

DM/53/20

INTERNATIONAL MONETARY FUND

Asian Department

Use of Fiscal Measures for the Promotion
of Government Capital Formation in the Far East Countries^{1/}

Prepared by Ching Chun Liang

August 11, 1953

<u>Contents</u>	<u>Page</u>
I. <u>Introduction</u>	1
(1) Scope and Concept.....	1
(2) Objective of Government Capital Formation.....	2
(3) Government Capital Formation vs. Private Investment...	2
II. <u>Government Capital Formation in the Far East</u>	5
(1) Japanese Experience.....	5
(2) Other Far East Countries.....	5
(3) Causes for the Slow Growth of Public Investment in the Far East.....	7
(4) Nature of Projects in the Far East Public Investment..	10
III. <u>Financing of Government Investment -- General Considerations</u> ..	12
IV. <u>Taxation for the Financing of Government Investments</u>	14
(1) Tax Burden in Far East Countries.....	14
(2) Taxation and Capital Formation.....	16
(3) Income Distribution vs. Private Capital Formation....	17
(4) Direct Tax vs. Indirect Tax.....	20
(5) Administrative Limitations.....	22
V. <u>Government Borrowing</u>	25
(1) Magnitude of Public Debt in the Far East Countries....	25
(2) Interest Burden.....	26
(3) Importance and Technique of Wide Distribution of Government Securities.....	26
(4) Holdings of Government Securities in the Far East.....	29
(5) Government Bond as Builder of a Capital Market.....	30
(6) The Question of Maximum Amount of Public Debts.....	31
(7) Economic and Legal Limitation of Public Debt.....	33
(8) Bond Price Support and Interest Rate Policy.....	34
(9) The Question of the Purchasing Power Bonds.....	36
VI. <u>Special Assessments, Fees and Tolls</u>	38
VII. <u>Government Reinvestment</u>	39

^{1/} This paper was prepared at the request of the Economic Commission for Asia and the Far East for the use of its Working Party of Experts on Financial Aspects of Economic Development Programme of the Far East to be held 7-12 September 1953 in Bangkok, Thailand. It expresses the views of the writer and does not necessarily reflect those of the International Monetary Fund.

Contents (continued)

Tables in Text

A. Total Investment and Gross Government Investment Compared with Gross National Product Japan, U.S.A., Australia, Sweden, France, Belgium, 1929-1951.	6
B. Government Expenditure and Investments as Percentage of National Income of Burma, Ceylon, India, Philippines, and U.S.A.	8
C. Burden of the Central Government Taxes of Far East Countries, 1951.	15
D. Comparison of Tax Burden and Gross Private Investment in Japan Pre-war and Postwar.	18
E. Interest Payments as Percentage of National Income of Burma, Ceylon, India, the Philippines, and U.S.A.	27

Tables in Appendix

I. Original and Revised Six-Year Development Program of the Colombo Plan and the Five Year-Plan of India.	40
II. Composition of Government Investments of Burma, India, and Pakistan.	41
III. Percentage Distribution of Government Revenue of Far East Countries.	42
IV. National Debt Burden of Ceylon, Japan, and the Philippines 1951.	45
V. Government Domestic Debts and National Income of Some Countries in Europe, Africa, and America, 1951.	46
VI. Postwar Change of Government Debts of Ceylon, Japan, and the Philippines.	47
VII. Government Bond Yield of Far East Countries.	48
VIII. Distribution of Japanese Government Bonds 1950 to 1952.	49
IX. Distribution of Holders of U.S. Government Securities, 1939 to 1952.	50
X. U.S. Government Public Debt and Interest Payments as Percentage of National Income, 1929-51.	51

I. Introduction

(1) Scope and Concept

1. The term "Government Capital Formation" used in this paper refers to government expenditure for enduring improvements, that is, any physical structure designed to yield utilities beyond one year -- the customary fiscal accounting period. In this sense, the term "Public Works" is here used interchangeably.

2. Public capital formation consists mainly of two distinct processes: (a) raising of funds, and (b) execution of investment projects. The first belongs to the receipt side, while the second belongs to the expenditure side of the government administration. It goes without saying that no government investment can be brought about without both of these two processes. In the present study, however, only the first part of the whole operation is discussed. The second part is more related to the technological field. It consists of appraisal of the availability of manpower, raw material, and natural resources, location of the investment projects, their engineering feasibility, training of skilled labor, calculation of costs, and estimate of benefits. Several studies have been made by UN agencies and other organizations. Special mention can be made of the set of comprehensive studies produced by the UN Technical Assistance Administration Training Institute.^{1/}

3. Government investments may be implemented in two ways, direct or indirect. Direct government investment takes place when the government itself executes the development projects and has absolute control and ownership of the finished public works. On the other hand, when the government merely extends financial assistance to individuals or organizations to execute the development works and does not claim absolute control or ownership in them, they become indirect government investment. Government financial assistance may take various forms, namely, (a) share subscription, (b) credit extension, (c) subsidies, and (d) guarantee. The lower down the list, the less will be the government's right to ownership and control of the project concerned until the investment loses entirely its public character. The status of such project, therefore, becomes very complicated. Governments may take part in corporations by subscribing to their capital stock. To what extent this arrangement makes the corporations part of the public capital formation is rather difficult to decide. The real nature of the extension of credit from the government budget to finance development projects is also ambiguous and their relation to government capital formation is not always clear. A loan from a central government to a local government for construction work may be considered as public capital formation. In certain cases, it is also true that the loan from the central budget differs from direct government capital expenditure only in form.

^{1/} Formulation and Economic Appraisal of Development Projects, Books I and II, and Lectures on Special Problems Developed at the Asia Center on Agricultural and Allied Projects, Books I and II, 1950, United Nations.

Government appropriations are sometimes changed into loans merely due to the change in the organizational setup of the government. For example, the management of railways, electricity, and civil supplies in Burma has been entrusted to separate boards; the capital outlays on these, formerly met from the budget, no longer appear as investments but as loans to the respective boards since the transfer.^{1/} This should not be considered as a reduction of the Burmese government capital formation. In other cases, however, loans have very little to do with capital formation even in the private sector, such as productive credit to agriculture. Since government loans are made up as items which differ greatly from each other in their effects on capital formation, it is not good procedure to consider all of them to be part of the total government capital formation. The other forms of government assistance, namely, government subsidies (such as those to shipbuilding) and guarantees (such as those for the payment of private loans for housing) partake still less of the character of public capital formation. They are therefore not discussed in the present paper.

4. There has grown not only a movement but also some actual implementation of nationalization in some Far East countries such as Burma, Ceylon, and Indonesia. The Prime Minister of Burma has estimated that the total cost of the nationalization program, to which the Government is committed, will be about Rs 670 million (approximately US\$ 140 million). The sectors to be nationalized are cultivable lands, at a cost of US\$ 74 million; forests, at about US\$ 4 million; and foreign industrial enterprises, at about US\$ 62 million.^{2/} It is obvious that nationalization, whether by government purchase of existing enterprises from nationals or from foreigners, is not capital formation. For instance, the acquisition of foreign-owned rubber estates by the government would not in itself enlarge the capital equipment of the country at all.

5. There are very few data about local government finance of the Far East countries, but the general tendency has been for the local governments to expand their responsibilities. As a result, capital formation from that sector has also been increasing in the form of schools and hospitals, residence buildings, streets and highways, and some public utilities. Public works have also been undertaken as a result of certain work relief projects. The tax system of the local governments is rather rigid. Their taxing power is limited in order to avoid competition with the central government. Main reliance has been on the inflexible property tax. The power of contracting debts has also been limited either by economic factors or by statutory provisions. In view of these circumstances, there has been a movement to shift part of the local functions to the Central Government or to obtain more grants in aid from the Central Government. For example, the Japanese Government has increased its financial aid to the prefectural governments and the Philippine Government has recently greatly increased its budgetary provision for primary education. In view

^{1/} Economic Survey of Asia and the Far East, 1951, p. 243, United Nations.

^{2/} Source: Department of Trade and Commerce, Foreign Trade, Ottawa, Canada, June 16, 1951.

of the scarcity of data about local finance, no special discussion of capital formation by local governments will be made in this study.

(2) Objective of Government Capital Formation

Although the underdeveloped countries, including those in the Far East, have not had much capital assets in the modern form in the government sector, they have inherited from their public authorities throughout the past centuries a large volume of public works, such as roads, bridges, canals, irrigation works, grain storage, schools, libraries, parks and many architectural pieces. These were brought about mostly not by deliberate planning but rather as a by-product of work relief at the time of natural calamities. This can be considered as an ancient form of government capital formation. A heavy volume of public capital formation took place in the 'thirties in Western industrialized countries. This modern development had as its objective the recovery of economic activities from the economic slump. In the postwar years the need for the development of underdeveloped countries leads to the conclusion that the government must take up the major part of the projected program of economic development. This means that the government must be itself engaged in building up durable physical assets in order to speed up the rate of new investments in the country. This kind of government capital formation is different in its objective from the two forms mentioned above (work relief and contracyclical expenditure). The present paper is concerned only with the third category of government capital formation, namely, deliberate government investment to fit in with an overall plan of economic development. This is rather a new field of government fiscal policy. The theories and practices developed in connection with counter-cyclical measures, such as pump priming, may need to be modified when applied to the development projects of underdeveloped countries but the lessons learned in the 'thirties are very useful in this regard.

