NEW APPROACHES TO TAXATION AND TAX ADMINISTRATION

IN THE

EASTERN CARIBBEAN CURRENCY UNION

Volume 1: A framework for Tax Reform

Prepared by the

TAX REFORM AND ADMINISTRATION COMMISSION

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EXECUTIVE SUMMARY

The member states of the ECCU face the immediate challenge of finding new paths to robust and sustained economic growth, having over the last few years experienced declining growth rates when compared with the previous decade. The decline in growth rates has been accompanied by the absence of improvements in employment and significant fiscal slippage. Against this background, the Heads of Government of the OECS agreed on a strategy for transforming OECS economies and achieving sustained real growth rates of 6.0 percent per annum, high quality jobs, a reduction in employment to 6.0 percent or less, and a level of poverty below 6.0 percent.

The foundation of this sustained growth would be a significant improvement in the level and efficiency of investment, the development of an effective and appropriate Information and Communication Technology (ICT) strategy as a basis for the expansion of e-commerce, the introduction of new economic activities and the modernisation of the traditional ones. The efficiency of investment could be improved by directing investment within a rational framework, and a careful selection and rigorous analysis of projects. At the same time leadership at the political level should be strengthened and an institutional capacity for the development of ICT firmly established.

In relation to the economic sectors, it was seen that the future growth prospects for the ECCU will depend on the further development of the services sectors. The member states are already exporting a range of business and professional services. These include accountancy, architecture and engineering services, computer and database services, internet-related and web design services, data processing and data repair services, legal services, consultancy, and market research. The capabilities of local businessmen and professionals in these fields will need to be identified and strengthened, and firms should be assisted in penetrating external markets.

In tourism, governments already recognise the need for both product and market diversification. Product development and marketing strategies should be re-oriented to creating and exploiting the growing demand for non-traditional tourist products, such as eco-tourism, heritage tourism, cultural tourism and nautical tourism. The ECCU countries will also need to access newly emerging markets such as Japan, and the higher income areas in Latin America, and Eastern Europe.

Fiscal policy in the Union should emphasise fiscal discipline and prudence. It should be directed to supporting the developmental and growth targets by generating surpluses for investment and emergencies, and government's role as the major facilitator in economic development. It should be consistent with and supportive of the monetary policy of the Union which is committed to a stable currency based on a fixed exchange rate, linked to the US currency. Fiscal policy should also embrace tax harmonisation across the Union beyond the fiscal convergence necessary for the effective operation of the Currency Union. This will facilitate the modernisation of the tax systems to achieve the revenue, resource, and administrative efficiencies and effectiveness that derive from economies of scale and improve the region's readiness for participation in the new international trading arrangements.

The role of OECS governments in the economic transformation is central. In support of this goal, they should conceive of themselves as institutional innovators, finding new organisational and management structures to develop the potential for new economic activities. Governments will be required to take the initiative, provide the initial thrust of innovation, supply some of the start-up finance, and assist with the mobilisation of the different partners required for developing projects.

The governments have a social role of providing those goods and services which are difficult to distribute in discrete segments, including public goods. These include law and order, defense, public roads, public buildings, and water and environmental protection. The government is also expected to intervene in the provision of those services which could conceivably be provided and distributed by market forces, but which the state chooses to provide to ensure equality of opportunity and good citizenship. The most noteworthy of these are education and health. The state has a duty to create the enabling environment for investment in human capital formation. In promoting development, the state must be involved in the provision of the vital services of education and training, and health and housing for its population. The provision of these basic services is the corner stone of a stable and productive society.

Finally, the government must be a provider of information for the development of the entire economy, but especially for the private sector. Information dissemination will be of paramount importance in this knowledge-based society.

The governments of the ECCU grant a wide range of incentives to stimulate economic growth. Governments will need to achieve a balance between the impact of these concessions on the revenue base and the achievement of the growth objectives of their countries. The following recommendations should therefore be accorded high priority:

Hotel Aid and Fiscal Incentives

The duty free imports granted under these Acts should remain in place. The tax holiday should be replaced by the tax credit system as obtains in Dominica.

Statutory Bodies

The tax concessions granted to statutory bodies should be limited to a specific period. The emphasis should be on increasing the efficiency of these organizations, particularly those dealing with electricity, water, ports and the marketing of agricultural products.

Concessions granted under Customs Act

The concessions granted to religious and other bodies under the Customs Act should be carefully circumscribed and should in no case exceed 75 percent of the taxes involved.

Concessions that are granted to civil servants should be limited to a 75 percent reduction in the taxes payable on acquisition of a motorcar every four years. The concession should be restricted to civil servants at an approved grade.

At the same time, there is the urgent need to monitor tax concessions and to harmonise tax concessions among the ECCU countries in order to avoid erosion of the revenue base. This is important, since a good revenue system mobilises adequate revenue and the burden of taxation should be equitable and the rules and guidelines relative to taxation should be transparent.

In developing a framework for tax reform, the following must be considered:

- recognition and identification of special development and social areas to which governments may wish to provide stimulus;
- the shift from tax holidays to tax allowances or tax credits to ensure that the value of the fiscal incentives provided is the same for all taxpayers;
- the use of *ad valorem* rate excises even in the case of petroleum, alcoholic beverages and tobacco.

In relation to the overall tax composition it is recommended that governments maintain tax to GDP ratios of 25 to 30 percent based on the following ranges:

	Existing Range As percent of GDP	**Average As percent of GDP**	**Proposed Range As percent of GDP**
Personal Income	0.9 - 4.7	3.5	4.0 – 6.0
Corporate Income	2.7 – 5.2	4.0	4.0 – 7.0
Property	0.1 – 1.1	0.45	2.0 – 4.0
Trade and Excise	6.0 – 14.4	7.6	3.0 – 5.0
Transactions	9.1 – 14.5	11.5	10.0 – 14.0
TOTAL	**23.9 – 29.1**	**25.5**	**25.0 – 30.0**

In addition, the following features should be incorporated in the tax system:

- Elimination of nuisance taxes such as dog licenses and entertainment tax
- Broadening of the tax base, particularly to include taxation of services
- Increased efficiency and simplicity to both government and taxpayer
- No more than 80 percent of current revenue for recurrent expenditures including interest payments, premium payments to general and captive insurance, and asset maintenance

- At least 20 percent of recurrent revenue plus revenue from the sale of capital assets and returns on productive enterprises should be used to finance:
  - Small projects
  - Principal repayments
  - Contributions to stabilisation and emergency funds
  - Counterpart contributions to large projects
- Central government and its statutory bodies should endeavour to finance about 15 percent of GDP in investment.

The intention is to replace all indirect taxes, except import duty with a Value Added Tax (VAT). Import duty should be phased out following an agreed transition schedule. When this is established, the suggested modalities are:

- **Coverage**: On sales of all goods and services except where exempted or zero rated
- **Rates**:
  - 0 percent on a basket of basic foods, medication, computers, public transport and exports;
  - 10 percent on transactions in hotels, restaurants, tour operators, theme park and attractions, car rentals, yacht charters, boat cruises;
  - 15 percent on other transactions in:
    - Retail outlets with sales of over $100,000 per annum
    - Wholesale outlets
    - Manufacturing enterprises
    - Entertainment centres
    - Sports events
    - Overseas travel
    - Electricity
    - Telecommunication
    - Professional service fees e.g. doctors, dentists, architects, engineers,

- beauticians, lawyers etc.

The VAT will replace a number of nuisance and other taxes such as consumption and travel taxes.

However, an efficient revenue system must be supported by improved tax administration.

In its survey of the region, the Tax Commission identified a number of areas in tax administration that are of concern to government, the private sector and other stakeholders in the society. These include:

- The plethora of taxes and tax handles that make administration difficult and costly;
- Tax legislation and administrative procedures that are complex and outdated;
- Tax policy and the use of tax revenues that lack transparency;
- Ineffective enforcement constrained by factors, including political interventions in the process of making tax decisions, weak technical capacity to deal with complex cases, inadequate ability to engage with highly trained corporate accountants and lawyers, lack of legal support in preparing and contesting tax cases, and the failure of tax appeal commissions to meet regularly to resolve appeals;
- The high cost of transacting with tax departments - revenue receipts, filing and audit processes are still manual.[1]

In the light of these concerns, the major reform objectives to be pursued should include:

[1] IMF Report on Modernization of the Tax System

- Restructuring tax departments to provide better taxpayer services; reduce transaction costs; strengthen planning and research capacity; and establish performance standards;
- Redesigning procedures and the legal framework to increase compliance and enforcement;
- Enhancing human and physical resources to foster efficiency in service delivery;
- Strengthening processes for tax transactions to accommodate e-commerce and E-government;
- Speeding up the judicial process for tax collection and the resolution of tax disputes;
- Improving communication with taxpayers and between tax agencies to facilitate information exchange and effective collaboration;
- Improving and integrating tax administration information systems;
- Strengthening tax coordination at the local and regional levels.

Revenue Authority

Given the small size of the tax administrations and the limitations of their budgets and skills capacity, significant efficiency gains could be achieved in consolidating selected services or sharing common services. The Commission highly recommends the establishment of revenue authorities in each jurisdiction, with autonomy to manage revenue functions based on business management principles.

Regional Revenue Authority

A significant consideration for regional tax harmonisation is the gain in efficiency and cost-effectiveness that can arise from regional coordination and the sharing of vital common services, especially in adjudication, planning and research, management, training, and information technology development. The case for a Regional Revenue Authority, therefore, rests on the need for tax harmonisation within a common market; tax policy coordination to facilitate equitable resource allocation; and fiscal diversity within the region as well as strengthening tax administration through sharing vital common services. The Tax Commission strongly recommends that, as part of a regional tax administration, a Regional Tax Tribunal should be established as soon as possible to adjudicate in tax matters.

Section 1

The FINANCIAL AND ECONOMIC CONTEXT OF TAX REFORM

1.1 Introduction

Fiscal Policy, sometimes called “tax and spend policy”, refers to strategic decisions of government involving collection and spending of revenue. More particularly, fiscal policy refers to decisions taken to stimulate economic activity through spending and to the methods by which this spending is financed. Taxation, one of two principal methods of financing (the other being borrowing), affects most areas of economic activity and therefore the design of tax policy is of critical importance. At the same time, the performance of any tax regime is influenced by trends in the economy, and in particular the economic performance.

Consequently, this report examines the economic and financial conditions in the Currency Union over the period 1980-2000, a period characterised by:

Variable growth in economic activity;

Significant fiscal slippages in member countries, in particular weakening public finances and strong growth in government expenditures, resulting in increasing fiscal deficits and the rapid accumulation of debt;

Changing structures of the economies as evidenced by the development of a wide range of services.

The economic and financial conditions of the ECCU forms the basis for the discussion on the role of fiscal policy and the recommendations on an appropriate fiscal regime[i].

1.2 Economic Performance

1.2.2 Macro Economic Indicators

Economic Growth

The member states of the ECCU face the immediate challenge of finding new paths of robust and sustained growth, having over the last few years experienced declines in growth rates as compared with earlier periods. Average growth in the ECCU over the period 1980-2000 was 5.0 percent per annum. In the decade of the 1980s the ECCU experienced real growth which averaged approximately 6.0 percent per annum. During this period economic performance was influenced by robust growth of banana exports and foreign direct investment inflows especially in the tourist industry. Significant public sector investments were also implemented during this decade. In recent times, however, growth has decelerated significantly to a modest 3.0 percent per annum. This modest growth performance has been heavily influenced by a deterioration in the main foreign exchange earning sectors; bananas, tourism and also a significant fall off in foreign direct investment inflows. These developments, have been influenced heavily by developments in the international economic environment. Of particular importance is the new trading arrangements under the World Trade Organisation (WTO) which has opened the unproductive banana producers of the ECCU to greater international competition in their traditional British market, and greater competition from other tourist destinations.

On the supply side the ECCU has experienced a significant deterioration in productivity growth since the early 1990s. This has been mirrored by a gradual fall off in the implied real return on capital. These factors point to the need for urgent economic reforms aimed at improving total factor productivity in the ECCU, if the growth locomotive is to recapture its forward momentum. Tax reform is viewed as a critical component for improving total factor productivity growth in the ECCU.

Inflation

Prices have generally been stable during the 1980s and 1990s, averaging 4.0 percent per annum. Over the period, there were three main patterns of inflation. In the first period, 1980-1984, inflation averaged approximately 6.0 percent per annum, influenced by rising prices at the global level as a result of the upward movement in oil prices. The inflation rate moderated to an average of 5.0 percent between 1984 and 1992. In the final period, 1992-2000, inflation was low, averaging 2.5 percent per annum which was in line with the fall in international prices (see Table I).

Table I
Economic Growth and Inflation in the ECCU 1980 –2000.
Period Averages

	Economic Growth				Annual	Inflation				Annual
Country	**1980 - 2000**	**1980-1984**	**1984-1992**	**1992-2000**	**2001**	**1980-2000**	**1980-1984**	**1984-1992**	**1992-2000**	**2001**
Anguilla			7.0	5.0	2.0			7.0	3.0	4.6
Antigua and Barbuda	5.0	5.0	6.0	4.0	1.5	5.0	7.0	6.0	4.0	1.5
Dominica	4.0	6.0	4.5	2.0	-4.6	4.0	5.0	5.4	3.0	1.9
Grenada	5.0	3.0	5.0	3.5	-3.4	4.0	4.0	5.0	2.5	3.2
Montserrat	-2.0	1.0	4.5	-1.0	-3.8	4.0	8.	3.5	4.0	4.7
St Kitts/Nevis	4.0	2.0	7.0	3.5	2.0	6.0	8.0	6.0	4.5	2.0
St Lucia	5.0	5.0	8.0	2.0	5.4	4.0	5.0	4.5	3.0	1.9
St Vincent and The Grenadines	5.0	5.0	7.0	3.0	0.2	4.0	9.0	4.0	2.5	0.9
ECCU	5.0	5.0	7.0	3.0	-1.5	4.0	6.0	5.0	2.5	2.1

Source: Statistical Offices and ECCB Estimates

Poverty and Unemployment

Notwithstanding the relatively good growth and inflation performance, particularly in the 1980s and 1990's, the extent of poverty and unemployment within the ECCU remained high. Unemployment continued to be a major challenge for the policy authorities. It must be noted, however, that there has been no systematic survey of the unemployment situation in the region. Nevertheless, based on the 10-year population census, unemployment appears to range from approximately 5.0 percent, on average, in the Leeward Islands to between 18.0 and 25.0 percent, on average, in the Windward Islands. The unemployment situation was aggravated by the slow and negative growth in 2000 and 2001. Available data from some sources appear to indicate that unemployment among age group 15-24 was over 25.0 percent, while the rate for persons over 25 was 50 percent or more. Human development indicators such as poverty levels, low education attainment and inadequate access to health care all speak to situations of slow economic growth and stagnation. Along with the unemployment factor, it is also projected that the average dependency ratio for the region will increase to 16.3 percent by 2010, which is 2.0 percentage points higher than the dependency ratio in the 1980's.

The combination of factors such as high unemployment and poverty, and growth in the dependency ratio are likely to contribute to higher demands on governments for job creation.

The Changing Economic Structure

The economies in the ECCU are small and highly open. The ratio of imports and exports to GDP is well over 100 percent. Therefore, trade with the rest of the world is a key factor in the economic performance of the region. In this context, the main foreign exchange earners in the ECCU are tourism services and traditional agricultural exports. However, these are generally showing tendencies towards decline.

At the same time, the countries are moving away from the production of goods, and value added in the economies is being dominated by the production of services, in particular, financial services, tourism, and personal and professional services. The services sector accounted for approximately 58.0 percent of GDP in 1994, and this increased to 71.0 percent in 2001. A number of these services are not captured in the calculation of national accounts and in the tax net.

The growth in use of information and communication technology, and the development of an Internet economy are gradually omitting the domestic middleman from trade transactions and hence from a visible tax base. The tax base will be further eroded by the emergent need to satisfy treaty obligations and the impact of international and hemispheric trading arrangements as most ECCU member countries are signatories to the WTO and will shortly conclude negotiations for a Free Trade Area of the Americas (FTAA).

Fiscal Indicators

The overall fiscal position of the combined central governments of the ECCU moved from a surplus over the previous decade to a deficit position in 2001. This was influenced by the growth in expenditure, which was accompanied by only moderate improvements in revenue (Table II).

Total expenditure to GDP over the period 1980-2000 averaged approximately 31.5 percent of GDP, while current expenditure averaged 23.7 percent of GDP for the ECCU. Within current expenditure, outlays on personal emoluments averaged 12.3 percent of GDP; expenditure on goods and services accounted for approximately 6.3 percent; interest payments averaged 1.9 percent of GDP; and transfers and subsidies averaged 3.1 per cent of GDP (Table III).

In terms of trends, total expenditure and net lending, as a percentage of GDP, has shown a downward trend between 1980 and 1996. However, between 1996 and 2000 the trend showed an increase in total expenditures. Personal emoluments declined between 1980 and 1992. However, from 1992 to 2000 expenditures on personal emoluments rose. Interest payments, on average, also rose over the period under consideration. Capital expenditures appear to have stagnated.

Table II
Fiscal Balances in the ECCU
(In percent of GDP, 1980-2000 average)

Categories	ECCU	Anguilla	Antigua and Barbuda	Dominica	Grenada	Montserrat	St Kitts and Nevis	St Lucia	St Vincent and the Grenadines
Current Account Balance	1.64	1.78	-0.54	0.65	-0.3	2.6	-0.11	3.99	5.32
Overall Balance	-2.89	-0.97	-3.73	-6.98	-7.1	0.83	-0.71	-0.71	1.2
Primary Balance	-0.98	-1.35	-0.76	-4.82	-4.66	0.95	-0.77	0.35	2.4

Source: Ministries of Finance and ECCB Estimates.

Table III
Expenditure Structure, in the ECCU.
(In percent of GDP, 1980-2000 average)

Categories	ECCU	Anguilla	Antigua	Dominica	Grenada	Montserrat	St Kitts and Nevis	St Lucia	St Vincent and The Grenadines
Current expenditure	23.7	21.5	21.9	27.2	25.9	31.3	27.3	20.2	24.2
Personal emoluments	12.3	11.4	11.1	16.5	13.4	14.9	12.1	10.0?	13.0
Goods and services	6.3	10.9	6.1	5.0	4.7	12.7	11.0	4.5	8.0
Interest payments	1.9	0.3	3.0	2.3	2.5	0.5	2.4	1.1	1.3
Transfers	3.1	0.7	1.8	3.6	5.5	3.2	1.8	3.9	1.9
Capital expenditures and net lending	7.9	5.3	4.5	13.5	13.8	11.4	4.5	6.7	6.8
Total expenditures	**31.5**	**26.8**	**26.4**	**40.8**	**39.7**	**42.7**	**31.8**	**26.9**	**31.0**

Source: Ministries of Finance and ECCB Estimates.

