there is no serious alternative to the technical assistance approach chosen for the project. On the basis of the analyses conducted during the project design stage, there is no option to lever a tax reform exclusively through ESF or PL 480 resource transfers. Further, there are too many outstanding technical issues related to the nature of the required reform to expect the GOJ to proceed without the expertise provided by this project. Thus, a technical assistance approach is essential and, as designed, at the level of effort contained in this Project Paper.

Therefore, the only remaining issue is whether this technical assistance is obtained at least cost. In this regard, the technical assistance team has been carefully selected on the basis of unique skills, which could not be obtained through normal competitive procurement. Consequently the costs of the project reflect the choice of contracting for this team through Syracuse University, or obtaining their services through another corporate or institutional means. Given the established relationships between these individuals and Syracuse University under the Local Revenue Administration Project, and the relatively lower overhead rate of Syracuse University compared to average overheads of consulting firms, the project as designed is considered the least cost approach.

Historical Perspective on Sole Source Procurement

In the process of preparing the Project Identification Document, the USAID Mission in Jamaica and the Revenue Board reached the conclusion that this project should be both designed and implemented by the most qualified tax experts available. The problem to be addressed by the Project was one of identifying flaws in the tax system, designing a set of changes in the system to remedy the flaws, and assisting in the timely and orderly implementation of the newly designed system. The project design process was essentially a process of developing a research program and an implementation plan for all of these tasks. It was important, therefore, that the details of the research and implementation proposal be prepared by the people who were to carry it out. This is the standard, accepted approach to a scholarly enterprise of this sort.

Based oan this conclusion, the Mission believed that the A.I.D./Washington collaborative agreement with Syracuse University (the Local Revenue Assistance Project) would be an appropriate vehicle through which to contract for a single team to design and implement the project. The General Counsel's office ruled, however, that this agreement could not be used. Therefore, the Mission sought, and received, a "Sole Source Procurement Waiver", permitting a separate contract with Syracuse to assemble a uniquely qualified set of experts to assist in the design and implementation of the project.

B. Administrative Feasibility: Organization of the Jamaican Revenue System

Since 1981, the revenue system of Jamaica has been organized under the overall supervision of a Revenue Board. It is charged with ...."direction and control of the three revenue Departments". The three referenced Departments are:

1. Collector-General Department
2. Income Tax Department
3. Land Valuation Office (of the Ministry of Finance).

These departments are responsible for administration of both the assessment and collection functions of the various taxes that, together, constitute the Jamaican tax system. The taxes administered by each are as follows:

### Collector General Department

| Tax Assessment | Tax Collection |
|---|---|
| Customs Duties<br>Excise Taxes | Land Taxes<br>Income tax outside of Kingston-St. Andrew |
| Consumption Taxes<br>Retail Sales Tax<br>Motor Vehicle Licenses | |

### Income Tax Department

| Tax Assessment | Tax Collection |
|---|---|
| Personal Income Tax<br>Companies' Profit Tax | Personal and Companies Income Tax inside Kingston-St. Andrew |
| Stamp Tax | |

### Land Valuation Office, Ministry of Finance

| Tax Assessment | Tax Collection |
|---|---|
| Land and Property Tax | None |

There has been discussion of establishing separate departments for customs and for stamp taxes. These changes are expected to occur in the near future, so that the number of independent departments under the Revenue Board umbrella will be five, rather than three as at present.

The reorganization that placed overall responsibility for revenue in the Board of Revenue was an important step. It identified a single agency as the key source of staff input into the development and framing of tax policy. While tax policy formulation rests ultimately with the Minister of Finance and Planning (a portfolio now held by Prime Minister Seaga), the reorganization is compatible with the conception of taxation as an integrated system that requires centralized guidance and control. Appropriately, the Revenue Board is a high level body that receives its guidance from a three man Policy Committee made up of the Minister of State for Finance, the Financial Secretary, and the Director of Revenue Services.

The Revenue Board, itself, is overseen by a four person Board of Commissioners, which is chaired by the Director of Revenue Services, Canute Miller. Mr. Miller functions as Chief Executive Officer. The other three Revenue Commissioners, Mr. Tulloch-Reid, Mr. Dudley Smith, and Mr. Brent-Harris, head the three offices under which Revenue Board functions are organized. These are Management Services (Mr. Smith), Resource Management (Mr. Tulloch-Reid), and Revenue Services (Mr. Brent-Harris).

The Revenue Board is clearly the appropriate government agency through which to implement the project, including both the policy and the administration components. Only this Board is concerned with taxation as a system, and has the broad authority and mission to address policy and administrative issues of each particular tax in the context of the system as a whole. The Board, for example, has management responsibility for areas of tax administration that are pertinent to all of the operating departments. These include legal services, training, and management information services.

The Revenue Board is a relatively new entity, and there clearly are problems that must be resolved before it becomes fully and efficiently functional in the important role it has been assigned. Jurisdictional issues are not fully resolved, for the Board is charged with oversight of the operating Departments, but is prohibited from becoming involved in their day-to-day operations or personnel selection. Moreover, the Board has encountered difficulty in recruiting qualified personnel to fill some of its 43 positions. One reason for this is that personnel trained in specialized areas, such as tax accounting and tax auditing, are in exceptionally short supply.

In spite of the problems that remain, the Board is deemed to be fully capable of playing the role it must play in this Project to make the Project a success. The Chairman, Mr. Miller, and the board members are capable and dedicated officials. The principal consultants and the Board of Commissioners established an excellent relationship during the project design phase, and all are ready and enthusiastic about getting on with the Project. There is a keen interest on the part of the government, from the Prime Minister and the Commissioners to the supporting staff of the Board, in making the project a success, clear through to the implementation of an efficient and improved tax system.

The organization of the Project provides specific counterparts for each member of the consulting team, to assure the effective implementation of the Project. The Project Coordinator, Professor Bahl, has overall responsibility for the work of the team. Accordingly, his counterpart will be Mr. Canute Miller, Chairman of the Board of Revenue Commissioners. The Project Manager/Senior Resident Advisor, who is responsible to Professor Bahl, will have responsibility for the day-to-day work of the other two resident advisors, and such other short-term consultants as from time to time will be working in Jamaica. Accordingly, his counterpart will also be Mr. Miller.

The Resident Income Tax Advisor will be working in the Collector General and Income Tax Departments. His counterparts, therefore, will be the heads of these departments. Likewise, the Resident Customs Advisor will have the head of the Customs Department as his counterpart. The work of these Resident Advisors will be designed and planned by Professor Oldman and the Senior Customs Advisor, respectively.

The permanent consulting team consists of six university-based Senior Advisors, a Senior Customs Advisor, and three Resident Advisors. The Project Coordinator, Professor Bahl, has overall responsibility for the substantive content and organization of the team's work, and all team members report, ultimately, to him.

In addition to the Permanent Consulting Team, the project will include a number of short-term consultants who will assist in the preparation of studies, and in the implementation of changes adopted under the guidance of the Senior Advisors in the functional areas. Counterparts to assist in these studies and implementation tasks will be assigned by the relevant Department Heads, as appropriate, from among staff personnel. The designation of such counterparts will be a Condition Precedent in the Loan Agreement.

The Senior Advisors and their Revenue Board Counterparts will be as follows:

| Functional Area | Senior Advisor | Revenue Board Counterpart |
|---|---|---|
| Income Tax | Dr. McClure | Head, Income Tax Department |
| Property Tax | Dr. Holland | Head, Land Valuation Department |
| Sales & Excise Tax | Dr. Bahl | Chairman, Board of Revenue |
| Trade & Incentives | Dr. Cnossen | Chairman, Board of Revenue |
| Tax Administration | Dr. Oldman | Chairman, Board of Revenue |
| Foreign Sector | Dr. Bird | Chairman, Board of Revenue |

## C. Social Soundness Analysis

### 1. Socio-Cultural Feasibility

One of the principal components of this Project is a major study of the system of taxation in Jamaica to improve tax administration, expand the revenue base and remove disincentives to production. There are no inherent socio-cultural constraints to this component of the Project. While there exist certain obstacles to implementation of major changes in tax structure, the Project design has incorporated components to address these.

The significant socio-cultural features which were considered in the Project design are income distribution patterns, the extent of self-employment, household expenditure patterns and attitudes to taxation.

#### Income Distribution

Income Distribution data suggest that the median income for 1981 was in the range of $50 per week. Given that the mean income is less than $30 per week, this would suggest that the income distribution in Jamaica is highly dispersed.

#### Self-Employment

41% of the employed labor force is self-employed and is therefore liable to tax based on self-assessment. Considerable evasion of taxes occurs in this group, which leaves the PAYE tax payers (wage and salary earners) bearing the brunt of income tax burdens.

#### Household Expenditure

No household expenditure survey has been conducted since 1972; consequently, the data base for assessing the impact of tax reforms on various groups is not available.

### 2. Multiple Occupations

Micro level studies of selected communities indicate that low income families utilize a number of strategies for survival. Although low income earners may not be formally employed, they have access to earnings which are not now liable for tax.

In recognition of these sociological patterns, the Project includes a component to study income and expenditure patterns of a sample of households from various lower income groups. The sample will be evenly divided among urban and rural households, and between households headed by low-income wage workers and by "unemployed" individuals. Thus, the findings of this study will provide information on which to predict the impact of possible tax reforms on low income groups. It will also provide new data on the economic conditions of women, as a large proportion of "unemployed" household heads are women.

3. Attitudes of Taxation

Pressure Groups

Resistance to taxation is expected in any society. In Jamaica, a number of pressure groups are organized to lobby for changes in the tax system. These groups include the Private Sector Organization of Jamaica, which represents companies and large employers of labor, the Small Business Association, the National Development Foundation, the Trade Unions and more recently, Life Insurance Companies. These interest groups have submitted various proposals to the government which can be reviewed during the course of the proposed study. Since the views of these groups represent the majority of persons currently affected by tax policy, their involvement in the Project will prove useful. Furthermore, these groups are effective in moulding opinions and encouraging compliance; and, as such, can be effectively incorporated in tax policy planning.

4. PAYE Taxpayers

Fifty PAYE taxpayers from 10 large companies representing financial, manufacturing, and public sector organizations were interviewed to establish the extent to which taxpayers would support or resist reforms. The findings from these interviews have been summarized and presented to support our conclusions that changes in the tax structure and improvements in tax administration are desirable at this time.

5. Perception Of The Level Of Taxation

Sixty percent of those interviewed indicated that they perceived that the level of taxation in Jamaica was high by comparison to other developing countries. The remaining 40% did not have enough information to make a comparison. Of this group of 50 PAYE tax payers, 10% felt that the proportion of income going to taxes was reasonable, while 90% felt that income which goes to meet tax liabilities was too high.

Support for reduction in tax rates was high (90%), even if it meant reduction in public expenditure.

Similarly, 90% of respondents felt that the quality of public services in relation to taxes was poor; only 20% reported willingness to pay more taxes in order to improve the quality of public services.

Over half of those interviewed recommended drastic changes in the tax structure. The changes recommended included:

- lower rates on overtime pay
- institution of an education tax
- reduction of duty on motor vehicles
- reduction of taxes on investment income.

6. Equity

The majority of respondents viewed the present tax structure as inequitable. While there is variability in views regarding the distribution of the burdens, respondents feel that PAYE employees bear the hardest burden.

- 40% cited the working class as hardest hit.
- 40% cited the middle income salaried employees as hardest hit
- 60% viewed executives and big businessmen as bearing the lowest tax burden.

Although all respondents felt that urban incomes were most adversely affected by tax policies, only 40% recommended high tax for rural dwellers. Despite the perception that high income earners were benefitting more from the present tax policy, only 30% of respondents supported expenditure taxes on luxury items.

7. Tax Administration

Eighty percent of the respondents viewed the administrative system as poor. Complaints against the system ranged from excessive documentation requirements, and long delays in processing to perceived corruption. Of those interviewed, 70% viewed the process of filing as complicated. Only 10% were unaware of tax credits available to them; however, as many as 40% reported that they did not make use of all the credits. Twenty percent of the respondents felt that the tax system was adequately equipped to deal with evasion, while 70% see the system as not at all well equipped for dealing with evasion. The majority of the respondents felt that over 50% of the tax liability is subject to evasion.

Our general conclusions are that among PAYE taxpayers:

(a) there is a perception that the tax structure exhibits inequities among income groups;

(b) there is support for reforms;

(c) there is a perception that tax evasion is extensive; and

(d) there is a lack of creditability in the tax administration system.

Tax evasion has become institutionalized, primarily in response to high tax rates. Compensation practices tend to emphasize the payment of emoluments as allowances in order to be competitive in securing scarce skills. For example, it is customary to give increases as allowances, rather than to increase basic pay. Overtime work is given on a contract basis, so as to eliminate tax liability. A review of management level salaries indicates that allowances exceed basic salary as a percentage of total compensation.

Tax avoidance by self-employed persons is well documented by the authorities. Several mechanisms have been identified for evaluation, for example the use of shelter companies by salesmen, understatement of income by professional practice owners, etc. Tax authorities recognize that a large number of unregistered companies exist in the services sector, which do not fall into the tax system. This project will examine the self-employed group in order to determine the extent to which it is feasible to levy taxes and attempt to collect from self-employed persons.

A review of the increased revenues generated from the recent 'Back Tax Axe' campaign -- a public education campaign directed at self-employed persons, indicates that where information is clearly disseminated and enforcement exists, compliance increases. We recommend that any program of tax reforms be accompanied by public education and activities which highlight the capability of the tax authorities to enforce the law.

8. Government Commitment

The restructuring of the tax agencies is seen by the Government of Jamaica as a pre-requisite for tax reform, and this is in progress (Ministry Paper/4). The purpose of restructuring is to rationalize the agencies, and increase efficiency and specialization. The establishment of the Revenue Board in 1981 demonstrates the commitment of the government to improve its tax administration capability.

D. Financial Analysis

The total financial investment in this project will amount to $5,011,560. Of this total, A.I.D will fund $3,553,564, or approximately 71%, while the Government of Jamaica will contribute $1,457,996, or approximately 29%. It has been determined that A.I.D. will supply 100% of the project's foreign exchange requirements, and that the GOJ will supply all the local currency costs. The total A.I.D. contribution will consist of loan financing. A.I.D.'s funds will be used, primarily, to pay for the cost of technical consultants. This component accounts for 84% of A.I.D.'s contribution. The GOJ will assume the local support costs, i.e. personnel, locally procured commodities, in-country training, etc.

The following is a brief explanation of the A.I.D. funded components.

| | | |
|---|---|---|
| 1. | Technical Assistance | $2,966,000 |
| 2. | Training | 350,000 |
| 3. | Equipment | 90,000 |
| 4. | Contingency | 148,000 |

Standard A.I.D. disbursement procedures will be followed. Payment will be effected by direct billing to the Controller's Office USAID/Jamaica. It is anticipated that recurrent costs will not pose a problem for the GOJ. This project is an institutional strengthening activity with a very high technical assistance component, which will end upon the completion of the project. Secondly, expenditures for new equipment, an item which would generate recurrent maintenance costs, are miniscule. Expenditures for new equipment is budgeted at $115,500. This would result in a recurrent maintenance cost of between five and six thousand dollars per year. Finally, the project will emphasize the training of existing employees, as opposed to the hiring of new ones. Consequently, when the project ends and the training programs terminate, there will be no personnel-related recurrent costs to deal with.

Table 2

Summary Cost Estimate and Financial Plan
(US$000's)

| | | Yr. 1 | Yr. 2 | Yr. 3 | Total |
|---|---|---|---|---|---|
| 1. | Technical Assistance | 1,295 | 836 | 835 | 2,966 |
| 2. | Commodities | 90 | - | - | 90 |
| 3. | Training | 50 | 150 | 150 | 350 |
| 4. | Contingency(t.a.only) | 65 | 42 | 41 | 148 |
| | TOTAL | 1,500 | 1,028 | 1,026 | 3,554 |

Table 3

Project Activity Cost by Fiscal Year

(U.S. $ 000)

| ACTIVITY | F.Y. 83 USAID | F.Y. 83 GOJ | F.Y. 84 USAID | F.Y. 84 GOJ | F.Y. 85 USAID | F.Y. 85 GOJ | F.Y. 86 USAID | F.Y. 86 GOJ | TOTAL USAID | TOTAL GOJ |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. Proj. Management (Home Office) | 65 | – | 271 | 13 | 268 | 11 | 186 | 2 | 790 | 26 |
| 2. Project Management (Kingston) | 109 | 89 | 276 | 183 | 280 | 186 | 113 | 92 | 778 | 550 |
| 3. Income Tax Study | 46 | 6 | 89 | 10 | 81 | 15 | 28 | 9 | 244 | 40 |
| 4. Indirect Tax Study | 37 | 6 | 167 | 19 | 40 | 9 | 16 | 3 | 260 | 37 |
| 5. Industrial Policy Study | 42 | 9 | 55 | 11 | – | – | – | – | 97 | 20 |
| 6. Health & Housing Tax Study | 70 | 11 | 165 | 32 | 34 | 6 | 13 | 4 | 282 | 53 |
| 7. Bauxite and Alumina Tax Study | 12 | 1 | 25 | 3 | – | – | – | – | 37 | 4 |
| 8. Special Projects | 30 | 19 | 205 | 134 | 42 | 28 | 21 | 13 | 298 | 194 |
| 9. Customs Advisor | 79 | 15 | 159 | 29 | 80 | 15 | – | – | 318 | 59 |
| 10. Income Tax Advisor | 69 | 12 | 149 | 28 | 156 | 29 | 75 | 14 | 449 | 83 |
| 11. Other Costs | – | 72 | – | 172 | – | 109 | – | 39 | – | 392 |
| TOTAL | 559 | 240 | 1,561 | 634 | 981 | 408 | 452 | 176 | 3,553 | 1,458 |

# IV. IMPLEMENTATION PLAN

## A. Implementation Responsibilities

### 1. The Government of Jamaica

The Revenue Board will be responsible for managing the implementation of this project. Mr. Canute Miller, the Chairman of the Revenue Board, will serve as the GOJ's Project Director, and will be the Jamaican counterpart to Professor Bahl, the Project Coordinator for the contractor, Syracuse University. Mr. Miller, acting for the Revenue Board, will appoint an appropriate senior tax official to serve as counterpart to each of the senior advisors of the Technical Assistance Team. Thus, the Board will assure, by way of explicit counterpart assignments and reporting channels, the cooperation of all relevant entities of the tax system.

The Board will receive and review all reports produced by the consultants and will initiate action to implement all recommendations accepted by the Government.

At quarterly intervals, the Board will advise A.I.D. of progress on the Project and will notify USAID/J and the Technical Assistance Team of any events or actions which will influence the Project's effective and timely implementation. The Board will also participate in the project evaluations scheduled in the Evaluation Plan.

### 2. Syracuse University

Syracuse University will be the prime technical assistance contractor; will provide the required advisors, analysts and staff; and will report to the Board of Revenue. The Syracuse team will be responsible for carrying out the analyses and providing the reports as specified in the Outputs and Implementation Plan. Syracuse will also manage the resident customs and income tax advisors.