(3) Government Capital Formation vs. Private Investment

Since the objective of government capital formation as discussed in this paper is the implementation of an overall development plan, it is obvious that government investment should not hinder in any way capital formation in the private sector. Speaking of anti-cyclical government financing, Professor Haberler emphatically states that government deficit financing should be resorted to only when certain conditions are satisfied. The conditions are that "the government deficit should be so financed as not to restrict the supply of investible funds for other uses; the object of expenditure must be so chosen and the policy so managed as to avoid unfavorable repercussions upon private investment decisions; the spending policy must not be coupled with cost-raising measures". ^{1/} The criterion of avoiding unfavorable repercussions upon private investment are just as important with respect to development of underdeveloped countries inasmuch as they need to build up their total investments (both public and private)

^{1/} G. Haberler: Prosperity and Depression, 1946, p. 504.

-44-

in the most rapid possible way. This is not the place to enter into a controversy of government ownership versus private enterprises. In this connection it should be noted, however, that government investment expenditures may encourage or deter private investment. Regional development, for instance, opens up new fields for private enterprises, and the expansion of the automobile industry would not have been possible without the national highway program. On the other hand, public investment may affect private investments in various ways. It competes with private investment for funds and resources, tends to raise interest costs to the private sector, increases the cost of capital assets through competition, and adds its interest burden to tax charges.^{1/} For the Far East although government investments on a large scale may have to be financed, for the present, at any rate, at the expense of private investment, owing to inadequacy of savings, such investments will increase the basic facilities for private investment in the future.

^{1/} Henry C. Simons: Hansen on Fiscal Policy, Journal of Political Economy, April 1942.

II. Government Capital Formation in the Far East

(1) Japanese Experience

The rate of government investment in Japan relative to its national income has been fairly high in recent years, being 6.0 per cent in 1950 and 4.9 per cent in 1951. It already had such a rate in the early 'thirties. There is also available a long series of data to show the development of both government investments and total investments of Japan. One remarkable fact is that the total investment relative to national income has been very high. From 1935 onward, it stood at more than 20 per cent. The ratio was higher than that of the United States and about equal to that of the countries with the highest ratio of capital formation, such as Australia and Sweden. The government investments of Japan showed similar position. (See attached Table A).

Another study of the total capital investment of Japan also showed that even in the first three decades of the twentieth century, Japan had a high ratio of capital formation: 12.1 per cent in 1900-09, 16.9 per cent in 1910-19, and 12.3 per cent in 1920-29. ^{1/} There are several factors figuring in this development. Thriftiness has been a well-known national characteristic of Japan. A highly developed system of financial institutions helped to mobilize the savings. The monetary unit was quite stable; so was the political situation. There was, at the same time, availability of imports of capital goods; annual value of such imports amounted to more than one third of the total investments from 1900-1936. Japan's experience in capital development has led people to think that the later a country embarks on an intensive process of "catching up" with modern industry, the more quickly it would run through the process, once the main political and social obstacles have begun to crumble. The installation of up-to-date railroads, factories, shipyards and mining equipment should take much less time after the step-by-step pioneering has already been done elsewhere.

(2) Other Far East Countries

Data are also available to study the government capital formation of Burma, Ceylon, India and the Philippines in the postwar years. Among these four countries, Ceylon had the highest average ratio (6.1 per cent) of government capital formation to national income during the five years from 1947 to 1951. There has been also an upward trend in this ratio.

^{1/} Rate of Capital Development in Japan by Robert W. Tufts, as Appendix to Chapter IV of Eugene Staley's World Economic Development, Montreal, 1944.

Table A: Total Investment and Gross Government Investment Compared with Gross National Product of Japan, U.S.A., Australia, Sweden, France, Belgium, 1929-1951 (As Percent of Gross National Product)

Year	Japan			U.S.A.			Australia			Sweden			France			Belgium		
	Total In-vestment	Gross Govern-ment Invest-ment	Total In-vestment	Total In-vestment	Gross Govern-ment Invest-ment	Total In-vestment	Total In-vestment	Gross Govern-ment Invest-ment	Total In-vestment	Total In-vestment	Gross Govern-ment Invest-ment	Total In-vestment	Total In-vestment	Gross Govern-ment Invest-ment	Total In-vestment	Total In-vestment	Gross Govern-ment Invest-ment	Total In-vestment
1929	...	...	...	18.3	2.3	...	...	...	...	...	...	...	...	...	...	...	...	...
1930	15.6	4.3	...	15.0	3.0	...	...	...	...	...	...	...	...	...	...	...	...	...
1931	14.5	4.1	...	10.7	3.4	...	...	...	...	...	...	...	...	...	...	...	...	...
1932	10.7	5.1	...	4.9	3.0	...	...	...	...	...	...	...	...	...	...	...	...	...
1933	12.0	5.3	...	4.8	2.2	...	...	...	...	...	...	...	...	...	...	...	...	...
1934	17.4	3.2	...	7.4	2.4	...	...	...	...	...	...	...	...	...	...	...	...	...
1935	22.0	3.1	...	10.4	2.0	...	...	...	...	...	...	...	...	...	...	...	...	...
1936	21.6	3.0	...	12.5	2.5	...	...	...	...	...	...	...	...	...	...	...	...	...
1937	26.1	2.7	...	14.9	2.1	...	...	...	...	...	...	...	...	...	...	...	...	...
1938	24.1	2.4	...	11.1	2.3	...	...	...	...	...	...	...	...	...	...	...	...	...
1939	27.3	2.7	...	14.4	2.6	...	22.6	5.9	...	24.6	6.2	...	...	...	...	18.6	...	3.2
1940	25.5	2.7	...	17.7	2.5	...	21.8	5.4	...	...	...	...	...	...	...	...	...	...
1941	24.0	3.1	...	19.4	4.0	...	19.9	4.1	...	...	...	...	...	...	...	...	...	...
1942	22.8	3.6	...	13.0	6.4	...	10.0	2.9	...	...	...	...	...	...	...	...	...	...
1943	22.6	3.1	...	4.9	3.1	...	5.5	1.9	...	...	...	...	...	...	...	...	...	...
1944	23.4	2.9	...	3.7	1.1	...	13.6	1.9	...	...	...	...	...	...	...	...	...	...
1945	...	...	...	5.3	1.0	...	16.6	2.2	...	...	...	...	...	...	...	...	...	...
1946	...	...	...	16.9	1.1	...	22.7	3.1	...	...	...	...	...	...	...	...	...	...
1947	...	...	...	18.3	1.5	...	24.8	4.9	...	26.1	7.7	...	...	...	...	...	...	...
1948	...	...	...	19.1	1.9	...	30.4	5.0	...	24.7	8.0	...	...	...	...	...	...	...
1949	...	...	...	15.6	2.5	...	27.4	6.1	...	26.4	8.9	...	...	...	...	...	...	...
1950	22.8	6.0	...	19.4	2.5	...	30.5	7.6	...	27.6	9.8	...	...	...	...	...	...	...
1951	29.1	4.9	...	20.7	2.8	...	32.2	8.2	...	27.0	...	...	...	...	...	...	...	...

Source: Uchimura: Rates of Investment and Economic Growth of Japan Compared with Other Countries, (in Japanese), Chosa Goppo, September 25, 1952, P. 29-53. Research Division, Secretary's Office, Ministry of Finance, Tokyo.

The average ratio for Burma was 2.5 per cent, and the Philippines 2.4 per cent. The ratio for India was 0.9 per cent in 1948/49. (See attached Table B). One of the obvious reasons for the disparity of these ratios is the difference in the per capita income. Ceylon had the highest per capita income among this group of countries.^{1/}

This, of course, does not mean that per capita income is the sole determinant of the ratio of government capital formation. The United States has the highest per capita income among all countries, but its ratio of government investment to national income is fairly low; only 2.5 per cent in the postwar period.^{2/} This can best be explained by the special economic system and the form of government of the United States. The desire to avoid encroachment upon the free enterprises as far as possible has greatly limited the scope of public investments in the United States. The recent planned sale of the government rubber plant is one example. The United States did gradually expand its functions, as evidenced by the fact that total government expenditure has taken as much as 25.7 per cent of national income in the postwar period. (See attached Table B). In spite of this, the ratio of government investment to national income is very small. This simply means that government functions have been expanded only in those fields where usually there has been the slightest chance of competition with private investments.

(3) Causes for the Slow Growth of Public Investment in the Far East

Aside from the low per capita income with its necessary concomitant of low tax revenue, there are other important causes for the slow development of public investment in the Far East. They are briefly indicated below:

1. Slow Growth of Urbanization. In a sense, public investment is, to a large extent, a function of urbanization. The growth of cities requires the setting up of more engineering projects and public utilities within the cities and highways and telecommunications to link them together. Although the density of population is high in the Far East, the degree of urban concentration is still low.

2. Consciousness of the need for social welfare still awaits to be awakened. The modern development in school buildings, public hospitals, libraries and other amenities like parks, is largely due to the growth of social consciousness. The general public in the Far East has not yet been fully conscious of the great need for such welfare work.

^{1/} Economic Survey of Asia and the Far East, 1950, p. 112, ECAFE.