Low Revenue Buoyancy

Tax buoyancy is defined as the responsiveness of tax revenue to changes in GDP. A buoyancy coefficient that is more than one suggests that tax revenue is increasing faster than the growth in

GDP. From an overall perspective, total revenue for the ECCU over the review period, with a ratio of 0.95, was not buoyant. Tax revenue for the ECCU as a whole over the 1980 to 2000 period has been generally marginally buoyant – a ratio of 1.04. The direct tax revenues were generally more buoyant, with a ratio of 1.17, than indirect tax revenues at a ratio of 1.01. The period of highest buoyancy was between 1992 and 2000. Tax revenues generally lacked buoyancy, partly on account of the extent of exemptions, both legislative and *ad hoc*, which were granted by the authorities.

1.3 Current Account Balance

Over the period of analysis, the current account balance (defined as the difference between current revenues and expenditures) for the ECCU was in surplus at 1.6 per cent of GDP. St. Vincent and the Grenadines, St. Lucia and Montserrat experienced the largest surplus balances at 5.3 percent of GDP, 4.0 percent of GDP and 2.6 percent of GDP, respectively. On the other hand, Antigua and Barbuda and Grenada experienced negative current account balances as a percentage of GDP.

Table IV
Fiscal Balances in the ECCU (As percent of GDP, 1980-2000 average)

Categories	ECCU	Anguilla	Antigua	Dominica	Grenada	Montserrat	St. Kitts	St Lucia	St Vincent
Current Account Balance	1.64	1.78	-0.54	0.65	-0.3	2.6	-0.11	3.99	5.32
Overall Balance	-2.89	-0.97	-3.73	-6.98	-7.1	0.83	-0.71	-0.71	1.2
Primary Balance	-0.98	-1.35	-0.76	-4.82	4.66	0.95	-0.77	0.35	2.4

Source: Ministries of Finance and ECCB estimates.

1.4 The Primary Balance

The primary balance, defined as the overall balance net of interest payments (excluding inherited portion of financial balance), averaged approximately 1.0 percent of GDP between 1980 and 2000. Grenada and Dominica had the largest negative primary balance to GDP.

1.5 Primary Deficit Gaps

The primary gap is defined as the difference between the primary balance required to ensure a stable debt to GDP ratio and the actual primary balance. The calculations reported in Table V suggest that, on average, over the 1980 to 2000 period, the ECCU as a whole pursued marginally sustainable fiscal policy programmes. However, this aggregate result masks serious fiscal problems of some of the individual countries.

In particular, over the entire period of analysis, there were four countries which on average pursued fiscal policies that were unsustainable. The first two were Grenada and Dominica, which generated primary gaps of approximately 3.6 percent and 3.4 percent of GDP respectively. The other two countries, Antigua and Barbuda and Montserrat, pursued policies that were marginally unsustainable, with primary gaps of 0.1 percent and 0.03 percent of GDP respectively.

Table V
Primary Gaps in Percent of GDP for the ECCU[2]

Country	1980-2000	1980-84	1984-88	1988-92	1992-96	1996-2000
Anguilla			-0.69	0.39	0.27	0.66
Antigua and Barbuda	0.1	0.66	-4.8	-0.94	0.39	3.21
Dominica	3.39	3.49	1.83	5.6	3.1	2.3
Grenada	3.54	14.2	1.6	2.9	-0.27	-0.05
Montserrat	0.03	0.09	0.63	-0.12	-0.23	-0.59
St. Kitts-Nevis	-0.38	-1.3	-5.48	-1.65	0.01	5.07
St. Lucia	-0.82	1.59	-2.68	-2.27	0.96	-1.16
St. Vincent	-3.24	-3.1	-8.55	-4.32	-1.49	0.69
ECCU	-0.08	1.32	-3.29	-0.72	0.45	1.11

Source: Ministries of Finance and ECCB Estimates.

[2] Please note that negative gaps, indicate a sustainable fiscal policy stance and conversely.

In the period 1996-2000, the ECCU, in aggregate, pursued unsustainable fiscal policy stances, with an overall primary gap of 1.1 percent of GDP. For the individual countries, only St. Lucia, Montserrat and Grenada had primary margins and therefore were pursuing sustainable fiscal policy stances during this period. Significantly, this period marked the first time that St. Vincent and the Grenadines generated a primary gap. Of note also is the significant primary gap generated by St. Kitts and Nevis of 5.1 per cent of GDP, indicating a highly unsustainable fiscal policy stance. In addition, Antigua and Barbuda and Dominica with primary gaps of 3.2 percent and 2.3 percent of GDP continue to pursue unsustainable fiscal policy positions.

1.6 Central Government Debt

Between 1984 and 2000 there was a rise in the debt to GDP ratio in the ECCU. Between 1994 and 2001 this moved from 40.0 percent to 55.8 percent. St. Kitts-Nevis, Dominica and Antigua and Barbuda were the three most highly indebted countries in the ECCU.

Between 1994 and 2000 the proportion of debt secured on concessionary terms declined from 82.2 percent of total debt to 71.0 percent (Table VII). The growth in debt and the decline in concessionality contributed to higher debt service payments. External debt service to exports of goods and services was 3.57 percent in 1994 rising to 6.35 percent by 2000. The ratio of debt service payments to current revenues rose from 9.4 percent in 1994 to 14.25 percent in 2000 (Table VIII).

Table VI
Total Central Government Debt to GDP Ratios

Country	1999	2000	2001	2002
Anguilla	4.5	7.6	5.3	9.8
Antigua and Barbuda	99.2	109.2	110.2	122.3
Dominica	64.0	74.2	86.2	103.3
Grenada	47.3	49.4	60.5	85.6
Montserrat	19.1	18.9	18.8	12.6
St. Kitts and Nevis	43.4	75.9	90.5	106.8
St. Lucia	34	34	41.1	46.4
St. Vincent and The Grenadines	61.0	60.3	62.7	63.1
ECCU	57.0	64.5	71.9	83.1

Source: ECCB Debt Digest

Table VII
Concessionality of the External Debt
(in percent of total debt)

Country	1994	2000
Antigua and Barbuda	76.5	64.9
Dominica	45.5	72.1
Grenada	99.9	93.2
Montserrat	78.4	94.7
St.Kitts and Nevis	82.7	54.4
St.Lucia	85.4	66.7
St.Vincent and The Grenadines	94.7	59.8

Source: ECCB Debt Digest

TABLE VIII
External Debt Service Ratios

	Debt Service to Exports of Goods and Services		Debt Service to Current Fiscal Revenues	
Country	**1994**	**2000**	**1994**	**2000**
Anguilla	1.27	1.96	5.2	4.8
Antigua and Barbuda	2.0	4.11	8.4	15.9
Dominica	7.26	5.2	14.3	9.0
Grenada	5.34	2.56	9.85	5.8
Montserrat	2.2	0.7	3.8	1.55
St. Kitts and Nevis	5.1	14.2	12.5	21.5
St. Lucia	3.13	9.8	8.3	20.6
St. Vincent and The Grenadines	5.7	6.1	9.3	11.1
ECCU	3.6	6.4	9.4	14.3

Source: ECCB Debt Digest

The issue of tax reform in the context of trends in the economy also arises because of discontent with the existing tax system in the ECCU, associated with its structural weaknesses and the administrative complexities.

1.7 Administrative Complexities

The tax system in some countries is complex and difficult to administer. For example, the revenue system of Antigua and Barbuda contains over 40 separate taxes and charges. Many of these taxes are levied on similar bases. A large number of exemptions in the tax systems of the ECCU add to this complexity. The tax base is narrow, with loopholes, incoherent provisions, concessions, unfocused incentives and weak compliance. The narrow tax base is a direct result of the high level of concessions which results in a high effective tax base on a few commodities. In addition to these factors there is the issue of the level of tax arrears.

1.8 Structural Weaknesses

The tax system in some countries suffers from a number of structural weaknesses. In some countries corporate and non-corporate tax bases are difficult to control, thereby facilitating tax avoidance. The statutory rate is also high. Total tax rates on many consumption items are high precisely because of the narrow tax base. The revenue potential of the real property tax could be further exploited, and there is scope for the introduction of a more progressive structure. The system is further compromised by an extensive array of tax concessions.

1.8.1 Earmarked Levies

In countries where income taxes do not now exist, the authorities have introduced a number of specific levies earmarked for specific expenditures. These include health expenditures, education, social services, etc. However, there is a perception by the general public that invariably these funds are not used for the purposes for which they are promoted.

1.8.2 Tax Burdens

Tax burdens are measured as tax revenues to GDP ratios**.** The tax burden has been reasonably high in most countries, averaging approximately 21.3 per cent for the ECCU as a whole. For some countries such as Antigua and Barbuda, where the tax burden appears to be low - approximately 17.7 percent of GDP - this may in fact be misleading as a number of activities are being financed by licenses and levies which go directly to statutory corporations and therefore do not feature in the central government’s tax net.

Another issue of concern is the general sustainability of these ratios over the long term. Given that these ratios are close to the international norms and the general perception that taxes are already too high in the regional economies, there is tremendous pressure for tax rates to be lowered over the medium term, irrespective of governments’ expenditure programmes.

1.8.3 External Factors: Full International Economic Integration

The fuller integration of the economies of the ECCU into the global financial and trading systems raises issues surrounding the taxability of factors of production or income, capital, labour and land. Globalisation has resulted in a situation where the room for fiscal manoeuvre by governments is considerably reduced. It requires that the revenue systems worldwide be at least compatible and skewed in the direction of relatively immobile factors, at least in the short term. The other implication of this, of course, is the pressure to tax expenditure generally but in particular, consumption more heavily. However, given the earlier discussion on the perceived high tax rates which already exist in these countries and the fact that the tax system is already focused largely on taxing consumption, it means that the degrees of freedom for action is considerably reduced. The expected net result of the increased mobility of the factors of production is a fiscal squeeze on the public sector, as revenues stagnate but expenditures are difficult to contain.

All ECCU member countries are signatories to the WTO and participate in other international trade agreements. However, given the existing structure of these economies, a significant portion of revenues originates from taxes on international trade and transactions. Given the specific provisions of the trade agreements, there is an urgent need for countries within the ECCU to re-examine their fiscal regimes and to redesign these in a manner which promotes competitiveness and encourages exports.

It is in this context that the governments need to examine the imperatives for economic growth as part of any programme of tax reform.

Section 2

THE IMPERATIVES FOR ECONOMIC GROWTH

Faced with negative trends in economic growth, employment, social indicators, and fiscal performance over the recent past, OECS governments have formulated new strategies for output and employment growth as well as improvements in human development, based upon the expansion of incipient sectors and the diversification of more established ones. These are reflected the Five-year Development Charter approved in October 2002 by the Heads of Government to bring about an overall reform and transformation of their economies on a phased basis, beginning in January 2003 and ending in December 2007. The Plan calls for new initiatives by governments to lay strong foundations for economic growth and stimulate production in the sectors identified.

Among the productive sectors targeted in the Charter are non-tourism services, tourism services, financial services and non-traditional agriculture. The effective use of Information and Communications Technology (ICT) and substantially improved efficiency in investment, have been identified as key elements in the creation of a strong foundation for growth.

2.1 Information and Communication Technology

The development of Information and Communications Technology to provide a platform for the development of e-commerce will be necessary to bring the economies of the ECCU in line with the global economy. This is also vital to social and economic development as it has the potential for stimulating economic growth, generating employment, and improving administrative efficiency. Since the quality of ICT infrastructure is closely linked with the state of e- readiness of a country, the ICT strategy will be examined in the context of a strategy for achieving e-readiness in the ECCU.[ii]

E-readiness is here defined as the level of preparedness of the public and private sectors with regard to the technological structures, policies, human and institutional resources to participate in the local and international communication network. The most important considerations are the extent of access to information and communication technologies and the level of connectivity to the global network.

The Centre for International Development at Harvard University, USA, has identified five central elements to be considered in assessing the state of e-readiness of a country. These are physical infrastructure; extent of access by citizens; application of ICT to daily life; the development impact of ICT in relation to income, employment, human resource utilisation, occupational structure etc; and the policy, regulatory and enabling environment. Assessed against these elements, the state of e-readiness in the ECCU must be considered as low.

A number of studies on e-readiness that have been undertaken for the region have shown that there exists the basic infrastructure for telecommunication services to support the development of an Internet economy. However, there are a number of limiting factors. These include:

- The level of Internet connections is considered to be very low;
- The cost of Internet access is very high;
- Computer access and use in the community, and particularly in the rural areas, is limited;
- The level of information technology skills is low and is aggravated by the brain drain in that area; and
- The legal and administrative framework for the development of e-commerce is rudimentary.

A regional approach to the development of an ICT strategy is necessary. A regional strategy will allow for economies of scale, harmonisation, and gains for the best practices. It is recommended, therefore, that responsibility be assigned at the political level for leading the development of such a strategy. Additionally, the following have been identified as major steps to be taken in efforts to improve the state of e-readiness in the region:

- Establish national and regional ICT policies and strategies;
- Develop a regional coordinating entity or Council, and build institutional capacity;
- Develop an industrial policy and sector plans and establish ICT projects which can be piloted in one state and rolled out to different states; and
- Undertake public sector reform and modernization through the development of e-government.

The strengthening of ICT must be accompanied by improvements in the efficiency of investment.

2.2 Improving the Efficiency of Investment

At the macro-economic level, investment is the main generator of economic growth and is derived from either domestic or foreign savings. How fast an economy grows is dependent not only on the quantity of investment but also, importantly, on the quality and efficiency of such investment. The Incremental Capital Output Ratio or ICOR, an economic indicator popularized by Sir Arthur Lewis, is used to assess the macro-economic efficiency of investment. It also indicates the level of investment that is required if desired growth rate targets are to be achieved. ICOR is derived by dividing aggregate investment over a period of time by the incremental output over the same period. The ICOR for developing countries normally ranges between four and six. Low ratios are indicators of investment efficiency while higher ratios indicate investment inefficiency.

For the period 1993-2001 the ICOR for the OECS as a group was as follows:

8.4	in 1993 - 1996
8.7	in 1993 - 2001 and
11.4	in 1997 - 2001

These figures show that investment was not only inefficient but that the situation seems to be worsening over time.

2.2.1. Factors Affecting the Efficiency of Investment

A number of factors contribute to the efficiency of investment. Some of these are outside the control of the countries. The principal factors over which the countries have little control are natural disasters, limited critical mass and economies of scale and the situation in the major export markets. However, even these factors can be mitigated by project design and construction and market diversification.

Most of the factors that affect the efficiency of investment are under the control of the economies and include:

- **poor project selection** and embarking on projects that have financial and /or economic rates of return that are either significantly lower than the nominal and opportunity costs of capital, e.g., ostentatious housing or social projects;
- **poor programme composition** with heavy imbalances in the composition of the investment programme, e.g., too much emphasis on social projects at the expense of economic infrastructure or directly productive sector projects;
- **poor project design**, among other things, not designing projects to suit local conditions e.g. heavy use of air conditioning in the tropics, and not designing to withstand the effects of storms and moderate hurricanes;
- **inefficiency in construction** arising from poor tendering, management and scheduling;
- **high construction costs and overruns** arising from high finance costs and poor procurement procedures; and
- **underutilization and even migration of skills**.

2.2.2 Steps Towards Improving Efficiency of Investment

The Investment/GDP ratio for the OECS countries for the period 1993 to 2001 was 34.5 percent. After adjustments for depreciation and maintenance of 5 percent, loss through natural disasters of

7 percent, and assuming population increases of 1.2 percent, this level of investment with an ICOR of 8.4 percent will only support a growth rate of 2.7 percent. If the 1997-2001 ICOR of 11.4 percent is applied, the resultant growth rate is 2.0 percent. As previously indicated, in their Development Charter the OECS governments have agreed to a target growth rate of 6.0 percent. *With the existing efficiency of investment at an 11.4 ICOR, the required Investment/GDP ratio is an impossible 94.1 percent. Even at an efficiency level of ICOR 8.4 the required Investment/GDP ratio would be a very hard to achieve 72.5 percent.*

Accordingly, if the OECS countries are to achieve their growth targets they have first to improve the efficiency of their investments and increase the level of their savings and investments. To ensure that the efficiency of investment is enhanced governments need to ensure the following, that:

- the projects they promote are technically feasible, cost-effectively designed and satisfy economic and financial viability tests;
- tendering, management selection, and procurement are awarded on the basis of competitive transparency;
- selected projects are part of an integrated programme;
- supportive policies and institutional arrangements are in place to optimize the macro-benefits.

This is best done through the framework of Public Sector Investment Programmes that are consistent with Medium Term Economic Frameworks, and Macro-economic Investment Management Plans with crude indicative distributions.

The development and management of the Public Sector Investment Programme is no longer vigorously undertaken and the process must therefore be strengthened.

The following is an example of a rough rule of thumb for investment targets:

- **Public Sector**
  - Social infrastructure such as schools, hospitals, community facilities: 5 percent of GDP

  - Economic infrastructure such as roads and ports: 8 percent of GDP
  - Productive investments in joint venture arrangements with the private sector: 2 percent of GDP
- **Private Business Sector**
  - Economic infrastructure such as utilities: 5 percent of GDP
  - Productive investments in agriculture, industry, tourism, commerce, other offshore and domestic commercial services: 12 percent of GDP
- **Households**
  - Social infrastructure in housing: 5 percent of GDP
  - Social infrastructure in tertiary education: 3 percent of GDP
  - Economic infrastructure and productive investments: 5 percent of GDP

Governments must endeavour to create a climate conducive to investment efficiency. This will include the development of appropriate policies, the right balance of cost-effective economic and social infrastructure and institutional arrangements to facilitate productive activity and the cost-benefit of overall investments. The level, composition and efficiency of public sector investment are critical in creating the environment for a vibrant process of national investment to spur fast economic growth.

2.3 Development of the Sectors

2.3.1 Non-Tourism Services

The development of capabilities in and the appropriate application of ICT can increase competitiveness in a number of service industries. Apart from the already established tourism and financial services, CARICOM countries are already exporting a range of business and professional services. These include accountancy, architecture and engineering services, computer and database services, Web design and other Internet-related services, data processing and data repair services, legal services, consultancy, market research, equipment and property maintenance services, services related to agriculture and fisheries, research and development, security services, wholesale and retail services, educational services, health related services, cultural and sporting services, and multi-media and film production services.

Much of this export activity is being undertaken by small providers. Small firms, especially those with less than 20 employees, play a significant role in the services industries in developed countries and in international trade. They are ideally suited to the OECS because of their high value added and their small size. However, they are knowledge-intensive because of the high level of professional skills required.