Professor Roy Bahl of Syracuse University will serve as Project Coordinator of the technical assistance team retained for this project.

While the contracting agency is Syracuse University, the team of advisors will be drawn from all over the world. They were selected because of their highly specialized expertise and their experience in working with developing countries, or in special areas of tax administration and policy.

Both the University and Professor Bahl have demonstrated their ability to manage contracts with A.I.D. and to deliver high quality, timely results. The other members of the team are internationally renowned experts in their fields. They are members of an unusually small group of scholars who have distinguished themselves, both by their contributions to their academic disciplines and by their ability to apply their knowledge and expertise to the resolution of real-world problems.

The members of the team are:

Project Coordinator and Senior Tax Policy Advisor: Dr. Roy Bahl, Professor of Economics and Director, Metropolitan Studies Program, Syracuse University. (Tax Incidence and Burden)

Senior Tax Policy Advisor: Dr. Richard Bird, Professor of Economics, University of Toronto (Indirect Taxation)

Senior Tax Policy Advisor: Dr. Sjibren Cnossen, Professor of Economics, Erasmus University, Rotterdam (Sales and Excise Taxes and Tax Administration)

Senior Tax Policy Advisor: Dr. Daniel M. Holland, Professor of Finance, Sloan School of Management, Massachusetts Institute of Technology, and Editor, National Tax Journal (Wealth and Property Taxation, Tax Administration)

Senior Tax Policy Advisor: Dr. Charles McClure, The Hoover Institute, Stanford University (Income Taxes)

Senior Tax Administration Advisor: Dr. Oliver Oldman, Professor of Law and Director, International Tax Program, Harvard University (Tax Administration)

Senior Customs Advisor: Mr. Ken Stacey, Retired Customs Official, British Customs Service.

Each Senior Advisor, in his particular area of concentration, will have primary responsibility for the design and conduct of studies, the preparation of alternative reform proposals, and related implementation plans, including recommendations on the type, content and level of training required by GOJ personnel.

These advisors will make periodic trips to Jamaica to consult with their Revenue Board Counterparts, to collect data, and to monitor progress in their respective areas of responsibility.

In addition to the foregoing non-resident advisors, the Technical Assistance Team will include three resident advisors -- a Senior Resident Advisor who will serve as Project Manager for the day-to-day operations of the Technical Assistance Team, a Resident Income Tax Administration Advisor, and a Resident Customs Advisor. The Senior Resident Advisor's counterpart will be Mr. Miller. However, as a member of the Technical Assistance Team, he reports to the contractor through the Project Coordinator, Professor Bahl.

The Senior Resident Advisor will have several functions. Most important, he will serve as the liaison between Syracuse University and the Revenue Board. This will involve transmitting the interim reports to the Board, discussing the results of these papers, and transmitting the Board's comments back to the Project Coordinator and authors. Second, the Senior Resident Advisor will serve as a consultant to the Board on tax policy matters, and will communicate the current interests of the Board to the Project Coordinator and staff. Third, the Senior Resident Advisor will supervise, as necessary, the work of the Resident Income Tax and Customs Advisors. Fourth, the Senior Resident Advisor will act as the Administrative Officer for the Project in Jamaica, and will see to all arrangements for visiting team members.

The Income Tax Advisor, with skills in collection and data processing, will have as his counterparts the Collector General and the Commissioner of Income Tax. His major functions will be to assist in the upgrading of procedures and organization of these departments; in the establishment of procedures, manuals and position descriptions; in the development of a taxpayer master file system; in the effective and efficient processing, examination, and securing of delinquent income tax returns; and in the establishment of a strong field office audit concept in the major office and sub-offices throughout the country. The Advisor will also work with the Senior Resident Advisor and other Project members in order to assess longer term implementation needs. In addition, the Advisor will assist the GOJ and the Project in considering the implications of the EEC computerization assistance for the comprehensive tax reform package. Finally, the Advisor will take the lead in coordinating the training programs provided in the Project budget with the GOJ. Where possible and appropriate, the Advisor will also provide on-the-job and classroom training.

The first three months of the technical assistance of the Tax Administration Advisor will be devoted to measures which are prerequisite to training and implementation. These include: identification of legal modifications, preparation of new regulations, assessment of staff requirements, and preparation of job descriptions. Much of this work will not be finished during the preliminary period, but will be continued during the subsequent 21 months of implementation and training.

The Resident Customs Advisor will have as his counterpart the Director of the Customs Department. He will concentrate on improvement of the administration of customs system, including document evaluation, record-keeping procedures, and methods of identifying irregular representations, inspection records, and documentation. The Resident Customs Advisor will also be responsible for specifying training requirements and planning methods for delivery of required training. He will be ultimately responsible to the Senior Resident Advisor for day-to-day operations.

3. <u>USAID/Jamaica</u>

USAID/Jamaica will contract with Syracuse University on behalf of the Revenue Board. USAID/Jamaica will maintain a continuous monitoring of the Project and periodically meet with the Board and the Syracuse team to measure progress. USAID/Jamaica will also insure that the scheduled evaluations noted in the Evaluation Plan are carried out.

4. <u>Internal Revenue Service (IRS) and U.S. Customs Service (USCS)</u>

Should the IRS and/or the USCS agree to provide the Resident Income Tax and/or Customs Advisors, their services will be provided through a PASA with A.I.D. However, any such Resident Advisors obtained by PASA will report directly to the Senior Resident Advisor of the Syracuse University Team.

5. <u>Reports</u>

Several forms of written output will emerge from this project. During 1983 and 1984, a series of interim reports related to outputs 1 through 6 will be produced. Bound working papers of 25-50 pages will be issued. Ample copies will be passed to the Board and USAID/J to enable a review by relevant personnel. The purpose of these Reports is to give the GOJ as much early information as possible about the direction of the Project, and to give the Project a way of soliciting early reaction from the GOJ.

A major interim report will be produced in early 1984. This report will include key findings of the income tax element of the study, along with recommendations for improvement of the income tax along lines consistent withi the Government's economic recovery program. It will serve as an input into the Prime Minister's proposed major tax reform of March 1984.

The tax design phase of the Project will be completed by June 1985. At this point, a <u>Final Report</u> in two volumes will be produced. Volume I will present a comprehensive review of the entire tax system, along with proposed alternative system designs that are consistent with the economic recovery program. Volume II will be supporting Staff Papers which form the basis of the proposals of Volume I. Following submission of the Final Report, a White Paper on tax reform will be produced, not as a project document, but by the GOJ with the assistance of the Project staff.

A third report will contain revised tax laws for submission to Jamaica's Parliament, which will be drafted with assistance from the Project staff. Finally, implementation of any revised system will lead to the writing of numerous regulative circulars, training manuals and forms.

C. Implementation Schedule

Timing of the Work

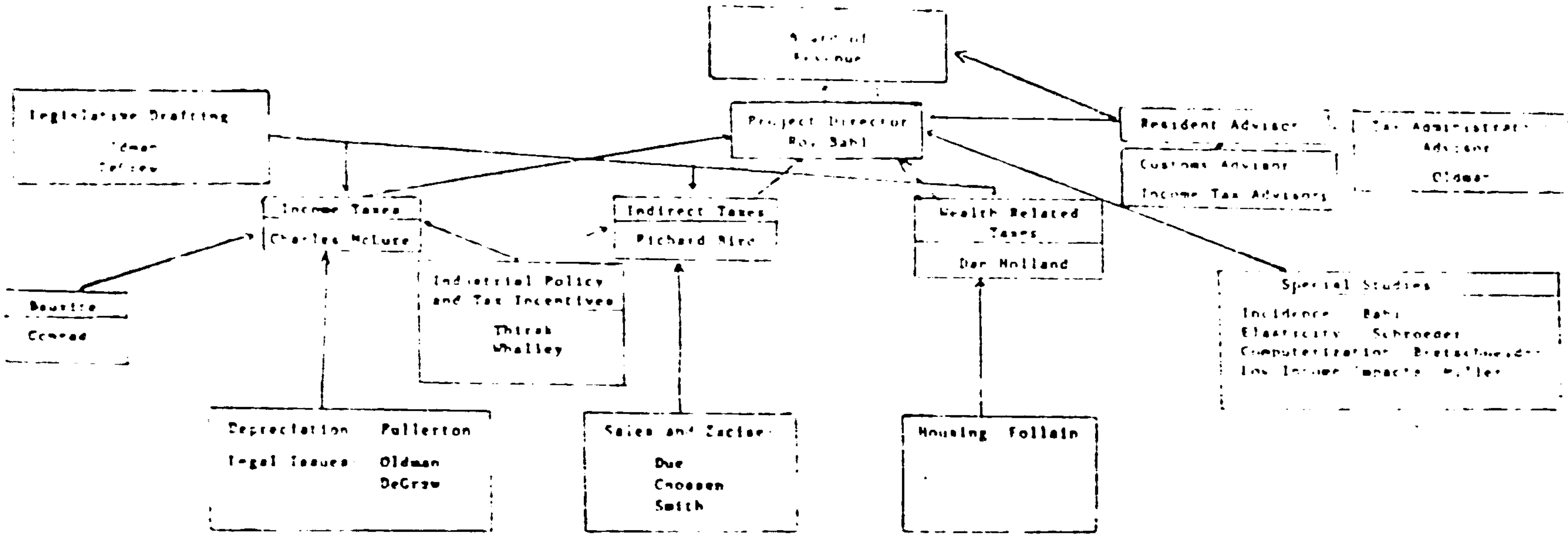
Work on the Project will begin as soon as the contracting process permits. June 1, 1983, is a preferred starting date. The Senior Staff, Professors Bahl, Bird, Holland, McClure and Oldman have agreed to the terms of reference listed here. A Resident Tax Advisor has been tentatively identified, and most principal researchers have been contacted. Syracuse University's contracts office has agreed to move as quickly as possible to comply with any requests made by USAID/J.

The first goal of the Project is to establish a general direction for comprehensive tax reform for presentation to the GOJ in January of 1984. To this end, the various studies will begin in the fall of 1983, and continue in 1984. The Resident Advisor will begin liaison with the BOR upon his arrival in Jamaica, and will serve in that role for three years. The Resident Income Tax and Customs Advisors will also begin their work in the fall of 1983, and continue for two and three years respectively.

The second major goal of the Project is to complete a comprehensive tax reform program by June 1985, and to assist the GOJ in drafting a White Paper on tax reform. Finally, an implementation phase will begin after the Government adopts a tax package. This implementation phase will include drafting of the legislation, as well as administrative and training assistance.

CHART 1

PROJECT ORGANIZATION



## PROJECT IMPLEMENTATION SCHEDULE

| | MAJOR ACTION | MONTH | RESPONSIBLE ORGANIZATION, INDIVIDUAL |
|---|---|---|---|
| 1. | Project Authorization signed | 0 | USAID/GOJ |
| 2. | PIO/T for proposed contractor sent to AID/W | 1 | USAID/J |
| 3. | Obligation | 1 | USAID/J |
| 4. | Conditions Precedent met | 3 | GOJ |
| 5. | Resident Tax Policy, Income Tax and Customs Advisors arrive | 1 | Contractor |
| 6. | Short-term T.A. arrives | 1 | Contractor |
| 7. | Field Research by T.A. team begins - - comprehensive training plan completed by Resident Income Tax Advisor | 2 | Consultants |
| 8. | Participant Training of staff in GOJ tax departments begins | 4 | USAID/J |
| 9. | In-service training of Revenue Board employees begins | 8 | Consultants |
| 10. | Presentation of a program of income tax reform suggestions to the Government of Jamaica - - presentation of income tax reform proposals to Parliament | 8 | Consultants/ AID |
| 11. | Presentation of comprehensive tax reform proposals to the Government of Jamaica, and providing them with assistance in preparing the "White Paper" on taxation | 20 | Consultants/ AID |
| 12. | Interim Evaluation of project | 20 | USAID/J |
| 13. | The presentation of tax reform proposals to Parliament | 22 | GOJ |
| 14. | Resident Customs Advisor departs | 25 | Contractor/ AID |

| | MAJOR ACTION | MONTH | RESPONSIBLE ORGANIZATION/ INDIVIDUAL |
|---|---|---|---|
| 15. | The implementation of specific tax reform proposals accepted by the GOJ, and Revenue Board personnel training oriented to those specific tax reforms | 25 | Consultants/ AID |
| 16. | Final evaluation of project | 32 | USAID/J |
| 17. | Income tax and Tax Policy Advisors depart | 37 | Contractor/ USAID/J |
| 18. | In-service training of Revenue Board employees ends | 37 | |

## PROJECT DEVELOPMENT SCHEDULE (1983)

**MAY 1983**

EC review Mission approval (5/11)

Loan Agreement prepared

Obligation (5/18)

## PROJECT TIMETABLE (1983-1986)

**JUNE 1983**

Tax policy and Income tax Advisors arrive. Field research starts. (6/1)

**OCTOBER 1983**

IBRD/AID loan discussions in re tax policy

**JANUARY 1984**

Presentation of general program of tax reform suggestions to government. Begin in-service training of Revenue Board employees. Customs advisor arrives.

**JANUARY 1985**

Presentation of comprehensive tax reform suggestions to GOJ. Assist GOJ with "White Paper" preparation.

**MARCH 1985**

Presentation of tax reform suggestions to Parliament.

**JUNE 1985**

Customs advisor departs.

**JANUARY 1986**

Project Implementation and personnel training oriented to specific tax reforms, initiated.

**JUNE 1986**

Income tax and tax policy advisors depart. In-service training of Revenue Board employees end.

## E. Procurement Plan

### 1. Commodity Procurement

A.I.D. financed commodities will be procured in accordance with the direct contracting procedures and requirements set forth in detail in Part 7.3 of A.I.D. Handbook 14.*

The total value of the commodities being purchased under the project amounts to $90,000 and will be broken down into separate procurement packages with the result that the landed cost of all equipment and materials purchased under a single contract will be less than $25,000. This situation allows the obtaining of the commodities from the various sources without the necessity of soliciting formal proposals from various firms.

The Project Officer, in accordance with the A.I.D. Procurement Regulations, will prepare for the review and approval of the Contract Officer a certification that the procurement meets the above criteria.

## B. Procurement of Technical Assistance Services

Except for the possibility of a PASA arrangement for technical assistance for the project, technical assistance personnel will be procured under an A.I.D. Direct Contract with Syracuse University. The preliminary identification of candidates for certain positions has been performed by A.I.D., and their job descriptions are contained in Annex H. The services to be provided include:

(a) Project Coordinator: 18 person months

(b) Senior Legal and Tax Administration Advisor: 5 person months

(c) Senior Policy Advisor (Income Tax): 8 person months

(d) Senior Policy Advisor (Indirect Taxes): 6 person months

(e) Senior Policy Advisor (Wealth and Property Taxes): 6 person months

(f) Senior Policy Advisor (Customs): 3 person months

(g) Resident Advisor/Project Manager: 36 person months

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*For justification of the use of AID direct contracting procedures, see Annex C.

(h) Resident Tax Administration Advisor: 36 person months

(i) Resident Customs Advisor: 24 person months

The technical services of the above individuals to begin on or about June 1, 1983, will be obtained by means of an A.I.D. direct contract with Syracuse University. A waiver of competition permitting the procurement of services solely from this institution has been approved by the AA/LAC. The Project Coordinator will be based in Syracuse, New York, and will make at least quarterly visits to Jamaica in the performance of his duties. Each Senior Advisor, in performing the duties under his particular area of concentration, will make periodic trips to Jamaica to consult with his/her Revenue Board counterpart(s), to collect data, and to monitor progress in his/her respective area of responsibility. In the case of the Resident Advisors, they will be based in Jamaica, beginning on or about June 1, 1983, for the periods of time stated above.

A.I.D., as required, will process payments to cover the costs of any technical assistance contracts awarded.

## V. EVALUATION AND MONITORING PLANS

### A. Evaluation Plan

The project will be evaluated on two levels. One level of evaluation will be a review of: a) the quality of the outputs; b) their timeliness in terms of the implementation schedule and c) an assessment of their reception by the GOJ. This level of evaluation will be conducted as a joint effort of USAID/Jamaica and the GOJ, and will include the members of the Board of Revenue, a senior representative of the Ministry of Finance, and a senior representative from USAID/Jamaica. This type of evaluation will be conducted at each point in the project's schedule in which major outputs are presented to the government by the consultants. In addition to the review of the project, these evaluations will be key opportunities to reaffirm the sequence of steps which must follow the evaluation to install the tax reform. In evaluating the quality of the outputs, the project will utilize independent consultants, as necessary, who will report directly to the evaluation group. The schedule for these evaluations is as follows:

| Date | Task |
|---|---|
| September 1984 | Evaluation of the reports related to Outputs 1 through 5 |
| January 1985 | Evaluation of final consolidated report related to Output 6 |
| July 1985 | Evaluation of timing and impact of GOJ's White Paper and draft of legislation and regulation |
| January 1986 | Evaluation of progress in implementing reform -- reorganization of administration and training |

For Outputs 1 through 6, quality will be assessed in terms of the breadth of coverage of each study, the accuracy of the undertaking of the legal and structural set-up of the existing tax instruments, the appropriateness of data used in the analysis, the methodology, and, finally, the creditability of the recommendations as reform proposals which support the new development policies of the government. Timeliness will be considered first in terms of meeting the project's implementation schedule. However, timeliness will also be considered in light of other actions of the government on structural reform, and related political and economic events which enhance or detract from the value of the output in contributing to the project's purpose. These evaluations will also review the readership of the outputs among those who are involved or influential in tax reform to determine the degree of understanding of the issues and recommendations conveyed, and the kind of reactions elicited. Such evaluations will also assess immediate and planned actions which result from the outputs, in terms of their contribution to tax reform.

The evaluation of the GOJ's White Paper, to be conducted in July 1985, is primarily to review progress with the government on implementing the reforms and strengthening administration. Again, some opportunity will exist to redirect the remaining project resources.

A second level of evaluation will assess the extent that the project achieved its purpose and goal. This evaluation must be conducted primarily by USAID/Jamaica, with participation by senior A.I.D./Washington personnel, and will occur at the end of the Project.

One important determination will be whether the reform package accepted by the government went far enough toward the kind of reform needed to support the development objectives of the government. This determination will follow from the earlier evaluation, but must be more fully assessed at this end of project evaluation. In light of the considerable analyses to be generated by the Project, this assessment will be mainly judgemental by the evaluation participants, and should solicit the view of the other key donors who support structural reform, as well as knowledgeable elements of the Jamaican society.

A second determination will be to assess the contribution the reform is making to achieve the Project goal, and the related activities and events which effect it. Material for this final assessment will be primarily World Bank, IMF and USAID/J analyses of current economic trends and their determinants.

B. Project Monitoring Plan

Monitoring will be performed by a Mission Project Committee, whose members will have the following responsibilities.

1. The primary administrative monitoring task will reside with the Project Officer. The Project Officer will maintain liaison with the Revenue Board, coordinate necessary Mission Project backstopping, and prepare and present quarterly progress reports to the USAID Mission.