^{2/} It should be noted, however, that the coverage of the U.S. figure is different from that of the Far East countries under study. On the one hand, it includes state and local governments while the Far East figures refer to central governments only. On the other hand, it covers only new constructions while the Far East figures refer to public works, capital outlays of government enterprises, etc. (See Table B)

Table B: Government Expenditure and Investments^{1/} as
Percentage of National Income of Burma,
Ceylon, India, Philippines
and United States

(In Millions of Domestic Currency)

Country and Year		Govern- ment Invest- ment ^{2/}	Govern- ment Expendi- ture	National Income	Government Investment as Per Cent of Total		Government Expenditure as Per Cent of National Income
					Government Expenditure	National Income	
<u>Burma</u>							
1947/48	Rs	45.5	489.6	2,584	9.3	1.7	18.9
1948/49		73.9	401.3	3,067	18.4	2.4	13.1
1949/50		46.2	419.9	2,857	11.0	1.6	14.6
1950/51		74.3	507.2	2,608	14.6	2.8	19.4
1951/52		112.4	773.5	3,166	14.5	3.6	24.4
Average		70.4	518.3	2,856	13.5	2.5	18.1
<u>Ceylon</u>							
1947/48	Rs	105.1	579.3	2,288	18.1	4.6	25.3
1948/49		159.1	652.7	2,627	24.3	6.1	24.8
1949/50		148.0	654.9	2,873	22.6	5.2	22.8
1950/51		189.1	703.1	3,840	26.9	4.9	18.3
1951/52		377.8	1,229.6	4,507	30.7	8.3	27.3
Average		195.8	763.9	3,227	25.6	6.1	23.6
<u>India</u>							
1948/49	Rs	751.7	4,820.5	87,300	15.6	0.9	5.5
<u>Philippines</u>							
1949/50	Pesos	164.6	611.3	5,646	26.9	2.9	10.8
1950/51		123.5	576.5	6,228	21.4	1.9	9.1
Average		144.1	593.9	5,937	24.2	2.4	10.1
<u>United States^{3/}</u>							
1946	\$	2,362	47,140	180,286	5.0	1.3	26.1
1947		3,496	44,044	198,688	7.9	1.8	22.2
1948		4,907	51,574	223,469	9.5	2.2	23.1
1949		6,405	59,875	216,259	10.7	3.0	27.7
1950		7,139	61,311	239,170	11.6	3.0	25.6
1951		9,341	79,490	277,554	11.8	3.4	28.6
Average		5,608	57,239	222,571	9.8	2.5	25.7

Table B (cont.)

- 1/ Figures refer to Central Government only.
- 2/ Investment: in general, public works expenditures on gross basis (i.e., including maintenance), capital outlays of government enterprises and departments, and grants to provinces and local authorities for the same purpose.
- 3/ U.S. figures include Federal, State, and local Governments. Government investment refers to new construction.

Source: (1) Far East Countries:

- (a) Economic Survey of Asia and the Far East 1951, United Nations, pp. 368, 371; Economic Survey of Asia and the Far East 1952, United Nations, p. 75.
- (b) Statistical Yearbook 1952, United Nations.

(2) United States:

- (a) National Income and Product of the United States 1929-50, U.S. Government Printing Office, Washington, 1951, pp. 158-159.
- (b) Survey of Current Business, July 1952, U.S. Department of Commerce, pp. 17, 18.

3. In the Far East organized pressure groups working for government investments have not yet become strong enough to exert their influence. Government investments cannot be completely divorced from political considerations and some of such investments were made elsewhere as a result of social pressure. In the Far East, labor unionism has not gone far enough and the farmers, the bulk of the population, are too unorganized to influence the governments in this direction.

4. Although government expenditures have grown in the Far East, much of them is devoted to building up of defense. The high proportion of administrative expenses in the budgets has also something to do with the small quota appropriated for investments. (See attached Table B).

5. Delayed formulation of overall development plans. In the absence of such plans, each of the government departments submitted its own investment programs which were often ill-conceived and in conflict with each other. They often requested big budgetary appropriations which taken together far exceeded the government's ability to undertake. The checks and balances and jealousies among departments also prevented the implementation of much of those investment programmes.

6. Public investments rely on development of technique and the deficiency of the Far East countries in this respect stands in the way of their progress.

7. Although the governments of the Far East countries have tended to take up more and more functions, some kinds of public works were traditionally carried on by private communal groups or clans. Privately built schools and hospitals, parks, canals and bridges and grain storage facilities are not uncommonly found in those countries.

8. As is widely known, the absence of a well-organized money and capital market hinders the flotation of bonds for government investment.

(4) Nature of Projects in the Far East Public Investment

Since the ability of the governments in the Far East to finance public investments is limited, it may be of interest to note how the limited fiscal resources are apportioned among the development projects. Overall development plans of some Far East countries have now been well formulated. They are the fruits of hard thinking of experts and the manifestation of the fundamental economic policies of those countries. The allocation of the total development budgets among various programmes as presented in the Colombo Plan is an illustration of the emphasis which has been put on the most important lines of economic development.

Generally speaking, the Colombo Plan countries devote about 30 per cent of their public financial resources to transportation, about 30 per cent to agricultural and multi-purpose projects, about 20 per cent to social capital and the remaining 20 per cent to manufacturing, mining and miscellaneous items. The original plans of a few of these countries have been revised^{1/} but

^{1/} The Six-Year Programme of India for the Colombo Plan has subsequently been changed to a Five-Year Plan.

they do not appear to have departed from the earlier patterns. (See Table I in the Appendix).

Even before those overall plans were decided upon, the actual government expenditures devoted to various projects under the heading of government investments had already shown the same emphasis on certain branches of developments as envisaged later in the overall plans. In 1950, Burma, India and Pakistan spent about 40 per cent of their government investment budget on railways alone, and only about 10 to 20 per cent on industrial investment. Agricultural and multi-purpose projects had not been given a sufficiently important place. (See Table II in Appendix). This was due to the fact that this kind of project has to be undertaken as a long-term programme and needs a large amount of funds to be raised both from domestic and foreign sources.

III. Financing of Government Investments - General Considerations

Government investments may be financed in several ways. In the following sections of this study, the following methods of financing will be discussed: (a) taxation; (b) government borrowing; (c) special assessment; (d) fees or tolls; (e) government reinvestment or plowing-back of profits from public enterprises. Foreign aid or loans will not be treated in this paper.^{1/}

The various ways chosen for financing have different effects not only on the fiscal situation, but also on the other phases of the national economy. Any fiscal operation has its impact on a country's economic activities. Since public work projects often involve expenditures of great magnitude, their impact on the economic condition of a country is bound to be considerable.

At least four kinds of non-fiscal effects need to be taken into consideration, i.e., (a) consumption standard, (b) price levels, (c) income distribution, and (d) employment situation. Consumption is the end result of all economic plans. The effects on consumption depend on whether the public projects are financed by tax or by government borrowing, by direct or indirect tax, by special assessments or by raising the fees charged on public services. Although the Far East has not yet completely reached the stage of monetary economy, experience showed that methods of government financing did affect either the general price situation or the levels of individual prices. The relation of financing to income distribution has also been mentioned in a previous section. With regard to the employment situation, it has been well established that when government investments are taken up at a time approaching full employment, taxation is a more preferable method of financing. From the above considerations, it appears that the financing methods to be adopted depend on the emphasis which the government authorities wish to put on the particular secondary effects of government investments.

According to William H. Beveridge new rules of national finance should replace the old rules. There are three such new rules in the following order of importance. The first rule is that total outlay at all times must be sufficient for full employment. The second rule is that outlay should be directed by regard to social priorities. The third one is that

^{1/} This phase of the subject has been adequately studied by the United Nations Secretariat, the Working Parties of the ECAFE and other international financial agencies. Many of the projects included in the government investment plans are not fit for foreign financing, such as social capital. Neither are some items under transportation or agriculture welcome by foreign investors, such as highway and work in connection with extension of agricultural technique. Foreign investments have been mostly connected with mining, which occupies only a minor place in the plans of Far East countries for public investments.

it is better to provide the means for outlay by taxing than by borrowing.^{1/} What is of particular concern to us here is the third rule of Beveridge. From this rule, the method of financing has been reduced to a rule of thumb, and the choice of methods appears to be a very simple matter. What we have to bear in mind is that Beveridge's preference for tax was essentially due to his abhorrence of the rentier class. In other words, he made the equality of income distribution as the chief criterion for the choice of financing methods. Since, as mentioned above, different effects are involved and different objectives may be served by using different methods of financing, it is rather difficult to lay down a hard and fast rule to suit all circumstances.

Generally speaking, the tendency in the development plans of the Far East is toward wider use of taxation rather than other methods for raising investment funds. It is not so much a matter of deliberate choice as one of necessity.

^{1/} William H. Beveridge, Full Employment in a Free Society, 1945, p. 147.

IV. Taxation for the Financing of Government Investments

The theories about the tax system with reference to capital formation have been well developed. Special studies have been made by the Economic Commission for Asia and the Far East on the relation of taxation to economic development. 1/ The question of using tax incentives to promote private capital formation has also been the subject of an ECAFE study. 2/ What is to be discussed in the present paper covers only certain issues about the relation of taxation to public capital formation with special reference to the Far East Countries.

(1) Tax Burden in Far East Countries

The first question about tax planning for the Far East countries is their existing tax burden. Data on local taxes are not available for many of these countries. A comparison is here made for the year 1951 of the burden of the central government taxes of six Far East countries, namely, Burma, Ceylon, India, Japan, the Philippines and Thailand. 3/

The per capita tax burden in terms of U.S. dollar is highest in Ceylon (\$22.49) and lowest in India (\$2.80). The variation in the tax burden among these six countries is only roughly related to the difference in the per capita income (see attached Table C). Of course international comparison of national income, and per capita income is subject to many limitations. For instance, national income is expressed in monetary terms, but the degree of development in monetary economy differs from country to country. The validity of the derived figures is also impaired for countries which have multiple exchange rates such as Thailand and the Philippines, when their national income data are converted at the official rate.