2.3.1.1 Action Plan/s for Non-Tourism Services

The following are recommended steps in the development of an action plan for non-tourism services:

(a) Undertake surveys to determine local business and professional capabilities and skills and identify the services that could be supported by these capabilities;

(b) At both OECS and national levels, designate ministerial responsibility for the development of non-tourism services, constitute sub-regional and national machinery with private sector involvement to serve as advisory mechanisms to governments;

(c) Conduct detailed feasibility studies of each service and prepare action plans for its implementation;

(d) Target firms that could be encouraged to enter export markets, assisting them with specifications of skill requirements and training needs, the identification of possible partners in production/exports, market areas to be penetrated, and negotiating strategies for so doing;

(e) Prepare plans for government support of targeted firms including local business opportunities that could be provided by local governments/private sectors.

2.3.2 Tourism Services

2.3.2.1. The Need for Diversification

Governments already recognise the need for both product and market diversification in tourism. The traditional packages of sand, sun and sea are losing competitiveness to other lower cost destinations. Tourists are increasingly showing a preference for different attractions, such as eco-tourism, heritage tourism, cultural tourism, and nautical tourism. Changes in patterns of demand, as well as the fall-out from threats of international terrorism, both point towards an increasing need to diversify attractions including the development of multi-destination packages.

For example, Dominica with its abundant natural resources is well placed to establish partnerships with neighboring islands offering the traditional packages of sun, sand and sea. Day trips to Dominica by tourists based on another island can enhance the variety of the tourism package while permitting Dominica to increase its tourist arrivals without a concomitant increase in hotels and other infrastructure. Similar complementarities may be possible with respect to diving, deep-sea fishing, and entertainment. The development of multi-destination packages through exploitation of complementarities will increase the appeal of the OECS to tourists.

Table IX gives an indication of some of the core areas of strength of the various islands.

TABLE IX
Complementaries in Tourist Destinations

	Historic Buildings and Sites	Heritage Areas	Eco-Tourism/ Nature	Music, Entertainment and Culture	Yachting/ Boating	Diving and Deep Sea Fishing
ANGUILLA				☒	☒	☒☒
ANTIGUA AND BARBUDA	☒			☒	☒☒	☒
DOMINICA	☒	☒☒	☒☒	☒		☒☒
GRENADA	☒		☒	☒	☒☒	☒
MONTSERRAT			☒	☒		☒☒
ST VINCENT AND THE GRENADINES	☒	☒	☒☒	☒	☒☒	☒☒
ST LUCIA	☒		☒	☒☒	☒	☒
ST KITTS AND NEVIS	☒☒		☒	☒		☒

The Table presents a very rough and imprecise indication of areas of strength, however, it suggests that most islands have much to offer in the area of history, music and culture and facilities for nautical tourism. Dominica and to a lesser extent St. Vincent and the Grenadines, may be the principal islands for heritage tourism (their Carib settlements being a major attractions) and eco-tourism. Both the common (not necessarily homogenous) and unique attractions can provide bases for further diversification of the industry.

2.3.2.2 Promotion of Tourism

All of the OECS states already recognise the need to engage in vigorous promotion of local, regional and foreign investment in their tourism sectors. This would necessitate efforts by governments themselves to encourage product improvement and innovation and the maintenance of an environment free of crime and harassment. Governments must also work with hoteliers and other operators of tourist attractions to achieve price competitiveness in the industry in a context where other destinations in the wider Caribbean are offering a variety of lower cost packages.

The following are recommended as important steps in the diversification of tourism:

(a) Local Tourist Boards on a national/sub-regional basis should undertake analytical studies of new attractions and packages. Tourist boards should convene meetings of hotels and tour operators to discuss the new packages and public relations/advertising programmes to market them.

(b) Governments will be expected to contribute towards core budgets for these programmes, but donor assistance should be sought for the initial promotion.

(c) Tourist Boards should undertake intensive programmes of public education to sensitise local publics to the importance of the "new tourism" strategies for local economies and to solicit their full support in marketing the packages.

(d) Determined efforts should be made to find new markets, e.g. Eastern European members of the EU, Japan, South East Asia and high-income sectors in Latin America.

(e) Air charter services for these new markets should be explored.

2.3.3 Financial Services

In the area of financial services, the OECD regulatory regime has set back the growth of the offshore banking sector. Accordingly, it is doubtful whether this sub-sector could regain its position as a major engine of growth. However, experience in other parts of the Caribbean indicates that there are opportunities in other areas such as insurance, fund management and securities trading. Taking advantage of these opportunities will involve the development of new products and possibly the development of local firms and the further attraction of overseas firms and/or partners. All of the governments must underline and present to the international community a strong commitment to best practice and to effective regulation of the sector.

2.3.4 Non-Traditional Agriculture

The diversification of the agricultural sector beyond the traditional industries of sugar and bananas to include non-traditional crops and fishing has for long been part of development strategies. It has now assumed critical importance because of the very negative market prospects for the traditional staples, which are already leading to production declines. Accordingly, governments are moving urgently to put in place comprehensive programmes for growth in production of non-traditional crops and fishing.

Some progress has already been made in defining a strategic focus and the elements of a policy framework for developing the sector. In December 2002, Ministers of Agriculture met in St. Lucia to consider a plan of action for development of the sector. Six areas were identified for immediate attention:

- strengthening institutional capacity and support
- access to credit
- production and marketing
- public/private sector participation
- legislation
- fisheries development

Following upon that, four main programme areas emerged: policy and legal reform; natural resources management; financial options and incentive regimes; and product development and marketing.

In addition to these areas, the strategic focus will also include cross-cutting programmes in human resources development, research and development, public-private sector participation, coordination and networking.

The central issues which need to be pursued relate to enhancing production and productivity, and putting into place efficient marketing arrangements for both fresh and processed products designed to penetrate intra-regional and extra-regional markets.

2.3.4.1 Imperatives for Development in Agriculture

A modern, efficient agricultural economy will require developments on several fronts. These include **Product Development** in both traditional and non-traditional crops. In both categories there are tremendous gains to be made from a shift to organic production. In addition, the potential for fish production, both marine and land based, needs to be harnessed.

Among the crops in which members states have indicated an interest are: fruit in all countries; vegetables and condiments in the Leewards; minor exotics (e.g. passion fruit, pineapples and soursop) in the Windwards and Montserrat; root crops in Dominica, St. Lucia and St. Vincent and The Grenadines; and livestock, primarily for domestic consumption, in all countries.

There is a general need for strengthening **Market Intelligence** systems, and developing the capacity to respond to domestic demand (tourism), regional demand (with a food security focus), and demands of international markets. At the international level, reports indicate a growing demand for tropical exotics, particularly organically produced fresh and processed products, and fish for which world demand is growing in excess of 6 percent per annum.

Another requirement is the development of an appropriate **Institutional Framework** (including legislative) to provide the necessary supports to both production and marketing with more direct private sector involvement. This will require new corporate approaches, for example, the development of mixed enterprises in which a number of interests can participate (e.g. governments, farmers, distributors (both local and overseas), and consumers. The existence of the East Caribbean Stock Exchange provides an opportunity to develop publicly listed companies along these lines. The institutional arrangements used for the development of the banana industry in the Windward Islands contain many, though not all, of the elements required for new organisational structures. Marketing Boards could also be suitably adapted to meet the new requirements.

It is argued later that governments need to move beyond their roles as facilitators, to become institutional innovators, creating new corporate and management structures which combine the capabilities of government with those of other entities, both at home and abroad, to support the development of the new economic activities.

Beyond corporate structures, governments have to tackle with exceptional vigour the needs that will arise for concessionary finance/donor assistance to drive the supports required in production inputs, product insurance mechanisms, value added initiatives (processing, cold storage), quality assurance, packaging, trade marking and in country/in market promotion. Altogether, given the limited, even negative, results arising from past efforts at agricultural diversification, governments have to be prepared to make unprecedented efforts in persuading local agricultural and business interests, potential partners within CARICOM and abroad, financial sources, especially external donors, to take a fresh look at the possibilities in the agricultural sector and to engage in commensurate action to realize their potential.

The following are recommended as important steps in the implementation of new strategies for agricultural diversification:

(a) A sub-regional organisation or particular member government should be mandated to update the analytical studies which are now about ten years old. These studies should be made available to interested member states for consultations with local farmer organisations and farmers. Discussions should lead to the formulation of sub-regional or national business plans for each of the crops / clusters of crops.

(b) In collaboration with the Caribbean Development Bank, approaches should be made to external donors, e.g. EU/ACP Private Investment Facility for quasi-concessionary finance, and the EU for concessionary finance, in particular areas where local capabilities may be deficient, e.g. start-up capital, technical assistance for international certification of production, technology for storage, packaging, and freezing of produce. This could take the form of quasi-equity finance for local companies.

(c) Convert local marketing boards or establish them where they do not exist, as publicly listed companies with shares partly subscribed by governments, and open to subscription by farmers, local distributors and the public at large.

(d) The marketing companies should be run on commercial lines. Their functions will be to contract deliveries from farmers at negotiated prices, store, package, freeze and process produce. They should sell on a contract basis to local distributors and overseas outlets. They may form partnerships/alliances with other companies and overseas distributors.

If the targets for economic growth are to be achieved, the governments of the OECS must create the optimum environment for growth. There are a number of policy instruments which can be used effectively to achieve development. These include Monetary Policy, Trade Policy, Incomes Policy and Fiscal Policy. In light of the monetary arrangements already in place and prospective international developments, the next effective policy area available to the governments of the ECCU is fiscal policy.

Section 3

THE ROLE OF FISCAL POLICY AND FISCAL HARMONISATION IN THE CONTEXT OF A CURRENCY UNION

3.1 Fiscal Policy

Fiscal policy relates to government taxes and expenditure designed to influence the level of overall demand in the economy and its course of development. Fiscal policy embraces the use of taxation to achieve a desired pattern of income distribution, the provision of incentives or disincentives to influence consumer expenditure, and private and public investment. It assumes that government or the public sector will play an active role in the society and economy somewhat along Keynesian lines. Monetary policy, on the other hand, relates to government's strategy, normally implemented through its central bank, for affecting the money supply and influencing wage and price levels, including the rate of interest, and the exchange rate. Monetary and fiscal policies both seek to achieve the desired growth and development goals.

It has been suggested that monetary and fiscal policies were applied to Caribbean economies in a manner applicable to large and developed economies, and without adequate recognition of their special nature: their small size, openness and heavy reliance on international trade. Once this special nature was taken into account, it was seen that the standard monetary and fiscal policy framework was defective when applied to the Caribbean and that the concept of an 'integrative public finance and monetary policy' was of greater relevance. This latter concept sees the fiscal system as particularly significant in Caribbean economies where the public sector should be seen as a major engine of growth. While this view is now well established, there are still those who would assign primacy to the role of the private sector. In practice, the relative significance of the public and private sectors in the region varies from country to country and even from one island to another in a given twin-island or tri-island arrangement.

In sum, fiscal policy may be seen as the government's design for taxation and spending intended to chart and influence the level of aggregate demand along some given macroeconomic path. According to Davie and Duncombe (1972: 28), depending on *"the economic conditions existing in the economy, the combined impact of public expenditures and revenues will affect prices, employment, and through the marginal propensity to import and changes in relative prices, the balance of international payments. Fiscal policy is this combined impact of public expenditures and revenues on economic activity."*

Fiscal policy may be examined in relation to implicit fiscal policy, and explicit fiscal policy.[iii] "Implicit fiscal policy is the combined impact of public sector expenditures and revenues when the goal of economic policy concerns resource allocation or equity rather than stabilisation." On the other hand, "explicit fiscal policy" usually requires (Parliamentary) action to initiate or expand expenditure programmes or to change tax rates or bases." The St. Vincent and the Grenadines issue of $30 million development bonds 1997-2007 on January 21, 1997, is an example of explicit fiscal policy designed to fund various capital development projects in that country.

The launching by St. Kitts and Nevis of a EC$70 million dollar bonds on the Regional Government Securities Market (RGSM) on November 18, 2002 under the auspices of the Eastern Caribbean Stock Exchange is another example of "explicit fiscal policy." Similarly, the 1998 upgrading of the main island road in St. Kitts, the OECS Solid Waste Management Project and the Basic Education Project in St. Kitts and Nevis are examples of explicit fiscal policy initiatives. The expenditures on these projects were designed to improve the infrastructure of the country, raise the health standards, expand investment opportunities of the country, and improve the human capital formation of the population through developing the educational capability of the population.

Some taxes are said to have built-in automaticity. It is therefore necessary to ensure that fiscal policy has a positive impact on economic development and transformation as one of its major goals. By automaticity is meant that tax receipts tend to vary directly with changes in GDP. Thus the impact of fiscal policy could be either active or passive. An example of passive fiscal policy is the case where GDP and national income increase in a country and personal income taxes rise, but property taxes remain constant.

A country may use its expenditure programmes to have a short or long-term impacts. Short-term programmes are sometimes called crash programmes, and are directed to providing an immediate fiscal stimulus as opposed to the longer-term developmental goal. However, these types of short-term programmes can have a long-term impact on the GDP if they are worked into the system in an efficient manner.

Fiscal policy in a Currency Union is more difficult to manage than in a single economy. Typically, fiscal policy is designed to be specific to the country or the state in question. However, the peculiarity of the OECS is such that the Eastern Caribbean Central Bank (ECCB) has been given the scope to promote an integrative monetary and fiscal policy in the overall ambit of monetary affairs of the Union - (See ECCB Agreement). This is really the essence of attempts to develop an integrative fiscal and monetary policy. Once it is accepted that a combined monetary and fiscal policy approach to economic development is desirable, it becomes clear that in a Currency Union they should be used in a complementary way, as opposed to being contradictory or competing.

This is especially important in the ECCU as it operates under a fixed exchange rate regime requiring the Central Bank to maintain adequate foreign reserves. Given the link between monetary and fiscal policy, uncoordinated fiscal policy among member states can adversely affect the monetary policy of the Currency Union. To ensure coordination between fiscal and monetary policy, it is desirable that member countries establish fiscal convergence criteria and develop mechanisms to monitor the convergence criteria. Such fiscal benchmarks were introduced in the European Union and are provided for in the Maastricht Treaty. The West African Economic and Monetary Union (WAEMUO) and the Central African Economic and Monetary Community (CEMAC) all require adherence to similar fiscal rules.

The ECCB had previously proposed fiscal benchmarks for the member countries of the ECCU as follows:

(a) Current account fiscal surplus of 4.0 percent of GDP;
(b) Overall fiscal deficit not to exceed 3 percent of GDP;
(c) Central government debt to GDP ratio not to exceed 60 percent of GDP;
(d) Debt service payment ratio to current revenue not to exceed 15 percent.

The requirement of 4.0 percent of GDP current account surplus was based mainly on the need to provide adequate counterpart financing of the order of 3 percent of GDP to support an annual capital expenditure budget of about 7.0 percent of GDP and principal repayments of about 1.0 percent of GDP. The overall fiscal deficit of 3 percent of GDP was based on the difference between the minimum savings ratio of 4 percent and the capital expenditure ratio of 7 percent. The 60 percent debt ratio was based on generally accepted international norms and standards used by international rating agencies such as Standard and Poors.

Table X

2002 Fiscal and Debt Indicators	Debt to GDP[1]	Debt Service to Current Revenue	Current Account Balance to GDP[1]
Fiscal Benchmarks	**60%**	**15%**	**4 - 6%**
Anguilla	2.8	4.3	1.0
Antigua & Barbuda	125.9	32.7	(1.5)
Dominica	95.7	28.9	(5.6)
Grenada	74.3	35.6	1.2
Montserrat	16.5	19.4	(34.5)
St. Kitts & Nevis	105.4	34.9	(2.7)
St. Lucia	39.9	33.7	1.9
St. Vincent & the Grenadines	63.0	24.1	3.1
ECCU	**80.0**	**30.6**	**(0.6)**

Debt Data includes External Debt Arrears

GDP at Market Prices

Source: Statistical Offices and ECCB

Most of the member countries do not currently meet these proposed criteria (Table X above) but they should be encouraged to do so in the interest of sustaining their goals of monetary stability and a stable and fixed currency. The setting and keeping of such targets are an important aspect of fiscal discipline and tax harmonization.

3.2 Debt and Fiscal Discipline

Fiscal discipline is necessary if the states in the OECS are to achieve the growth and development targets they set for themselves. Fiscal discipline is sometimes taken to mean the maintenance of a balanced budget. However, in order to achieve development, governments must go beyond that. They must make deliberate efforts to generate adequate domestic revenue to cover current operations and a surplus to contribute to the financing of capital programmes, to accumulate an adequate level of reserves for emergencies, and to implement economic stabilization programmes, as may be necessary.

Fiscal discipline in the ECCU should be given priority in order to enable the region to cope with the competitive demands of the new globalized environment and to be able to respond to rising expectations among the people of the ECCU. Prudent debt management is an important aspect of this. The debt ratio, that is, the ratio of national debt to GDP, is an indicator which governments should monitor in order to determine measures they should follow to avoid imbalances in the economy resulting from excessive debt. To this end, it is suggested that bands of debt to GDP ratio should be established as guides within which the countries should operate. These should be based on established targets for the overall deficits of the governments. When these are set, the average of the last three years of revenues and expenditures could be utilised as a guide for planning. This would provide the government with a clear picture of the relationship between the present fiscal situation and its growth and development targets, facilitate better management of the annual budget deficit, and minimize problems in forward planning.

The size of the annual current account deficits often does not always tell the full story. The following methodology is therefore recommended to assist with obtaining an effective measure. The moving average of the last three years should be the lower limit of the status and direction of the expenditures and revenues of the country. The upper limit should be that average plus an estimate of population growth and inflation. By way of illustration, if, over a three-year period, revenues and expenditures were $130m, $150m, $170m, with an average of $150m, then this figure will be the lower average limit for operations. The upper average limit for operation will be that average plus estimates for population growth and inflation. If, for example, population is estimated to grow by 1.0 percent and inflation is expected to increase by 9.0 percent, then the lower limit would be raised by 10.0 percent. The upper limit then becomes $165m. This may be one of many approaches for a reasonable understanding or estimate of the operational demands of the countries. One benefit implicit in all of this is that it brings into focus policies that may be directed at the management of the growth in population and inflation. Population growth is taken into consideration because the changing demographics of countries can impose stresses and strains on the fiscal situation and can handicap the achievement of development objectives.

Many existing models of revenue and expenditures, tax multipliers and government expenditure multipliers, tend to overstate and/or understate the accuracy of revenue and expenditure forecasts. In view of this, the simple bands of revenues and expenditures projections could serve as a first approximation for debt planning, debt containment, and debt management in the OECS.

It is to be noted that the level of the national debt is not significant, taken in isolation. The more meaningful measure is the debt to GDP ratio. It is also important for governments to consider the long-run implications of the pattern of the budgetary debt. Some authorities note that as long as the current debt is not growing at a rapid rate, it is not a problem, but it is suggested that a more realistic benchmark is that the "current stock of debt plus the present value of all future primary deficits should not exceed zero." In the normal course of events, this suggests that in the long run, chronic debt should be contained, and that surpluses should be planned and encouraged.