2. Liaison with the consulting experts and with the Revenue Board on matters relating to scheduling, conduct and content of economic analyses will be the primary responsiblity of the Senior Economic Advisor.

3. The USAID Controller will review all disbursement requests for conformity with A.I.D. regulations, and will ensure that adequate financial control methods are followed by the Revenue Board.

Quarterly progress reports, annual evaluations and audits, financial and other reports will be required of the Revenue Board. Specific instructions as to the substance of these reports and other implementation actions will be issued by Implementation Letters.

# VI. CONDITIONS, COVENANTS AND NEGOTIATION STATUS

## A. Conditions Precedent

### 1. Conditions Precedent to Initial Disbursement

Initial disbursement will be made following receipt of:

a. Evidence that senior tax official(s) have been designated by the Chairman of the Revenue Board as official Project manager and official counterparts to each person financed by A.I.D. to render technical assistance the Revenue Board.

b. A statement of the name of the person who is to act as the official authorized representative of the Borrower in connection with the Project Agreement and of any additional representatives, together with a specimen signature of each person specified in such statement.

c. An opinion of Counsel acceptable to A.I.D. that the Project Agreement has been duly authorized and/or ratified by, and executed on behalf of the Borrower, and that it constitutes a valid and legally binding obligation of the Borrower in accordance with all of its terms.

### 2. Conditions Precedent to Disbursement of Training Funds

a. Funds for training cannot be spent until A.I.D. approves a comprehensive training plan and schedule covering the entire Project activity, for all contemplated personnel training under the Project.

b. Disbursements for training overseas will not be funded prior to receipt of evidence from the Borrower that a system of bonding, or some other method, is in effect to ensure that participant trainees will return to their posts for a period of time not less than twice the length of time spent in training.

## B. Covenants

1. The Borrower shall covenant that, unless otherwise agreed to in writing by A.I.D., it will provide adequate budget allocations for Project implementation in a timely manner consistent with the implementation schedules developed by the Revenue Board.

2. The Borrower shall covenant that it will continue the mandate to regulate the tax system given to the Revenue Board under the terms of the Revenue Board Act.

## C. Negotiation Status

This project has had substantial inputs, in the form of pre-Project activities, of training assistance given to employees of the Revenue Board. There are no serious constraints to Project implementation, and the Chairman of the Revenue Board and the Project Officer are in agreement with regard to the requirements of the conditions precedent and covenants.

# TECHNICAL ANALYSIS OF THE TAX SYSTEM

Analysis of the Jamaican tax system and a program for reform will require intensive study of each major component of the system. The project has been designed to include such individual studies, and to integrate findings and recommendations so as to produce a proposal for comprehensive tax reform. For purposes of organization of the project, the work has been divided into the following parts: income taxation, incentives and subsidies, domestic indirect taxation, wealth taxation and housing, the taxation of bauxite and alumina, and special topics. In addition the Project has a tax administration/training component; the preparation of a comprehensive tax reform package; and an implementation phase.

While the discussion below is heavily focused on the issues surrounding each tax, an integrated approach will be taken (see Management Plan Discussion below). Likewise, there will be a final report on comprehensive tax reform, but also an intensive set of papers addressing specific topics.

## Income Taxation

The major income tax concerns in Jamaica have to do with company and personal income tax structure and administration. These taxes will be considered together with a series of studies under the supervision of Professor Charles McLure.

## Personal Income Tax

Background. Jamaica experienced a brisk inflation over the five year period 1977-1981. Taking 1977 as 100, the Consumers Price Index in 1981 was 250. Over this same period only modest adjustments were made in the rate brackets and allowable tax credits of the income tax. Both were adjusted somewhat, but not substantially, in nominal terms, and even less so in real terms. The tax structure was strongly progressive as illustrated in Table 1.

In the face of all this, however, receipts from personal income tax declined in real terms from \$126 million in fiscal year 1978 to \$110 million in fiscal 1981 (Both years' revenues are in 1977 dollars.) See Table 2.

This performance points up the malaise of the personal income tax. Apparently taxpayers (and those who should be taxpayers, but aren't have found legal and, more likely, "informal" ways of protecting themselves from bracket creep. But given that the most important methods of avoidance are "informal" and fall in a "group" area between legal and illegal or are illegal but not vigorously policed as such, one would expect the success of taxpayers in avoiding income tax to be very uneven. As a consequence, the horizontal equity of the tax has probably

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TABLE 1

EFFECTIVE AND MARGINAL RATES OF PERSONAL INCOME TAX AT SELECTED STATUTORY INCOME LEVELS IN JAMAICA, 1981

| Statutory Income[a] (in Jamaica) | Effective Rate | Marginal Rate |
|---|---|---|
| 6,000 | 30.0% | 30.0% |
| 8,000 | 31.3 | 40.0 |
| 10,000 | 33.0 | 45.0 |
| 12,000 | 35.0 | 50.0 |
| 15,000 | 38.5 | 57.5 |
| 20,000 | 43.3 | 57.5 |
| 30,000 | 48.0 | 57.5 |
| 50,000 | 51.8 | 57.5 |
| 100,000 | 54.7 | 57.5 |

[a] After all allowances and exemptions. No account taken of credits in computing tax liabilities.

TABLE 7

NOMINAL AND REAL TAX RECEIPTS: GOVERNMENT OF JAMAICA,
FISCAL YEAR, 1978-82[a]
(dollar amounts in millions)

| Tax Revenue | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|
| Total | (487.9)<br>487.9 | (546.2)<br>737.4 | (479.7)<br>836.1 | (397.3)<br>880.9 | (460.5)<br>1149.9 |
| Taxes on Income and Profits | (190.7)<br>190.7 | (195.5)<br>263.9 | (189.1)<br>329.6 | (185.9)<br>412.2 | (210.1)<br>524.7 |
| a. Company | ( 64.3)<br>64.3 | ( 79.6)<br>107.5 | ( 91.0)<br>158.6 | ( 89.4)<br>198.2 | (100.3)<br>250.4 |
| b. Personal | (126.4)<br>126.4 | (115.9)<br>156.4 | ( 98.1)<br>171.0 | ( 96.5)<br>214.0 | (109.8)<br>274.3 |
| Taxes on Production and Consumption | (240.2)<br>240.2 | (293.5)<br>396.2 | (236.3)<br>411.8 | (178.9)<br>396.7 | (200.1)<br>499.6 |
| Taxes on Property | ( 24.6)<br>24.6 | ( 17.4)<br>23.5 | ( 13.3)<br>23.2 | ( 10.5)<br>23.3 | ( 11.5)<br>28.8 |
| Taxes on International Trade and Transactions | ( 32.4)<br>32.4 | ( 39.9)<br>53.9 | ( 41.0)<br>71.5 | ( 22.0)<br>48.7 | ( 38.8)<br>96.8 |
| ADDENDUM | 1977 | 1978 | 1979 | 1980 | 1981 |
| CPI - Jan. 1975=100[b] | 130.1 | 175.6 | 226.7 | 288.4 | 324.8 |

[a]Number in parenthesis are in terms of 1977 dollars.

[b]The present year ends on March 31st. Hence, 1977 is the appropriate deflator for fiscal 1978, etc.

SOURCE: IMF, Jamaica: Recent Economic Development, December 13, 1982, Tables 21 and 23.

been adversely affected. Persons equally circumstanced with respect to economic income are probably paying widely different income tax.

This has always been the case for the two broad classes of income taxpayers--employees and self-employed--from whom the tax has been collected differently. Employees are subject to withholding on their compensation under the Pay As You Earn system (P.A.Y.E.), while the self-employed are on a self-assessment basis.

Those subject to P.A.Y.E. are, in the main, reached by the income tax. The self-employed, however, are not, so when income tax revenues go up due to bracket creep or purposeful legislation, it is those under P.A.Y.E. who pay the income. They account for over 90 percent of total personal income tax liability, a figure well above the fraction that earnings of the employed constitute of total earnings of employed and self-employed.

Over the years, then, the income tax has really been a levy on the employed; the self-employed have been the beneficiaries of unsalutary neglect.

In principle the income tax is designed to get at personal income from all sources which is taxed at progressive rates after various exemptions, and the total tax liability is then adjusted by various tax credits (listed below in Table 3) that adjust for particular circumstances of individual taxpayers.

Income subject to the personal income tax includes income from: employment, interest, dividends, business and property. Capital gains are not taxed. The law requires that any benefits, in kind or in cash, payable to the employee for services rendered must be included in income. This includes any living housing allowance paid to the employee. Where free housing is provided by the employer that portion of this allowance in excess of 10 percent of his salary is not taxed. Travel, entertainment, etc., allowances are taxable to the extent they are not actually expended by the employee in performing a service for the employing firms. The value of the use of a company car is a matter of negotiation with the Commissioner of Income Tax who will take the particular circumstances of the employee into account.

That there is serious trouble with the income tax is illustrated by the following evidence:

1. Between 1978 and 1982, receipts from taxes on income and profits declined, in real terms, from $126 million to $110 million (Table 2).

2. Of the 28,440 self-employed on the master list, only 23 percent, on average, filed returns over the last 7 years; only 15 percent over the most recent 3. About $50 million a year is lost in income tax revenues because of non-filing of those on the master list.

TABLE 2

PERSONAL INCOME TAX CREDITS AS OF ASSESSMENT YEAR 1980

| | | | Tax Credit |
|---|---|---|---|
| 1. | Personal Allotment | - | $600 |
| 2. | Pensioners | - | $400 |
| 3. | Wife | - | $140 |
| 4. | Wife Earned Income | - | 40 percent of earned income or $320, whichever is less |
| 5. | Maintenance and Alimony | - | 40 percent of Alimony or Maintenance or separation allowance to a maximum of $160. |
| 6. | Child | - | $80 |
| 7. | Child at University | - | $120 |
| 8. | Dependent Relative | - | $40 each with a maximum of $80 |
| 9. | Female Relative have care of widow's or widower's child | - | $40 |
| 10. | Life Assurance and Capital Growth Funds linked to Life Assurance | - | 60 percent of sums used to purchase premiums or units to a maximum of $360 |
| 11. | Mortgage Interest | - | 40 percent of interest paid on $60, whichever is less |
| 12. | Medical and Dental Expense | - | 40 percent of expense paid or $40, whichever is less |
| 13. | Household Helper | - | $4 per week to a maximum of $208 |
| 14. | Savings in Cooperative and Building Society | - | 60 percent of shares subscribed, or $360 whichever is less |
| 15. | Donations | - | 40 percent of donations not exceeding 1/20 of statutory income made to approved institutions |

TABLE 3 (CONT.)

| | Tax Credit |
|---|---|
| 16. Special | $156 in any case where the major part of income is emoluments, statutory income does not exceed $12,000, does not derive from a business in which taxpayer is principal owner or partner |
| 17. Pensioner's Relief | $400--Available to a pensioner at least 60 years old, participating in an approved statutory pension or superannuation scheme. |
| 18. Banks and Other Savings Institutions Interest | A provision introduced in 1982, makes Bank and other savings institutions interest earned by individuals exempt from income tax if left on deposit for at least one year. |

(This recent increase appears to pose real problems in the context of the combination of personal and company tax or for taxing personal business income. Apparently an owner of a business can deposit, say, $10,000 in the bank, collecting tax-free interest. With that deposit as security he could borrow $10,000 from the bank for use in his business. The interest paid to the bank by the business would be deductible, the interest received by the individual would be non-taxable. This would be profitable for the taxpayer as long as the rate charged to the business on bank loans exceed the rate earned on bank deposits by less than the marginal rate of tax on his company.)

3. But the self-enclosed master list is seriously deficient. The Commissioner of Income Tax estimates that about 65,000 more names should be on the list. The income tax revenue loss is about $100 to $140 million.

4. Together the revenue loss from self-employed non-filing is $170 million, which is over 62 percent of the tax collected from those employees whose income tax is withheld under the P.A.Y.E. system. (Since some of the self-employed who do file under-report their income, the self-employed revenue loss could be higher, about $200 million.)

5. Reflecting widespread evasion, the schedule of income tax rates is extremely high and reaches its maximum at a rather low income. As Table 1 indicates effective rates of tax on those who do pay the tax are very high. More than one-third of a relatively modes statutory income of $12,000 would be taken in income tax. And the marginal rate at this income level is 50 percent, which lends some credence to the claim that high tax rates are discouraging overtime work.

6. Evasion breeds further evasion. With rates on those subject to P.A.Y.E. so high, employers increasingly are carving up the compensation they pay employees into a smaller and smaller salary component and expanding a set of emoluments of all kinds. These latter are legally includable in taxable income, but the practice of not declaring them is widespread.

7. The personal income tax rate schedules have not been adjusted proportionately to inflation in Jamaica, consequently taxpayers whose real income remained the same have been subject to much higher effective rates in recent years compared with an earlier period. A submission prepared by the Joint Taxation Committee (comprised of lawyers and accountants) for the Minister of Finance shows the effective rate of tax on a Jamaican with $5,000 of statutory income in 1970 and the purchasing power equivalent thereof in 1980, rising from 22 percent to 47 percent. A similar calculation at the $10,000 real income level, yielded an effective rate of 34 percent in 1970 as against a rate of 53 percent in 1980.

8. These high rates, however, as noted above did not prevent income tax revenues from falling in real terms (Table 2).

9. The various allowances noted above have become a sore spot in income taxation. With effective rates of tax increasing as taxpayers move into higher nominal income brackets, non-taxed allowances have proliferated. To some extent this reflects changes in the tax. Thus, in 1980 an amendment to the Income Tax Act provided for an increase in the tax-free allowance for a local holiday to $300 per individual and a maximum of $1,200 for taxpayer, spouse and two children. But the major growth in allowances has been the development of many more types of allowances, most of them of dubious legality or clearly illegal. Employers have cooperated with employees in arranging to pay more of total compensation in "tax-free" allowances. They have become a component of the compensation package unions bargain for. Allowances--legal, illegal, and perhaps legal--are all hard to detect and control.

The income tax is threatened, then, with real disarray. The self-employed sector has never carried its fair share of the income tax burden, and the employed sector has developed a mechanism for lightening its unduly heavy tax load. While improved tax administration could help Jamaica get more out of the self-employed sector and, hence, permit a lighter burden on the employed (P.A.Y.E.) sector, more will be required to make the income tax viable.

A major restructuring of the tax is in order.

Plan of Study. We propose to attack the problem of the income tax by developing two alternative "models" for the GOJ to consider. Each of these alternatives would be clear-cut "models" or versions of a broad-based tax. Each will be evaluated with respect to the distribution of the tax burden, economic effects, administrability, and the relation between the personal income tax and the corporate income tax.

1. One possibility would be to replace the present income tax with an expenditure tax. Like the income tax, the expenditure tax could be progressive. And it would, in fact, involve much the same kind of reporting as under the income tax in determining the tax base.

This would not be as remarkable a modification as it might seem. For, in fact, it is hard to say right now whether the current personal income tax in Jamaica is really an income tax or an expenditure tax. And it is quite clear that the personal income tax has over the years come more and more to resemble an expenditure tax.

The difference between an income tax and an expenditure tax lies solely in their treatment of savings. Under the income tax, savings are included in the tax base; under the expenditure tax they are excluded. Some kinds of savings have always been excluded or deductible under Jamaica's income tax. Capital gains have never been taxed; private plan superannuation contributions and NIS contributions have always been deductible and the earnings of their respective funds have not been taxable to individuals, a number of the credits enumerated above are for savings, and in 1981 a major category of savings--interest on deposits left at least a year in banks and other savings institutions--was exempt from tax.

Therefore to go from the present so-called income tax to an expenditure tax would not be so drastic a step. But it would have important implications for the taxation of business income. Under an expenditure tax current expensing of capital goods purchases would replace the present depreciation allowances and inventories would likewise be on a current outlay basis rather than FIFO. A major flaw in the current tax treatment of depreciation in Jamaica is the failure to allow recovery of replacement costs for depreciable assets (or to provide for accelerated nominal depreciation that would be somewhat equivalent) or to allow current cost inventory accounting which would minimize the spurious capital gains on inventory brought into the tax base by FIFO (which is currently the only accounting convention permitted for inventories.)

One path to expenditure taxation would be via a tax solely on labor income. Such a tax is described in the section on Company Taxation where it is explained in the context of a merged personal-company tax. Basically, as noted there, individuals would be taxed only on their wage and salary receipts and income from self-employment. Companies would be permitted to deduct only outlays on plant and equipment, raw materials, and wages and salaries. The allowances that are now part of total emoluments of individuals would not be deductible by companies nor taxed to individuals. And the same treatment would be accorded dividends and interest paid by companies and received by individuals.

This version of the expenditure tax, as noted in the section on company taxation, is particularly appealing on administrative grounds. And it would distort economic decisions less than an income tax. However, it permits progressive rate structure only for labor and self-employment income; all other income would be taxed at the flat company rate. On the personal income tax side this may not be a serious departure from what exists now in Jamaica. Currently only those subject to P.A.Y.E. are effectively taxed and primarily on labor income since a good portion of savings is exempt, deductible, or creditable. And only on a fraction of labor income--from 60 to 70 percent--due to nontaxed allowances.

Again, as noted in the section on company taxation, some proponents of this version of an expenditure tax suggest a flat rate for all income, both personal and corporate. Despite the "flat rate", some progressivity could be achieved in labor income taxation by exemptions, but it would not be as progressive as the current income tax.

Compared to an income tax, this version of the expenditure tax would have advantages, in principle, on grounds of simplicity, administrability and allocational efficiency. It would be inferior to the income tax, however, on distributional grounds. There is a trade-off, therefore, between these two sets of considerations. And it will be an objective of our research to develop a sense of what is involved in this trade-off in the specific context in Jamaica. Further considerations and areas to be explored with respect to this alternative are noted in the section on company taxation.

2. The second alternative to the present tax in Jamaica is a pure income tax model. This would involve developing a tax base that measured real additions to economic power. It would require the inclusion of all savings in the tax base, the taxation of capital gains, and indexing to ensure that real, not nominal, income and savings were taxed. Whether such a tax is possible in Jamaica (or anywhere else) in pure form is conjectural. But an income tax conforming more closely than the present income tax to this "model" can be developed.

Compared with the present tax, this alternative can be evaluated with respect to resource allocational efficiency, distribution of the tax burden, simplicity and administrability.

<u>How the Project Will be Carried Out</u>. . No matter what the choice--an expenditure tax, a purer income tax or an improved version of the present personal income tax, special attention must be given the self-employed who are "hard to tax." New administrative measures--requiring, for example, all motor vehicle registrants or persons seeking to leave the country to produce an income tax receipt, it will have to be introduced. The self-employed cannot remain outside income tax.

To explore both alternative models and develop the evidence relevant to choosing among the three alternatives represented by these two and the current tax, a sample derived from tax returns will have to be developed. The tax return data are not computerized. Therefore assembling the basic sample required for the research will be a laborious task.

Once we have it, however, it will be possible to compare the distribution of the tax burden for the two alternatives and the present income tax under a number of assumptions about the revenue required from the tax--such as revenues equal to that currently raised by the personal income tax, or 25 or 50 percent more than that, etc.