A better indicator of the tax burden is the total tax as percentage of national income. This ratio was below 20% for all the six countries, with the lowest ratio (3.7%) for India and highest (18.3%) for Ceylon. Ceylon devoted in 1951 as high a part of its national income to government expenditure as did the United States (18.4%). The variation in these ratios is fairly closely related to per capita tax burden. However, it does correspond very closely with the difference in per capita income in terms of U.S. dollar. The per capita income in 1951 of the Philippines was highest but only 5.9% of total national income

1/ See Taxation as an Instrument of Development Policy, ECAFE/INT/FED/4/ July 1953 and Taxation and Economic Development, ECAFE/INT/FED/6, 21 July, 1953.

2/ See Use of Taxation Techniques as Incentive to Private Investment in the Far East Countries, ECAFE, 1953.

3/ It should be noted that comparison of the burden of the taxes of only the central government can not very accurately reflect the relative tax burden of various countries inasmuch as the role of the central government varies considerably among the countries. The low figure of tax burden for India is explained by the fact that local finance in India is quite important, which is not included in the figure presented here. For the same reason the figure for the tax burden of the U.S. appears to be much lower than that of the U.K. in which local finance occupies a much less important place (see Table C).

Table C: Burden of the Central Government Taxes of the Far East Countries, 1951

Country	Population (Million)	National Income			Tax Revenue			Tax as % of Na- tional Income
		In Domestic Currency	Rate of Exchange per U.S.\$	In U.S.\$ (Million)	Per Capi- ta Income in U.S.\$	In Domestic Currency (Million)	Per Capita tax in U.S.\$	
Burma	18.7	Mil.Kyat	4.7619	664.9	35.56	513.5	107.8	16.2
Ceylon	7.7	Mil.Rupee	4.76190	946.5	122.92	824.9	173.2	18.3
India 1/	346.0	Bil.Rupee	3.50852	26,386.4	76.26	3,208.6	969.8	3.7
Japan	84.3	Bil.Yen	360.0	12,678.8	150.40	560.809	1,557.8	12.3
Philippines	20.2	Mil.Peso	2.00	3,793.0	187.77	451.4	225.7	5.9
Thailand	18.8	Mil.Baht	12.55	1,862.7	99.08	2,357.7	187.8	10.1
U. K.	50.4	Mil.Pound	0.357143	31,875.2	632.44	4,008.0	11,222.4	35.2
U. S. A. 2/	157.3	Mil.Dollar	1.00	277,554.0	1,764.49	51,106.03/	51,106.0 3/	18.4

1/ 1948

2/ 1952

3/ Referring to income and old-age taxes, miscellaneous internal revenue, and taxes on carriers and employers of 8 or more.

Source: Population: India: Statistical Yearbook 1952, United Nations, P. 27.
Other Countries: The World Almanac and Book of Facts 1953, N.Y.

National Income : Statistical Yearbook 1952, United Nations.

Rate of Exchange : International Financial Statistics, International Monetary Fund, July 1953.

(Par Value)

Tax Revenue: Japan: General Survey of Japanese Economy 1953, (P. 43) Ministry of Finance, Tokyo.
: Preliminary Estimates of National Income and Expenditures 1948 to 1952 (P. 6) Great Britain,
U.K. : Central Statistical Office, March 1953.
: Federal Reserve Bulletin, May 1953, (P. 503)
U.S. : Board of Governors of the Federal Reserve System, Washington, D.C.
Others : Economic Survey of Asia and the Far East, 1951 (P. 372-377) ECAFE.

was taken by taxation; the per capita income of Burma was the lowest but its ratio of tax to national income was the next highest (16.2%) among the six Far East countries. Again comparison of per capita income especially when converted into U.S. dollars is subject to many pitfalls as mentioned above.

The existence of multiple exchange rates and free exchange markets is related to the question of tax burden in a very significant way. Where such exchange restrictions prevail, the importers or persons making invisible payments have to pay a hidden tax to the exchange control authorities which does not appear in the tax revenues of the government budget. The "tax burden" on the people of such countries would be shown to have greatly increased if import duties were substituted for multiple rates. This again is another point which makes measurement and comparison of tax burden very difficult.

A recent survey by the U.S. Department of Commerce in connection with the possibilities of increasing U.S. private foreign investments presented some comments on the tax burden of India, Japan and the Philippines. Individual income rates of India on most income brackets above \$5,000 are at present somewhat higher than those prevailing in the United States. Some potential investors believe that the tax level in Japan is too high to encourage new capital investment. The Japanese Government announced that it would lower income taxes in order to stimulate capital accumulation. An income tax reduction measure was introduced in the Diet but was not enacted into law before the Lower House was dissolved on March 14, 1953. The bill provided for a reduction of the corporation tax to encourage modernization of industry and capital investment. The overall level of taxation under the general Philippine tax structure is not considered excessive. 1/

(2) Taxation and Capital Formation

Theoretical discussions of the effects of taxation on private investment abound in economic literature. The results of such discussions cannot be applied to Far Eastern countries for lack of data. Very little is known in the Far East in regard to the effects of changes in the tax structure. The limited experience which came to our attention showed divergent results.

In the Philippines, the recent increase of taxation did not appear to have hindered private investment. "The tax revenues of the Philippines Government were increased by 80 per cent in 1951 as compared with 1950.

1/ Factors Limiting U.S. Investment Abroad, Part I - Survey of Factors in Foreign Countries, U.S. Department of Commerce, 1953, P. 111, P. 117 and P. 125.

There is no indication that production and investment were in any way hampered by the increase." 1/

Some data are available on the tax burden and rate of gross private investment in Japan in the prewar and postwar periods. During the immediate prewar years, tax burden and private investment showed increase at the same time. This was the period when the economic activities of Japan was rapidly expanding. Gross private investment as per cent of the gross national product in 1940 was 21.3 and taxation (including both national and local) as per cent of national income was 18.4. They were both much higher than the respective figures of about 14.0 and 16.0 in 1935 and 1936 (see Table D). In the postwar period, however, private investments tended to change from year to year in the opposite direction of the tax burden. The six postwar years (1946 to 1951) can be divided into two distinct periods, one of increasing tax burden and the other of decreasing tax burden. From 1946 to 1949, the tax burden increased steadily from 10.9% to 26.0% while the rate of private investment decreased from 18.1% to 13.1%. From 1949 to 1951, tax burden decreased from 26.0% to 19.5% while the rate of private investment increased from 13.1% to 23.0%. If this statistical relationship should hold in the event of changes in the tax burden in other Far East countries, due regard should be paid to its effects on private capital formation.

(3) Income Distribution vs. Private Capital Formation

The question of equal distribution of income has received the greatest attention in the field of taxation discussions. This is important not only with respect to Western countries where there is a high concentration of income and wealth. Its bearing on the Far East scene is that anything which leads to further worsening of the income level of the lower class will lead to social unrest. On the other hand, certain special circumstances prevailing in the Far East make income distribution as less of a guiding principle than some other considerations.

The mass of the population in the Far East belongs to the low income group. If this whole group is exempted from sharing the burden of taxation for the financing of government investment, the whole impact will be on the limited few who are in the higher income group. The history of economic development of many countries shows that except for the U.S. which had relied very much on foreign loans in its early stage of development, countries like Great Britain and Japan resorted to the means of compulsory austerity and savings by the mass of the population for the formation of national capital. Since the only group which can contribute something to private capital formation is the small sector of the high income group, if the whole burden of taxation falls on them the net effect would be merely a diversion of private capital formation to government

1/ E. M. Bernstein and I.G. Patel: Inflation in Relation to Economic Development, Staff Papers, Nov. 1952, p. 394, International Monetary Fund.

Table D. Comparison of Tax Burden and Gross Private Investment
in Japan, Prewar and Postwar

Year	Tax Burden ^{1/}	Rate of Gross Private Investments ^{2/}
1930	15.7	8.4
1935	13.6	15.5
1936	13.9	16.8
1940	18.4	21.3
1946	10.9	18.1
1947	18.5	15.0
1948	24.2	15.6
1949	26.0	13.1
1950	21.2	15.3
1951	19.5	23.0
1952	20.8	...

^{1/} Total national and local tax as per cent of National Income by Distributive Shares, based on the Estimates by the Economic Counsel Board (calendar year for 1930 to 1936 inclusive, and fiscal year for 1946 to 1952). National tax includes stamp revenue, monopoly (except alcohol monopoly) profits, but does not include receipts from Special Account of Property Tax.

^{2/} Gross Private Investments as Per Cent of Gross National Product.
Source: Tax burden: Quarterly Bulletin of Financial Statistics, 3rd Quarter 1952, p. 32, Ministry of Finance, Japan.

Gross private investments: Uchimura: Rates of Investment and Economic Growth of Japan Compared with Other Countries (in Japanese), Chosa Goppo, September 25, 1952, p. 32, Research Division, Minister's Office, Ministry of Finance, Japan.

capital formation. As was stated above, this is not a desirable way of building up the capital of a country as a whole. The question for the Far East is not entirely a matter of mobilizing the existing savings but rather the creation of new savings. Aside from the limited possibility of getting more investment out of the idle funds from the rich class, the main hope for an increasing volume of investment lies in cutting down consumption. Since the bulk of the consumers is in the low income group, some sort of compulsory saving from that group is imperative. The two principles, social justice and rapid capital formation, therefore, cannot be both served at the same time. It is to be hoped that the period of scaling down consumption for the mass would not be too long inasmuch as a growing volume of public investment will naturally lead to higher income. The increased income will serve more and more as the object of taxation without encroaching on the previous level of consumption. This simply means that during the early stage of economic development, both the low and higher income groups must share the burden of development financing.