Again, if the size of the national debt is not to become a problem, it should be properly managed, appropriately structured, and closely linked to projects that are holistically developed. Debt which is incurred without specific reference to an overall planning framework, time frame, identifiable strategy or source of funding, tends to have a life of its own and a tendency to get out of control. It would also be desirable for it to have its own revenue stream. If these parameters do not exist, then as in the biblical expression, it will become a millstone around the people's neck.

In the ECCU there is a shortage of local investment capital. External borrowing is therefore necessary to finance development projects. However, in micro-economies like the OECS, high and excessive levels of debt must be avoided at all cost. High and excessive debt means debt in excess of the debt/GDP ratio limit of 60 percent. The management of the debt along the lines described above, is a necessary part of fiscal prudence and fiscal discipline and should be institutionalized in any system for the better management of the economy. Fiscal discipline and proper debt management are the *sine qua non* for the development of microstates such as those of the ECCU.

Fiscal prudence and discipline will strengthen the Currency Union and the currency itself. In a Currency Union, it is expected that the beneficial effects of joint use of the currency will redound to all members of the Union. The special characteristic of the OECS Currency Union is the existence of the ***unanimity principle***. This means that for the EC dollar to be devalued, given its peg to the US dollar, all members of the ECCU must agree on devaluation.

Three features are of the institutional and public policy framework of the ECCU underpin the unanimity principle:

- According to Venner (2000.1) the ECCB Agreement and specifically the so-called entrenched Clauses, Articles 17 (2) and 24 (2) support the concept of a fixed exchange rate by requiring unanimous decisions by the (Monetary) Council to change the parity and the backing for the currency.

- The Monetary Council has explicitly supported the fixed exchange rate by outlining what has been referred to as a "strong dollar policy." The participating governments, by their pronouncements and policies, have subscribed to the fixed exchange rate and the "strong dollar policy."

- The populations of the OECS and the governments of member states have explicitly and implicitly supported the fixed exchange rate by holding the Eastern Caribbean

> (EC) currency as a medium of exchange and a store of value in very large proportions. It is more than noteworthy that there is no black market for currency in the EC Currency Union.

These social, political and economic features of the OECS arrangements, and the unanimity requirement make a devaluation of the EC dollar highly improbable, and ensure the maintenance of a strong currency. The EC dollar has continued to be pegged to the USA dollar for over twenty-five years and the member states have continued to support this. This suggests that the original policy framers were farsighted in their decision to adopt the unanimity principle.

Nevertheless, it should not be ignored that some continue to hold the view that a floating exchange rate would have been the ideal for the region, but there can be no doubt that the stability that has been experienced in the economies of the Union over the years can be attributed in large measure to the fixed exchange rate of the EC dollar.

In this context, fiscal harmonisation which is discussed in the following section, is indispensable to the development of the Currency Union.

3.3 Fiscal Harmonisation

The similar nature of the OECS economies, namely their small size and narrow structure, and their relatively similar economic, administrative and other institutional arrangements, should make it comparatively easy to harmonise their fiscal strategies. Fiscal harmonisation would facilitate closer cooperation and joint operations to permit the efficiencies of economies of scale and scope in both the administration and a range of services such as health care delivery and educational services, telecommunication and information technology and regional transport. It would be an important step towards tax administrative reform. Finally, it would lead to considerable improvement in the efficiency of the operations of the Currency Union.

While it may be clear that fiscal harmonization and joint cooperation in the use of both economic and administrative resources are more efficacious in the long run than acting in isolation, the propensity of the countries in the region to insularity means that the adoption of a harmonized approach, especially in fiscal policy, will require a fundamental attitudinal change in these countries and governments. However, it is hoped that there are enough examples of close cooperation and integration among large states in order to achieve economic viability and even survival, to persuade the small and vulnerable countries of the ECCU of the need to act in harmony to achieve a minimum critical mass, and to adopt common policies in order to address the global agenda with some confidence and chance of sustained economic growth.

The OECS region already has in place two treaties that can serve to underpin greater cooperation and coordination in fiscal and other economic policies: The Treaty of Basseterre of 1971 that established the OECS and the 1983 Eastern Caribbean Central Bank Agreement. These can be the platform for a more deliberate and determined effort by policy makers (especially those in these two institutions) than in the past, to seek to move the region to a deeper level of unity. This is the more urgent with the challenging circumstances of globalization, since individual action will be both costly and ineffectual.

The task of fiscal harmonization involves identifying what taxes exist, arriving at consensus on which taxes will be maintained, agreeing on the elimination of those which are revenue neutral, and promoting those which are revenue enhancing. It also involves the establishment of appropriate legal and administrative mechanisms to monitor and sustain the harmonisation targets and decisions.

Accompanying those decisions must be a public educational programme about the role of government in economic development and fiscal management in the OECS states. The societies must be helped to understand the role of taxes: that they are levies on income, property and goods or services, whether directly or indirectly, whose purpose is to raise revenue, to deter or encourage an economic activity, in the interest of those who pay them. Many persons in the OECS, and perhaps in the entire Caribbean, see taxes as merely a government device to extract funds from the population. Public education must be used to assist them in perceiving that the revenue derived from taxes brings tangible benefits to themselves and the society as a whole.

Governments should therefore at both the state and regional levels, mount a serious educational campaign about the importance of the role of taxes in the system. The programme should be coordinated and not contradictory. It is a major task, but it is necessary if the idea of harmonisation is to be meaningful and successful.

3.4 Currency Union

A currency union is an arrangement whereby member countries agree to adopt a single currency controlled by a single central bank. The OECS established the Eastern Caribbean Currency Union in 1983. By deliberate policy, the ECCU adheres to the unanimity principle in relation to the exchange rate and a commitment to a fixed regime and a strong dollar policy. This is the framework of monetary policy in the OECS.

On the side of fiscal policy, it has been shown that the size, nature and structure of the OECS states demand a regime of fiscal discipline directed to:

- a balanced budget that also provides surpluses for investment and emergencies;
- a well managed debt policy that protects foreign exchange reserves; and
- an active fiscal role that recognises a critical function of the state that goes beyond minimalist, and prudently seeks to drive the developmental process.

There is an inherent tension between the fiscal and budgetary policies of member states of the Currency Union and the policies of the monetary authorities of the union, since economic and fiscal requirements of individual states may require budgetary and stabilisation measures that are at variance with those required, or even desirable, in the Union as a whole, or as perceived by the Monetary Authorities. To minimize the predictable conflicts member states in the Union are normally expected to agree before hand on fiscal targets designed to achieve convergence necessary for agreed financial and economic targets across the Union. This is an aspect of the policy of tax harmonisation discussed above. Unless this is achieved and maintained the effectiveness of the Currency Union will be seriously undermined.

The strategy of fiscal harmonisation has also been shown to be an appropriate approach for enabling the region to exploit the potential efficiencies and economies that derive from economies of scale and the most efficient use of scarce professional skills in tax administration. It is an essential component of tax reform and tax modernisation in a customs union.

It has been made clear that while tax harmonisation requires some loss of fiscal autonomy to member states, a considerable degree of sovereignty remains, providing scope for a level of budgetary freedom at the state level to enable effective management of the domestic economy.

Finally, the adoption of a regime of fiscal discipline and tax harmonisation in the framework of a Currency Union represents a platform for closer economic cooperation and collaboration. It is a relatively short step from economic union.

The case of closer economic and fiscal cooperation has become more urgent for the OECS as it seeks to negotiate a safe position within the Caribbean Single Market and Economy (CSME) and engages with the wider Caribbean for equitable and favourable terms of entry into the new global arrangements characterised by the World Trade Organisation, the Free Trade Association of the Americas (FTAA) and other regional, bi-lateral and multilateral trade regimes.

Section

4

THE ROLE OF GOVERNMENT AND THE FINANCING OF GOVERNMENT, INCLUDING EXPENDITURE REFORM

4.1 The Role of Government

Governments in the OECS countries play a pivotal role in the development process. One may adopt the notion of the state or government as enunciated in Jones-Hendrickson (1976): "[The] state refers to the government and other institutional mechanisms which interact, sometimes as complementary and at other times (seemingly) contradictory to form what may be termed the state system". Again according to Jones- Hendrickson, (1985: 57) "..the goals (of the public sector) are the promotion of economic growth, the stabilization of economic activity, the efficient allocation of resources, and an equitable distribution of income.

It is axiomatic that the role of government in micro-economies like those of the OECS, must be significant. In micro-economies the basic operations and institutions required for government, automatically bulk large in the GDP. This is the case in all of the OECS states. Table XI indicates that over the period 1992 to 2000, the size of the governments in the OECS, as measured by the ratio of government expenditure on goods and services to GDP (G/GDP) has been of the order of 15.0 percent. This is the single largest component of all of the contributors to GDP, whether in current or constant prices.

Table XI
ECONOMIC ACTIVITY AT FACTOR COST IN CONSTANT (1990) PRICES FOR THE EASTERN CARIBBEAN CENTRAL BANK AREA (EC$M)

YEARS	GOVERNMENT SERVICES	GROSS DOMESTIC PRODUCT	GOVERNMENT SERVICES As percentages of GROSS DOMESTIC PRODUCT
1992	$624.84	$3965.44	15.76
1993	$634.79	$4066.67	15.61
1994	$655.70	$4188.78	15.65
1995	$663.84	$4216.23	15.74
1996	$672.81	$4328.89	15.54
1997	$686.36	$4469.21	15.36
1998	$717.68	$4647.33	15.44
1999	$727.19	$4845.22	15.01
2000	$743.87	$4973.08	14.96

*Source: EASTERN CARIBBEAN CENTRAL BANK, **NATIONAL ACCOUNTS STATISTICS, 2001**, Tables 1.2 and 1.4pp. 32 and 34*

There is no agreed standard for determining the ideal size of government relative to GDP and in practice wide ranges can be observed. In Singapore, often cited as the model small state, Government accounts for 48 percent of GDP. In the USA it accounts for 30 percent of GDP, in Denmark 53 percent. Ultimately, the size will be assessed in terms of its effectiveness in achieving the development goals desired by the people at the least social and economic cost.

With regard to the economic role, the so-called ‘state minimalists’ would argue that the state should be confined to providing an enabling environment. This would include a stable currency, law and order, the social and physical infrastructure, and social and cultural cohesion including the maintenance of literacy in one of the world’s major languages. The OECS has a high rate of literacy in English as a result of 300 years of British colonialism. It is a now a question of maintaining it.

Government’s role in economic management is directed to achieving economic stability, sustained growth, high levels of employment and low inflation. An important aspect of this is its conduct of fiscal and monetary policies and their positive impact on adequate levels of investment for growth and development. In this regard, government’s approach should take into consideration the interactive nature of monetary and fiscal policy, recognizing that there is little room in the microstates of the OECS for individualistic and uncoordinated operations of monetary and fiscal policies within the ECCU. Adherence requires a commitment by the states to a strict programme of monetary and fiscal discipline as a means of fostering a favourable, stable and positive environment for investment.

There remains a view that fiscal policy should support the role of the private sector as the major engine of growth. This would favour a lowering of the tax burden on the private sector to free up of resources for private enterprise to develop the economy through private investment. This view requires careful analysis. It is doubtful whether in small economies domestic consumer demand should be given the same prominence as a determinant of growth and employment, as it merits in large and relatively closed ones. In the first place, total demand is small. Secondly, this demand is principally for imports such as motor vehicles, food and clothing, electronic goods, and, of course, building materials such as lumber and cement.

Cuts in personal income tax leading to an increase in disposable income are therefore likely to result in an increase in imports and thus the depletion of foreign exchange reserves. Even if the tax cuts were confined to corporate income tax, it does not automatically follow that such cuts would lead to an increase in investment and a stimulation of the economy. Many of the productive enterprises in the islands are already enjoying tax holidays of one kind or another. A large proportion of taxes is in fact paid by banks and insurance companies and it does not follow that cuts in their taxes will necessarily result in increased investment.

A feature of these island societies is that they may be unduly influenced through the media, to a view of fiscal policy that favours tax cuts in the same manner as these are applied in economies such as China, USA and Europe where they are used as an instrument of growth. This places government policy makers under enormous pressure to cut taxes. The danger in this situation has been recognized by the ECCB and is described in one of its research papers as follows.

> *"The rise of economic populism in the ECCU mirrors the historical development of the Argentine crises of boom and bust policy cycles. Economic populism is characterised by*

> *expansionary domestic demand policies aimed at income redistribution and job creation. These policies are ultimately self-defeating given a balance of payment constraint".*[iv]

In sum, it would be undesirable for small open economies to rely on domestic consumer demand to drive economic growth; rather it is necessary to look to investment, and above all, to exports. In these very small economies with their narrow resource base and tiny domestic markets, the key is an adequate number of reliable exports to finance import needs.

Public sector investment is one device that governments might use to provide the enabling environment that is needed. Public sector investment, particularly construction, can boost the level of economic activity especially during a recession, and many small states regard construction as the swing sector of the economy to be used for moderating booms and recessions. This emphasises the importance of the Public Sector Investment Programme (PSIP) in the countries of the OECS.

In the pre-Independence period, most of the PSIP was financed by grants from the UK and its Ministry of Overseas Development, which, through its Division in the Eastern Caribbean, gave considerable assistance with the identification, preparation and implementation of projects. This facility is no longer available.

Today, European Union (EU), the Caribbean Development Bank (CDB) and commercial loans finance most of the PSIP. In addition, the local National Insurance Schemes set up just prior to independence, have been a useful source of local investment capital. Some governments have also set up national commercial banks largely utilizing funds from National Insurance.

Currently, most of the OECS countries have debt levels in excess of the ratio of 60 percent of GDP levels considered prudent. Admittedly, some of the borrowing has been wisely handled. However, there are far too many instances where projects have not been carefully selected and alternative methods of financing not fully evaluated. Planning Units in the individual territories can help in the identification and preparation of projects. Where there is need for additional expertise, they should seek technical assistance funds from the CDB, the EU or other aid agencies.

The critical need is for new ways of earning foreign exchange from exports to serve as the major growth engine in these economies. The government has a major role to play in developing new exports, as an innovator, and of filling the role performed in large or industrialised countries by private research and development facilities that support both large and small private enterprises. Government's role is also to ensure that the vast advances in communication and information so easily accessible in the developed countries are made available to, and capitalised on, by their societies. Responsibility for the initiation and operation of new enterprises, if only for a short period, therefore devolves on the state.

A clear example of the government in this role as innovator is the banana industry, which for fifty years has been the largest enterprise in the Windward Islands. It was the defunct Federal Government that had brought together the large conglomerates Marks and Spencer, the retailer in Britain, and Geest, the shipper/distributor, with the farmers, to establish this industry on a viable and sustained basis. The Government of St.Vincent and The Grenadines played a similar role later in this industry, and again in the sea-island cotton industry even later. At this time, there is an important role for government as a partner with the private sector in identifying new export growth industries, services and sectors, and facilitating their establishment and growth. This is the role that that it has played in more recent times in the tourism sector.

Another significant role for government in the Eastern Caribbean is that of stimulating investment through the creation of an enabling legal, political and social environment. This includes the provision of an efficient infrastructure such as transport, education, health, utilities and similar public goods.

It is then possible to identify several roles for the state that can positively affect the economic development and growth. We list them some of them as follows:

4.2 Government's Economic Role:

Two key aspects of Government's economic role, in this context, are highlighted here.

Government as initiator and innovator. Governments should act as institutional innovators finding new organisational and management structures which combine their capabilities with those of other entities, both domestic and foreign, to develop new or the potential for the new economic activities. In that capacity, they would essentially be honest brokers, bringing together the different parties possessing the required inputs, to constitute networks for getting the job done. They might provide the initiative, the initial thrust of innovation, some of the start-up finance, and the mobilization of the different partners required for developing the project. They might direct investment or directly invest in 'business' ventures where the demonstration effect could induce others to follow, or where the initial risk may be a deterrent.

***Government and fiscal policy*.** Government should design its fiscal policy to generate and build up budget surpluses which can be used as investment to contribute towards the development of enterprises in the sectors and in the manner indicated above. It should maintain prudent tax ratios and exercise strict control over consumption expenditure and careful selection of government investment expenditure.

4.3 Government and Social Policy

The social role of government includes:

- Income re-distribution to achieve social equality and the alleviation or elimination of poverty. This might be achieved through progressive income taxes, land reform, national insurance schemes and other poverty alleviation programmes. National Insurance schemes should be protected through the effective collection of contributions and the wise investment of their funds;

- The provision of those public goods such as law and order and defense; and road and transport infrastructure, public buildings, and water and environmental protection. Regulatory authorities should be established in relation to public utilities.

- The provision of a group of services which could conceivably be handled by the market but which the state deals with primarily to ensure equality of opportunity and of good citizenship. Some of these are of important economic significance as enabling investment and essential inputs for increased productivity. Among these are education and health and housing.

4.4 Government, the Rural Sector and Social Cohesion

Most governments play a major role in agriculture, including agricultural marketing, in the interest of ensuring food security, preserving the economy and stability of its rural sector, and poverty reduction This may be included in the social role of government. However in the OECS at this time, the new international trade environment requires governments to take the lead in the transformation of agriculture from one dependent on external protection and subsidy to a modern industry with emphasis on non-traditional and niche products.

4.5 Government and National Strategic Planning

a) Government should develop a vision and a structured framework for charting the course of the economy and society into the future. This would assist the necessary exercise of macroeconomic discipline. It involves establishing the appropriate institutional framework, and public institutions and structures that are efficient, effective and stable. It should ensure that there is a continuous programme of public education to promote an understanding of and support for policies necessary for economic growth and development.

4.6 Summary of the role of Government

The governments should lead in "business" ventures, where a demonstration would induce others to follow and where the risks are manageable.

(i) Government's fiscal policy should be directed at increasing domestic savings by

a) Maintaining prudent tax ratios sufficient to generate revenues to pay for essential services and necessary investments;

b) Strict control of consumption expenditure and careful selection of investment expenditure.

(ii) Government should facilitate the conversion of domestic savings into domestic investment by providing supportive infrastructure and services (including research and development services).

(iii) Government's participation in "private investment" should follow the stages set out below:

A. Assisting domestic private sector to identify and explode investment opportunities (including assisting with technological research and market information).

B. Brokering partnerships between the domestic private sector and foreign investors.

C. Entering into partnerships with domestic private sector and/or foreign investors.

D. Director investment in low risk ventures where neither domestic private sector nor foreign investors can be induced to enter, with clear exit path as far as possible.

4.7 Expenditure Reforms

In respect of government expenditure in the region, a number of reforms to improve management and productivity are suggested. Too frequently, it appears that government expenditure and government debt are incurred without corresponding plans for debt financing and repayment. This often leads to debt over-hang. While it may be possible to service the debt, unnecessary debt is both inefficient and costly, as the true cost then includes the displacement cost and the opportunities lost. What is required therefore is that expenditure should take place within a planning framework that minimises expenditure and links it to a plan for debt recovery.