For each alternative "model" as well as the present personal income tax we will evaluate the appropriate relation between that tax and company tax.

With respect to bringing the self-employed into the tax system, which must be accomplished for a successful broad-based tax, whether it be one of the "model" alternatives or an improved variant of the present tax, we would study the experience in other countries with the "hard to tax." Also we would consider other measures similar to, but more general than, the foreign exchange quotas which limited to registered trades flushed out a good number of people in the informal trading sector, hitherto unregistered, and in the requirement that mini-bus operators must show an income tax receipt before they will be able to get their motor vehicle registration. These two measures have, apparently, been rather successful. Why not extend them more thoroughly to all motor vehicle registrations, all persons applying for professional licenses--doctors, lawyers, accountants, etc., to all persons who apply for an exit permit, etc.

## Taxation of Companies

Description. Resident corporations (hereafter called companies, following Jamaican terminology) are taxed on their worldwide income, and non-resident companies are taxed on income originating in Jamaica. Tax rates are 35 percent on agricultural companies and 45 percent on non-agricultural companies. Of these, 10 percentage points (the "additional company profits tax", or ACPT) can be offset against the withholding tax on distributions, which is levied at a rate of 37.5 percent. Partnerships are not taxed as such; rather, they are treated as conduits, and partners are taxed on their pro-rata shares of partnership profits.

Intercorporate dividends are taxed at 37.5 percent, the rate at which tax is withheld on distributions. Dividends received by individuals (except where paid from statutorily exempt income) are included in taxable income and taxed at the marginal tax rate of the recipient. Because the ACPT can be offset against the withholding tax on dividends, partial relief from double taxation of dividends occurs. Preference dividends are treated as (deductible) interest, if paid by a widely held Jamaican company (and if paid by other companies, under certain circumstances).

Business expenses incurred in earning income are generally deductible. Explicit provision is made for the disallowance of expenses found to result from the use of artificial transfer prices on various types of transactions between affiliates. Losses can be carried forward five years (eleven years, if they result from special investment allowances, to be defined below). Members of groups of affiliated companies are treated as separate entities for tax purposes. Since consolidated returns are not allowed, losses of one member of a group cannot be offset against taxable income of another member of a group.

Inventories are valued at the lower of cost or market value. For the purpose of calculating cost, first-in, first-out (FIFO) is acceptable. Last-in, first-out (LIFO) might not be accepted by the fiscal authorities.

Annual depreciation allowances are generally based on a declining balance method applied to the historical cost of assets. Illustrative rates follow:

| Type of Asset | Rate Per Year |
|---|---|
| Buildings housing machinery | 5.00 |
| Non-residential buildings | 2.25 (straightline) |
| Reinforced concrete buildings | 2.50 |
| Other buildings | 3.00 |
| Machinery (in general) | 10.00 |
| Gasoline agricultural equipment | 20.00 |
| Trade motor vehicles | 12.50 (straightline) |
| Other motor vehicles | 12.50* (straightline) |

*Up to J$400 per annum; aggregate J$3,200.

In addition, an initial allowance of 20 percent of cost is granted in the year of purchase for industrial buildings and for plant and machinery. The initial allowance is deducted from the cost of assets in calculating depreciation to be taken in subsequent years. In other words, for these assets, 20 percent of cost is expensed and 80 percent is depreciated.

Even more advantageous "investment allowances" and "special investment allowances" are provided in lieu of initial allowances for certain types of investments in selected industries. (The term "special" is employed here to distinguish between the 40 and 20 percent bonus allowances). Both of these allowances are "bonus" allowances that need not be deducted from cost in determining annual allowances in future years. Investment allowances of 20 percent apply to investment in buildings, plant, and machinery in basic industries--essentially a range of manufacturing activities, construction, power generation, warehousing and cold storage, and docks. The special investment allowances of 40 percent of cost apply to qualified investments in the manufacture of sugar, cane farming, passenger docks, and certain other farming. Whereas initial and annual allowances are recaptured when assets are sold at a price exceeding depreciated value, investment allowances and special investment allowances are not recaptured. Special investment allowances can be set off only against income from the activity in which investment occurs.

Objectives. As is the case with the personal income tax, taxation of company income can be appraised under either of two models: taxation of income or taxation of consumption. Moreover, under the income tax model the goal can be integration of the company and personal taxes or a classical (separate) system. The choice between these objectives has potentially important implications in terms of distributional equity, neutrality of resource allocation, effects on saving, investment, and development, and the simplicity of tax administration and compliance. (This is explained in the next paragraph). Once the choice of models is made, the objective of tax policy should be to realize that model as completely as reasonably possible. This will prevent unintended violations of horizontal equity and social views of vertical equity, distortions in the allocation of resources, and even complications in compliance and administration. The description of problems in the next section is predicated primarily on comparison of the existing Jamaican tax with a pure income tax. The consumption-based model is discussed above.

Problems: Income Tax Model. The present treatment of capital consumption allowances raises a number of inter-related concerns that deserve further investigation. First, even in the absence of inflation, some of the depreciation allowances may be less generous than required to approximate loss of economic value. (For example, non-industrial buildings other than those of reinforced concrete are implicitly assumed to lose three percent of value each year, on a declining cost basis. This rate of tax depreciation seems far too slow in the case of wooden structures.) Where this occurs, tax-free recovery of capital does not occur and the income tax, in effect, becomes, in part, a capital levy. Moreover, to the extent that depreciation allowed for tax purposes differs significantly from economic depreciation in ways that differ systematically between types of assets, investment choices are distorted. Initial allowances help to offset the inadequacy of depreciation allowances, and they are inherently neutral in their impact on investment choices. But they are conceptually inconsistent with the taxation of income, rather than consumption.

Second, in a time of rapid inflation, any tendency toward failure to allow tax-free recovery of investment is aggravated by the use of historical cost as the basis for depreciation. The availability of initial allowances partially offsets this tendency, but only for the types of investments for which they are allowed. The existence of investment allowances and special investment allowances that do not reduce the value of assets subject to subsequent depreciation compensate for the inflation-induced erosion of depreciation allowances, but introduces a further element of distortion. In particular, whereas initial allowances that reduce the depreciable base are neutral with regard to the choice between long and short-lived assets, investment allowances that do not reduce the depreciable base discriminate in favor of short-lived assets. Moreover, these bonus allowances are, at best, a very crude way to compensate for inflation. These allowances are

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discussed further in the section on industrial policy and tax incentives.

If depreciation for tax purposes exactly equalled economic depreciation, the current deductibility of interest expense would be entirely appropriate in a world without inflation. But if all investment could be expensed immediately, allowing interest to be deductible would result in negative tax rates on income from debt-financed investment. While theoretical arguments can be constructed for negative income tax rates, it generally seems that social priorities in the use of scarce resources--not to mention tax equity--are likely to be better served if they are avoided. Where expensing is partial, as under the initial allowance, only part of interest should be allowed as a deduction, if negative rates are to be avoided. The implication of this analysis, which is complicated by the existence of rapid and variable inflation, is that the combination of debt finance with initial allowances--and allowances--can result in low or even negative rates of tax on income resulting from affected investments. This tendency is accentuated by the recently enacted exemption of bank interest, which is discussed further below.

The existence of inflation also has important implications for inventory valuation and the treatment of interest income and expense. First, the mandatory use of FIFO for tax purposes in a time of rapid inflation means that the cost of goods sold can be seriously understated and taxable income can be significantly overstated. LIFO reflects costs of goods sold more accurately and therefore reduces the overstatement of income.

If prices are stable, it is entirely appropriate to include interest in taxable income and allow it as a deductible expense in calculating taxable income. But if inflation is expected, interest rates adjust to reflect the loss of real value of principle. To the extent that this inflation premium, as well as the real rate of interest, is subject to tax, the income tax is, in effect, a tax on principle. Conversely, deduction of the full nominal rate of interest allows a debtor to deduct part of his implicit repayment of capital, as well as the real interest he is paying. In either event, real income is mismeasured. Where inflation is moderate the mismeasurement is not significant. But at a rate of inflation such as those experienced recently in Jamaica, the mismeasurement can become cause for concern.

The Jamaican income tax contains a number of standard provisions intended to prevent understatement of income and underpayment of tax through various kinds of manipulation, including transactions between affiliated persons and firms. But apparently only some 3 percent of company returns were audited in [illegible]. Given what appears to be a low level of administrative capability, one must wonder to what extent these statutory safeguards really work as intended. Even in the traditional areas of concern--interest, [illegible] and transfer prices on transactions [illegible] other areas, including especially industries benefitting from various types of industrial incentives, where the tax administration may not even realize there are potentially serious problems. These potential problems are discussed further below.

The interaction between the personal and company taxes deserves attention at several levels. The most obvious of these is the present provision for partial relief from double taxation of dividends. Though this is not necessarily a problem areas in the same way that others discussed in this section are, it certainly deserves further study, as noted below. Complicating the situation is the fact that since early 1982 all interest on bank deposits of individuals has been legally exempt. Thus, any tendency for partial dividend relief to eliminate the tax discrimination against equity finance has been more than offset. In addition to the obvious stimulus for legitimate saving via banks and other savings institutions, which by itself should encourage the use of debt, relative to equity finance, this exemption opens the door to massive tax avoidance via tax arbitrage. First, any entrepreneur considering investing in his own firm would be foolish to make an equity investment, since any return would be taxed at both the company and personal level (if distributed). Instead, he could place the money in a bank account paying tax-free interest, using the account as collateral for a loan to his company at a comparable interest rate. Under this scheme the entrepreneur would not pay tax on the return to investment; rather, since the interest paid to the bank by his company would be a deductible expense, only the excess over that rate would be taxable at the company level (and at the personal level, if distributed). In extreme cases the taxable profit would be converted to a deduction to be offset against other income. Another version of this arbitrage scheme would involve borrowing via the company, lending to its owner, and reinvesting the funds in an exempt account.

The lack of capital gains tax is commonly seen as a problem, primarily in the taxation of individuals. In fact, it has important ramifications in the area of company taxation and its relation to the taxation of individuals. Even in countries where capital gains are merely taxed at preferential rates, rather than actually being legally exempt, there are well-developed techniques for converting ordinary income into capital gains. Such approaches are easily translated to developing countries that exempt gains from tax, especially if tax administration is weak.

By law, most payments companies make to (or on behalf of) employees are taxable to employees, as well as deductible to employers. Among the legal exceptions are housing expenses in excess of 10 percent of emoluments and holiday allowances. It appears, in fact, from all accounts, that non-housing allowances are being paid to (or for) employers against which no withholding is being made for P.A.Y.E. Moreover, recipients are said not to include such allowances in taxable income, even if they cannot support deductions, as required by law. Indeed, unions apparently bargain for sizeable portions of all remuneration to be paid as allowances. Finally, it is said that the self-employed use this approach to evade taxes by having their own companies pay to themselves deductible allowances on which they do not pay personal tax.

The Object of Study. The analysis of capital consumption allowances under the income tax should proceed on several levels. First, existing patterns of depreciation allowances should be analyzed to see how closely they correspond to actual patterns of loss of economic value. Studies of this type have been made in developed countries, but their transferability to the Jamaican context must be investigated.

Second, consideration should be given to various means of dealing with the erosion of depreciation allowances based on historical costs that occur under rapid inflation. Among the possibilities to be considered are replacement cost depreciation, indexing of depreciation allowances, accelerated depreciation, and immediate expensing. Whereas the first three of these are most usefully seen as ways of dealing with capital consumption allowances under an income tax, the fourth is inherent in proposals to base taxation on consumption, rather than on income. (See also the discussion of consumption-based taxation in the second part of this section.) Under immediate expensing inflation cannot erode the value of capital consumption allowances. Of course, partial expensing can be combined with depreciation, as with the Jamaican system of initial allowances.

Most approaches to dealing with the problem of inflation-adjustment of depreciation suffer from one fatal defect: they do not address the liability side of the balance sheet. (In other words, when businessmen complain that depreciation allowances have been eroded by inflation, they usually do not bother to mention that the value of their outstanding debt has also been eroded.) Both horizontal and vertical equity and efficiency in resource allocation demand that indexing be extended to both sides of the balance sheet, if it is allowed for one. On the other hand, administrative simplicity may dictate that this conceptually preferable approach is not really feasible. One aspect of the project will be to investigate experience in other developing countries where various approaches to indexing of the tax system have been employed. This will assist judgement of whether such extreme steps are called for in Jamaica.

A number of standard equity and efficiency arguments can be made in favor of an integrated system of taxing corporate income and against a classical system, under which separate taxes are imposed on corporate profits at the company level and on dividends at the shareholder level. Against these must be considered the greater simplicity of the classical system. Indeed, complete integration (for retained earnings, as well as for dividends) is commonly thought to be administratively infeasible, and integration is, at most, extended to part or all of corporate income flowing into dividends. The Jamaican system follows this approach, by allowing the [illegible] to be offset against the withholding tax on dividends.

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The project will examine the present system of partial dividend relief, in comparison with a) a classical system, b) complete relief from double taxation of dividends, and c) complete integration. There is some reason to believe that complete integration may actually be easier in a developing country characterized by concentrated ownership of (predominantly closed) corporations than it is in a developed country where equity ownership is widespread and primarily in large open companies.

In any system of integration or dividend relief it is necessary to decide how to treat tax preferences (exempt income and credits and deductions not required to define economic income) that occur initially at the company level. That is, should the advantages of tax preferences be available only to the extent that preference income is not distributed? And in what order should preference income and fully taxed income be assumed to be paid out? Incentive legislation provides that income earned during a tax holiday is exempt to shareholders when distributed during the holiday. By comparison, the general income tax law appears to follow the British model under which preferences are nullified if preference income is distributed, but taxable income is, in effect, implicitly assumed to be distributed before preference income. Whether this is the most appropriate way to deal with this issue deserves attention, as does the treatment of dividends paid from tax holiday income.

In the Jamaican context, integration may not be the most important question involving the relationship between the company and individual income taxes. As noted earlier, there appear to be many instances in which companies may be taking deductions for payments to or for employees that the latter are not reporting in taxable income. It is entirely possible that it would be more feasible to disallow deductions for such expenses than to attempt to include them in the taxable income of employees. This is particularly true where valuation of fringe benefits provided in kind is involved.' Thus, the study will consider a variety of alternative ways of dealing with this problem, including a) withholding on fringe benefits under P.A.Y.E., b) reliance on closer auditing of individual returns, without inclusion of benefits under P.A.Y.E., and c) disallowance of deduction for fringe benefits at the company level. Of course, disallowance at the company level has no impact if the firm--including the government and firms benefitting from tax holidays--pay no tax.

An even closer merging of the company and individual taxes would involve collecting taxes on certain types of income at the company level, through disallowance of deductions, rather than at the personal level. For example, all interest income might be exempted at the personal level, but made non-deductible at the company level. In extreme versions of such proposals, individuals would pay tax only on wages and salaries and self-employment income, and companies would be allowed deductions for only capital investment, goods and services, raw materials, and wages and salaries. (Withholding could be applied to wages and salaries, and individuals could be allowed personal credits or deductions.) Fringe benefits, interest payments, and dividends would not be taxed to individuals and they would not be deductible to companies. In effect a) the corporate and personal income taxes would be completely integrated and b) the income tax would be converted to a consumption tax. Under such a system progressive rates could apply only to wage income, since all other income would, implicitly, be taxed at the company rate. A component proposal for systems of this type is therefore commonly a flat uniform rate applied to all taxable income of both companies or individuals.

While this approach has clear administrative advantages and is probably more neutral than the income taxes imposed in most countries, it is often criticized because of being less progressive than existing taxes because it eliminates double taxation of dividends, it is based on consumption, rather than on income, and it may be levied at a flat rate. Moreover, there may be problems in the taxation of multinational corporations. (For example, disallowance of interest expense and fringe benefits as deductions might reduce the attractiveness of the island to investors and jeopardize the credibility of the tax in the United States. The second of these could probably be handled by a generalized system of withholding, but the first deserves further attention.)

An approach as novel as this, while attractive in many respects, could not be proposed lightly. Thus, one aspect of research must be a thorough investigation of the administrative simplification it would allow, the reduction in economic distortions it would entail, and the difference in tax burden under this scheme, as compared to both the present income taxes and incomes taxes that had been reformed administratively, as well as structurally. A particularly important question is whether the administrative advantages could be realized without sacrifice of a graduated rate structure. Any such analysis would, of course, need to consider carefully the implications of the large role multinational firms and firms subject to tax holidays play in the Jamaican economy.

## Research Activities and Outputs

The main outputs of this research will be, (a) an analysis of the alternative approaches to income tax reform, as noted above, with recommendations to the GOJ; (b) an implementation plan, developed in conjunction with the GOJ, including legislative drafting, tax administration assistance, and training; and (c) implementation. In order to produce these outputs, a number of special studies will be required. Our initial proposal is for these studies to include consideration of the tax treatment of the following:

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a. taxation of the self-employed;
b. taxation of untaxed fringes;
c. the structure of credits, exemptions and deductions;
d. capital gains and transfer taxes;
e. capital consumption allowances;
f. inflation adjustments;
g. legal shortcomings of the current system.

## Industrial Policy and Tax Incentives

### Description

Jamaica currently provides a variety of tax incentives intended to encourage particular economic activities. The present program of tax concessions, with some modification, dates from 1956. Jamaican policy, particularly in the area of tax holidays and import duties, have been constrained somewhat by its obligations as a member of the Caribbean Common Market (CARICOM) since 1973.

The most prominent incentives under the income tax are the tax holiday provisions and investment allowances. Protection of production for the domestic market is provided by the combination of quantitative restrictions and custom duties applied to imported final goods and the customs exemptions for imported raw materials and capital goods. (General incentives to saving found in the personal income tax are covered below). Running counter to efforts to encourage both import substitution and export promotion is the maintenance of an over-valued exchange rate.

Tax holidays of six to ten years (up to 15 years for convention-type hotels and factories sited in selected geographic locations) are granted for manufacturers of certain products, producers of non-traditional exports, agriculture and hotels. Dividends paid out of profits benefitting from tax holidays are also exempt to Jamaican shareholders, up to the level of the company tax that would be paid. Dividends paid to non-Jamaicans from holiday profits are taxed only to the extent that they are taxed in the country of residence of shareholders. (This provision is presumably intended to take advantage of any foreign tax credits that would be available to shareholders in the U.S., and perhaps elsewhere, and of "tax sparing" provisions in the laws of other developed countries.) Losses sustained during the holiday period can be carried forward to the first six years following expiration of the holiday. (The law is unfortunately vague as to whether it is all losses incurred during the holiday period, or only net losses, after offsetting profits during the period. A court has recently decided in favor of the latter interpretation.) Firms locating in the Kingston free trade zone also benefit from special tax exemptions.