The main task of the financial authorities for the purpose in hand is to broaden the tax basis as much as possible and to tap all sources of revenue. In doing this, much educational work is necessary in order to enlighten the public about the value of economic development and the necessary price which has to be paid for the great reward in the future.

Recent fiscal reforms in certain countries such as Ceylon, Japan and Pakistan raised the minimum exemption limit in the individual income tax. This was meant to lighten the tax burden on the lowest income group. Due to the loss of revenue by this measure, consumption taxes were in some cases increased. This offsets the benefit conferred upon the low income group by the income tax reform. This simply shows that financial exigencies do not always permit the observance of redistribution of income as the fundamental objective of a country's taxation system.

In order to avoid lowering the standard of living of the low income groups too much, the only alternative would be to slow down the speed of capital formation. In recognition of this fact, some Far East countries have made downward adjustments of the volume of investments in their development plans. In 1950-51, it was estimated that 92.5% of the gross national product of India went for consumption purposes. It was projected that by 1956-57 the consumption level will be still as high as in 1950-51, so that only 7% of the gross national product^{1/} will be available for investment. 1/

In fact, the incidence of taxes on the upper and lower income groups works quite differently in the Far East as compared with some Western

1/ The Colombo Plan: The First Annual Report of the Consultative Committee on Economic Development in South and Southeast Asia. Karachi, March 1952, page 22.

countries. The sense of social solidarity in the Far East is so high that when the consumption level of the low income group is impaired to an extent so as to cause hardship on them, part of the burden is shifted to the upper income group through the working of the social forces. The upper income group will have to incur expenditures for personal aid and charity to be made available to their poor relatives and neighbors. On the other hand, progressive taxes which are meant to appropriate incomes in the upper bracket may actually be shifted to the population in the lower brackets. This is especially true in that part of the Far East where the social structure has not yet been rid of its feudalistic features. The rigidity and isolation of such community made it possible that bigger profits, higher rent and exorbitant interest rates could be exacted from people of low social status by those in the higher strata of the society. This makes it more difficult to trace the real effects of certain tax system on income distribution and capital formation in the Far East.

(4) Direct Tax vs. Indirect Tax

There is no place for the appraisal in this paper of the merits of each separate kind of taxes. The discussion here will be in terms of broad categories of taxes, such as direct vs. indirect taxes. Theoretically direct tax has many advantages, such as elasticity and equity. Many treaties on the financing of economic development of the under-developed countries emphasize direct tax as the golden touch in the whole field of financing.

Up to now a high proportion of tax revenues of the Far East countries has been obtained from indirect taxes. The available tax data for a recent year showed that total direct taxes in relation to total revenues of the Far East countries ranged from nothing for Brunei to 49.5% for Japan. Of the 20 government units under study more than half (11 units) had percentages of direct tax to total revenue within the range of 11 to 30%. The distribution of the ratios of direct tax to total revenues of all these governments is as follows:

<u>Distribution of the Far East Countries According to the Ratio of</u>		
<u>Direct Tax to Total Revenue</u> ^{1/}		
<u>Percentage of</u> <u>Direct Tax to</u> <u>Total Revenue</u>	<u>No. of</u> <u>Government</u> <u>Units</u>	<u>Name of</u> <u>Govern-</u> <u>ments</u>
0-10	5	Brunei, N.Borneo, Savawak, Central Government of Pakistan, Thailand, Cambodia, China (Taiwan), Indonesia, Laos, Malaya, Local Governments of Pakistan, Philippines.
11-20	7	Ceylon, Hongkong, Central Government of India, Local Governments of India
21-30	5	Korea, Korea (South).
31-40	2	Burma, Singapore.
41-50	1	Japan.
	<u>20</u>	

^{1/} For details, see Table III in Appendix.

There are many reasons for the slow development of direct taxes in the Far East. The following appear to be the most important ones:

1. Prevalence of Non-Monetary Transactions. Bartering still occupies an important position in the rural community. Self-producing and self-consuming economy dominates not only agriculture but also the handicraft branch of industry. According to tax laws, all non-monetary transactions affecting the income of the taxpayers need to be imputed at market value. Such transactions are much more numerous in the Far East than in the countries where monetary economy is highly developed. The tax laws often require that such valuation should be based on "fair market value". The conceptual uncertainty and practical difficulties in applying this criterion have been well illustrated by the report of the Committee on Postwar Tax Policy, organized by a group of economists to propose a simple, equitable and productive tax system for the United States. A passage from that report is quoted below.

"Whether in the income tax, the estate tax, or the gift tax, by law and regulation, the test of realization of gain or loss assumes a transaction in which gain or loss is established by a free, voluntary purchase and sale. There are many transfers and exchanges which are presumed to involve gain or loss, although there has been no clear-cut realization in cash through a market operation. In all such cases the law provides for establishment of the gain or loss by reference to fair market value. However clear and definite the concept of fair market value may be as a matter of statutory definition and judicial construction, it is difficult to apply in practice under some conditions and the results may be unfair to the taxpayer. An important reason for these results is that many Bureau examiners as well as many taxpayers' representatives for that matter, are not persons of such specialized business knowledge and experience as to be capable of estimating with any accuracy, what particular properties would sell for in a voluntary market transaction. Those who pass upon these matters in the preparation and in the examination of taxpayers' returns, cannot possess the requisite skill and knowledge to establish fair market values in all of the cases before them. And yet, for the purpose of determining the tax, a precise figure must be set down." 1/

2. Even in the cases of monetary transactions, the assessment of direct tax is handicapped by the absence or inadequacy of bookkeeping on the part of the taxpayer. This deficiency is due to the scarcity of persons who have accounting training. In fact the imposition of direct taxes creates such high demand for the services of the accountants who specialize in the preparation of tax returns, it is a pity that the ~~scarc~~ supply of such talents should be diverted from the commercial and industrial fields.

1/ Harley L. Lutz and Others: A Tax Program for a Solvent America, The Committee on Postwar Tax Policy, New York, 1945, p. 88, 89.

3. In spite of numerous tax booklets or commentaries to be issued for the convenience of the taxpayers, illiteracy still prevents them from mastering the technique of filling in tax returns. A relatively greater number of tax officers is needed in the Far East than is required in countries where literacy is high.

4. Individual income tax is more applicable to countries where the population is made up of individual family unit (husband and wife and their children). The Far East is characterized by communal type of families. Wealth, income and expenditures are freely shared and transferred among a larger group of people belonging to a clan. To split all such transactions into individual tax returns is surrounded with tremendous difficulties.

5. Even in the case of business income tax, the business intelligence in this region has still to catch up with the proper concepts of many technical arrangements, such as inventory valuation, depreciation and reserves. To report on these items properly, the services of numerous accounting firms are again needed. A part of the technical talents will also be diverted to add to the number of lawyers so that litigations can be carried on between the business circles and the government.

6. As a rule, the actual coming in of revenue from direct tax is slower than that from indirect taxes. Due to the special difficulties in the Far East as mentioned above, the need to get quick returns from taxation leads the government to rely more on indirect taxes.

7. Indirect taxes are also preferred in the Far East from the point of view of stability of revenues. Tax revenues in some countries in the Far East suffer from wide variation due to fluctuations in the earnings of raw material exports. 1/ Relatively speaking, however, the yield of indirect taxes is less variable than that of direct taxes because a certain volume of consumption is bound to be maintained even though the income of certain people is greatly reduced or becomes nil or negative when they become unemployed.

There is no denial that the proportion of direct taxes in the whole tax structure of some Far East countries is low and there is room for some increase. The increase will serve the purpose of tapping whatever sources of revenues are available. Judging from the special reasons responsible for the previous slow progress of direct taxes as mentioned above, unless these handicaps are removed, the hope for rapidly increasing the yield from direct taxes in the near future is not great.

(5) Administrative Limitation

Of all the principles of taxation, it seems to the writer that the fourth of the four classical maxims laid down by Adam Smith is of topmost

1/ Development Expenditures and Variability in Tax Yields, ECAFE/T & T/
FED/5, July 7, 1953.

importance for the Far East countries, namely, that "every tax ought to be so contrived as both to take out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state." The ways in which the above rule is violated, as were enumerated in the Wealth of Nations were reported to have prevailed at certain times and in certain places in the Far East. A great number of officers have been known to eat up the greater part of the produce of the tax and their perquisites impose another additional tax upon the people. The industry of the people has been obstructed to the detriment of production. The law creates a great temptation to evasion and then ruinous penalties are imposed on those who yield to it. Frequent visits of tax examiners expose the taxpayers to much unnecessary trouble, vexation and oppression. Therefore, before any new tax is to be proposed to any country, a thorough study of the ways and means should be made in order to avoid its adverse repercussions.