Government expenditures should take account of the views and priorities of the population if they are to have credibility. There is a tendency for the population to see and appreciate real income increases, psychic or otherwise, when they can associate benefits with public expenditures. When they link costs with public expenditures, their perceived income tends to fall. It cannot be simply stated that taxes will be hated. Taxes, properly marketed and targeted, could be properly explained to the citizens. In order to be in a better position to justify government expenditures to the population, there ought to be ongoing analyses to determine tax and expenditure incidence and impacts in the region. This will also provide a basis on which the government can engage in short and long run planning and in the implementation of appropriate measures to achieve equity, income redistribution and poverty eradication. This approach will enable governments to avoid fire-fighting tactics and crisis actions. This short run or long run planning and public education will also place governments in a better position to resist insularity and constituency biases as opposed to regional and national imperatives.

All of the stakeholders in the society expect governments to respond to their individual and personal needs and they become impatient when these are not satisfied. Sometimes these run counter to what is best for the state. Politicians and leaders have to be mindful, at all times, that they are constituency caretakers and statesmen and stateswomen and that the needs of the state must be given priority over personal and family considerations in government expenditure. There is an important role for the bureaucracy in the planning process and ensuring that special interests are balanced with the state's interests.

In nearly all of the countries, the growth of the recurring expenditures over the years has been faster than the growth in revenues. This raises the question of whether the states can sustain such levels of expenditures. The growth in GDP over time was, on average, one percent below this expenditure growth. Revenue growth was not in line with the expenditure growth, nor was it in line with the growth in GDP. In considering this question, some analysts suggest that expenditure growth in debt or expenditure should not be faster than growth in GDP. Pragmatically, this means that the states or governments may incur debt, but they must be in a position to pay off portions of their debt on time. Fundamentally, therefore, expenditure should be considered in relation to the ability of the state to generate revenues, and its ability to impose on itself a discipline to operate in the context of those revenues. This is not to suggest that the states and governments of the ECCU should not incur debt, or should not borrow. It is simply to emphasise that debt should be structured and monitored so that the economies are not operating on the thin edges of development, and that it does not become a permanent burden on the society.

In terms of monetary policy, the monetarist notion that budget deficits are a major cause of inflation is not applicable to the situation in the ECCU. Given the nature of the ECCB, there is no possibility for governments to finance their budgets by money creation. Caution must be taken, however, that those domestic banks in which governments have special interest or in which they are majority holders, are not used to monetize government debt.

Expenditure reforms should relate to the vulnerability of the ECCU to external, exogenous and unplanned events like hurricanes and other national disasters. When these occur they have to be addressed. In view of the proneness of the region to them, account should be taken of them in budgetary projections.

The role of government, the financing of government and the expenditure reform that the ECCU must undergo over the next several years are here discussed in the context of an already narrow tax revenue base. As the region is drawn into the new global arrangements of the Free Trade Area of the Americas (FTAA) and the World Trade Organisation (WTO) bringing with it the elimination of taxes that affect trade in both goods and services, the scope for tax revenues will become even more restricted, demanding on the one hand, tax reforms and increased efficiency and productivity of the tax effort, and on the other hand, better expenditure management.

In the discussion on its role, government is given a decisive thrust in the economic management and development of the member states and the region. This role includes that of being a principal engine of growth through an active role both as a provider of an enabling environment, and an active participant in investment and in the production of goods and services. However, this role should not be seen as static. Government should enter the developmental process, when necessary, and leave when it is expedient. Its role in the development process should be seen as being a necessary but not a sufficient condition. By this is meant that while ECCU governments should continue to be involved in the development process, they need not continue beyond that critical junction where the business or the industry is ready to grow.

In all of this it is necessary for government to provide information designed to promote development in the entire economy, but especially for the private sector. Information dissemination will be of paramount importance for the knowledge-based society that the region must seek to become. In microstate economies, such as those of the ECCU, information is at a premium. If the government and the private sector are to operate at their optimum, then information has to be on the agenda of governments' concerns at all times.

In that regard, open communication and consultation to assist with the economic and fiscal management of the ECCU could strengthen the critical nexus between the government and the private sector in the ECCU. Some states have already adopted the model for consultation approved by the Monetary Council of the ECCB. It comprises:

(i) Cabinet committees to undertake quarterly reviews of the economies of member states.

(ii) National Economic and Social Development Councils to promote consensus on economic policies at the member state level.

(iii) Tripartite Committees comprising government, the private sector and trade unions to discuss and review wages, prices, employment and productivity issues in order to maintain and improve the competitiveness of economies.

Another modality for fostering and promoting communication and links between the government and the wider society and its involvement in the planning process, is the establishment of Advisory Committees. Those Committees would also serve as a means of empowerment for the population in the fiscal and economic management of their country and the region and serve as a generator of ideas and as a source of information.

In the final analysis it is likely that government's role in the OECS in the developmental process will be one in which at different times as may be appropriate, it will go through the alternative states of being "An Engine of Growth", assume a "Minimalist" position, or adopt a "Residualist" stance. Whatever position the states in the Union adopts, it should be borne in mind, that at the disaggregative level, stakeholders in the society should be part and parcel of the information and communication strategy. Discussions and conversations are essential in the role of government.

Section

5

AN APPROPRIATE REVENUE SYSTEM: FRAMEWORK AND ELEMENTS

5.1 The Existing Revenue System and its Weaknesses

Government revenue in the ECCU countries has traditionally come from a medley of taxes, levies, licenses and fees – with taxes on international trade and transactions accounting for the major share of total revenues; and there is little doubt that over the years, the critical objective of most tax measures in the region has been revenue generation. This is not to say that tax policy in the OECS has been totally oblivious of the possible use of tax policy to induce investment and stimulate growth. However, the focus on revenue has tended to be paramount.

Actual and potential commitments to CARICOM, WTO, and FTAA have already begun to limit the extent to which OECS governments will be able to continue to use taxes on foreign trade as main revenue sources. In fact, the imperatives of international economic competitiveness dictate that a tax base other than foreign trade transactions will have to be identified and rationalized and the necessary tax reforms undertaken rather quickly.

5.1.2 The Existing Revenue Sources

The sources of revenue in the ECCU are classified as follows:

(a) direct taxes;

(b) indirect taxes; and

(c) non-tax revenue, which includes levies, fees, fines and charges for goods and services provided to the user.

A matrix of these sources is given in Table XII. The main sources of revenue in each member country, with indications of their relative share in GDP are shown in Table XIII.

From Table XIII, it can be noted that:

- Taxes on international trade account for the majority of the revenue in the ECCU; and
- Some countries do not have personal income tax; but where it exists, income tax contributes significantly to total revenue.

Table XII
MATRIX OF TAXES, LEVIES, LICENSES, FEES IN THE OECS

DESCRIPTION	ANGUILLA	ANTIGUA AND BARBUDA	DOMINICA	GRENADA	MONTSERRAT	ST KITTS AND NEVIS	ST LUCIA	ST VINCENT and the Grenadines
TAXES ON INCOME, PROFITS, GAINS								
Personal Income[3]	-	-	√	√	√	-	√	√
Corporate Income	-	√	√	√	√	√	√	√
Agriculture Income	-	-	-	-	-	-	-	-
Withholding taxes	-	√	√	√	√	√	√	√
LEVIES								
Health								
Education	-	√						
Social Services	-					√		
TAXES ON PROPERTY								
Land	√	√	√	√	√	√	√	√
House	√	√	√	√	√	√	√	√
Undeveloped Land	-	-	-	-	√	-	-	-
Transfers	√	√	√	√	√	√	√	√
Aliens Land Holding	√	√	√	√	√	√	√	√

[3] In Antigua and Barbuda there is no personal income tax, but a tax is levied on incorporated business and a personal income tax on non-residents.

Table XII
Matrix of Taxes, Levies, Licenses, Fees in the OECS
(Continued)

Description	Anguilla	Antigua and Barbuda	Dominica	Grenada	Montserrat	St Kitts and Nevis	St Lucia	St Vincent and The Grenadines
INDIRECT TAXES (DOMESTIC GOODS/SERVICES)								
Excise Consumption	-	√	√	√	√	√	√	√
Hotel (Rooms) Occupancy	√	√	√	√	√	√	√	√
Hotel Services (…. Restaurant)	-	√	√	-	-	√	-	-
Stamp Duties	√	√	√	√	√	√	√	√
Entertainment	√	√	√	-	-	√	√	√
Telecommunication	-	√	-	√	-	√	√	√
Insurance	√	√	√	√	√	√	√	√
LICENSES	√	√	√	√	√	√	√	√
INDIRECT TAXES (INTERNATIONAL TRADE)								
Import Duty	√	√	√	√	√	√	√	√
Customs Service Charge		√	√	√	√	√	√	√
Export Duty	√	-	-	-	-	√	-	√
Foreign Exchange Levy	√	√	-	-	√	-	-	-
Consumption Tax	-	√	√	√	√	√	√	√
Embarkation Tax	√	√	√	√	√	√	√	√
Travel Tax	-	√	-	√	-	√	√	√
Cruise ship Passenger Tax	√	√	√	√	√	√	√	√

Table XIII
Tax Structure: Tax Revenue as Percentages of GDP (1999)

	Anguilla	Antigua and Barbuda	Dominica	Grenada	Montserrat	St. Kitts and Nevis[4]	St. Lucia	St. Vincent and The Grenadines
Direct Taxes	**0.1**	**2.2**	**8.1**	**4.4**	**8.7**	**6.4**	**7.5**	**8.2**
Taxes on Income, Profits and Capital Gains	0.0	2.0	7.8	3.7	8.2	6.0	7.4	7.9
of which:								
Personal Income Tax	0.0	0.0	4.7	0.6	7.2	2.0	2.5	3.7
Corporate Income Tax	0.0	1.9	3.0	3.1	0.8	3.9	3.3	3.5
Taxes on Property	0.1	0.2	0.3	0.7	0.4	0.4	0.1	0.3
Indirect Taxes	**20.6**	**15.0**	**16.6**	**18.3**	**14.6**	**15.9**	**15.6**	**16.7**
Taxes on Domestic Goods and Services	4.6	3.6	4.1	4.3	2.9	4.6	3.3	4.5
of which:								
Consumption Tax	0.0	0.0	0.8	2.4	0.0	0.1	0.8	0.7
Hotel Occupancy Tax	2.3	1.3	0.1	0.0	0.2	1.1	1.0	0.5
Entertainment Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Telecommunications Tax	0.0	0.6	0.0	0.0	0.0	0.2	0.3	0.4
Insurance Levy	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.2
Licences	1.5	0.6	1.4	0.5	1.9	0.7	0.4	1.0
Taxes on International Trade and Transactions	16.0	11.4	12.5	14.0	11.7	11.2	12.3	12.2
of which:								
Import Duty	15.1	3.3	3.7	3.1	2.3	4.7	4.0	2.7
Export Duty	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.1
Consumption Tax	0.0	5.0	7.5	7.8	3.7	5.0	6.0	7.8
Customs Service Tax	0.0	1.7	0.6	2.3	3.8	1.2	2.0	1.2
Foreign Exchange Tax	0.3	0.5	0.0	0.0	1.6	0.0	0.0	0.0
Travel Tax	0.0	0.2	0.0	0.0	0.0	0.2	0.0	0.1
Embarkation Tax	0.6	0.5	0.3	0.0	0.0	0.0	0.0	0.4
Total Tax Revenue	**20.7**	**17.2**	**24.7**	**22.7**	**23.2**	**22.3**	**23.1**	**24.9**

Source : Ministry of Finance and ECCB

[4] Social Services Levy

5.1.3 Features of the Existing Revenue System

A review of the performance of this mix of taxes suggests that they tend to be costly to administer; lack buoyancy; have too narrow bases; and are usually subject to relatively poor and inefficient administrative practices, resulting in much non-compliance and wide spread evasion and avoidance. Consequently, the fiscal regimes do not generate adequate revenue to finance services provided to the public. Further, some of these revenues are relatively costly to collect and have only “nuisance” value. Moreover, the number of tax concessions granted further reduces the already narrow tax bases and helps to depress the revenue yield.

It is not clear whether the existing tax system seeks to stimulate economic output. There appears to be no systematic and consistent convergence of tax policy with macro-economic policies and goals. Tax measures may be introduced as frequently as every year in order to raise revenue with little attempt to provide economic stimulus, and with limited consistency or coherence with macro-economic policy and goals. This is combined with a lack of consensus-seeking and communication with the public on tax measures.

Finally, the fiscal implications of some existing and future international trade agreements dictate that the ECCU will no longer be able to use taxes on international trade as a major source of revenue.

5.2 An appropriate revenue system: framework and elements

It is proposed that an appropriate revenue system for the OECS countries should be:

(a) Simple;

(b) Designed to provide stimuli for sustained economic growth;

(c) Crafted to involve the least possible cost per revenue dollar;

(d) Broad-based, with minimum of exceptions;

(e) Designed to engender a high rate of compliance;

(f) Buoyant;

(g) A reliable source of financing the recurrent expenditure budget;

(h) Able to generate a surplus to assist in the financing of the capital budget;

(i) Expected to contribute to a contingency or stabilisation fund which can be drawn upon in extraordinary circumstances.

In this regard, a number of features of a good tax system have been identified.

5.2.1 Features of a Good Revenue System

A good revenue system should:

(a) Mobilise sufficient revenue to:

- *meet recurrent expenditures including interest payments on existing loans and self – insurance premium payments*
- *contribute to capital programmes financing*
  - ***Counterpart contributions to large projects***
  - ***Small project financing***
- *repay principal on existing loans*
- *maintain adequate reserves for emergencies and for economic stabilisation purposes.*

(b) Give encouragement, stimuli and incentives to boost and generate economic activity;

(c) Encourage economic activity and, in particular saving, investment, and exports;

(d) Be sufficiently competitive with those of other countries so as to maximise local investment and attract international and regional investors ;

(e) Not be administratively costly to collect and should be designed to ensure that compliance by taxpayers is neither inconvenient nor burdensome;

(f) Ensure that the tax burden must be equitable and transparent and based on ability to pay;

(g) Ensure that taxpayers are generally satisfied with the level and quality of service provided;

(h) Have as wide a base of burden-sharing as possible so that as many as possible can feel that they are contributing to the effort;

(i) Conform with international agreements and be consistent with best practice within the realm of what is domestically feasible;

(j) Meet its revenue and macro-economic objectives;

(k) Transparent and progressively based on ability to pay while making due allowance for, and providing the necessary relief to those who are unable to pay.

The revenue systems of the ECCU have been changing over time. While the tax to GDP ratio has been increasing, this has been accompanied by an increased dependence on taxes on international trade and transactions. Within the indirect tax structure, new taxes have been introduced, in particular, the customs service charge and the sales tax. The direct tax structure has been modified mainly by the simplification of income taxes. Property tax has remained an insignificant source of revenue in the currency union and the tax base has changed from rental value to market value, with adjustments to the rates.

The existing revenue system is threatened by the high dependence on trade taxes, which will be affected by International Trade Agreements. In addition, the narrow tax base, and the complex system contribute to non-compliance. There is therefore the need for a new tax structure involving new forms of taxation.

5.3 The Proposed Revenue Structure

The system proposed is a basic revenue structure that can be applied to the typical OECS economy. The exact structure for each would be dependent on:

- The required level of tax revenue
- The efficiency of collection
- The particular emphasis and dependence that each government may wish to place on the various major taxation elements
- The level of exemptions and allowances that are provided
- The state of the economy which may either be sluggish and requiring stimulus or overheating and requiring some dampening
- Its compatibility with other member countries of the ECCU.

The elements of the tax framework are roughly the same as that which currently exists, except in the following areas:

- Recognition and identification of special development and social areas to which governments may wish to provide stimulus e.g. savings into long-term savings instruments, investment in productive areas and in the nascent capital market, retirement income, expenses associated with tertiary education, expenses associated with alternative energy projects e.g. solar water heaters, and expenses associated with procuring and maintaining basic residential accommodation;

- The shift from tax holidays to tax allowances and tax credits to ensure that the value of the fiscal incentives provided is the same for all taxpayers and not weighted towards the more affluent taxpayer who would need less of the incentive than the low and middle-income counterpart;

- The use of *ad valorem* taxes on excise even in the case of petroleum, alcoholic beverages and tobacco. Despite the possible volatility in revenue that may result, this is a more buoyant tax than the fixed and cumbersome regime of taxes that now apply and should be good for the fiscal system**.** The challenge would be to manage the volatility and there are different means to achieve this;

- The phased substitution of transactions taxes for trade taxes.

In relation to the overall tax composition, institutions have tended to use a rule of thumb that tax to GDP ratios should be approximately 25 to 30 percent. The following is therefore proposed:

	Existing Range As percent of GDP	**Average As percent of GDP**	**Proposed Range As percent of GDP**
Personal Income	0.9 - 4.7	3.5	4.0 - 6.0
Corporate Income	2.7 – 5.2	4.0	4.0 – 7.0
Property	0.1 – 1.1	0.45	2.0 – 4.0
Trade and Excise	6.0 – 14.4	7.6	3.0 – 5.0
Transactions	9.1 – 14.5	11.5	10.0 – 14.0
TOTAL	**23.9 – 29.1**	**25.5**	**25.0 – 30.0**
Non-tax Revenue	2.0-7.5	4.0	3.0-5.0

It is also recommended that the tax system contain the following features:

- Elimination of nuisance taxes such as dog license and entertainment tax;
- Broadening of the tax base, particularly to include the taxation of services;
- Increased efficiency and simplicity to both government and taxpayer;
- No more than 80 percent of revenue for recurrent expenditures including interest payments, premium payments to general and captive insurance, and asset maintenance;
- At least 20 percent of recurrent revenue plus revenue from the sale of capital assets and returns on productive enterprises to finance:
  - Small projects
  - Principal repayments
  - Contributions to stabilisation and emergency funds
  - Counterpart contributions to large projects
- Central government and its statutory bodies should endeavour to finance about 15 percent of GDP in investment.

For countries without personal income tax, the payroll levies should be implicitly incorporated in an income tax structure.

The components of the tax structure should be implemented as follows:

5.3.1 Personal Income Tax

Target range for revenue:

- 4 percent to 6 percent of GDP

Threshold:

- The larger of $12,000 or 125 percent of per capita GDP

Bands:

- Three rates at 10 percent, 20 percent, and 30 percent and the maximum rate to be equal to corporate tax rate

Bandwidth:

- The higher of per capita income or $10,000 to the nearest $1,000

Coverage:

- All income in cash or in kind

All expenses associated with motor vehicles and housing paid for and/or expensed by the employer except maintenance, insurance and depreciation, at an agreed rate will be treated as income to the recipient.

All entertainment allowances that are non-accountable will be treated as income to the recipient.