The treatment of depreciation under Jamaican incentive legislation is complex and not easily characterized. Investment in production eligible for six and seven year tax holidays must be depreciated according to normal rules during the holiday period, even though the allowances carry no tax benefit (unless they contribute to a loss that can be carried forward beyond the holiday period). By comparison, depreciation on investment used in industries benefitting from holidays of at least ten years can be postponed entirely to the post-holiday period. (Besides reducing post-holiday taxes, this increases the amount of profits that can be distributed tax-free to shareholders.) The investment allowances provided for investment in "basic industries" are described below on the company income tax. Of course, these are generally not available to holiday firms.

The length of the tax holiday depends on the projected effect on employment, local value added, net earnings of foreign exchange, and efficiency (the comparison of costs of local production with the price of imported substitutes). In calculating local value added, extra weight is given to local labor costs. Particularly important is the fact that, by law, a tax holiday cannot be granted for the establishment of new production in an industry in which 60 percent of local demand is already being supplied domestically. Finally, between 25 and 50 percent of profits of a firm that does not currently qualify for a holiday can be exempt from tax, on a sliding scale, if as much as 10 percent of profits are from exports.

Holiday status carries with it exemption from import duties on raw materials and capital goods (but not from the 10 percent stamp duty levied on the value of imports). Raw materials and machinery used in the production of certain items are exempt from customs (and stamp) duties, even if the firms do not have holiday status. Such imports accounted for roughly 88 percent of all Jamaica's imports, by value, from 1979 to 1981. (More than half of the remaining 12 percent was food, in each of the three years.) These exemptions, combined with outright prohibition, quotas, and/or duties on imports of finished products, result in extremely high rates of effective protection for production for the domestic market.

Agriculture is favored in several ways. First, tax holidays of five to nine years (depending on local value added as a fraction of gross sales) are provided for some crops. Farmers eligible for tax holiday also get exemption from import duty on fertilizers, insecticides, and equipment. Agricultural companies that do not benefit from holidays pay a corporate tax of 35 percent (including ACPT), rather than the standard 45 percent. Finally, qualifying capital investment is allowed a 40 percent special investment allowance.

Objective

The purpose of tax incentives should be to stimulate increased employment and exports at a reasonable fiscal cost. Policies that

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unduly encourage capital-intensive methods of production should generally be avoided, since they do relatively little to increase employment, and they may aggravate the inequality of income distribution. (An exception would be capital-intensive activities that have linkages to activities that are highly labor intensive.) In addition, incentives should be designed in such a way that they are relatively immune from manipulation that results in increased fiscal cost and decreased effectiveness.

Problems

In addition to the basic question of whether they constitute good economic policy, the incentives found in Jamaica raise potentially serious administrative questions. Of course, the actual economic effects of a given incentive scheme depend crucially on whether it can be administered effectively and the nature of any administrative defects. Questions of economic policy and of administration of incentives under the income tax are discussed in turn. Administration of customs exemptions is discussed below

Economic Policy. The policy of import substitution that was so prevalent throughout the Third World during the 1960s has been thoroughly discredited. This is especially appropriate in Jamaica; given its small market, there are few opportunities for significant economies of scale, and these were soon realized. Once this happened, industrialization lost its momentum and stagnation replaced dynamism. By comparison, economic development based on exports faces virtually unlimited opportunities for expansion. The success of such countries as Hong Kong, Singapore, Taiwan, and Korea bear witness to the superiority of a strategy of export-led growth over one of import substitution.

How far policy in Jamaica has deviated from favoring exports--or even neutrality towards various economic activities--can be seen from the coefficients of effective protection calculated for 1978 reported in Table 1. With a few exceptions (notably garments and furniture), firms producing for the Jamaican market could charge substantially more than the cost of comparable imports would warrant, if they were available. A similar pattern prevailed for exports to the CARICOM market; though the level of effective protection-export promotion was generally much lower and subject to less variation between products, production for this regional extension of the domestic market was, on average, favored by policy. The big difference occurred in the column for non-CARICOM exports. Policy was, at best, neutral toward production for exports beyond the region, and in some instances it was quite punitive. It is thus hardly surprising that Jamaican entrepreneurs look first to the domestic market, next to the CARICOM market, and hardly ever to the larger non-CARICOM export market.

This natural preference is accentuated by the provisions of incentive legislation that prohibit tax holiday status to new firms if 60 percent of the local market is already being supplied from domestic sources. If tax holidays and customs exemptions on capital goods and raw materials were freely available <u>and</u> the domestic market were large, competition might be expected to eliminate extraordinary profits in import substituting industries. In fact, the market is small, even if all CARICOM is included, and tax incentives are not freely available. As a result in many industries there are only one or two domestic firms and competition from imports is inconsequential. Thus one would expect to see extraordinary profits, rather than merely high costs of production, in production for the domestic market. Since the external market contains no similar high-yield havens for Jamaican exports, it is doubly unattractive. To some extent it may be possible to stimulate interest in exports by reducing the shelter currently provided to those producing for the domestic market.

Jamaica's primary question of economic policy in this area is how (and how fast) to convert from a policy of import substitution to one of export promotion. Subsidiary questions involve a) the choice of economic activities to target for export promotion and b) the policies that should be used to spur exports, and c) the careful design of whatever incentives seem appropriate to implement such a policy. The second and third of these are as important as the first, in that improper--or poorly designed--incentives can be largely ineffective, and yet have substantial revenue costs, and they can have adverse side effects. For example, nothing is gained from subsidizing (or failing to tax) export activity that would have occurred anyway. Even worse, export incentives that are geared to the use of capital, as is commonly the case, can encourage the substitution of scarce imported capital for abundant local labor, and therefore have less impact on employment and local value added than would an equally expensive scheme targetted more directly toward employment.

<u>Administration of Income Tax Incentives.</u> In many countries where tax holidays are allowed there is a natural tendency to pay relatively little attention to the national tax accounting of firms still in their tax holiday periods. Since no revenue is to be collected from such firms, the tax administration may believe that scarce resources should be devoted to other sectors. Inattention to tax holiday firms can, however, facilitate a wide variety of forms of tax evasion. A few hypothetical examples will illustrate the nature of the problem. Whether (or how much) these particular abuses--and other--actually occur in Jamaica will be one subject of investigation in the project.

Suppose that one taxpayer owns two different companies, one of which benefits from a tax holiday and one of which does not. If the exempt company buys locally produced raw materials, rents office or manufacturing space, or borrows from its tax-paying affiliate at less than arms' length prices, rents or interest rates, profits are shifted from the taxpaying firm to the commonly owned holiday firm, where they will be exempt. In other words, exactly the same problems of transfer prices on transactions between affiliated firms that occur in the international sphere are imported into the domestic economy when tax holidays are allowed. The Jamaican income tax act contains provisions for adjustment of terms of transactions between affiliates found not be at arms' length. The question is whether these are actually employed to prevent abuses such as that described.

A second potential abuse involves the 20 percent investment allowance and the 40 percent special investment allowance provided for capital expenditure on assets to be utilized in selected industries. Such allowances would be valuable to a tax holiday firm only if they could be taken after expiration of the holiday. But it appears that manipulation might allow a taxpayer to benefit simultaneously from both the tax holiday provision and the 20 to 40 percent investment allowance. In such a case, the marginal tax rate applied to the income involved would not be merely zero; it could be significantly negative.

In broad outline this scheme could function by having a taxable entity buy debt financed equipment and lease it to its tax-exempt affiliate. The taxable firm would benefit from the interest deduction, the investment allowance, and annual depreciation allowances, items that would generally be of low value to its exempt affiliate. This scheme is attractive even if the lease occurs on an arms' length basis; it is even more attractive if the lease fee is artifically low. Indeed, the extreme version of this scheme involves no lease at all. The equipment is bought by the taxable firm, but actually employed by the exempt affiliate (or is bought by a taxable firm, ostensibly for use in taxed activities, but is actually used in exempt activities). Whereas the leasing approach might attract the attention of the tax administration, this less subtle form of fraud might not, as it would require on-site inspection of the uses of plan and equipment benefitting from allowances.

The Object of Study

The purpose of the study will be to determine a) the facts about administration of tax incentives under the income tax and b) the economic effects of incentives, once administrative realities are taken into account. The analysis of administration will focus on ascertaining how widespread and fiscally costly are abuses such as those described above and on framing proposals for the prevention of abuse. Of course, to the extent that policy analysis suggests that incentives should be phased out or take new forms, suggestions for administrative reform will be unnecessary or will take different forms. But even if incentives were eliminated prospectively at once, administrative reforms might be needed to prevent abuses during the remaining years of existing holidays.

Analysis of incentive policy should focus on at least three elements: income tax incentives, customs duties and quantitative import restrictions, and exchange rate policy. Such related matters as credit policy (for example, export finance) may also properly be included. Though analysis of these three (or more) elements may require specialized expertise, an overview of incentive policy is required, in order that the complementary or offsetting effects of various policies can be assessed. Moreover, the analysis of incentive policy must be coordinated with the general study of the income taxes.

Among the questions to be asked about both income tax and foreign trade incentives are how they affect the relative attractiveness of various economic activities, (imports, exports, various forms of manufacturing, agriculture, tourism, etc.), how they affect choices of production techniques (especially the choice between labor and capital intensive techniques), their distributional consequences, and their fiscal cost in terms of foregone tax revenue. The purpose will be to examine whether incentives are properly structured to stimulate the right activities, using technology appropriate to Jamaica, at reasonable fiscal cost. As noted earlier, the analysis will be based on an understanding of how the incentives operate in practice, rather than on an abstract description that takes no account of administrative realities and schemes to minimize taxes.

Implementing the Study

The standard approach to the study of the effects of tariffs and quantitative restriction is the calculation of rates of effective protection. Essentially this indicates how inefficient a domestic firm can be and yet compete with imports. Analysis of this type for Jamaica is hampered by the deficiencies of available input-output tables. Work reported in Made in Jamaica, by Mahmood Ali Ayub (1981), should, however, provide a useful starting point for this analysis. Of course, the effects of movement to (and maintenance of) the parallel market for foreign exchange must be incorporated in any such study, since maintenance of an over-valued exchange rate reduces the protection provided by tariffs (see Table 4).

Much of the same approach should be employed in the examination of policies to promote exports. "Effective promotion" would indicate the extent to which various kinds of domestic production for export is being subsidized (or taxed). Analysis may reveal that the overvaluation of the Jamaican dollar is offsetting all policies intended to stimulate exports.

Given that virtually all Jamaican incentives under the income tax are geared to either stimulating investment or exempting capital income from tax, a useful place to start in analyzing them is to calculate effective tax rates on income resulting from investment in the favored activities. These can then be employed to estimate effects on the relative costs of labor and capital and incorporated in estimates of

TABLE 4

EFFECTIVE PROTECTION COEFFICIENTS FOR DOMESTIC AND FOREIGN SALES, 1978

| | Domestic Sales | CARICOM Sales | Extra-Regional Sales |
|---|---|---|---|
| Food Processing | 1.53 | 0.98 | 0.90 |
| Beverages | 3.19 | 0.64 | 0.85 |
| Tobacco | --- | --- | 0.65 |
| Garments | 1.02 | 1.27 | --- |
| Footwear | 1.77 | 1.16 | --- |
| Leather Goods | 1.47 | 1.38 | --- |
| Furniture | 1.01 | 0.99 | 0.99 |
| Building Materials | 1.84 | --- | --- |
| Paper and Paper Products | 2.09 | 1.25 | --- |
| Jewelry | 1.16 | 1.00 | 1.00 |
| Rubber and Plastics | 1.89 | 1.14 | 1.00 |
| Metal Products | 1.54 | 1.14 | 0.55 |
| Chemicals | 1.17 | 1.13 | 0.99 |
| Pharmaceuticals and Cosmetics | 1.48 | 1.40 | 0.99 |
| Electrical Appliances | 2.35 | 1.96 | 1.07 |
| Overall Manufacturing | 1.68 | 1.19 | 0.90 |

SOURCE: Mahmood Ayub, *Made in Jamaica*.

effective stimulus of import substitution and exports. Moreover, they can be used to indicate distributional consequences of incentives. In making such estimates of effective tax rates, account must be taken of a) tax exemption during the holiday period, b) carryover of losses and depreciation and other capital consumption allowances until the tax-paying period, c) investment allowances available to firms in activities that do not benefit from holiday legislation, d) flow-through of tax preferences to shareholders, and e) schemes such as those described above that allow manipulation of incentives to multiply their benefits. Where possible, conceptual analysis will be supplemented with data from firms actually benefitting from incentives. But if, as suspected, monitoring of holiday firms is lax, data from such firms may be rather incomplete, inaccurate, or otherwise unreliable.

The study of income tax incentives in Jamaica must take account of the tax treatment accorded holiday income in the home countries of multinational firms. Clearly Jamaica should make full use of foreign-tax credits and tax sparing allowed by developed countries. Allowing tax-free distribution of holiday income to foreign shareholders only if the income is not taxed in the home country may be an effective way to do this, but it deserves further study.

## Indirect Taxes[1]

The system of indirect taxation in Jamaica has four major components: customs, excise duty, consumption duty, and retail sales tax. The importance of indirect taxes in the Jamaican revenue system has at least four dimensions. First, these taxes are the major source of revenue, extracted from the Jamaican people. Secondly, it seems likely that there will be some substantial short-term pressure to increase revenue from domestic sources in Jamaica, and, if so, the revenue increases will likely be gained through alterations in the indirect taxes. It is therefore particularly important that this is examined very closely. Third, it is extremely important that the elasticity of this important portion of the revenue system be maintained at a high level, so as to avoid constant rate changes. Finally, largely because of its importance--but also owing to its complexity and obviously unplanned nature--the indirect tax system in its present form undoubtedly has substantial undesirable effects on resource allocation

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[1] There are two earlier reports on indirect taxation in Jamaica, that we know of. Fiscal Affairs Department, International Monetary Fund Taxation in Jamaica, January 29, 1979; and Charles McLure Indirect Taxation in Jamaica, 1973 (a report submitted to the Ministry of Finance of Jamaica, August 24, 1973).

and on income distribution. An important aspect of the planned study must therefore be to bring these issues into the open, and also to consider carefully the implications for both resource allocation and distributions of alternative structures that may be considered.

Customs duties are minor revenue producers at the present time but this does not mean that the customs office is unimportant from the point of view of the indirect taxes: on the contrary, it is probably extremely important in that a significant part of the revenue base of domestic taxes resides in imports which are counted and valued in the customs office. Moreover, from the point of view of resource allocation, some of the effects that must be examined most closely concern the coordination of direct and indirect taxes and the effects this has on the utilization of Jamaican resources. An important part of the proposed study therefore concerns a careful examination of the structure and effects of Jamaica's foreign trade regime in conjunction with its indirect tax and subsidy regimes, and of course an examination of the customs system forms one part of this.[1] In addition, there are reportedly significant problems with customs administration which are likely to spill over into both excise and domestic sales tax administration in one way or another and must be looked at for that reason as well as owing to the importance of the customs system as such.

Although Jamaica's indirect tax system is not unusual in there being more than one tax on particular products or heavy concentration on a relatively limited number of products--both characteristics which are common to developed and less developed countries alike--it is undoubtedly correct that the Jamaican system is unusually complicated and can stand significant structural revision. The complicated rate structure with both specific and ad valorem rates, the apparent almost complete reliance of the tax administration on excise techniques--which are suitable and certainly should be retained in some cases but cannot be extended to all parts of the indirect tax structure--indicate that at least very careful examination and almost certainly restructuring of the basic indirect tax system is required.

This study will take three forms. First, there should be a careful study of the suitability of a general sales tax in a country like Jamaica in general, and in Jamaica specifically, with particular attention to the level and form such a tax might take. In addition, however, it will be particularly important to study closely the excise commoditi[illegible] which produce the major part of the revenue under the present system a[illegible] which in all likelihood will continue to do so for some years to come. It is therefore important that there be special studies of the traditional sumptuary taxes on alcohol and tobacco as well as those on petroleum products and motor vehicles. The first two of these products

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[1]See also the discussion under "Industrial Policy" above.

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are perhaps more important for their distributive implications than for their resource allocation implications, but the third group needs to be examined closely in terms of efficiency and resource allocation effects. In all likelihood it will be appropriate to retain particular forms of special taxes on these groups of products, even if a general sales tax is put into effect.

With respect to a general sales tax as such, a question that requires particular examination is the possible broadening of base to include services. It is not clear, for example, that service taxes of the sorts discussed in some of the existing reports on this matter can be easily tied into a manufacturers level tax. The administrative aspects of maintaining separate excise and customs systems together with a general sales tax, the differing kinds of skills required to administer these types of taxes, and the possibility of administrative improvement over the next few years, are all matters that will have to be considered very closely in designing an appropriate indirect tax structure for a country such as Jamaica.

In addition to these general reports, there should be a particular studies of

-- taxes on automobiles and petroleum products,

-- taxes on the traditional sumptuary excises on alcoholic beverages and tobacco,

-- the coordination between excise taxes and more general sales taxes,

-- the coordination and relation between the sales tax and the customs duties,

-- the resource allocation effects on the foreign trade and indirect tax systems as a whole, both as they now exist and with respect to the various alternatives that might be considered.

-- the administrative aspects of all existing taxes and possible tax changes, both because of the difference between excise and sales tax administration mentioned above and because of the extent to which administrative possibilities will limit what can be done, particularly in the general sales tax area.

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## Wealth Taxes, Housing Taxation, and Related Problems

The principal forms of wealth taxation in Jamaica are property taxes and motor vehicle taxes. There is no income tax on capital gains, but there is a transfer tax which is somewhat of a substitute, but also can be considered a tax on the transfer of wealth. It is also the case that there are numerous and complex links between the entire Jamaican tax system and the housing sector.

The wealth taxes will be considered with a series of studies under the supervision of Professor Daniel Holland. Professor James Follain will analyze the relationship between the tax system and the housing sector and assist in the study of the land price index.

## The Property Tax

### Background

Property tax, in principle, should be one of the major sources of revenue in Jamaica. It is the primary tax on wealth, and, unlike other revenue measures, its base is easy to identify because it is visible and not moveable. Moreover, a tax on property would catch those people, many it appears in Jamaica, who slip through the income tax net. And, because provision of infrastructure and current services raises the value of property, it is appropriate that this base be used to support the government budget.

However, the property tax has never been an important source of revenue either earlier when it was levied on capital value or more recently on unimproved land value. When the unimproved land value base was adopted and the valuation exercise Land Val 74 provided a property tax roll based on current value, it was the expectation that a greater portion of the property tax's revenue potential could be tapped. But while in the first several years that followed property tax revenues did increase, in the last five years property tax has been on dead center. Between fiscal 78 and fiscal 82, property tax receipts rose by 17 percent, while the Consumer Price Index rose by 150 percent. Other taxes responded more buoyantly. Property tax receipts fell from a modest 5 percent of total tax revenue to an insignificant 2.5 percent.

These were not good years in Jamaica; land values did not boom as in the past. But a major reason for the poor revenue response of property tax lay in the constancy of the assessed values from 1974 on. With assessments unchanged and nominal rates constant, with inflation the tax has remained unproductive for government, and has become a continually smaller burden for taxpayers.