For example, the imposition of a betterment levy on the farmers who are benefitted by the implementation of an irrigation project should be considered as a very proper tax measure. The administrative loopholes in connection with such a tax scheme however are numerous. In the first place, a comprehensive survey of the benefitted properties and valuation of the benefits conferred are necessary in order to determine the charges to be made against those properties. A big army of surveyors, examiners and tax collectors have to be added to the government payroll. The owners of plots of land will be visited by them. The determination of the size of the land thus benefitted and its value will become an object of discussion if not bargaining between the property owners and the tax officials. The determination of the land value contains arbitrary elements in any case and the ascertainment of the benefit or increment of such property is even more subject to human error. Chances for extortion by tax officials on the one hand and evasion by the property owners on the other are certainly great. There is no doubt about the equity of imposing such a tax but the real problem is how to make the yield of the tax exceed its direct and indirect cost to the taxpayers.

Another example of the administrative limitations to the introduction of a good tax is afforded by the Japanese experience with the net worth tax. The net worth tax was adopted in Japan in 1950, as a nominal property tax imposed upon persons or property to supplement the income tax. It is a very good tax from theoretical considerations. There are, however, great difficulties in the appraisal of properties, especially intangible properties. For these reasons "the net worth tax has been of little help as a supplemental income tax and the tax revenue from it is too small although much trouble is involved in tax administration. Consequently a bill has been proposed to the Diet to abolish it as from 1953." 1/

1/ Essential Features of the Japanese Tax System which Contribute to Relative Stability in Revenue, Paper prepared by the Ministry of Finance of Japan, ECAFE/I & T/FED/9, 28 July 1953, P.2

Insofar as we recognize that administration is the weakest link in the whole chain of requirements for a good tax system, the above discussion underlines the need of caution toward direct tax. Whatsoever form a direct tax may take, whether it be income tax or inheritance tax, certain complicated concepts are involved, which are difficult to define. Much is left for estimate and judgment. It is a well-known fact that the determination of taxable income and the calculation of the amount of tax to be paid provide room for administrative interpretation. This offers an opportunity for evasion and corruption. Injustice may be done to many taxpayers and yet the yield from such taxes may still be small.

In the field of fiscal administration reform, the most important question for the Far East countries is tax personnel. As technical competency is imperative for the tax service, nepotism in recruitment should be ruled out. In order to maintain a high level of honesty in the revenue staff, the Ministry of Finance should offer them more adequate salaries and security of tenure.

V. Government Borrowing

The second method of financing government investment is borrowing. It has long been established by economists that for a government to run into debt is not in itself an economic evil. During the past two decades this thesis has been further developed. "The success or failure of public policy cannot be determined only by whether or not debt is being retired or assets accumulated. The success or failure of public policy can be determined only by noting the effect of expenditures, taxes, and loans on the total income and how that national income is distributed." 1/ "When the State borrows from its subjects, the State does not obtain the power of disposal over additional funds, for these funds were already within the realm of its power, and might, in fact, have been obtained through taxation." 2/ "The sums spent for interest or repayment become income for the creditors, so that total income remains unaffected." 3/

This section will begin with a discussion of the debt burden, interest burden, and distribution of holders of government bonds. This will be followed by the presentation of certain important problems in connection with debt management.

(1) Magnitude of Public Debt in the Far East Countries

The absolute magnitudes of public debts considered by themselves have little meaning. The burden of public debt depends on (a) whether it is incurred for unproductive expenditure or productive investment; (b) the change in price levels; (c) sources of borrowing; (d) beneficiaries of public expenditure; and (e) efficiency of public investments relative to private investments. In order to compare the debt burden between countries some statistical device has to be used such as the ratio of the debt to other economic variables, such as taxable income, savings, the volume of private securities outstanding, and so on. Most important, in general, is the relation between the debt and the economic size, so to speak, of the country. For purposes of analysis, it is necessary to express this economic size by means of some kind of an index, such as the national income. 4/

The data on government debts are available only for a few Far East countries. The per capita domestic debt in 1951 of Ceylon, the Philippines, and Japan was the equivalent of US\$13.70, US\$10.80 and US\$9.10, respectively. The ratio of domestic debt to national income was 11.0 percent for Ceylon and 5.7 percent for both Japan and the Philippines. These countries had also foreign debt. The ratio of total government debt to

1/ Alvin H. Hansen, Fiscal Policy & Business Cycles, 1941, p. 141.

2/ Professor J. Pedersen, quoted by Hansen on p. 142.

3/ Op. cit., p. 144.

4/ Public Finance and Full Employment, Federal Reserve Board, Washington, D.C., 1945, pp. 55-6.

national income was 12.7 percent for Ceylon and 8.3 percent for the Philippines (see Table IV, in Appendix). The debt burden of these countries cannot be considered as high. The amount of domestic debt of the United Kingdom, the United States, the Union of South Africa, and Norway was in the same year more than half of their national income (see Table V in Appendix). The United Kingdom had the highest debt burden, amounting to twice its national income (189.2 percent for domestic debt and 19.0 percent for foreign debt).

Some changes have taken place in the debt burden of the above Far East countries. These three countries represent three different tendencies in the postwar period. The Philippines had increased both the absolute amount of debt and its ratio to national income; Japan showed decreases in both these two indicators, while Ceylon had raised the absolute amount of total government debt but reduced its ratio to national income (see Table VI in Appendix).

(2) Interest burden

Scattered data of interest payments on government debts as percentage of national income showed that the figure for Ceylon was around one per cent in the postwar years. The interest burden of Burma, India, and the Philippines was below one percent. In the same period, the interest burden of the United States was mostly above two percent of the national income (see attached Table E).

With regard to the interest rate or yield of government bonds in the Far East, fairly long series of data are available for Ceylon, India, Indonesia, Japan, and Pakistan. In most cases, the yield is around 3 percent (see Table VII in Appendix), which is not too much of a departure from the rates offered by the Governments of France, the United Kingdom, and the United States. A much higher rate (5.5 percent) is offered for the government bonds of Japan, which is still considered low compared with the rates of around 9 per cent for loans charged by the Japanese commercial banks.

In view of the present low level of savings and the slow increase of national income in the Far East, it is quite possible that further increase of public debt may bid up the interest rate. In that case, increasing attention should be given to the whole problem of debt management.

(3) Importance and Technique of Wide Distribution of Government Securities

Government bonds should be issued in such a way that their ownership should be widely distributed. This is important for the prevention of the emergence of a new rentier class. From the point of view of monetary and credit policy, it is undesirable to have the government bonds concentrated in the Central Bank and commercial banks, since they serve as basis for note issue and credit expansion.

Table E. Interest Payments as Percentages of National Income of
Burma, Ceylon, India, Philippines, and United States

(In Millions of Domestic Currency)

Country and Year		National Income	Interest Payments	Interest as Per Cent of National Income
<u>Burma</u>				
1947/48	Kyats	2,584	4.3	0.2
1948/49		3,067	2.7	0.1
1949/50		2,857	3.7	0.1
1950/51		2,608	2.9	0.1
1951/52		3,116	2.9	0.1
<u>Ceylon</u>				
1947/48	Rs	2,288	32.0	1.4
1948/49		2,627	33.7	1.3
1949/50		2,873	37.3	1.3
1950/51		3,840	38.5	1.0
1951/52		4,507	42.6	0.9
<u>India</u>				
1948/49	Rs	87,300	630.2	0.7
1949/50		--	617.3	--
1950/51		--	652.2	--
1951/52		--	728.4	--
1952/53		--	745.9	--
<u>Philippines</u>				
1949/50	Pesos	5,646	33.6	0.6
1950/51		6,228	32.5	0.5
<u>United States</u>				
1946	US\$	180,286	4,722	2.6
1947		198,688	4,958	2.5
1948		223,469	5,211	2.3
1949		216,259	5,339	2.5
1950		239,170	5,750	2.4
1951		277,554	5,613	2.0
1952		--	5,859	--

Source: Interest Payments: (1) Far East Countries: Economic Survey of Asia and the Far East 1951, pp. 368-71, United Nations.

(2) United States:

1946-48: Federal Reserve Bulletin, Vol. 34, 1948.

1949-52: Federal Reserve Bulletin, May 1953.

National Income: Statistical Yearbook 1952, United Nations, pp. 406-407.

If internally raised loans are subscribed to by the consumers or business enterprises, who, as a result, would reduce either private consumption or investment (and not hoarding), the borrowing then represents a reduction in private outlay corresponding to public outlay financed by such borrowing. Borrowing from commercial banks does not diminish their ability to expand private credit, and must be accompanied by stringent controls in order to offset the inflationary impact of the additional government spending financed by such borrowing. Borrowing from the central banks leads directly to currency expansion. It should be recalled that from an historical point of view, the incurring of large public debts has been actively linked to periods of economic expansion and not frequently associated with inflationary booms and subsequent collapse.

In case credit expansion should develop, one way of dealing with it is by raising of the reserve requirements. At the end of 1947, the amount of liquid purchasing power in the hands of the public of the United States, that is, currency, bank deposits, and government securities, aggregated in all about \$254 billion, or more than three times the amount held in 1940. The commercial banking system held nearly \$70 billion out of the total amount of about \$250 billion of government securities. 1/ According to Mariner S. Eccles, former Chairman of the Board of Governors of the Federal Reserve Board System, banks can increase loans by six times the amount of Federal Government bonds held. In order to restrain credit expansion, the Federal Reserve Board made several changes in 1948 in the reserve requirements against deposits. In September 1948, for instance, the required reserves against demand deposits were increased from 24 to 26 percent for central reserve city banks. 2/

The technique of changing the reserve requirement to control credit has rarely been used by the Far East banking authorities. 3/ The time may come for this mechanism of credit control to play an important role when government development financing necessitates a large volume of bond issues.