Tax Credits shall be to a maximum of $3,000 and shall include the following with respective limits:

- Savings and investments in approved housing, education, retirement, and pension and investment funds in an amount of 10 cents per dollar saved per year to a maximum of $1,000.
- Residential housing expenses including interest, maintenance, insurance premiums, property taxes in an amount of 10 cents per dollar expended for the year to a maximum of $1,000 and reducing by 5 percent per annum, and subject to good standing on the servicing of the relevant debt and other expenses.
- Tertiary education expenses in an amount of 10 cents per dollar saved for the year to a maximum of $1,000, subject to good standing on the service of the relevant debt.
- Purchases of solar water heaters in an amount of 10 cents for each dollar expended to a maximum of $400.
- Senior citizens, to a maximum of $1,000.

Exempted Income:

- Interest, capital gains and dividends as an incentive to the development of capital market.
- Fifty percent of offshore income from consultancy, entertainment, sports, contracting, and offshore pensions, as an incentive for the development and the export of services.
- As a requirement for international agreements.
- Agricultural and fisheries income as an incentive to resuscitate the agricultural and fisheries sectors.

The following is the estimated threshold and band-with for the individual countries of the Currency Union.

	Anguilla	**Antigua And Barbuda**	**Dominica**	**Grenada**	**Montserrat**	**St Kitts And Nevis**	**St Lucia**	**St Vincent And The Grenadines**
Threshold, 000	25	25	12	12	20	18	12	12
Bandwidth, 000	20	20	10	10	12	14	10	10

5.3.2 Corporate Income Tax: Including a Special Regime for Unincorporated Small Business

Threshold:

- None. Assessed on all net income for the year except where there are provisions for group and carryover losses.

Bands: Two bands -

- Band 1: 15.0 percent on up to $30,000 for small incorporated enterprises with sales of less than $500,000 and assets of under $300,000.
- Band 2: 30 percent

Exemptions:

- Interest income on sovereign tax-free bonds.

- Mortgage interest income where passed on in lower interest rates to low-income households. A tax credit of 30 percent of each one percent of interest below 8 percent provided to a low-income household. Low income household is household with at least two persons including a child under 18 in receipt of under $30,000 per annum

Depreciation:

- 5 percent on residential housing
- 10 percent on hotels and restaurants
- 20 percent on machinery, furniture, fixtures and equipment, and motor vehicles
- 50 percent on computer hardware and software
- Staff training and research and development expenses at 150 percent of cost.
- Captive insurance costs for certain sectors under such conditions as:
    - Unavailability and/or high cost of coverage
    - Funds are not available to and/or managed by the company
    - Where funds are returned to the company it shall be taxed at normal tax rates
- Contributions to social programmes to a maximum of 2 percent of gross revenue
- Up to 50 percent of current years income can be utilised in carry over losses
- Maximum life of carry forward losses is 5 years.

5.3.3 The Property Tax

The Tax Commission endorses the recommendations on the property tax as put forward in the Technical Study on Tax Policy, which was completed by the Fiscal Affairs Department of the IMF as follows:

“ Over the medium term, property tax reform in the region should entail broadening the tax based to include all property. Valuation should be based on market principles and assessment should take place at regular intervals, say every 3-5 years. Taxpayers should have public knowledge of property tax assessments to ensure that valuation is not done in an arbitrary manner. The tax rate should be in the rate of 1 to 2 percent on

market value, which is high enough to generate significant revenues but low enough to avoid imposing too high a tax burden on taxpayers who have a low income in comparison with their property value. Exemptions should be limited to some low income or elderly taxpayers with genuine reasons that they cannot pay their property tax. A differentiated property tax rate could apply in different municipalities to facilitate variation in provision of public services, if desired, or else across property used for residential and business purposes. Changes in assessment should be phased in."[v]

5.3.4 Recommendations

- Base property tax valuation on the market value of property, including land and structures;
- Update property tax valuations on a regular basis, say every 3 to 5 years;
- Make property tax valuations publicly available to ensure integrity of the process;
- Restrict exemptions to the government and non-governmental organisations;
- Phase in changes in property valuations to avoid undue hardship on tax payers;
- Administer the tax at the central government level.

5.4 Trade Taxes

The import duty regime should be in line with the requirements of the Common External Tariff and other special trading arrangements agreed to at the level of CARICOM except that:

(a) In the adoption of an import duty regime and additional tariffs, every effort should be made to utilise transitional arrangements to protect locally produced food, subject to the need to maintain prices at levels that are affordable to the consumers. Similar consideration should be given to locally produced manufactured goods where they provide employment.

(b) To facilitate the introduction of VAT, excise taxes should be applied on the following special goods on the basis of C.I.F. plus import duties, so that the total tax rate, including VAT should be as follows:

Vehicles

- Vehicles at a maximum rate of 150 percent
  - Vehicles under 1600 c.c. and/or under a c.i.f. value of 2003 US$15,000 – an import duty, VAT and excise of 70 percent;
  - Vehicles between 1600c.c. and 2500c.c. and/or with a ci.f. value of between 2003 US$15,000 and 2003 US$30,000 - an import duty, VAT and excise of 110 percent;
  - Vehicles above 2500c.c and/or above a c.i.f. value of $30,000 - an import duty, VAT and excise tax of 150 percent;
- For imported vehicles over three years, a special tax of 250 percent will be applied.

Petroleum

- Petroleum unleaded for use in the generation of electricity by a utility - an excise tax at an *ad valorem* rate of 30 percent;
- Petroleum leaded for use in the generation of electricity by a utility - an excise tax of 45 percent;
- Petroleum unleaded for all other uses - an excise tax of 45 percent;
- Petroleum leaded for all other uses - an excise tax of 60 percent;

Alcoholic Beverages

- Beers and wines - an excise tax of 35 percent;
- Alcohol of up to 86 proof - an excise tax of 70 percent;
- Alcohol of above 86 proof - an excise tax of 85 percent;

Tobacco

- An excise tax of 150 percent.

5.4.1 Dealer Margins

Dealer margins should be closely monitored and made subject to competition law already in force or when enacted.

5.5 Transactions Taxes

5.5.1 Value Added Tax

The intention is to replace all indirect taxes with a Value Added Tax (VAT). Import duties should be phased out following an agreed transaction schedule. The suggested modalities for its introduction are:

Coverage: On sales of all goods and services except where exempted or zero-rated;

Rates:

- 0 percent on a basket of basic foods, medication for an agreed schedule of diseases approved by local medical authority, public transport, computer hardware and software, and exports;

- 10 percent on transactions in hotels, restaurants, tour operators, theme parks and similar attractions, car rentals, yacht charters, boat cruises;

- 15 percent on other transactions in:
  - retail outlets with sales of over $100,000 per annum
  - wholesale outlets
  - manufacturing enterprises
  - Entertainment centers, including gaming, horse racing and therapeutic services
  - Sports events
  - Overseas travel
  - Electricity
  - Telecommunication
  - Professional service fees e.g. doctors, dentists, architects, engineers, beauticians, lawyers etc.

- The VAT will replace a number of nuisance and other taxes such as consumption and travel taxes, and dog licenses.

LIST OF NUISANCE TAXES	
▪ Entertainment Tax ▪ Export Tax ▪ Foreign Currency Levy ▪ Cable TV fees ▪ Vehicle Rental Levy	▪ Mercantile Tax ▪ Interest Levy ▪ Dog License ▪ Occasional Licenses ▪ Peddlers Licenses

Based on some crude estimates, a 15 percent VAT on a broad base is likely to yield adequate revenue. However, if zero rating and exemptions are applied on a large scale, a higher rate of 20 percent will be required to raise adequate revenue. Arrangements have been made to estimate the yields of the tax reform proposal and this will be submitted in a separate volume.

5.5.2 Status of Readiness for Vat Implementation

The following indicates the current status of the tax administrations regarding their readiness to implement a broad based VAT type consumption tax.

Assumptions

For this analysis it is assumed that a regional initiative will be set in train to support the countries deciding to move to a VAT. This support would include assistance in:

- Preparing VAT revenue estimation
- Drafting VAT legislation
- Designing publicity campaigns

- Designing public education programmes
- Designing staff training and training trainers

The decision to implement the VAT should be accompanied by an extensive education campaign, which in many instances will require *a minimum of two years planning for its introduction.* It is noted that some countries are more VAT-ready than others (Table XIV). However, implementation must be properly sequenced in the Currency Union.

Table XIV
Status of Readiness for VAT Implementation[vi]

NO		Anguilla	Antigua and Barbuda	Dominica	Grenada	St Kitts and Nevis	St Lucia	St Vincent and The Grenadine
01	**VAT INTRODUCTION**							
	Capacity to establish local team (a leader and 2-3 staff)	Low	Aver	Aver	Aver	Aver	High	High
	Capacity to provide a local budget (considering the regional support)	Low	Aver	Low	Aver	Aver	High	Aver
	Adult Literate Rate	High	High	High	High	High	High	High
	Level of bookkeeping	Aver	Aver	Aver	Aver	Aver	Aver	Aver
	Publicity capacity	Low	Aver	Low	Aver	Aver	Aver	Aver
	Planning	Aver	Aver	Aver	Aver	Aver	Aver	Aver
	Timely decisions	Aver	Aver	Aver	Aver	Aver	Aver	Aver
02	**VAT OPERATION**							
	IT Support	Low	Low	High	High	High	High	High
	Taxpayer service	Low	Low	Aver	Aver	Aver	High	High
	Taxpayer registration	Low	Low	High	High	High	High	High
	Filing and payment procedures	Low	Low	High	Aver	High	Aver	High
	Audit	Low	Aver	Aver	Aver	Aver	Aver	Aver
	Objections and Appeals	Low	Aver	Aver	Aver	Aver	Aver	Aver
	Enforcement of Arrears Payment	Low	Low	Aver	Aver	Aver	Aver	Aver
	Experience with Consumption/Sales Tax	Low	Low	High	Aver	Aver	Aver	Aver
	General	Low	Low	High	High	Aver	High	High

Based on the analysis, Dominica, Grenada, St Kitts and Nevis, St Lucia and St Vincent and the Grenadines are considered to be VAT ready while Anguilla and Antigua and Barbuda are at the lower end of the scale.

In their use of fiscal policy, the governments of the Currency Union have been utilising tax concessions as an instrument to stimulate economic activity. This policy has contributed to a reduction in the revenue base of the member countries of the Currency Union. The authorities therefore need to balance the achievement of the growth objectives of the tax concessions with the likely impact of the concessions on the revenue base of the economies and the efficiency of tax administration.

Section 6

THE INCENTIVES REGIME AND DEVELOPMENT

6.1 Scope Of Tax Concessions

The countries of the ECCU grant a wide range of tax concessions. They cover almost every sector of the economy: - agriculture, manufacturing, tourism, transport, communication, government as well as other services. Most of the concessions have to be approved by Cabinet but some authority has been delegated to Ministries of Industry, Development Corporations, Directors of Finance, and Comptrollers of Customs.

For the sake of analysis the concessions may be examined under three headings:

- The Hotel Aid Act and the Fiscal Incentives Act.
- Exemptions granted to statutory bodies.
- Exemptions under the Import Duty Act

6.1.1 The Hotel Aid Act and the Fiscal Incentives Act

The current regime is based on a system of tax holidays and duty free imports for periods varying from ten to fifteen years, and applies to approved industries and hotels. The legislation setting out the criteria for granting incentives is clear and harmonised throughout the region, but considerable flexibility is exercised in its application, as jurisdictions bargain for the attraction or retention of investments.

Discussions with the private sector reveal how important duty-free imports are to their investment decisions. This can be explained by the impact on initial capital requirements, inventory costs and working capital needs.

Incentives are extended when investors add to their plant or introduce new or improved machinery and equipment.

There is little transparency in the application of the fiscal incentives schemes. Investors do not submit returns to permit monitoring of their operations or their entitlements. Conditions set out in their incentives licenses are often ignored. There has been evidence of abuse of the system; and the revenue cost invariably exceeds the social and economic gains.

The Dominica Income Tax legislation offers an alternative to the tax holiday incentive scheme. There, an investment credit is allowed to permit investors to write off ten percent of their investment against present or future profits automatically; but this has never been used. One reason advanced for the non-acceptance of this alternative is that the ceiling on each year's permissible credit at $50,000.00 is too low.

6.1.2 Exemptions granted to Statutory Bodies

The Acts of Parliament setting up the various government corporations, particularly in electricity, water, ports and the marketing of agricultural produce, usually contain provisions exempting them from income tax and allowing them to import plant and equipment free of duty. For many years Cable and Wireless has been the only telephone company in the islands and under the Acts by which it was set up it has been granted tax exemptions in varying degrees in the individual countries. Now that the telecommunications regime has been liberalised the new entrants into the field are using the concessions granted to Cable and Wireless as a base from which to start negotiations.

6.1.3 Exemptions Under the Import Duty Act

These comprise ad hoc concessions to individuals, institutions and firms for beneficial or welfare purposes. The authority for granting such concessions is contained in a section of the Import Duty Act and the Consumption Tax Order which allows the Ministry of Finance (or in some cases, Cabinet) to remit duties or taxes, in whole or in part, if it is considered fair and reasonable to do so. This was intended to give the Minister some discretion in cases where customs impositions could be considered unfair or unreasonable. Under this exemption, concessions are usually granted to educational, health, sporting and other organisations, and civil servants in some islands are allowed to import cars at reduced rates of duty.

It is the unfettered nature of these discretionary ad hoc concessions that has been the source of greatest concern.

6.2 Impact of Tax Concessions

Evaluation of the impact of tax concessions on the economies of the OECS is complicated by several factors. In the first place, it is extremely difficult to decide if an industry would have come to a particular state had there been no concessions and exactly how many concessions are necessary. Of course, if the industry would not have been established one cannot talk of revenue foregone. Even if it is agreed that the industry came as a result of the concession, the cost/benefit analysis remains complex. The financial costs may be fairly easily counted by looking at the corporation tax and indirect taxes foregone. The revenue benefits are not easily quantified. These could include property taxes, direct and indirect taxes paid by employees of an enterprise, and the corporation taxes as well as the indirect taxes payable by the venture itself once the tax exemption has expired.

Beyond the narrow financial question there is the wider issue of the impact that the establishment of the enterprise has on the economy as a whole, that is, the external economies. Given the foregoing difficulties and the consideration that the concessions granted are not carefully monitored in the various countries, it is hardly surprising that evaluation studies of tax exemptions are very rare. One of the few done concluded that:

- Revenue lost due to tax concessions in the OECS ranged from 36.4 percent in St. Vincent and The Grenadines to 24 percent in Anguilla, Dominica and Montserrat. Revenue loss was calculated by estimating the indirect tax foregone through concessions and expressing it as a percentage of total indirect tax collected plus the indirect tax foregone;
- Concessions to statutory bodies accounted for the largest portion of the loss, 40 percent. Exemptions granted under the Fiscal Incentives and the Hotels Aid Acts together were second, with 30 percent.

At first glance, the second finding is a bit surprising, but it must be remembered that the islands are not heavily industrialized, and that the statutory bodies such as the electricity and water corporations; Cable and Wireless, the port, and the marketing organisations, are heavy and perennial importers of heavy equipment, vehicles and materials. It is also true that it is easier to collect statistics from these organisations than from industries associated with Hotels Aid and Fiscal Incentives generally.

6.3 Recommendations for Tax Concessions

The following are therefore recommended with regards to the granting of tax concessions:

(a) Hotel Aid and Fiscal Incentives

The duty free imports granted under these acts should remain in place. The tax holiday should be phased out and replaced by the tax credit system as obtains in Dominica.

(b) **Statutory Bodies**

The tax concessions granted to statutory bodies should be limited to a specific period. The emphasis should be on increasing the efficiency of these organisations particularly, those dealing with electricity, water, ports and the marketing of agricultural products.

(c) **Concessions granted under Customs Act**

The concessions granted to religious and other bodies under the Customs Act should be carefully circumscribed and should in no case exceed 75 percent of the taxes involved.

Concessions that are granted to civil servants should be limited to a 75 percent reduction in the taxes payable on acquisition of a motorcar every four years. The concession should be restricted to senior civil servants at an approved grade.

(d) **Monitoring of Concessions**

All concessions granted should be carefully monitored by the Ministry sponsoring the concessionaire and there should be an appendix in the Estimates of Revenue and Expenditure detailing the concessions granted during the year and where possible the loss of revenue incurred.

(e) **Harmonisation**

In order to forestall the "*playing off*" of one island's incentives against those of another, particularly those under Hotel Aid, the incentives should be harmonised throughout the OECS.

The system for granting of the tax concession should be transparent and should not undermine the revenue base and the equity of the revenue system. In particular, tax concessions on goods and services will disappear with the introduction of VAT and should not be included as an essential part of the tax regime. This is important as the revenue system and its administration must remain efficient.

Section

7

TAX ADMINISTRATION REFORM

7.1 Introduction

Just as tax policy reform is aimed at getting the tax system to respond effectively to changing economic circumstances, the objective of tax administration reform is to structure tax systems and organisations to respond to changing market conditions by reducing transaction costs, enhancing the environment for external competitiveness and optimizing revenue yields.

The performance of tax administrations in the ECCU has been moderately satisfactory, given the tax systems that presently exist and the divergent policies that have been adopted among member states.

- Tax/GDP ratios range from 20 to 30 per cent, which indicates fairly high rates of revenue extraction.
- Major improvements have been made in organisation and processes and in the quality of staff engaged in the various tax functions.

The Inland Revenue Departments have benefited substantially from the Canada International Development Agency (CIDA)-financed Eastern Caribbean Economic Management Programme (ECEMP) which focused on the computerisation of tax administration processes, with consequential changes to operational procedures, legislation, and priorities for human resource development. Similarly, the Customs Departments, through the Automated System for Customs Data (ASYCUDA) and technical assistance from the Department for International Development (DFID), have made significant progress in computerizing and upgrading their operational processes and have continued to benefit from basic customs training offered within the region, particularly in drug prevention and security.

Notwithstanding these improvements and the relatively high tax to GDP ratios, the tax gap remains high[vii]

- The rate of non-compliance is between 50 to 70 per cent and arrears are estimated in the range of 20 to 50 percent of annual collections for direct taxes.
- Indirect taxes are eroded by under-valuation, smuggling, leakage arising from generous duty and tax concessions and poorly administered fiscal incentives, and non-compliance with the sales tax.

The unit cost of administration ranged from 1.71 to 3.39 percent of revenues collected by the Inland Revenue. Similar ratios are not available for Customs; but, from the perspective of the private sector generally, the cost of doing business with the customs has been reported to be very high.