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A new valuation exercise is underway, scheduled for completion in 1983. It will be adopted for property tax bills due April 1984. Ten years between valuations is too long. The departures between market and assessed values that develop over time lead to strong inequities among taxpayers, and destroy the credibility of the tax.

But with the new valuation these disparities will have been taken account of. The property tax could become a more powerful revenue source. This is a very appropriate time, therefore, to reconsider its role in the revenue structure.

## Problems to be Studied

### A. Unimproved Value Versus Capital Value

A major argument for converting the property tax from capital value (the value of land and the improvements thereon) to unimproved land value was that the latter would force idle lands into productive use. Some have argued that a cursory inspection is enough to indicate that the tax has not accomplished this objective, and urge on this and distributional grounds (noted in an ensuing paragraph) that Jamaica should revert to taxing capital values.

But put this way the criticism is too strong; one can hardly argue that this last decade has been appropriate to evaluate the experiment. A lack of investor confidence and the unavailability of funds joined to discourage development of vacant land or further improvements on properties already built on.

"Forcing idle lands into productive use" is a special and extreme argument for the unimproved value base. The more general supporting argument is, simply, that a tax base on unimproved values would not deter development, whereas a tax on the capital value base would. The tax on capital value would increase with the degree of development. The land value tax would not.

Additional grounds for favoring a tax on unimproved land lie in its relative simplicity and lower cost of administration. The Commissioner of Valuation has estimated, very roughly, that it requires at least three times the resources he presently has (with an even higher multiple applied to such skilled and scarce categories of personnel such as professionally qualified property valuers) to undertake a valuation on the capital value base of Jamaica's 540,000 parcels.

This is an important consideration, but it is not definitive. If there would be substantial benefits in other respects from switching to the capital value base, the additional cost of doing so could be a good investment.

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Setting the revenue to be raised from a property tax at a given figure, either base could be used to raise that sum. Under both bases those parcels with an "average degree" of development would bear the same tax. If on such parcels, for example, improvements are three times as valuable as land, a capital value tax of 1 percent or a land value tax at 4 percent would result in the same tax liability. On other properties, of course, the two bases would result in different tax liabilities. On properties that have a below average degree of development, the land value tax would be heavier, while on properties that have a higher than average degree of development the capital value tax would be heavier.

There is concern, therefore, that a tax on unimproved value may result in a pattern of burden distribution that does not appropriately reflect "ability to pay," if, by that phrase, we mean the value of both land and the improvements on it. How serious is the difference between the two bases, and what kinds of properties are particularly affected? The only way to answer these questions is to develop the "facts". A start was made on such a study in a report by O. St. Clare Risden, then (April, 1977) Commissioner of Valuations (and now Permanent Secretary of the Ministry of Mining and Energy). But values could have changed very much since then. By September, 1983, we will have a new set of values, and a more extensive sampling is in order.

## B. A Classified Property Tax

Information will be developed in the new land valuation that would permit a greater degree of "fine-tuning" in setting property tax rates to meet GOJ objectives than has yet been possible. Presently, one rate applies to all uses of property with departures therefrom provided by a system of reliefs sometimes based on categories of property use (e.g., agricultural land) and sometimes on particular circumstances of the taxpayer. In the new solution all parcels of land will be classified by use--residential, commercial, industrial, agricultural, etc. (and additionally by quality grades in each use category). This would permit development of a property tax whose rates varied with use and quality in that use. A "classified" property tax would permit a differential structure of property tax rates. Would this be useful in achieving GOJ objectives, in a more equitable distribution of the tax burden, in easing the administration of the property tax? And, if so, what would be the most appropriate structure for a classified property tax? And, finally, based on a selected sample of properties, how different would the burden distribution under a classified tax be?

## C. Rate Structure

Reflecting a concern with "ability to pay", Jamaica's property tax is levied at progressive rates with respect to each property. Above a certain minimum value, the higher the unimproved value the higher the effective rate (ratio of tax liability to value) on it. Some have argued that this feature of the tax is unacceptable, and recommended that

Jamaica should adopt the generally common practice in property taxation of a flat rate of tax for all properties. Others who think that the progressivity feature of the property tax currently does not go far enough, have urged that the tax be progressive with respect to the aggregated holdings of a taxpayer rather than with respect to each individual parcel he holds.

Arguments in principle will take us just so far. The fundamental question is "what difference does it make". To answer that question we need to develop the relevant information from a sample of properties.

Similarly we would need such a sample to answer more general questions about rate structures such as (these are illustrative only):

a. What rate schedule would minimize the difference between property tax based on the current valuations and the new valuations. (The Prime Minister has promised that property tax liabilities will not change significantly when the new valuations are made the basis of property tax.)

b. Suppose we want to double the revenue raised by property tax over the next three years: Develop alternative rate and exemption (or flat amount of tax) levels that will meet this objective.

## D. De Facto Differentials in Property Tax

There is currently concern that with the situation in the Corporate Area-Kingston-St. Andrew--taken as the benchmark (implicitly perhaps) for an appropriate schedule of property tax rates, conditions may vary so substantially across Jamaica that very different effective rates apply on similar kinds of properties in different parishes. We have been told, for example, that in Kingston on a plot worth $100,000, a $30,000 house may be "typical", whereas in Mandeville on plots valued at $10,000, the "usual" house may be worth $50,000. With one rate of tax prevailing over all of Jamaica, the homeowner in Mandeville compared with his counterpart in Kingston is not paying his "fair share" of the costs of public services. If the "facts" derived from samples of property reveal that this is a serious problem, the GOJ may have to think of supplementary parish rates, or a term in the formula for local grants that takes account of "tax effort", or user changes, or some other measures to modify the discrepancies.

## E. Exempt Property

One reason the property tax has raised a disappointing amount of revenue is that a good deal of the base is exempt from tax. We need a census of exempt properties, and a review of exemption policy based thereon to minimize erosion of the property tax base.

## F. Administration of the Property Tax

Whatever base is chosen and whatever rate schedule is decided on, the property tax will remain a meagre revenue source unless major administrative difficulties are remedied.

1. A substantial number of parcels on the property tax roll are under objection. As long as the assessed value is in dispute, collection procedures cannot be instituted.

2. A substantial amount of property tax is in arrears.

3. The collection process for tardy and reluctant taxpayers is cumbersome and unduly drawn out.

4. As noted earlier, a new valuation is underway, scheduled for completion in September, 1983, to be used in preparing the tax bills due April 1, 1984. Ten years between valuations is too long. The departures between market values and assessed values widen inordinately over time. And the base is frozen until a new valuation is made. It is hard to adjust rates to keep revenues as the price level rises because of the inequities that would result among taxpayers whose properties have gone up in value at different rates. Hence, the current perilous state of property taxation.

   Successful property taxation requires a mechanism for keeping values up to date. More frequent valuation is the obvious remedy. But valuations are expensive, and to undertake them every 3 or 4 years is about the most one could expect. Based on sales evidence and other relevant data sources, the Commissioner of Valuations plans to develop a land price index, which could be used to up-date values annually in the inter-valuation years. This is an interesting idea and should be pursued.

5. While development of land values for property tax is his primary responsibility, the Commissioner of Valuations is increasingly drawn into estimating capital values for transfer tax purposes and in other connections. For this purpose his office needs to build up a greater capability involving both more resources and training of personnel already attached to it.

6. A matter of growing concern to the Commissioner of Valuations is assessing the value of property under rental restrictions. Technical advice and training by assessors expert in this area of valuation would be helpful.

## How the Research Will Be Carried Out

Projects A through D will rely heavily on values drawn from the new valuation to be completed in September, 1983. They will also require capital valuations to be made by the Commissioner of Valuations and his staff to make up the sample of capital values to be compared with unimproved land values.

Projects F1, F2 and F3 will require the services of a property tax administration and collection expert. Projects F4 and F5 will require the services of a skilled assessor or appraiser, particularly experienced in the area of the study. Project F6 may also require the services of an economist familiar with the operation of a rent controlled market.

## Outcome of Proposed Research

This research is expected to generate the information, administrative procedures and technical competence that will enable the GOJ to get more revenue from the property tax, design a property tax more suitable for meeting its economic and social objectives, and keep the property tax on a more current basis, thereby making it a more reliable as well as productive revenue measure.

## Other Considerations.

1. The training requirements for the particular projects herein proposed have been noted above. In addition arrangements should be made to send members of the staff of the Land Valuation Division to various programs in assessing procedures, both urban and rural. And to follow these programs with on-the-job experience in an assessor's office. Some people in the Land Valuation Division have already had such training cum-experience. More should have that opportunity.

2. Funds should be provided to send a particularly promising member of the Land Valuation Department to a more extensive program in tax administration such as the course offered annually by the International Tax Program at Harvard University.

## Transfer Tax

All real and personal property tax transfers are subject to taxation, although many are not effectively taxed. The transfer tax seems to some degree as a substitute for a capital gains tax, it is 5 percent of the gross amount of the transfer, but not to exceed the capital gains on the transferral property.

But the transfer tax can also be considered a tax on wealth. And viewed in this light it is neither well designed nor effectively administered. The potential of wealth taxation deserves examination.

We propose to study the operation of the present transfer tax, its economic potential, and alternative "models" for taxing wealth. While Jamaica is not unique in failing to tax this base, there is no reason in principle why more revenue should not come from wealth. This is particularly the case for Jamaica, since a tax on wealth or wealth transfers could catch those who avoid income tax.

## Taxes and Housing

This aspect of the study will explore the numerous ways in which the Jamaican tax system interfaces with the housing sector. The three premier examples of this interface are the housing finance trust, the fringe benefit provision of the income tax that allows exclusion of employer provided housing from taxable income and the property transfer tax. In addition to these, though, there are some other housing related issues that will be explored. For example, how should rent controlled properties be valued for purposes of the new rent control law?

The study will address two questions. First, how much tax revenue is lost because of these various subsidies to the housing sector? Second, what are the effects of the subsidies on the housing sector? For example, one might explore whether the various subsidies result in Jamaicans consuming higher quantities of housing than households in developing countries of similar incomes. Additionally, one might examine the distribution of the subsidy to see if all income classes benefit equally or whether one class is benefiting more than another.

The output of the study will be at least two documents. The first would be an examination of the current tax system. Each major interface of the tax system would be identified, described and analyzed to determine the revenue loss and the effect on the housing sector. The second output would be a set of recommendations as to how the tax laws might be changed to better meet the goals of the government. Of course, this paper would only be done after some of the other analysis is complete so that the recommendations of the housing paper would be consistent with the policy reform suggested by the larger pieces of analysis.

## Special Studies

A number of special issues arise which are essential to the formulation of a comprehensive reform but do not neatly fall into the three categories above. These are: the taxation of bauxite and alumina; tax incidence; the elasticity of the tax system; social impacts of the tax system; housing finance and rent control; and training.

## Taxation of Bauxite and Alumina

### Description

The bauxite-alumina industry in Jamaica is subject to two different tax regimes: the production levy and the company income tax. (Royalties are also collected on bauxite, but these are sufficiently unimportant that they are ignored in what follows.) In the case of alumina companies the company income tax is credited against the production levy. For the bauxite companies the two taxes are kept separate, in order to avoid issues of credibility under the U.S. income tax.

The production levy is an ad valorem tax on the mining of bauxite. Since all bauxite is transferred between affiliated firms, there are no free-market prices for it, and the valuation of output must be based on a reference price for aluminum metal, for which there are arms' length transactions. The ad valorem tax rate varies inversely in a complicated way with the price of aluminum. To protect revenues and avoid the possibility that the bauxite producers would shift output from Jamaica in response to the tax, the production levy, when enacted in 1974, included presumed minimum output quantities. These presumed minimums have, however, commonly been waived.

The company income tax is applied in two different ways. For companies that process alumina (Alcan and Alcoa), the tax base is calculated in the usual way: that is, expenses are subtracted from sales, where the latter are valued using free market prices. Needless to say, allocation of expenses of these vertically integrated multinationals between the North American parents and their Jamaican subsidiaries poses problems. Since there are no arms' length transactions in bauxite, the two companies that produce only bauxite (Kaiser and Reynolds) calculate liability for company tax on the basis of a "deemed profit" per ton of bauxite that is set in consultation with the companies and depends on the price of alumina. Inherent in this approach is a constraint that taxable profits cannot be negative in any year.

Legislation establishing the production levy provided for Jamaican purchase of 51 percent of the operations of Kaiser and Reynolds. The resulting bauxite mining operations are conducted through a partnership between Jamaican affiliates of the foreign firms and Jamaica Bauxite Mining Limited (JMBI), which is wholly owned by Jamaica National Investment Co. (JNIC), a public enterprise. JBMI also owns 6 percent and 7 percent, respectively, of joint ventures with Alcoa and Alcan.

Objectives

The primary objective of tax policy in mining, especially in developing countries acting as hosts to foreign-based multinationals, is generally taken to be the extraction of a sizeable fraction of economic rents in the sector. Economic rents are the surplus of receipts over costs that can be tapped without affecting output. If taxes do not strike only rents, they will adversely affect production and they may adversely affect the choice of mining techniques. (For example, they may encourage "high-grading".)

The objective of the taxation of processing of alumina is, to some extent, that of the general taxation of foreign companies. But because of the importance of this industry in the Jamaican economy and the importance of Jamaica in the world market, this industry deserves special attention. In particular, the trade-off between tax revenues and other forms of domestic value added must be weighed carefully. (Of course, this is also true in the mining stage, but to a lesser degree.) Assessing the likelihood that taxes will affect economic activity at either the bauxite or alumina stage is complicated by the facts that a) production is concentrated in a few vertically integrated firms, b) bauxite reserves are concentrated geographically in a few countries, some of which have attempted to take advantage of the concentration by forming a cartel (the International Bauxite Association--IBA), and, c) processing requires enormous amounts of energy, which is scarce in Jamaica, but not for all its competitors.

Particularly important in both instances is the need to absorb as much of the foreign tax credits available in capital exporting countries as possible. Since taxes that can be credited raise revenue for Jamaica without imposing any burden on foreign firms, they presumably do not affect the attractiveness of Jamaica to foreign firms. In addition to the level of taxes, this involves important issues of tax structure, since the United States, in particular, does not allow credits for taxes that are not based on income.

Problems

It does not appear that the production levy was carefully designed to capture economic rents, rather than impinging on output. It makes no allowance for costs, and its rate falls as the reference price--and presumably, rents--rises. To some extent this potential defect may have been ameliorated in the early years of the levy by the provision of presumed minimum output levels, which, in effect, converts the tax into a capital levy if the optimal level of production from the firm's viewpoint is below the minimum. But the deterioration of the world bauxite-alumina market, the development of additional alternative sources of bauxite, and the cost disadvantage of processing alumina in Jamaica with fuel oil, rather that elsewhere with coal, have been mutually reinforcing influences that have caused foreign firms to reduce production in Jamaica despite the presumed minimum output provisions. Certainly careful analysis of the production levy is needed to determine whether it should be restructured to make it a more effective tool for capturing rents. Consideration of the effectiveness of the BA would be an important part of such an analysis.

The United States currently does not seem disposed to question the creditability of the Jamaican income tax imposed on either bauxite companies or alumina processors. Since this could change, it may be well to consider ways in which the tax could be restructured to assure that it will continue to be creditable, while achieving goals of Jamaican tax policy.

## The Study

The primary purpose of the study will be to determine how Jamaica should tax the bauxite-alumina industry, considering, a) the need for revenue, b) the desire to avoid discouraging local production, and c) prospects for the industry, including the continued development of alternative supplies of bauxite and movements in energy prices. The starting point for such an analysis is understanding of the Jamaican bauxite-alumina sector and its place in the world market. This will allow the development of a tax strategy geared to the taxation of economic rents. It will also facilitate putting such a strategy in a dynamic context in which Jamaica is reacting to external influences on it and the rest of the sector.

A distinctly subsidiary aspect of the study will focus on creditability of the Jamaican income tax. Since the U.S. currently seems to be content to tolerate the Jamaican tax, even though it resembles a production excise, there may be little cause for concern. If the production levy is restructured to tax economic rents, it might even be less likely to be questioned.

## Data Problems

Data is the bauxite-alumina sectors should be among the best in the country. Though more detailed examination may reveal problems, it is anticipated that data will suffice for the purpose at hand. Location of the offices of the IBA in Kingston should facilitate the study.

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8. Pindyck, Robert S. "Cartel Pricing and the Structure of the World Bauxite Market." The Bell Journal of Economics 8, No. 2 (Autumn, 1977): 343-360.

## The Incidence of Jamaican Taxes

Who pays Jamaican taxes and will pay them under a reformed tax system? As has been pointed out by many, this question cannot easily be answered, but it lies at the center of evaluating alternative tax proposals. The objective of this analysis is clear: to establish the distribution of burdens across income classes under the present system, and to simulate the change in progressivity/regressivity under alternative changes in structure and/or administration. At the suggestion of the Board of Revenue we will also attempt to make estimates of the distribution expenditure benefits. Comparing these with the distribution of tax burdens, we may get a rough idea of the income redistribution which occurs through the tax/expenditure process.

These estimates are especially important in the Jamaican context. While the tax system presently gives the appearance of being quite progressive, because of its very high income tax rates and progressive rate structure. In fact, the administration of the tax may make it quite regressive. It follows that the movement of the tax system toward a more simple, flat rate levy with a broader base, may actually not harm the overall equity of the system. In any case, changes in the distribution of tax burdens have to be viewed against the distribution of expenditure benefits to gain some idea of the overall equity effects of tax reform.

### Tax Burdens

The estimation of tax burdens is complicated by conceptual problems and data shortcomings. We might, however, list the steps necessary in estimating the distribution of tax burdens:

1. Clearly identify the rate structure, base coverage, etc. of each major tax

2. Separate those base exclusions due to legal exemption from those due to poor administration

3. Identify the extent to which the tax reduces various sources of income or increases various sources of income or increases various product prices

4. Estimate a distribution of income by source, over a number of income size classes, and a corresponding distribution of consumption expenditures, by various classes of consumption.

5. Allocate the reductions in income or the increase in product prices, by income classes.

In the easiest of cases, this is an extremely difficult job and involves much rough estimation and judgement. In the Jamaican case, it is especially difficult because there are not good data on the distribution of income, because poor income tax administration so compromises the distribution of burdens as between PAYE and self-employed taxpayers, and because the price effects of indirect taxes on hydrocarbon oils may to a large extent be hidden in domestic prices. Yet the question is important enough to warrant the best efforts that can be made. Moreover, there is some information on consumer expenditure patterns, a census, an input-output table that might allow tracing some of the indirect effects of taxes, and one can sample taxpayer files to get some idea of effective tax rates.

After completing the analysis through step 5 for the existing system, we will attempt to trace out the tax burden implications of each reform proposed. The objective will be to derive an estimate of the overall change in the distribution of tax burdens resulting from the proposed reform. Hopefully, this will shift emphasis away from questions of the regressivity or progressivity of specific components of the tax structure, to the overall equity effects of the system.