The positive way of avoiding the concentration of government bonds is by the issue of various types of government securities, such as treasury certificates, short-term notes, and long-term bonds to suit the needs of different varieties of investors. Various special

1/ Credit Policies - Hearings before the Joint Committee on the Economic Report, U.S. Congress, 1948, p. 2.

2/ Annual Report of the Board of Governors of the Federal Reserve System, 1948, p. 44.

3/ The Philippine Central Bank has broad authority over the reserve requirements which the banks must observe. The Monetary Board of the Bank may prescribe reserve ratios from 10 to 50 percent against demand deposits and from 5 to 25 percent against time and savings deposits (Art. 101 of the Philippine Central Bank Act). The ratios actually prescribed are 18 percent against demand deposits and 5 percent against time and savings deposits, which have not been changed ever since the establishment of the Central Bank in 1949.

features should also be introduced in the securities, with respect to interest rate, maturity, denomination, negotiability, conversion rights, and preferential tax treatment. Experience shows that commercial banks prefer securities of less than a year's maturity, while life insurance companies prefer long-term securities of more than ten years' maturity. Individual investors choose securities of small denomination and high interest rate. When high-interest bonds are issued, the maximum holding by each individual should be limited so that they would not be concentrated in the hands of wealthy rentiers.

(4) Holdings of Government Securities in the Far East

Detailed data are available to show the distribution of holders of outstanding government bonds of Japan in recent years. The average of the three years from 1950 to 1952 showed that only 10.4 per cent of the government bonds were held outside the banks and the government. The Bank of Japan took the highest share (43.4 per cent); Government and government agencies occupied the second place (29.7 per cent); while other financial institutions took about one sixth (16.5 per cent). (See Table XIII in Appendix.) During the past three years, there was a tendency for the banking system to decrease and for the government to increase its share of holdings in the total amount of outstanding Japanese government bonds.

Available data also show that holdings of the public debt by individuals in the Philippines, Thailand, Ceylon, and India are also small. The holdings of private individuals and nonfinancial institutions of government securities ranged from only 1 per cent to 20 per cent. The conditions in these countries are as follows:

a. In the Philippines, private persons, associations or corporations, and unregistered holders of the bonded debt held less than 1 per cent of the total.^{1/}

b. From December 31, 1948 to June 1950, about 6 per cent of the long-term internal debt of Thailand was held by individuals or corporations other than the Bank of Thailand, the Savings Bank, and commercial banks.^{1/}

c. In Ceylon, of the Rs 90 million loan issued in November 1950 under the National Development Loan Act, only about 8 per cent was taken up by insurance companies, institutional investors, and other individuals. Commercial banks had taken up 45 per cent and the remainder was absorbed by the two government savings banks and other government agencies.^{2/}

1/ Economic Survey of Asia and the Far East, 1950, United Nations, p. 137.

2/ Economic Survey of Asia and the Far East, 1951, United Nations, p. 232

d. A study of the ownership of the rupee loans of the Central Government of India indicates that, in June 1951, 22.8 per cent were subscribed by the Reserve Bank of India in its issue and banking departments and 14 per cent were held by the Bank on account of other institutions, 21.6 per cent were subscribed by commercial banks, 7.8 per cent by insurance companies, 10.2 per cent by Part A and B States, and 4.1 per cent by nonresidents. Only, therefore, 20 per cent of the rupee loans have been subscribed by joint stock companies, trusts, and other institutions, as well as private individuals.^{1/}

By way of comparison, the recent record of more than ten years, from 1939 to 1952, showed that almost half of the U.S. government securities was held by private individuals. Besides, other personal holdings from trust funds took another one fourth of such securities. Business organizations, including financial corporations, held only a little more than one fourth of the total volume of government securities. (See table IX in Appendix)

The nonfinancial sector not only took a large part of the U.S. government securities, but has also absorbed an increasing share of the total U.S. federal debt. "On June 30, 1952, the banking system held 32 per cent of the total Federal debt outstanding as compared with 42 per cent at the peak of the debt, and 39 per cent before our entry into World War II. While much more remains to be done in the distribution and funding of the debt, this gradual shifting of the Federal debt into the hands of non-banking holders is the product of considered plans for strengthening the economy and the government's credit."^{2/}

(5) Government Bond as Builder of a Capital Market

One of the important gaps in the financial structure in the Far East is the absence of an organized capital market. Serious efforts should be made to establish this missing link in the chain of measures aimed at the economic development of the countries in this region. The issue of government bonds is one of the most valuable means toward that end. In the first place, an entrepreneur cannot afford to put all the funds at his disposal into risky business pursuits. He must be assured that at least a part of his funds should enjoy steady return. In other words, government bonds make possible an increase of supply of corporate securities of fluctuating yields and thus add variety to the kinds of financing instruments in the capital market. From the point of view of the financial institutions or private investors, the most important consideration is distribution of risk by the selection of a balanced portfolio. The gilt-edged government bonds also enable them to go more into securities investment by supplying a stable factor in their investments. Government securities therefore can pave the way for the development of a capital market.

^{1/} Economic Survey of Asia and the Far East, 1951, United Nations, p. 232.

^{2/} The Sustaining Economic Forces Ahead, Joint Committee on the Economic Report, U.S. Congress, 1952, p. 4.

(6) The Question of Maximum Amount of Public Debts

The former prejudice against public debts was based on the bad experience of some countries whose public debts were connected mostly with war (international or internal) and often resulted in financial collapse or repudiation. Modern thinking has recognized that internal debt is merely a transfer of income from one group to another. Nevertheless, the transfer affects different groups differently, depending on how the tax revenue comes and for what purposes the government expenditure goes. When the debt is incurred for expenditures in productive or self-liquidating projects and the means for repayments are obtained from idle savings or cutting down of luxurious consumption, the public debt should not become a burden on the national economy.

Even a constantly increasing volume of public debt may not be an economic evil, if this merely keeps up with an upward trend of national income. This is well illustrated by the experience of the United States in recent decades. The volume of public debt of the United States increased fifteen times from 1929 to 1951, while the ratio of public debt to national income changed only from 19 per cent to 92 per cent. During the same period interest payments increased more than eight times, while the ratio of interest payments to national income increased from 0.8 per cent to 2 per cent. (See Table X in Appendix.)

The experience of Ceylon also indicated a decreasing relative debt burden. From 1947 to 1951 Ceylon's total government debt increased from Rs 396 million to Rs 575 million, but the ratio of government debt to national income decreased from 17 per cent to 12 per cent. This was due to the fact that Ceylonese national income was about double in this period. (See Table VI in Appendix.)

Some economists even claim that borrowing for government investment is in itself a way of lightening the future tax burden. According to William Beveridge, "in fact, if the State policy were guided by purely fiscal considerations - that of reducing the rates of taxation to a minimum - the best course to pursue would still not be to refrain from borrowing, but to undertake public investments which lighten the future tax burden through increasing the national income and thus the yield of given rates of taxation." ^{1/}

In this connection, the plan of government investment and borrowing for Great Britain, as worked out by Beveridge, may be of special interest to the Far East countries. In Britain, the annual debt burden (interest payments) as a proportion of the national income reached a maximum on two occasions, 1815 and 1924, and in each case amounted to some 7 per cent of the national income. After World War II, it was estimated to be just under 6 per cent of private income of 1948. Between 1924 and 1948 the national debt

^{1/} William H. Beveridge: Full Employment in a Free Society, 1945, pp. 400-401.

would have increased by 300 per cent, the annual interest charge by only 66 per cent, while the national (private) income in money terms increased by 108 per cent. Thus, despite a second world war, which - in terms of borrowing - was twice as costly as the first, the burden of the debt is likely to be smaller after World War II than it was after World War I, a striking consequence of the cheap money policy inaugurated by the Treasury in the 1930's.^{1/}

It was estimated that the national money income of Great Britain would rise over the period 1948-1970 at the rate of 1 per cent per annum, i.e., on the average by some £90 million per annum. This implies that the British Government could go on borrowing an amount which adds some £5 million to the interest charge annually without thereby increasing the interest burden as a proportion of the national income. Assuming that the Government borrows on the average at 2 per cent, it could borrow an average annual amount of £250 million without increasing the ratio of the annual interest burden to the national income above the level reached at the end of the war. It could, moreover, borrow at an increasing volume through time, since with an even rate of increase in the national income, the annual increment in income will get steadily larger. With the rates of taxation at the level necessary to balance the post-war Central Government budget, 25 per cent of any increase in the national income could be expected to be paid in Central Government taxation. In case post-war taxation is higher than that, the marginal yield of taxation will be more than 25 per cent. This means that with an average annual increment of £90 million in the national income, Central Government tax revenue would expand annually by £22.5 million. While the annual increase in Central Government expenditure could only be put at £7 million, a large part (£15.5 million) will be available each year to cover additional interest on the national debt. These estimates are based on the annual growth of the national income that can be expected under any full employment policy. Insofar as the loan is spent in ways which directly raise the productive efficiency of the community, we must also allow for a further increase in income and tax revenue resulting from it. On the above assumption of 25 per cent of any increase in income being paid automatically in taxation, any public investment which increases the future national income by more than 6 per cent of the loan expenditure will actually make the prospective tax burden relatively smaller than it would have been without the loan expenditure.^{2/}

From the data presented in a previous section, it was shown that the present debt burden of Far East countries relative to national income has not been high. There may be room for some increase of the volume of debt. This possibility also depends on the future increase of national income.