7.2 Areas of Particular Concern

In its survey of the region, the Commission has identified a number of areas of concern to government, the private sector and other civic groups:

- There were too many taxes, most of them low yielding;
- Coverage of the major taxes was narrowed by the exemption of government and quasi-government incomes and expenditures, and generous concessions and incentives to individuals and private sector enterprises;
- The plethora of taxes and tax handlers make administration difficult and costly;
- The wide range of exemptions, concessions and incentives erodes the revenue base and complicates administrative processes;

- In the two jurisdictions where personal income taxes no longer apply, loopholes have been created to divert taxable income from corporate profits to non-taxable personal income;
- Tax legislation and administrative procedures are complex and outdated. Most of the tax statutes were designed for economies and business environments that are very different from what obtains presently;
- Tax policy and the use of tax revenues lack transparency;
- Effective enforcement is constrained by several factors, including political interventions in the process of making tax decisions, weak technical capacity to deal with complex cases and to engage with highly trained corporate accountants and lawyers, lack of legal support in preparing and contesting tax cases, the failure of tax appeal commissions to meet regularly to resolve appeals, and the rapid growth of activity in the informal sector;
- The cost of transacting with tax departments is high, with manual systems operating for revenue receipts, filing and audit processes.[viii]

All of the above point to the need for a major overhaul of the organisation of the tax departments to provide efficient services to the public, improve planning capacity to carry out the functions of tax assessments and collection and to administer tax laws fairly and judiciously.

7.3 Objectives of Reform

In the light of these concerns, the major reform objectives to be pursued should include:

- Restructuring tax departments to provide better taxpayer services, reduce transaction costs, strengthen planning and research capacity and establish performance standards;
- Redesigning procedures and the legal framework to increase compliance and enforcement;
- Enhancing human and physical resources to foster efficiency in service delivery;

- Strengthening processes for tax transactions to accommodate e-commerce and e-government;
- Speeding up the judicial process for tax collection and the resolution of tax disputes;
- Improving communication with taxpayers and between tax agencies to facilitate information exchange and effective collaboration;
- Improving and integrating tax administration information systems;
- Strengthening tax coordination at the local and regional levels;

7.4 Restructuring Tax Departments

In designing an appropriate and effective organisational structure for the tax departments, a number of distinctive factors must be taken into account:

- the nature of the taxes to be administered;
- the kind of taxpayer services to be provided;
- the technology that should be employed in the operations of the department;
- the cost to government of collecting taxes and the cost to the taxpayer of complying with the tax laws.

Notwithstanding the differences in the nature of taxes collected by the two principal tax departments - Customs and Inland Revenue - and in the range of functions which they manage, their basic tax collecting operations lend themselves to a generic organisational design, with add-ons for specialised services such as security and prevention, in the case of the Customs. This will facilitate consolidation of common services with consequential savings in cost, and eventual unification of services, especially if the transition to a VAT comes into effect.

The aim of any restructuring should be to improve taxpayer services and optimize revenue collection at reduced costs both to government and the taxpayer. It has been found that the functional approach[ix] is most effective in clearly identifying the services to be delivered, developing and maintaining the required level of skills for each service and in setting performance standards. The basic structure should, therefore, include the following outlined functions:

7.5 Recommendations for Restructuring

7.5.1 Planning and Research

There is an urgent need to upgrade planning capacity to programme tax activities effectively, to determine the level and number of staff required to undertake those activities and to set and evaluate performance standards.

Steps must be taken to improve research capacity to access, analyse and utilise data stored in SIGTAS and ASYCUDA to assist management decision-making and tax policy and administration decisions as well as to keep abreast with developments in tax and trade developments and treaty negotiations that affect tax policies, and to monitor tax performance in the domestic economy.

7.5.2 Personnel Management

In most jurisdictions, the function of personnel management is administered directly by the Comptrollers/Controllers or relegated to low-level officials. The importance of this function is lost in the routine aspects of managing personnel files and responding to staff complaints or through competing career opportunities. More attention needs to be paid to the skills resource needs of the departments, succession planning, staff selection, compensation and training. Above all, performance evaluation and reward must play a key role in upgrading the quality of service provided by each department.

7.5.3 Taxpayer Services/Goods Clearance

Many of the concerns expressed by the private sector related to the low level of services provided by, and the high cost of doing business with, the tax departments. Beyond the narrow range of assistance given to taxpayers in tax registration and filing, there is the wider scope of services and facilitation in the major operations of Inland Revenue and Customs. Of particular concern is the customs clearance and warehousing of goods, especially containerized goods, which is reported to be time-consuming and costly, since most of the work is undertaken after normal working hours. The service should be so organized that dedicated teams are available throughout normal working hours, if necessary on a shift basis.

Another important service that should be provided to taxpayers is information – statistical data that can assist business decisions as well as information concerning the operations and objectives of the departments concerned, the services that are available to taxpayers and guidelines and instructions for the use of taxpayers. In that regard, the ECCB commissioned an information booklet for dissemination by all Inland Revenue Departments to assist taxpayers in understanding their role and functions. To date the information booklet has not been put to use. A similar information booklet should be prepared for the use of the customs and disseminated among users of the customs services.

7.5.4 Assessments/Customs Entries and Audit

By far the largest number of taxpayers account for only a small part of tax collections, yet considerably more time is spent in auditing those small accounts. More effective planning would assign audit and assessment work on the largest accounts to highly qualified and experienced staff (if necessary, outsourcing the skills required for this purpose). Minor accounts should be dealt with by compliance improvement programmes, including communications and information dissemination, and the expansion of taxpayer services, except for random and targeted audits. The cost-effectiveness of retaining the large number of lower level staff engaged in audit and assessments should be re-examined.

7.5.5 Collections

The high cost of collection and the rising levels of income tax arrears is evidence that the collection machinery is deficient and ineffective. It has already been pointed out that the tax gap in the two principal revenue departments is high, ranging from 50 to 70 percent.

Part of the problem stems from failure to identify taxable individuals and businesses that may be registered in any one of the major revenue generating institutions – the Social Security, the Customs, and the Inland Revenue. Each of these institutions has designed separate client codes that cannot be linked or cross-referenced. It would be of mutual advantage if a single Personal Identification Number (PIN) were used by all of these institutions to facilitate audit or identification trails. Considerable savings could be achieved in field collection activities if collections could be enforced through transactions with other revenue collecting departments.

The cost-ineffectiveness of pursuing a large number of small accounts has already been mentioned. Field collections should be devoted to large accounts which justify the expenditure of staff time, travel and similar expenses to pursue them.

7.5.6 Arrears Management

Most jurisdictions have experienced considerable build-up of tax arrears arising mainly from

(a) failure to resolve contestable assessments;

(b) untraceable defaulters and defunct businesses; and

(c) weak enforcement machinery.

A well-functioning arrears management unit should be set up and supported by readily accessible legal counsel and an effective appeals body in order to keep the build-up of arrears within manageable limits.

The arrears list contains a number of accounts which are either untraceable or are no longer operative. This tends to inflate revenue expectations and to distort the workload involved in tax recovery. The arrears list should be cleaned up so as to facilitate realistic recovery programmes and realistic performance targets for the arrears management unit.

A number of recommendations have already been made for strengthening the enforcement arm of the Inland Revenue, including stronger focus on large accounts, effective distraint and garnishee procedures, demanding corporate guarantees from corporate directors and effective, consolidated tax collection legislation that enhances the enforcement powers of the Comptrollers/Controllers.[x]

7.5.7 Internal Audit

A well-functioning tax department depends on the continuous review of its operating systems and procedures by an effective internal audit. These already exist in most tax departments, but are sometimes misused to carry out routine financial audits. Their management functions should be extended to identify system failures, organisational deficiencies and resource wastage.

7.5.8 Tax Tribunal

The ineffectiveness of the appeals procedure has been the subject of much concern among taxpayers. The view has been expressed that "the Office of the Appeal Commissioners must be made more proactive and dynamic to ensure equity to all parties."[xi] Steps should be taken to institute Appeals Boards that will gain the confidence and respect of taxpayers in order to quickly resolve contestable assessments and reduce the build-up of arrears.

A submission by the Dominica Association of Industry and Commerce on the subject had this to say:

> *"We are of the view that the current system of appeal is defunct. There is urgent need to formalize and institutionalize the (Tax) Commission's procedures and the 'duty of care' incumbent on the commissioners. The Chairman should be a lawyer, retired judge or judicial officer of experience. Members must be persons of independence, impartiality and competence in legal, accounting and commercial matters."*
>
> *The commissioners should meet monthly and their decisions gazetted in accordance with Section 91(7). Further, hearings should be held in*

public unless objected to by the aggrieved. We feel that this level of transparency would:

i. sensitize taxpayers to their rights and obligations;

ii. deepen knowledge of practitioners in the public and private sectors, thereby reducing the level of misunderstanding;

iii. encourage aggrieved taxpayers to utilise the process more often; and

iv. temper the potential for abuse by the office of the Comptroller."

The Commission finds that these recommendations are commendable and finds that tax adjudication could best be done on a regional basis taking account of efficiency and cost-effectiveness. The Commission strongly recommends that a regional tax tribunal should be established as soon as possible to adjudicate in tax matters.

7.6 Redesigning The Legal Framework

The complexity of the tax laws seems to promote massive avoidance (if not evasion) of tax payments since corporate lawyers and accountants appear better equipped to manipulate them than tax officials to defend them. It has also been found that enforcement powers are scattered among several statutes, making it difficult for tax officials to use them effectively.

In recent times, the tax departments have been challenged by a growing number of objections to tax decisions on the grounds of unconstitutionality and differences in the interpretation of tax laws. Tax departments should be strengthened with legal counsel on staff to deal with the growing number of injunctions against their decisions.

The Commission is of the view that immediate action should be taken to review tax legislation to consolidate enforcement powers, enhance tax recovery instruments, streamline statutory procedures and simplify the tax code for both Inland Revenue and Customs.

7.7 Enhancing Human And Physical Resources

The profile of staff in most tax departments shows a hierarchical structure with very large components of operators and few managers and technicians. Out of 57 staff members at the Inland Revenue in Dominica, only 5 could be considered managerial or technical. The same structure is found in most tax departments, including Customs.

If a new approach to functional organisation is adopted, more attention will have to be paid to developing skills at the managerial and technical levels. The immediate challenge is to develop a cadre of professional tax officers to interface with the growing body of accountants and corporate lawyers in the private sector and to manage the range of functions in the tax departments. New skills will be required in tax law, accounting, computer technology, service delivery, and personnel management and tax analysis. Greater use of electronic transacting should reduce the large number of support staff presently employed to carry out manual operations. The emerging structure should be less pyramidal and more oriented towards flat functional organisations.

At the professional and technical levels, the compensation package in the public service appears to be uncompetitive with that obtaining in the private sector. If higher skills are to be developed and retained in the tax departments, salaries and other benefits must be adjusted in line with comparators in the private sector. Moreover, adequate salary levels should help to foster professional integrity among tax officers.

Several recent reports on tax administration have adverted to the improvements made to physical accommodation of the tax departments. The situation as it stands presently appears to be satisfactory.

7.8 Strengthening Processes For Tax Transactions

Both Inland Revenue and Customs manage considerable flows of revenue documents – tax filing documents for income and corporate tax and sales tax, and customs entries. Operational processes have not kept pace with IT development in the public sector. Nor have the requisite skills been developed sufficiently to make optimal use of the new IT environment. The business culture in the public service is still rooted in manual procedures and un-dynamic or rigid organisational relationships that make the transition to an IT environment difficult. It appears that there is considerable resistance to making that transition.

Substantial savings could be made in staff time in both the private sector and the public sector, and revenue flows could increase significantly, if existing processes should be reengineered to accommodate electronic filings of income tax forms and customs entries as well as electronic receipts rather than manually written receipt forms.

It is recommended that an immediate review of the procedures and processes in the tax departments be undertaken and a strategy developed to reengineer them to suit the new IT environment.

7.9 Improving Communication

Effective communication is vital for taxpayer understanding of the services provided by the tax departments, the way they work, their role and objectives and the manner in which tax dollars are spent, so that, with a better understanding of the purpose and use of taxation and the operations of the collecting departments, taxpayers would more willingly meet their tax obligations. Section 7.5.3 above refers to the need to implement recommendations contained in a booklet commissioned by the ECCB for use by Internal Revenue Departments, and the need for a similar booklet to be prepared for Customs Departments and their clients. It is recommended that such information booklets be disseminated to promote better understanding between the tax departments and public generally.

At an operational level, channels of communication with the public should be clear with specific persons identified as reference points for various services. Tax information, including guidelines, should be readily available, if necessary at locations outside the central agencies. In addition, regular programmes of tax information should be designed to improve communication between the tax departments and the public. It is recommended that a model communications strategy be designed for the OECS tax departments.

From another perspective, communication between tax departments is virtually non-existent. It has already been recommended that an effective interface between the electronic systems of the tax departments should be established to facilitate access to tax data and taxpayer information. In addition, systems of collaboration should be developed to facilitate exchange of information and coordinated action in revenue collection and the identification of defaulting taxpayers, especially stopfilers. This kind of collaboration will be critical if VAT is introduced since both principal tax departments will be involved in the VAT transaction chain.

It has been brought to the Commission’s attention that communication between the tax departments and the Ministries of Finance, particularly on tax policy development, is less than adequate. Tax legislation is often drafted without input by the tax departments. On the one hand, ownership of and commitment to the legislation is often absent; and, on the other, loss of technical input results in defective regulations and procedures that could be avoided if effective lines of communication had been established between MOF and the tax departments.

Recommendations have been made for the establishment of tax policy units at the MOF. It is important that such units liaise closely with the tax departments or permit representation of the tax departments in their work.

7.10 Information Technology

Both principal tax departments have benefited from substantial investment in electronic systems that have expanded capacity for online processing, information storage and retrieval and data analysis. Several and recent reports on tax administration have shown that the systems are presently underutilized and no linkages exist with other related systems. For instance, ASYCUDA is not directly linked with the Statistics Departments for purposes of converting and analysing trade data. The Inland Revenue is not linked to the Accountant General’s Office for daily transfers of revenue receipts. Neither is Customs so connected. The Inland Revenue and

Customs systems are not networked for exchange of information that could be mutually beneficial for audit purposes. None of these are linked with the Social Security, which is the depository of vital employment, business and statistical data.

Both ASYCUDA and SIGTAS have not developed in usage beyond simple accounting and recording tools although considerable capacity exists for information transfer and data analysis. Furthermore, while electronic systems have been installed, little re-engineering has taken place in processes. In some cases, data-entry forms are not suitably designed for optimal capture of information required for management use. It is further reported that while electronic systems remain underutilized, transactions processing is still basically manual. This is so in the audit functions of Inland Revenue and entry processing at the Customs.

Most departments are well equipped with electronic systems, although they are not put to optimal use. However, there is urgent need for a holistic approach to IT development in the tax departments in particular, but also in the entire public services. There is need to ensure compatibility if different systems are to interface with each other. Any future development or expansion in existing systems should take this into account.

IT development in the private sector and in private households has been phenomenal over the past decade and capacity exists for information transfer *via* the Internet. The recent rapid growth in e-commerce attests to that. There is, therefore, the readiness in the private sector to do business efficiently with greater use of IT; but not so in the public sector.

Moreover, while the business environment becomes more and more oriented to e-commerce, e-government has not kept pace and there continues to be a reluctance to accept the validity of business documents transferred by electronic media.

Extant laws do not specifically authorise electronic transacting, especially with regard to receipts and payments. A Finance (Management) Bill and related Regulations were drafted for use of the OECS that, *inter alia*, permitted payments by electronic media as well as the issuance of electronic receipts. It does not appear that these have been enacted in all countries. The countries that have not passed the new draft legislation are, therefore, not legally positioned for online processing of business transactions that could reduce budgetary costs for both government and the business sector.

A number of detailed recommendations have been made in the various IMF reports referred to in the earlier part of this section, concerning the computer systems installed in the Inland Revenue and the Customs. These include enhancing the functionality of ASYCUDA and correcting a number of defects in SIGTAS. They also include developing the capability to access and analyse data stored in both systems to provide management information and data for policy evaluation.

Most of the work in filing customs entries and tax reporting forms, assessment and auditing is done manually, despite the adequate capacity of the computerised systems installed in both departments. Offering online services to taxpayers and reducing processing time by minimising manual operations could improve these services.

The Commission draws attention to these recommendations and urges governments to give consideration to them at an early date.

7.11 Revenue Authority

Tax administration in the region suffers from the following weaknesses:

- Lack of coordination and information exchange among revenue agencies - the Inland Revenue and the Social Security use a common base for withholding from wages, while Customs and Inland Revenue have a common interest in establishing the true value of import purchases and domestic production for purposes of taxation; yet, in most cases, data presented to the revenue agencies differ significantly although they derive from the same sources.
- Taxpayer rights and obligations are set out in different statutes.

- Considerable intervention occurs at ministerial level that sometimes serves to undermine the authority of the Comptrollers and the integrity of the revenue.

Given the small size of the tax administrations and the limitations of their budgets and skills capacity, significant efficiency gains could be achieved in consolidating selected services or sharing common services.

Different approaches may be considered for coordinating revenue assessments and collections. One option is to bring the two principal tax departments under common management. Another option is to establish a Revenue Authority with autonomy to manage the assessment and collection of revenues.

7.11.1 The Case for a Revenue Authority

In the context outlined above, benefits to be gained from a Revenue Authority include:

- coherence in tax administration;
- a common approach to revenue enhancement;
- improved compliance deriving from information exchange and system linkages between tax departments;
- improved ethical standards fostered through effective scrutiny and audit of agency operations;
- economies of scale and operational efficiency from sharing common services (including strategic planning, financial management, internal audit and human resource management) and a common data base;
- better coordination in collection, compliance and enforcement, information technology, adjudication of tax cases, legal services (in many instances tax offences straddle the authority of both Inland Revenue and Customs), technical services, investigative services and intelligence.

However, differences in functional objectives and operational cultures in the two principal tax departments should be recognised[xii]. To a large extent differences will be minimised with a move away from trade taxes to expenditure or consumption taxes, particularly with the adoption of a VAT.

As far as possible, the determination of which revenues should be brought within the ambit of the revenue authority rests with the efficiency with which collections can be made and service delivered to clients. Two main criteria should guide decisions in that regard – enhancement of compliance deriving from an integrated database, and cost-efficiency in operations.

7.11.2 Recommendation

The Commission recommends the establishment of revenue authorities in each jurisdiction with autonomy to manage revenue functions following business management principles.

7.12 Regional Revenue Authority

7.12.1 The Case for a Regional Revenue Authority

The Treaty of Basseterre established the OECS as a common market in a manner similar to the Eastern Caribbean Central Bank Agreement which created a currency union governed by uniform monetary policies. Article 3 of the Treaty provides in part that the member states, "will endeavour to co-ordinate, harmonise and pursue joint policies particularly in the fields of …… income tax administration and customs and excise administration …"

In the context of the OECS common market, the issue of tax harmonisation derives from three major concerns:

- Creating a level playing field for the movement of commodities, capital, labour and technology;
- Fostering non-discrimination in the treatment of resident and non-resident income among member states;
- Eliminating tax arbitraging as an important factor in investment location.

In addition to the above concerns, a significant consideration for regional tax harmonisation is the gains in efficiency and cost-effectiveness that can arise from regional coordination and the sharing of vital common services, especially in adjudication, management, training and IT development. Tax harmonisation should not preclude healthy tax competition that leads to overall improvements in resource allocation, especially in the area of tax and expenditure levels and inter-country tax diversity that takes account of local conditions and business cultures. Furthermore, deliberate policies of tax differentiation could become an important policy instrument leading to adjustments in resource allocation within the region. Where this occurs, the issue of regional coordination becomes of critical importance.