Expenditure Benefits and Budgetary Effects

One might stop with the above differential incidence analysis as having answered the essential question of how any proposed tax reform might change the distribution of income. Another question, however, is how does any given distribution of tax burdens stack up against the distribution of expenditure benefits. A country whose expenditure benefits are distributed in a progressive manner can more easily afford to compromise on the progressivity of the tax system than can a country whose expenditure benefits are not so progressively distributed.

Expenditure benefit analysis involves even more judgement than tax incidence studies. What we may do in the Jamaica case is follow the conventional approach to allocating expenditure benefits across income classes under various, plausible assumptions. In addition, the project will attempt to make some estimate of the extent to which benefits are pushed into the future while tax burdens are not, a comparison of the extent to which burdens and benefits are exported to other countries, and an estimate of how various tax structure reforms would change these ratios.

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## Elasticity Analysis

Both the World Bank and the International Monetary Fund have called for reforms to improve the buoyancy of the Jamaican tax system. While it is not clear that an increase in the effective rate of taxation is in the best interest of the country, it is clear that some estimates need to be made of the effect of alternative tax reforms on the buoyancy of the tax system. In carrying out these efforts, progress will also be made in developing a revenue forecasting model for the country which can continue to be used for budget planning purposes after this project has been completed.

We propose to estimate the income elasticity of the Jamaican taxes, on a tax-by-tax basis, using standard methods of analysis. A partitioning approach will be taken whenever possible, i.e., where the data permit, rate and base elasticities will be estimated separately and used in developing a forecasting model. In the case of taxes which have been utilized in the past such analysis first requires reconstructing the series of revenues collected under each separate tax (disaggregated, whereever appropriate, into its component parts, e.g., the alcohol, tobacco and motor spirits excise and consumption taxes) together with a history of the statutoty changes that have occured in the levy. These historical data are then related to variables which are likely to influence tax yields including the level of income in the country.

In the case of newly recommended taxes it will not be possible to construct an historical data series of tax revenues; instead it will be necessary to estimate the responsiveness of the proposed tax base to income and, in turn, apply the proposed tax rates. In some instances, e.g., in the case of the bauxite levy, it may be possible to use directly the results of any modeling efforts which take place in conjunction with the analysis of that portion of the tax system.

At the heart of this work will be estimation of the extent to which administrative improvements, broadening the tax base, changing the rate structure, etc. can work to make the tax system more or less responsive to real and nominal income growth. Thus, a comparison of estimated elasticities under the previous and proposed systems will be the principal output of this portion of the work.

This component does, however, also contain a technical assistance element. Estimation of tax buoyancy is the first step in the development of a revenue forecasting model. Thus, by the time the analysis is complete the final models can be used as an integral part of a revenue forecasting model which the GOJ can, in turn, utilize for economic planning and budget-making purposes.

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## Impacts on Low-Income Families

Central government tax policies can have important effects on low income taxpayers. These effects, however, are often hidden because the burdens are borne in the form of employment reductions in the informal sector or in the price of consumer necessities. Currently we know little about how far "down" the socioeconomic scale effects of central government tax policies are felt. This research will provide information on that important topic.

The purpose of this research is to identify the effects of alternative tax reforms on low-income taxpayers. The research requires estimation of the current tax burden on these payers, and then projections of how they would fare under various reform programs. The basic technique will be establishing "representative taxpayer families" (rural and urban) and estimating their tax burden on a basis of knowledge about the sources of family income and the distribution of the family budget.

Although estimates of these effects may be made from secondary data, consumer expenditure surveys, etc., these sources will not be as informative as specific household data. Therefore, we propose to carry out a set of in-depth case studies of twenty low-income Jamaican families. The following stratification might be considered. Of the total twenty case-study families, ten will be urban families (five will have unemployed households heads, and five will have household heads employed in low-wage labor) and ten rural families (five will have household heads engaged in agricultural labor and five will have household heads engaged in petty trade). The urban families will be selected from an area in Kingston, while the rural parish is still under consideration.

We recognize the difficulties involved in selecting families and in establishing the kind of rapport necessary for gathering high quality data on the variables being studies. A counterpart relationship will be used.

Major methods employed in the case studies will be unstructured interviews, participant observation (in which the researcher spends much time with the family observing behavior), and also structured interviewing on key variables after a good relationship with the family has been established.

The several dependent variables to be considered all relate to the household level and roughly fall into three categories: demographic variables (number of children, age of family members, sex of household head), economic variables (household income and expenditure patterns weekly), and social welfare variables (health, education, nutrition status of family members).

The research has clear practical value in terms of development planning by showing the kinds of impacts tax policy changes have on poor families. Findings in this regard will have relevance to questions concerning the effects of development on women since poor households are preponderantly headed by women. Changes which general development theory might predict in times of economic scarcity such as increased fertility and decreased family investment in childcare will also be illuminated.

## Management Plan

This technical assistance project requires careful coordination if the tax structure reform is to be comprehensive. The following management plan is suggested. Professor Roy Bahl will serve as Project Director. Professor Bahl and a Senior Resident Public Finance Advisor will both report directly to the Chairman of the Board of Revenue. Professors Richard Bird, Daniel Holland and Charles McLure will take responsibility for the direct taxation, wealth taxation, and income taxation sections, respectively. This senior staff will be in touch on a regular basis and will have a series of scheduled meetings in the United States and in Jamaica to discuss the project and go over issues of coordination. Insofar as possible, their trips to Kingston will overlap. Each team leader will be responsible for reviewing and approving the work of his research group. The lines of relationship are described in Chart I.

The Senior Resident Advisor will serve as the day-to-day liaison with the government of Jamaica, and will be in charge of the work of the resident tax administration advisors. A major function of the Resident Advisor will be to work with the Board of Revenue in reviewing the interim project papers, in anticipation of preparation of a White Paper on the tax reform for fiscal years 1984 and 1985.

The Senior Resident Advisor and the Resident Tax Administration Advisors will be in Kingston during the June, 1983- June, 1986 period. The remainder of the research staff will divide their work between on-site research in Kingston and research carried out in their home offices. All travel plans will be coordinated through the Team Leaders, Project Director, and Resident Advisor.

ANNEX B.

# THE REVENUE BOARD

JAMAICA

THE OFFICE CENTRE [illegible] FLOOR KINGSTON MALL 12 OCEAN [illegible] KINGSTON [illegible] TELEPHONE [illegible]

YOUR REF

[illegible] RB 28/1

May 6, 1983

Mr. Lewis P. Reade,
Director,
USAID/Jamaica,
United States Embassy,
2 Oxford Road,
Kingston 5.

Dear Mr. Reade,

On behalf of the Government of Jamaica, I would like to request technical assistance in conducting a comprehensive review of the Jamaican tax system. The project we wish to carry out would include the design of an alternative structure that might be more fully compatible with our Economic Recovery Programme, and the subsequent implementation of any changes the Government adopts.

Our objective is to arrive at a tax system that applies equitably to the wealth base of the economy, that is [illegible] with respect to economic fluctuations, and that generates sufficient revenue to finance the expenditure obligations of the public sector. At the same time, we seek a tax structure that reinforces our efforts to promote exports and to rely more heavily on private sector initiative and private market mechanisms.

We seek your assistance through a project that would supply the highest level of technical expertise that is available in the field of tax policy and tax administration. This project is among our highest priorities in the area of policy-related structural adjustment, and timing is of the essence.

We have reviewed the project paper prepared by your staff and the Consultants you retained and find that it reflects accurately the concepts we have discussed with them over the past several months. The cost of the project is reasonable in our view. In addition to the comprehensive tax programme being [illegible] by the [illegible], it [illegible] that it would be useful if the [illegible] would [illegible] the [illegible] of the Income Tax Department and [illegible] Services.

In our discussions with the [illegible] (Mrs. [illegible]/[illegible]) we were advised that the [illegible] would support the project and [illegible]

[illegible] the project.

[illegible]

We recognize that the usual channel of communication is through the National Planning Agency, but Dr. Headley Brown has agreed that in this instance we should communicate directly with you. A copy of this letter is being sent to Dr. Headley Brown.

We would appreciate your response at the earliest possible date, as it is urgent that this project be underway by June, 1983.

I shall be grateful for your kind assistance in this matter.

Yours faithfully,

(C. R. Miller)
Chairman
Revenue Board.

c.c. Dr. Headley Brown
Director
National Planning Agency.

ANNEX C

ACTION MEMORANDUM FOR THE A.I.D. DIRECTOR

FROM: The Project Committee

SUBJECT: Recommendation for Direct A.I.D. Procurement of A.I.D.-Financed Commodities--Board of Revenue Assistance, Project 532-0095

The A.I.D.-financed commodities to be purchased under the subject Project consist of one micro-computer, one sedan and one stationwagon. They will be used in direct support of Project operations. The budget amount for this procurement will not exceed $45,000. (Two additional, and compatible, micro-computers will be purchased for the Project from local currency provided by the GOJ.)

It is proposed that direct A.I.D. procurement of those commodities be approved. The reasons for recommending direct A.I.D. procurement are:

(1) the relatively small amount of commodities involved; and

(2) the need to provide quick support to the Project.

As might be anticipated, the contemplated procurement is insufficient to permit the Revenue Board to gain any significant institutional experience in A.I.D. procurement techniques, nor does such knowledge seem to have any continuing value for the Board. Further, overburdening the Board with this responsibility would, necessarily, detract from its performance of primary Project duties.

Recommendation: For the foregoing reasons, it is recommended that direct A.I.D. procurement of up to US$45,000 be approved, and an exception be made to the general policy stated in Handbook 1, Supplement B, Chapter 3, that A.I.D.'s policy is one of general preference that the procurement of A.I.D.-financed project goods and services required to implement bilateral projects be undertaken by the Borrower, rather than by A.I.D.

APPROVED: ______
DISAPPROVED: ______
DATE: 13 May 1983

DRAFTER:DDarby/RFriedline:mr:5/4/83

Clearance: A/ECON:SSkogstad ______
RHUDO:JHjelt ______
OPED:DRathbun ______
CONT:GBerrios ______

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Annex C

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

LAC/DR-IEE-83-4

# ENVIRONMENTAL THRESHOLD DECISION

| | | |
|---|---|---|
| Project Location | : | Jamaica |
| Project Title and Number | : | Revenue Board Assistance<br>532-0095 |
| Funding | : | $3,146,000 |
| Life of Project | : | FY 1983 - FY 1986 |
| IEE Prepared by | : | Bruce Kernan, LAC/DR/MAD |
| Recommended Threshold Decision | : | Categorical Exclusion |
| Bureau Threshold Decision | : | Concurrence with recommendation |
| Action | : | Copy to Lewis Reade,<br>Director, USAID/Jamaica |
| | : | Copy to Barry Burnett, LAC/DR/CAR |
| | : | Copy to Bruce Kernan |
| | : | Copy to IEE file |

James S. Hester Date 10 November 1982

James S. Hester
Environmental Officer
Bureau for Latin America
and the Caribbean

11/23/82

# INITIAL ENVIRONMENTAL EXAMINATION

| | | |
|---|---|---|
| Project Location | : | Jamaica |
| Project Title and Number | : | Revenue Board Assistance<br>532-0095 |
| Funding | : | $3,146,000 - Loan |
| Life of Project | : | FY 1983 - FY 1986 |
| IEE/CE Prepared by | : | Bruce Kernan, LAC/DR/MAD |
| Environmental Action Recommended | : | Categorical Exclusion |

I. Examination of Nature, Scope, and Magnitude of Emvironmental Impacts

The project purpose is to assist the GOJ in its efforts to broaden its revenue base, increase its revenue, and develop a revenue structure and administration that will provide adequate revenue for the public sector and reduce disincentives for the growth of the private sector. The purpose is also to insure that the financial burden will be equitably distributed among the population.

To accomplish this purpose, the project will provide technical assistance, training, training aids, and in-country travel and special support services.

Two subparagraphs of the AID Environmental Regulations, 22 C.F.R., Part 216, Section 216.2, apply to the project. Under subparagraph (i), Initial Environmental Examinations are not required for education, technical assistance, or training programs, except to the extent such programs include activities directly affecting the environment. The project includes no activities directly affecting the environment. Under subparagraph (iii), projects supporting analysis, studies, academic or research workshops and meetings do not require an Initial Environmental Examination. The project will support analysis and study of the Jamaican tax system.

Based on the above, this determination of categorical exclusion finds that the project will not have a direct, significant environmental impact.

II. Recommendation for Environmental Action

The proposed project will foster no foreseeable harmful change in the human or natural environment of Jamaica. It is recommended that the Chief Environmental Officer for Latin America and the Caribbean approve a Categorical Exclusion for this project.

## 5C(2) PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A. includes criteria applicable to all projects. Part B. applies to projects funded from specific sources only: B.1. applies to all projects funded with Development Assistance Funds, B.2. applies to projects funded with Development Assistance loans, and B.3. applies to projects funded from ESF.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

### A. GENERAL CRITERIA FOR PROJECT

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b).

   (a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?

   Congressional Notification has been submitted

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $100,00, will there be

(a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

(a) Yes, firm financial plans Yes have been developed as part of the Project Paper.

(b) Yes

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No, further legislative action required.

4. FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973? (See AID Handbook 3 for new guidelines.)

N/A

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?

N/A

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

This project is not susceptable to execution as a regional or multilated project. Impact will be country specific

7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

(a) No

(b) Project will have impact on private companies and individuals and will promote economic equity.

(c) Not directly.

(d) No.

(e) Yes, equitable taxation should result in better planning.

(f) No.

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Improved tax administration should improve operating conditions for U.S. investors and others Commodities and technical assistance are U.S.

9. FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? — No

11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes

12. FY 1982 Appropriation Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? — Not Applicable

13. FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16? Does — N/A



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the project or program take into consideration the problem of the destruction of tropical forests?

14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)? — N/A

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria — Not Applicable

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and



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otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

N/A

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activitiy with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"? (M.O. 1232.1 defined a capital project as "the construction, expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than $100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character.

N/A

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes esential to self-government.

2. Development Assistance Project Criteria (Loans Only)

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan? N/A

c. ISDCA of 1981, Sec. 724 (c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)? N/A

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic or political



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stability? To the extent possible, does it reflect the policy directions of FAA Section 102?

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?

c. FAA Sec. 534. Will ESP funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. Procurement

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

   Yes

2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?

   Yes

3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

   Jamaica does not so discriminate

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be

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| | financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) | Not Applicable |
| 5. | FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one of these areas? | Not Applicable |
| 6. | FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates? | No |
| 7. | FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other | |

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| Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? | Yes |
| 8. <u>International Air Transport. Fair Competitive Practices Act, 1974</u>. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available? | Yes |
| 9. <u>FY 1982 Appropriation Act Sec. 504</u>. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? | It will so provide |

B. <u>Construction</u>

| | |
|---|---|
| 1. <u>FAA Sec. 601(d)</u>. If capital (e.g., construction) project, will U.S. engineering and professional services to be used? | Not Applicable |
| 2. <u>FAA Sec. 611(c)</u>. If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? | Not Applicable |

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP)? — Not Applicable

C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter?

2. FAA SEc. 301(d). If fund is established solely by U.S. contributions and administed by an internatioal organization, does Comptroller General have audit rights? — Not Applicable

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes

4. Will arrangements preclude use of financing:

a. FAA Sec. 104(f); FY 1982 Appropriation Act Sec. 525: (1) To pay for performance of abortions as a method of family

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| planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion? | Yes |
| b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property? | Yes |
| c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? | Yes |
| d. FAA Sec. 662. For CIA activities? | Yes |
| e. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? | Yes |
| f. FY 1982 Appropriation Act, Sec. 503. To pay pensions, annuities, retirement pay, or | |

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| adjusted service compensation for military personnel? | Yes |
| g. FY 1982 Appropriation Act, Sec. 505. To pay U.N. assessments, arrearages or dues? | Yes |
| h. FY 1982 Appropriation Act, Sec. 506. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? | Yes |
| i. FY 1982 Appropriation Act, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields? | Yes |
| j. FY 1982 Appropriation Act, Sec. 511. Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? | No |
| k. FY 1982 Appropriation Act, Sec. 515. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? | No |

## LOG FRAME

| Narrative Summary | Objectively Verifiable Indicators | Means of Verification | Important Assumptions |
|---|---|---|---|
| Program or Sector Goal: | | | |
| Promote the recovery and sustained broadbased growth of the Jamaican economy | --Real growth of GDP equals or exceeds 4 percent per year by 1986 | GOJ national accounts data | --World economy recovers from current recession |
| | --Unemployment declines below 22 percent of the labor force by 1986 | GOJ unemployment statistics | --Key structural reforms of Jamaican economy are carried out |
| Project Purpose: | | | |
| Design and introduce a Jamaican tax system that supports the government's economic recovery program. In particular, the reorganized structure and procedure of tax administration must encourage an export oriented market based recovery and growth | -Tax avoidance and under-reporting by self employed is reduced by 75 percent by 1986 | --Board of Revenue | --EEC assistance in providing ADP is completed on schedule |
| | --individuals who are economically similarly situated pay essentially the same tax | --GOJ budget data | |
| | --revenues equal current account expenditures | | |
| | --budget deficit declining to 10% of GNP by 1986 | --GOJ budget and GNP data | --Economic stability and growth<br>--Improvements in tax administration will lead to greater revenues<br>--Consistent application of equitable tax policy and regulations<br>--Continued GOJ support of the tax departments |

LOG FRAME

| Outputs | Magnitude of Outputs | Means of Verification | Important Assumptions |
|---|---|---|---|
| A. Analysis of income tax | 1 final report | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --timely availability of consultants, availability of adequate data; full cooperation of all relevant elements of the GOJ. |
| B. Analysis of Tax Incentives | 1 final report | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --timely availability of consultants, availability of adequate data; full cooperation of all relevant elements of the GOJ. |
| C. Analysis of foreign trade and domestic indirect taxation | 1 final report | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --timely availability of consultants, availability of adequate data; full cooperation of all relevant element of the GOJ. |
| D. Analysis of wealth taxation | 1 final report | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --timely availability of consultants, availability of adequate data; full cooperation of all relevant elements of the GOJ. |
| E. Analysis of the taxation of bauxite and alumina | 1 final report | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --timely availability of consultants, availability of adequate data; full cooperation of all relevant elements of the GOJ. |
| Special studies<br>1. The distribution of tax burdens<br>2. The elasticity of the tax system<br>3. Impact on low income families<br>4. Computerization and tax administration | 4 final reports | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --timely availability of consultants, availability of adequate data; full cooperation of all relevant elements of the GOJ. |
| Trained core group of managers and collectors | 14 persons trained in U.S., 30-70 persons trained by GOJ. | Review of U.S. and GOJ training statistics | --that the GOJ will provide the financial and other incentives necessary to retain core group |
| A comprehensive tax reform proposal | 1 final report | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --that the GOJ tax system is in need of major overhaul |

LOG FRAME

| Outputs | Magnitude of Outputs | Means of Verification | Important Assumptions |
|---|---|---|---|
| I. Long term Implementation | Plan prepared | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --that the consultants will be available in a timely manner |
| J. Initiation of Implementation of accepted tax reform(s) | Draft legislation prepared; training oriented to specific tax reforms. Approx. 30-70 personnel trained in-service and at GOJ staff training institutes | Consultation with Project Coordinator, members of T.A. team, and Revenue Board counterparts | --that the GOJ will adopt a specific tax reform package. |

LOG FRAME

| INPUTS | Implementation Target/ objectively verifiable indicators | Means of Verification | Important Assumptions |
|---|---|---|---|
| A.I.D. Technical Assistance | 140 person months of assistance, 96 long term, 44 short term | Project records (USAID files) | -- Availability of U.S. and GOJ resources• acceptance of U.S. technical.Assistance modes and ability of technicians to adjust to Jamaican context. |
| Overseas | -- 14 tax department personnel trained at Executive and working level in accounting, collection, compliance, etc. | Site Inspection | -- That the GOJ will provide adequate incentives to retain qualified personnel. |
| Commodities | -- $45,000; for ADP equipment and 2 motor vehicles. | -- AID Mission files | -- Timely procurement of needed equipment. |
| GOJ Inputs | | | |
| Functional responsibilities clearly assigned to counterparts. | -- GOJ provides J$243,213 over LOP for payment of counterparts | -- On-site review of operations | -- GOJ will nominate project counterparts to oversee implementation of project. |
| Housing and PER DIEM of Expatriate Staff | -- GOJ provides J$607,868 | -- Consultation with Expatriate Staff | -- GOJ will provide an adequate host-country contribution. |
| In-Country Logistics Costs | -- GOJ provides J$28,128 | -- Consultation with GOJ senior personnel | -- GOJ will provide an adequate host-country contribution. |
| Training (In-Country, Government Staff training institutes). | -- GOJ provides J$822,000 over LOP | -- On-site review of operations | -- That current priority placed on training by GOJ is maintained. |

Department of State
INCOMING TELEGRAM
American Embassy Kingston

# UNCLASSIFIED

ANNEX G

| TO | ACT | INFO |
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ACTION OFFICE: 4209
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| A. DIR | HNP |
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UNCLAS ~~SECTION 01 OF 02~~ STATE 280014

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: REVENUE BOARD ASSISTANCE (532-0095) DAEC

REF: (A) KINGSTON 8051; B) STATE 252848

1. SUMMARY. THE DAEC MET AND REVIEWED THE SUBJECT PROJECT ON WEDNESDAY, SEPTEMBER 8. THE PID WAS APPROVED SUBJECT TO THE GUIDANCE SET FORTH BELOW, AND TO THE SUBMISSION OF AN INTERIM REPORT DESCRIBED MORE FULLY BELOW IN PARA 3. BUREAU RECOMMENDS REDUCTION IN SCOPE OF PROJECT TO FOCUS ON POLICY STUDY AS INITIAL STEP BEFORE PROCEEDING WITH OTHER AREAS SUCH AS ADMINISTRATION. END SUMMARY.

2. INTEGRATION OF PROJECT ELEMENTS. THE MOST SERIOUS PROBLEM NOTED IN THE PID REVIEW WAS THAT THE THREE ELEMENTS OF THE PROJECT--TAX ADMINISTRATION, CUSTOMS, AND TAX POLICY--WERE NOT WELL INTEGRATED. PID DOES NOT MAKE THE POINT CONVINCINGLY THAT ALL THREE ACTIVITIES MUST BE CARRIED OUT SIMULTANEOUSLY. MISSION SHOULD CONSIDER THREE SEPARATE ACTIVITIES FOR THESE AREAS. EACH WILL BE DESCRIBED BELOW.

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A. TAX ADMINISTRATION. DAEC EXPRESSED CONCERN THAT
AN UPGRADING OF THE GOJ'S TAX ADMINISTRATION CAPABILITY
MAY BE PREMATURE IN THE ABSENCE OF A CLEARLY STATED TAX
POLICY. WHILE IT IS CLEAR THAT TAX POLICY AND
ADMINISTRATION ARE CLOSELY LINKED, MISSION SHOULD
RECONSIDER PROPOSAL TO IMPROVE REVENUE-COLLECTION ELEMENT
BEFORE TAX POLICY ELEMENT IS DEVELOPED. MANY ELEMENTS OF
EXISTING TAX STRUCTURE (SUCH AS HIGH MARGINAL INCOME TAX
RATES) SHOULD BE REVISED BEFORE ADMINISTRATIVE ELEMENT IS
ADDRESSED. BUREAU DOES NOT WISH TO PRECLUDE LIMITED
ACTIVITIES IN THIS AREA, BUT RECOMMENDS THAT POLICY BE
CLEARLY STATED IN THOSE FEW AREAS WHERE ADMINISTRATION
IMPROVEMENT IS UNDERTAKEN.

B. CUSTOMS. DAEC OBSERVED THAT THIS ELEMENT IS
EXTREMELY COMPLEX AND, GIVEN LIMITED SCOPE OF THE
PROPOSED PROJECT, MAY NOT BE GOOD CANDIDATE FOR REFORM AT
THIS TIME. THIS IS FOR TWO REASONS: (1) THE GAINS TO BE
MADE, IN A PRAGMATIC SENSE, THROUGH UPGRADING OF CUSTOMS
PROCEDURES, ARE PROBABLY VERY LIMITED WITHOUT A THOROUGH
OVERHAUL OF THE EXISTING ENFORCEMENT SYSTEM. FYI,
SECTION 660 OF THE FOREIGN ASSISTANCE ACT PROHIBITS
ASSISTANCE IN THE AREA OF TRAINING FOR LAW ENFORCEMENT
FORCES AND RELATED ACTIVITIES. END FYI. (2) CUSTOMS
POLICY IS CLOSELY LINKED TO TRADE POLICY (IN THAT THE
LEVELS OF EFFECTIVE TARIFF PROTECTION ARE DETERMINED AT
THE CUSTOMS LEVEL) AND WOULD DEMAND EXTREMELY THOROUGH
STUDY WITH CLOSE GOJ COOPERATION BEFORE REFORMS CAN BE
PROPOSED. DAEC SUGGESTS THAT CUSTOMS ELEMENT OF THE
PROJECT BE DEFERRED UNTIL SUCH TIME AS THOROUGH STUDY CAN
BE EFFECTED.

C. TAX POLICY. BUREAU VIEWS TAX POLICY ELEMENT AS
THE KEY TO SUCCESSFUL IMPLEMENTATION OF THIS PROJECT, AND
URGES MISSION PARTICIPATION IN THE DEVELOPMENT OF THE
NATIONAL REVENUE BOARD (NRB). BUREAU IS ENCOURAGED BY
GOJ'S INTEREST IN ESTABLISHMENT OF THE BOARD, AS
EVIDENCED BY THE RESOURCES BEING INVESTED THERE, AND
BELIEVES THAT SUPPORT FOR THIS INITIATIVE IS KEY TO
IMPROVEMENT OF THE TAX STRUCTURE. URGE THAT THE NRB
BECOME A PERMANENT TAX POLICY BOARD, SENSITIVE TO

FLUCTUATIONS IN THE JAMAICAN MACROECONOMY, AND ABLE TO
PRESCRIBE SOUND TAX POLICY ON A DYNAMIC BASIS. BECAUSE
OF IMPORTANCE OF TAX POLICY TO SUCCESSFUL IMPLEMENTATION
OF A MEANINGFUL TAX REFORM, SUGGEST THAT MISSION EXAMINE
APPROPRIATENESS OF SCALING PROJECT BACK TO CONCENTRATE ON
TAX POLICY STUDY. THIS SUGGESTION IS A RESULT IN PART OF
CONTENTS OF REF (A), ESPECIALLY PARAS 9, 10, AND 13, SENT
SUBSEQUENT TO PREPARATION AND SUBMISSION OF THE PID. PP
SHOULD ADDRESS THESE MAJOR POLICY ISSUES RAISED IN REFTEL
WHICH APPEAR AMENABLE TO REMEDY THROUGH THE PROJECT. IT
IS OF CRITICAL IMPORTANCE THAT GOJ'S STATED OBJECTIVES IN

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[illegible] [illegible] TAX POLICY STUDY
([illegible]), [illegible] OBJECTIVES [illegible] [illegible] EXPORT PROMOTION,
FOREIGN INVESTMENT, AGRICULTURE, REVENUE [illegible]IZATION AND
[illegible] ECONOMIC GROWTH). TAX POLICY STUDY SHOULD BE
PROCEED FROM A BROAD PERSPECTIVE AND SHOULD ADDRESS ALL
KEY SECTORS OF THE ECONOMY. ADOPTION OF THIS APPROACH
WILL PERMIT IMPLEMENTATION OF THE OTHER PROJECT ELEMENTS
AT A FUTURE TIME, WITH A MUCH BETTER SENSE OF THE POLICY
ENVIRONMENT IN WHICH TAX AND ADMINISTRATIVE REFORM WILL
OPERATE.

3. INTERIM REPORT. BUREAU REQUESTS THAT MISSION PREPARE
AN INTERIM REPORT BEFORE PROCEEDING WITH FULL INTENSIVE
REVIEW. THIS REPORT SHOULD DEMONSTRATE, IF POSSIBLE, HOW
THE THREE ELEMENTS DESCRIBED ABOVE ARE TO BE INTEGRATED
AND IDENTIFY THE MISSION'S STRATEGY FOR UNDERTAKING THE
THREE ACTIVITIES, EITHER SIMULTANEOUSLY OR IN STAGES. IF
THE FORMER STRATEGY IS CHOSEN, A STRONG JUSTIFICATION FOR
THIS APPROACH IS EXPECTED.

4. ADDITIONAL CONSIDERATIONS. SEVERAL OTHER DESIGN
ISSUES WERE DISCUSSED AT THE DAEC, AS DESCRIBED BELOW:

A. TECHNICAL ASSISTANCE. DAEC WAS NOT CONVINCED OF
THE WORKABILITY OF A THREE- OR FOUR-PERSON TEAM, EACH
WITH AN AREA OF SPECIALIZATION. AS DESCRIBED IN THE PID,
TAX POLICY INDIVIDUAL WOULD HAVE RESPONSIBILITY AS CHIEF
OF PARTY AND AS COORDINATOR FOR PRODUCTION OF THE GLOBAL
SUMMARY REPORT. THIS MAY NOT BE THE IDEAL SCHEME, AS THE
CHIEF OF PARTY WILL CERTAINLY BE EXPECTED TO ASSUME MANY
LOGISTICAL AND COORDINATING RESPONSIBILITIES WHICH MAY
IMPEDE COMPLETION OF HIS RESEARCH. ALSO, MISSION SHOULD
EXAMINE A VARIETY OF CONTRACTING MODES, INCLUDING
POSSIBILITY OF EMPLOYING INSTITUTIONS OTHER THAN THE IRS,
WHICH MAY NOT HAVE THE REQUISITE EXPERTISE IN TAX

POLICY. SUGGEST THAT AN ECONOMIST WITH EXPERIENCE IN TAX
POLICY BE CONSIDERED TO STRENGTHEN THE POLICY ANALYSIS
AND FORMULATION CAPABILITY OF THE TEAM. FINALLY,
ACKNOWLEDGING THE IMPORTANCE OF TAX POLICY TO THE PRIVATE
SECTOR, URGE THAT THE JAMAICAN BUSINESS COMMUNITY BE
INVOLVED IN THE STUDY. DEPENDING ON GOJ OBJECTIVES PER
PARA 2C ABOVE, MISSION MAY WISH TO CONSIDER CONTRACTING
FIRM TO ANALYSE CLIMATE FOR FOREIGN INVESTMENT. BUSINESS
INTERNATIONAL (BI) IS ONE SUCH PRIVATE FIRM WHICH
PROVIDES ADVISORY SERVICES CONCERNING LAWS, REGULATIONS
AND POLICIES WHICH AFFECT PRIVATE INVESTMENT IN
DEVELOPING COUNTRIES. REF B PROVIDES GREATER DETAIL
ABOUT BI.

B. PROJECT OUTPUTS. PID DID NOT FULLY DESCRIBE THE NATURE OF THE WHITE PAPER TO BE PRODUCED BY THE TEAM. WILL IT BE A STUDY WITH RECOMMENDATIONS, AS WAS THE REPORT PRODUCED BY ASH, OR A POLICY STATEMENT BY THE GOVERNMENT WITH DRAFT LEGISLATION FOR THE LEGISLATURE? MISSION SHOULD DESCRIBE THE NATURE OF THIS DOCUMENT MORE CLEARLY.

C. GOJ COMMITMENT. INFORMAL RESEARCH INTO THE HISTORY OF TAX REFORM PROJECTS FOR THE AGENCY WORLDWIDE

DEMONSTRATES THE IMPORTANCE OF GOVERNMENT COMMITMENT TO TAX PROJECTS. MISSION SHOULD DEMONSTRATE THAT GOJ IS SOLIDLY BEHIND THIS INITIATIVE AND WILLING TO DEVOTE RESOURCES TO IT. BUREAU URGES STUDY OF RESULTS OF PREVIOUS LAC TAX PROJECTS WITH AN EYE TO MAXIMIZING IMPACTS AND AVOIDING IDENTIFIABLE PITFALLS. BUREAU PROVIDING LIST OF SUCH PROJECTS PREPARED BY DIU. PROJECT DOCUMENTS CAN BE REQUESTED THROUGH THEM FOR CLOSER STUDY.

D. PROJECT PURPOSE. IN LIGHT OF ABOVE SUGGESTED MODIFICATIONS, MISSION DEVELOP ANOTHER PROJECT PURPOSE WHICH IS MORE SHARPLY FOCUSED. FYI, PURPOSE STATED IN PID WAS VAGUE AND OVERLY GENERAL. END FYI.

5. ECONOMIC ANALYSIS. ECONOMIC ANALYSIS OF A PROJECT OF THIS TYPE IS COMPLEX AND DIFFICULT. BUREAU PREPARED TO PROVIDE ASSISTANCE IN THIS AREA IF NEEDED. PLEASE ADVISE HOW ANALYSIS IS TO BE UNDERTAKEN.

6. FYI, ALL LAC BUREAU PID APPROVALS SUBJECT TO REVALIDATION IF POST-PID PROJECT PAPER PREPARATION EXCEEDS ONE YEAR. DAM
BT
#0014

27 JAN 1983

Annex I

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR, LAC

FROM : LAC/DR, Dwight B. Johnson

SUBJECT : Jamaica Revenue Board Assistance Project (532-0095) - Waiver of Competition

Problem: Your approval is required to permit noncompetitive negotiation with Syracuse University for the provision of technical assistance under the subject project.

Background: The PID for the subject project was reviewed on September 8, 1982. The project's purpose is to assist the Government of Jamaica (GOJ) in an effort to broaden its revenue base, increase its revenue and develop a revenue structure and administration which will (i) provide adequate revenue for the public sector and reduce disincentives for the growth of the private sector and (ii) distribute the tax burden equitably among the population.

The intensive review and implementation phases of the project will require the procurement of technical assistance services. At the time of PID review, the Mission was instructed to "consider a variety of contracting modes" and submit an Interim Report. The Interim Report contained a request to utilize the services of Syracuse University pursuant to an amendment of a Cooperative Agreement (AID/DSAN-CA-0198) with A.I.D.'s S&T Bureau. Although AID/W agreed with the Mission that Syracuse was a logical choice because of its prior experience in Jamaica and ability to field excellent personnel on short notice, the use of the Cooperative Agreement mechanism was rejected, and the proper instrument for the procurement of the requisite consultant services was determined to be a direct AID contract. However, to contract directly with Syracuse, a waiver of competition is required.

Discussion: Tax reform is a critical element of the structural adjustment required to get the Jamaican economy moving; and thus, it is directly related to the primary objective of the A.I.D. program in Jamaica. That objective is to assist Jamaica to develop economically in a manner which will satisfy Jamaican aspirations and serve as an example to other developing countries in the Caribbean. The IBRD has made tax reform a condition for further Structural Adjustment Loan funding in Jamaica. The IMF is also concerned.

The proposed project is in response to Prime Minister Seaga's personal public pledge to reform the Jamaican tax system. After the electoral victory of Seaga, legislation to carry out his pledge was introduced into Parliament and passed in December 1981. That legislation created the Revenue Board and gave it the mandate to present the Parliament with comprehensive tax reform legislation by March 1984. Seaga and the Board are looking to A.I.D., specifically under the proposed project, to help develop policy reforms and assist in administrative improvements.

In light of the deadline for presenting comprehensive tax reform legislation to Parliament of March 1984, A.I.D. must act immediately to contract technical assistance so that the project can be quickly designed and authorized so that

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implementation can start in the near term. Only in this way will there be adequate time to permit the development by the technical assistance team of adequate reform legislation by the deadline. Assuming approval of this waiver, the project's implementation team could have seven-eight months to analyze the Jamaican tax system and make recommendations before the legislation is drafted. If, however, competition is required, the period of analysis would be cut almost in half to four-five months, and the opportunity for A.I.D. to provide meaningful input lost and the probability of inadequate legislation increased.

The services of a U.S. university are considered preferable to that of a private firm because of the need for an ongoing relationship between the Revenue Board and a U.S. institution capable of assembling and managing teams of highly specialized tax experts on a continuing basis. It is further believed that the university selected for project design should also be charged with project implementation. Not only would this save time in moving into the implementation phase, but also would establish early-on a relationship between the university and the Revenue Board that is considered critical to project success.

Due to the highly technical nature of the technical assistance required (e.g., Tax Policy Analyst, Public Administration Economist, Tax Administration Specialist, Excise Tax Specialist), no single university can assemble a team from its own faculty. Therefore, the key to the selection of a university is its ability to assemble teams of high quality experts and provide them with necessary support on short notice. Syracuse University has already demonstrated this ability. It is familiar with the project, having been involved in pre-PID studies; this familiarity would give Syracuse an estimated two-three month head start on other universities unfamiliar with the project. Further, Syracuse has already identified a technical assistance team for carrying out the intensive review of the project under its Cooperative Agreement with the S & T Bureau. Thus, it will have little difficulty in quickly assembling a team to carry out the intensive review and eventually implement the project. Neither USAID/Jamaica nor AID/W is aware of any other university which can respond as rapidly to the critical technical assistance needs of the project.

To obtain the services of Syracuse, a direct AID contract is necessary which requires a waiver of competition. It is estimated that the project development services will cost approximately $75,000 and the implementation services $3 million over three years. In accordance with A.I.D. Procurement Regulations (Section 7-3.101-50), the requirement for competition in awarding contracts may be waived and noncompetitive negotiation authorized when the Assistant Administrator responsible for the project makes a formal written determination that procurement from any other source would impair foreign assistance objectives and would be inconsistent with the fulfillment of the foreign assistance program.

Recommendation: That you approve noncompetitive negotiation with Syracuse University for provision of technical assistance services to the Jamaica

Revenue Board Assistance Project during intensive review and implementation phases and determine that procurement from any other source would impair foreign assistance objectives and would be inconsistent with the fulfillment of the foreign assistance program.

APPROVED: Marshall Brown Act. [illegible]

DISAPPROVED: ____________

DATE: 1/28/87