The case for a Regional Revenue Authority therefore rests on the need for tax harmonisation within a common market, tax policy coordination to facilitate equitable resource allocation and fiscal diversity within the region as well as strengthening tax administration through sharing vital common services.

7.12.2 Structure: Considerations and Alternatives

The OECS political and economic management framework presents a challenge for the design of an appropriate structure for a Regional Revenue Authority. The options to be considered include:

a. A fully integrated and centrally managed administration;
b. Central management of selected functions;
c. Regional coordination within a loose cooperative relationship.

The first assumes a degree of integration more appropriate within a federal structure. The second requires the regionalisation of some parts of the administration:

- To improve the cost efficiency of inland revenue and customs administrations in the OECS region;
- To upgrade the technical capacity of the tax administrations;
- To reduce the opportunities for smuggling, tax evasion and false customs declarations and tax statements.

Through the ECCB there already exist mechanisms for exchange of information and policy coordination at the level of three important committees:

- Financial Secretaries
- Comptrollers of Customs
- Comptrollers of Inland Revenue

However, these committees meet separately no more than twice each year and are presently oriented more towards project steering and monitoring.

7.12.3 Structure: Recommendations

The Commission proposes the establishment of a Regional Revenue Authority by inter-governmental agreement. The Authority should be established along the following lines, taking account of legal and other organisational implications:

(a) It should be an autonomous body responsible to the Monetary Council, with powers to:

- Coordinate the harmonisation of tax policy, including the elimination of tax arbitrage; but also advising on the need for locational differentiation;
- Coordinate regional training and IT development for tax administration;
- Promote best practices among tax administrations.

(b) The structure should provide for

- A technical group of tax and customs officials (jointly) to serve as consultative and steering committee;
- As part of the regional machinery, a regional tax tribunal to adjudicate tax matters in each jurisdiction;
- High-level support for common services delivery – technical advisors in direct and indirect taxes, legal attorney (for legislative drafting and court appearances) and Information Technology Expert.

(c) The Terms of Reference of the Regional Revenue Authority would include coordination of:

- Planning and research
- Training/capacity building
- Specialist auditing
- Legal drafting and case preparation
- Information technology development and maintenance

The Commission recommends that donor assistance be sought to support this initiative and that governments should contribute towards its establishment and operations. The Commission suggests that the Government of Canada be approached to contribute initial financial resources and that governments' contributions should be by assessed subventions until a suitable formula can be agreed for an independent source of financing for the Authority.

7.13 Implementation

Chart 1 sets out timelines for the implementation of the several recommendations made in this chapter. The sequencing of most activities follow logical lines and takes account of existing capacity in the tax departments and Ministries of Finance including the procurement of technical assistance. The restructuring of the two principal tax departments should precede the setting up of the Revenue Authority to clearly identify functional areas and common services that should be consolidated. It has been estimated that tax departments will be ready to implement VAT within an 18 to 24 months time frame. However, no decision has been taken concerning a commencement date. A timeline of three years for implementation is indicated.

Chart 1

TAX ADMINISTRATION IMPLEMENTATION

	Year 1	**Year 2**	**Year 3**
Improve Coordination			
• Establish policy unit			
• Coordinate work of policy units for regional tax harmonization			
• Attach specialist in tax law to IRD			
• Establish Revenue Authority			
o Undertake feasibility study			
o Implement recommendations			
• Establish Regional Taxation Authority			
o Undertake feasibility study			
o Implement recommendations			
Improve IT			
• Enhance SIGTAS			
o Introduce SIGTAS in Anguilla and Antigua			
o Computerize cashier's process, including preparation of deposit forms and issue of electronic receipts			
o Connect SIGTAS with Treasury system to transmit information on daily collections			
o Amend SIGTAS to take account of outstanding refunds when calculating tax arrears balances, to make distribution of payments automatically and to facilitate payments by instalments			
o Review assessment forms and validation system			
o Design plan to introduce electronic filing			
o Implement electronic filing system			
o Create log of objections filed			
o Develop system to store results of objections			
o Develop and put in place objective on-screen taxpayer selection capability			

Organization restructuring												
• Implement organization plan for IRD consistent with FAD recommendations at Chart I • Improve planning function in IRD o Create unit to deal with planning, supporting and monitoring operational units o Define selection criteria, basic procedures and estimate audit time and resources o Prepare plan for expanding cross-checking system o Develop system for follow-up of tax cases o Establish formal system of planning and reporting with monthly targets o Introduce the use of performance indicators and management information o Develop seminars on planning and use of management information o Formalize/strengthen taxpayer service function o Establish special control of largest taxpayers o Establish tax policy unit o Attach specialist in tax law to IRD												
Introduce modern audit system												
• Create industry profiles o Design audit programmes aimed at different taxes and tax payers • Improve information sourcing and exchange system												
Consolidate tax administration legislation and strengthen enforcement and taxpayers' rights provisions Develop and put in place tax legislation database with indices to facilitate taxpayers'												
Taxpayer registration												

• Introduce universal TIN • Clean up existing tax identification system system • Create system to update information on inactive taxpayers • Adopt UN UIIC for coding economic activity • Include information of accountants' TIN in taxpayer register information												
Implement VAT												

Section 8

SUMMARY OF RECOMMENDATIONS

8.1 The Imperatives for Economic Growth

8.1.1 Information and Communications Technology

The development of Information and Communications Technology to provide a platform for the growth of e-commerce will be necessary to bring the economies of the ECCU in line with the global economy. The following have been identified as major steps to be taken in efforts to improve the state of e-readiness in the region:

- Establish national and regional ICT policies and strategies;
- Develop a regional coordinating entity or Council, and build institutional capacity;
- Develop an industrial policy and sector plans and establish ICT projects which can be piloted in one state and rolled out to different states; and
- Undertake public sector reform and modernization through the development of e-government.

8.1.2 Improving the Efficiency of Investment

To enhance the efficiency of investment governments need to ensure the following:

- that the projects they promote are technically feasible, cost-effectively designed and satisfy economic and financial viability tests;
- that tendering, management selection, and procurement are awarded on the basis of competitive transparency;

- that selected projects are part of an integrated programme and that supportive policies and institutional arrangements are in place to optimize the macro-benefits. This is best done through the framework of Public Sector Investment Programmes that are consistent with Medium Term Economic Frameworks; and Macro-economic Investment Management Plans with crude indicative distributions. The development and management of the Public Sector Investment Programme is no longer vigorously undertaken, and the process must be strengthened.

8.1.3 Development of the Sectors

Non-Tourism Services

The following are recommended steps in the development of an action plan for non-tourism services:

(a) Undertake surveys to determine local business and professional capabilities and skills and identify the services that could be supported by these capabilities;

(b) At both OECS and national levels, designate ministerial responsibility for the development of non-tourism services, constitute sub-regional and national machinery with private sector involvement to serve as advisory mechanisms to governments;

(c) Conduct detailed feasibility studies of each service and prepare action plans for its implementation;

(d) Target firms that could be encouraged to enter export markets, assisting them with specification of skill requirements and training needs, identification of possible partners in production/exports, market areas to be penetrated and negotiating strategy for so doing;

(e) Prepare plan for government support of targeted firms including local business opportunities that could be provided by local governments/private sectors.

Tourism Services

Governments already recognise the need for both product and market diversification in tourism. The traditional packages of sand, sun and sea are losing competitiveness to other lower cost destinations. Tourists are increasingly showing a preference for different attractions, such as eco-tourism, heritage tourism, cultural tourism, and nautical tourism. Changes in patterns of demand, as well as the fall-out from threats of international terrorism, both point towards an increasing need to diversify attractions including the development of multi-destination packages.

The following are recommended as important steps in the diversification of tourism:

(a) Local Tourist Boards on a national/sub-regional basis should undertake analytical studies of new attractions and packages. Tourist boards should convene meetings of hotels and tour operators to discuss the new packages and public relations/advertising programmes to market them.

(b) Governments will be expected to contribute towards core budgets for these programmes, but donor assistance should be sought for the initial promotion.

(c) Tourist Boards should undertake intensive programmes of public education to sensitise local publics to the importance of the "new tourism" strategies for local economies and to solicit their full support in marketing the packages.

(d) Determined efforts should be made to find new markets, e.g. Eastern European members of the EU, Japan, South East Asia and high-income sectors in Latin America.

(e) Air charter services for these new markets should be explored.

Agriculture

A modern, efficient agricultural economy will require developments on several fronts. These include:

(a) **Product Development** in both traditional and non-traditional crops. In both categories there are tremendous gains to be made from a shift to organic production. In addition, the potential for fish production, both marine and land based, needs to be harnessed.

(b) Strengthening of **Market Intelligence** systems, and development of capacity to respond to domestic demand (tourism), regional demand (with a food security focus), and demands of international markets. At the international level, reports indicate a growing demand for tropical exotics, particularly organically produced fresh and processed products, and fish for which world demand is growing in excess of 6 percent per annum.

(c) Developing an appropriate **Institutional Framework** (including legislative) to provide the necessary supports to both production and marketing with more direct private sector involvement. This will require new corporate approaches, for example, the development of mixed enterprises in which a number of interests can participate (e.g. governments, farmers, distributors (both local and overseas), and consumers. The existence of the East Caribbean Stock Exchange provides an opportunity to develop publicly listed companies along these lines. Marketing Boards could also be suitably adapted to meet the new requirements.

The following are recommended as important steps in the implementation of new strategies for agricultural diversification:

- A sub-regional organisation or particular member government should be mandated to update the analytical studies which are now about ten years old.

These studies should be made available to interested member states for consultations with local farmer organisations and farmers. Discussions should lead to the formulation of sub-regional or national business plans for each of the crops / clusters of crops.

- In collaboration with the Caribbean Development Bank, approaches should be made to external donors, e.g. EU/ACP Private Investment Facility for quasi-concessionary finance, and the EU for concessionary finance, in particular areas where local capabilities may be deficient, e.g. start-up capital; technical assistance for international certification of production; technology for storage, packaging, and freezing of produce. This could take the form of quasi-equity finance for local companies.

- Convert local marketing boards or establish them where they do not exist, as publicly listed companies with shares partly subscribed by governments, and open to subscription by farmers, local distributors and the public at large.

- The marketing companies should be run on commercial lines. Their functions will be to contract deliveries from farmers at negotiated prices, store, package, freeze and process produce. They should sell on a contract basis to local distributors and overseas outlets. They may form partnerships/alliances with other companies and overseas distributors.

8.2 The Role of Fiscal Policy and Fiscal Harmonisation

Fiscal policy in the Union should

- Emphasise fiscal discipline and prudence. The effective control and management of debt within a clear planning framework is an essential element of fiscal discipline;
- Be directed to supporting the developmental and growth targets by generating surpluses for capital investment, emergencies, and government's role as the major facilitator in economic development;

- Be consistent with and supportive of the monetary policy of the Union which is committed to a stable currency based on a fixed exchange rate, linked to the US currency;
- Pursuant to those goals, governments should seek to implement the benchmarks previously proposed by the ECCB:

  (a) a current account fiscal surplus of 4 percent of GDP;
  (b) an overall fiscal deficit not to exceed 3 percent of GDP;
  (c) a central government debt ratio not to exceed 60 percent of GDP; and
  (d) Debt service payment ratio to current revenue not to exceed 15 per cent;

- Embrace tax harmonisation across the Union beyond the fiscal convergence necessary for the effective operation of the currency union. This will facilitate the achievement of efficiency gains and cost effectiveness in tax administration and tax revenues. It will enable improvements especially in the areas of adjudication, management, training and IT applications. It will increase the region's readiness for participation in the new international trading arrangements. Fiscal harmonisation will require the establishment of appropriate legal and administrative mechanisms to monitor and sustain the implementation of harmonisation targets and decisions.

Governments should, at both the state and regional levels, mount a serious educational campaign about the importance of their role and of taxes in the system. This is necessary if the idea of harmonisation is to be meaningful and successful.

8.3 The Role of Government

The governments will need to support actively the economic transformation of the economies. In this regard, governments should conceive of themselves as institutional innovators finding new organisational and management structures to develop the potential for the new economic activities. Governments will need to provide the initiative, the initial thrust of innovation, some of the start-up finance, and the mobilisation of the different partners required for developing projects.

The governments should lead in “business” ventures, where a demonstration would induce others to follow and where the risks are manageable. More specifically,

(i) Government’s fiscal policy should be directed at increasing domestic savings by:

- Maintaining prudent tax ratios sufficient to generate revenues to pay for essential services and necessary investments;
- Strict control of consumption expenditure and careful selection of investment expenditure.

(ii) Government should facilitate the conversion of domestic savings into domestic investment by providing supportive infrastructure and services (including research and development services).

(iii) Government’s participation in “private investment” should include the following:

- Assisting domestic private sector to identify and exploit investment opportunities (including assisting with technological research and market information);
- Brokering partnerships between the domestic private sector and foreign investors;
- Entering into partnerships with domestic private sector and/or foreign investors;
- Directing investment into low risk ventures where neither domestic private sector nor foreign investors can be induced to enter, with clear exit path as far as possible.

Governments should enter the developmental process, when necessary, and leave when it is expedient. While they should continue to be involved in the development process, they need not continue beyond that critical juncture where, systemically, the business or the industry is ready to grow.

Governments ..

- have a social role of providing those goods and services which are difficult to distribute in discrete segments, including public goods. These include law and order, defense, public roads, public buildings, and water and environmental protection.
- Are expected to intervene in the provision of those services which could conceivably be provided and distributed by market forces, but which the state chooses to provide to ensure equality of opportunity and good citizenship. The most noteworthy of these are education and health;
- Have a duty to create the enabling environment for investment in human capital formation. In promoting development, the state must be involved in the provision of the vital services of education and training, and health and housing for its population. The provision of these basic services is the corner stone of a stable and productive society;
- Must be providers of information for the development of the entire economy, but especially for the private sector. Information dissemination will be of paramount importance in this knowledge-based society. Open communication and consultation to assist with the economic and fiscal management of the ECCU could strengthen the critical nexus between the government and the private sector in the ECCU. Some countries have already adopted the model for consultation approved by the Monetary Council of the ECCB. Another modality might be the establishment in the states of Advisory Committees as links between the government and the wider society and as generators of ideas and sources of information.

The new imperatives of globalisation require a wider role for both the ECCB and the ECSE in strengthening the economic and trading capacity of regional governments. The Exchange and the Central bank must work together to mobilise within the region all available funds for public sector developmental projects through the development and expansion of a regional market for government bonds. This will reduce dependence on external funds for this process and, in that sense, reduce the external debt. To facilitate this process governments will be required to put in place a supportive legislative framework, including securities legislation, and an effective regulatory authority to encourage transparency, efficiency, and the confidence of traders and investors.

8.4 The Revenue System

The revenue system must facilitate economic growth. It should provide stimuli to the development areas which the governments wish to promote, while at the same time generating adequate revenues. It is proposed that tax ratios be maintained between 25-30 percent of GDP as follows:

	Existing Range As percent of GDP	Average As percent of GDP	Proposed Range As percent of GDP
Personal Income	0.9 - 4.7	3.5	4.0 - 6.0
Corporate Income	2.7 – 5.2	4.0	4.0 – 7.0
Property	0.1 – 1.1	0.45	2.0 – 4.0
Trade and Excise	6.0 – 14.4	7.6	3.0 – 5.0
Transactions	9.1 – 14.5	11.5	10.0 – 14.0
TOTAL	**23.9 – 29.1**	**25.5**	**25.0 – 30.0**

The tax system should therefore be simple, comprising the following taxes:

- Personal Income
- Corporate Income
- Property
- Trade and Excise
- Domestic transactions (VAT)

The Value Added Tax (VAT), implemented at a general rate of 15.0 percent, will replace the nuisance and other indirect taxes on domestic transactions.

Detailed recommendations for levels of taxation in the above categories are at Section 5.

It is also recommended that the governments should save approximately 20 percent of current revenue for financing investment and for the accumulation reserves.

8.5 The Incentives Regime and Development

In their use of fiscal policy to stimulate economic activity, the authorities will need to balance the impact of concessions on the revenue base and the achievement of the growth objectives. The following are therefore recommended with regards to the granting of tax concessions:

Hotel Aid and Fiscal Incentives

The duty free imports granted under these acts should remain in place. The tax holiday should be phased out and replaced by the tax credit system as obtains in Dominica.

Statutory Bodies

The tax concessions granted to statutory bodies should be limited to a specific period. The emphasis should be on increasing the efficiency of these organizations, particularly those dealing with electricity, water, ports and the marketing of agricultural products.

Concessions granted under Customs Act

The concessions granted to religious and other bodies under the Customs Act should be carefully circumscribed and should in no case exceed 75 percent of the taxes involved.

Concessions that are granted to civil servants should be limited to a 75 percent reduction in the taxes payable on acquisition of a motorcar every four years. The concession should be restricted to senior civil servants at an approved grade.

8.5.1 Tax Administration

The revenue system should be supported by an efficient tax administration. The major tax administration reform objectives to be pursued should include:

- Restructuring tax departments to provide better taxpayer services; reduce transaction costs; strengthen planning and research capacity; and establish performance standards;
- Redesigning procedures and the legal framework to increase compliance and enforcement;
- Enhancing human and physical resources to foster efficiency in service delivery;
- Strengthening processes for tax transactions to accommodate e-commerce and E-government;
- Speeding up the judicial process for tax collection and the resolution of tax disputes;
- Improving communication with taxpayers and between tax agencies to facilitate information exchange and effective collaboration;
- Improving and integrating tax administration information systems;
- Strengthening tax coordination at the local and regional levels.

A Revenue Authority with autonomy to manage the assessment and collection of revenues should be established in all member states. This will facilitate the exchange and sharing of information for tax assessment and collection among the three revenue agencies: Inland Revenue, Social Security and Customs, strengthen the integrity of the administration, improve the utilization of available resources, and improve the efficiency of the administration.

In addition a Regional Revenue Authority should be established to facilitate the harmonization of tax policy, the elimination of tax arbitrage within the Common Market, achieve the efficient resource allocation across the administrations, facilitate fiscal diversity, and generally strengthen tax administration through sharing vital common services. The Regional Authority will promote best practices among tax administrations, and coordinate the following:

- Regional training and IT development;
- Planning and Research;
- Special auditing;
- Legal drafting; and
- Information technology development and maintenance.

Section

9

FURTHER WORK

Based on the recommendations for tax and administration reform, the Commission is completing a detailed analysis of the likely revenue impact of the proposals and any implications of those for the implementation schedule.

The Commission is still in the process of examining the very important issue of the taxation of the tourism sector, on which there is a diversity of views among governments and the industry in member states.

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[iii] The notion of implicit and explicit fiscal policy is taken from Davie and Duncombe (1972), chapter 15, p.346

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