The prospective increase of national income under the over-all development plans has not been projected to be large. The increase of 2% a year is about

1/ Nicolas Koldor: The Quantitative Aspects of the Full Employment Problem in Britain, Appendix C in William H. Beveridge: Full Employment in a Free Society, 1945, p. 395.

2/ William H. Beveridge, *Loc. cit.*, pp. 399-408.

all that can be expected. In the case of India, "the total effect of the revised Six-Year Plan, without considering improvements arising from the Community Development Program, may be estimated as an increase of roughly 10% in the gross national product. From an estimated level of Rs 104,000 million in 1950-51, the gross national product may be expected to reach around Rs 115,000 million at current price, by 1956-57."^{1/} The Five-Year Economic Self-Support Plan of Japan also envisages an increase of national income only by 10% from ¥ 5,820 billion in 1953 to ¥ 6,550 billion in 1957.^{2/}

If the present debt burden relative to national income in the Far East countries were to be maintained in the future, there would be room for the increase of the amount of government debt by only 2% a year. This is rather discouraging in view of the increasing need for government financing of public projects.

Theoretically, the part of national income which is an increase over the previous income level due to the implementation of development plans may bear a larger debt burden than the former debt-income ratio. In fact, such a possibility is slim, inasmuch as the newly increased income has to share the responsibilities of meeting a heavier tax burden and providing a higher level of private consumption. The only way out is not to adhere to the present low ratio of national debt to national income so that both a larger absolute amount and a higher relative burden of public debt are to be effected.

It is difficult to determine what should be the optimum ratio between public debt and national income. One thing, however, is certain. The higher the per capita income, the higher this ratio can go. It is not a mere accident that the highest public debt burden (more than 50% of national income) is obtained in the United Kingdom, the United States, the Union of South Africa, and Norway (see Table V in Appendix), while the debt burden of some of the Far East countries still stands at about 10% of their national income (see Table IV in Appendix).

(7) Economic and Legal Limitation of Public Debt

Since the proper volume of public debt should be related to certain economic indicators, such as total and per capita national income, a limit may be set to the amount of total government debt. Limitation on government borrowing may be divided into economic and legal potentialities. Besides consideration of national income, there are other factors, such as poor credit standing, lack of a capital market, inadequate tax system, and general economic conditions, which do not warrant the support of a big volume of public debts. Statutory limitations on public debts are found in both the

^{1/} The Colombo Plan--The First Annual Report of the Consultative Committee on Economic Development in South and South-East Asia, Karachi, March 1952, p. 21.

^{2/} Data supplied by Economic Counsel Board of Japan.

central government and other political entities of some countries. The legal limitations restrict the amount which may be borrowed and the purpose for which debts may be incurred, and also create considerable time lags in the execution of any desired loans by virtue of the procedural requirements for modifying the almost prohibitive restrictions.

The power of issuing bonds by the Central Government of Japan is limited by law. After World War II, Japan relied mainly on taxes to meet the expenditures in the general account. "The issue of public bonds for the purpose of supplying the deficiency of general account revenue was prohibited under the Finance Act passed after the introduction of the new Constitution and was abandoned completely after 1947."^{1/} During the Second World War, the debt limit of the United States was fixed at \$300 billion. After the War, the debt limit was revised downward in July 26, 1946, and set at \$275 billion. This was stipulated in the Second Liberty Bond Act, as amended, which provides that the face amount of obligations issued under authority of that act, and the face amount of obligations guaranteed as to principal and interest by the United States (except guaranteed obligations held by the Secretary of the Treasury)^{2/} shall not exceed in the aggregate \$275 billion outstanding at any one time.^{3/}

The limitations on debt apply more often to local government than to the central government. In Art. 250 of the Local Autonomy Law of Japan, the issue of bonds by the local governments and their interest rates, except those repayable within the fiscal year, need the approval of the Prefectural Government. In fact, bonds of the local government are usually taken up by the Trust Fund of the Central Government.

(8) Bond Price Support and Interest Rate Policy

The support of the bond price is sometimes an important problem in the debt management of any country. It is more so in the case of countries in the process of development. The continuous issue of bonds to finance government economic projects appears to be a necessity in the Far East countries. A decline in the price of the initial issue of development bonds will bring disaster to the investing individuals and institutions, discourage future savings, damage the prestige of the government, and require higher interest rates for its future issue of securities. What is more serious is the setback to the development of a security market in general, of which the Far East is in dire need, inasmuch as a decline in the so-called gilt edged government bonds cannot but react on the marketability of industrial securities. This had been the experience of the United States after World War I (1920), when a decline in the price of government bonds by 20% demoralized the whole security market and became a partial cause for the reduction of productive activity in 1921.^{3/}

1/ Essential Features of the Japanese Tax System Which Contribute to Relative Stability in Revenue, prepared by the Ministry of Finance of Japan, ECAFE/I and T/FED/9, July 1953, p. 2.

2/ Treasury Bulletin, July 1953, U.S. Treasury Department, p. 21. In this connection, it may be of interest to note the recent discussion in the U.S. about the raising of the debt limit (New York Times, July 30 and 31, 1953).

3/ Richard W. Lindholm: Introduction to Fiscal Policy, 1948, p. 200.

Several methods, including monetary, fiscal, or direct control, are available for the support of bond price but most of them are difficult to administer and may produce unfavorable repercussions. The problem is not merely to maintain bond price at par, but to do so without inflation. Since the price of bonds is closely related to the interest rate, the first logical step would perhaps be for the monetary authority to enforce a cheap money policy by using lower interest rates. This has been the method used by the United States and Great Britain during World War II and in the immediate postwar years. However, at the time when inflationary situation developed, the monetary authority is deprived of the most important tool of raising the discount rates for the control of credit. Another important method is open market purchase by the monetary authority. This may be effective in the short run, but eventually increasing liquidity of the public may lead to an advance of commodity prices which in turn may bid up the interest rate and depress the price of bonds. A further method is an increase of the reserve ratio against deposits. This has been frequently used by the Federal Reserve System of the United States in previous years. Its effectiveness was limited on account of the existence of excess reserves in the banking system. Persuasion and voluntary restraint may also be used to contract credit with a view to supporting the price of bonds. Any scheme, however, that reduces the quantity of credit when credit is desired will raise interest rates and thus cannot prevent the price of bonds from falling.

Methods of direct control are also available to restrict credits. Unfortunately direct method can only be applied to a limited extent. The problem of who should get commercial credit is so complicated that direct controls are useful only during a period of emergency.^{1/}

Inflationary demand for credit and increase of the interest rates can be checked also by fiscal methods, such as high tax on excess profits and reduced government expenditures. Their efficacy depends on the way in which they offset the consumption and investment expenditures of various income groups.

Still another method to prevent bonds from fluctuating either below or above par is the use of a flexible interest rate, so that the interest rate to be paid each period is to be determined by a formula based on the market rate of the previous period. However, after what is said about the methods of maintaining the price of bonds, the most important consideration for the investors is the stability of the purchasing power of the monetary unit, rather than the maintenance of their face value. If the price of bonds is maintained at par through easy money that results in an inflation, the holders of government bonds have perhaps suffered more than if the bonds fell considerably below par through a tight money policy. What is imperative, therefore, for a successful program of financing of government development projects is a coordination of fiscal, monetary, and direct controls in order to assure fairly constant value for its monetary unit.

^{1/} In the majority of these countries, however, government budgetary operations and movements in the balance of payments are more decisive than a credit policy, because credit played a minor role.

(9) The Question of the Purchasing Power Bonds

One of the factors hindering the issue of government bonds is the past experience of the public about the continuous rise of prices and the apprehension of further inflation in future. It has sometimes been suggested, therefore, that purchasing power bonds be issued such that the amount of repayment would be tied to the index number of prices and the investors would get back a fixed amount of purchasing power instead of a fixed number of currency units. This scheme has also been further elaborated by various provisions by which only investors who have held the bonds over a certain length of time and under a maximum amount would be entitled to this privilege.

The advantages claimed for this arrangement are as follows: (1) with the removal of the fear of loss which may fall on the real value of the investment the incentive to save will be increased; (2) a new kind of protection will be accorded to the small savers since they, unlike the wealthier people, cannot hedge against inflation through the purchase of real estate or stocks or more speculative assets, the prices of which will respond to rise in the general level; (3) the participation of small savers in bond purchase and the diversion of existing liquid assets to bonds will broaden the ownership of the public debt by individuals; (4) the purchase of gold or foreign currency for hoarding, leading to the loss of foreign exchange assets for the monetary authorities, especially prevalent in the Far East, will be greatly reduced; (5) advance purchase of consumer goods or hoarding of other commodities will be reduced so that inflation from artificial shortage of goods will be checked; (6) this kind of government bonds will provide the government with a new tool of anti-cyclical control, since they are more attractive when prices are rising and less so when they are falling.

On the other hand, more and weightier reasons can be advanced in opposition to such a scheme. They are as follows: (1) it is questionable whether the purchasing power bond can actually increase savings since the concept of purchasing power is quite unfamiliar to the small income earners and they, as a group, have very little liquid savings anyway; (2) it may weaken the response of the public in supporting government anti-inflationary programs since they are under the influence of illusory advantage of receiving more dollars for their savings than they had actually invested; (3) this device of bond issue itself may induce inflation since the government authorities show doubts of their ability to control inflationary pressures and the people will rush to buy goods to protect themselves against possible price advance; (4) it is against sound fiscal principles to commit the government to liability of an indeterminable amount and to pay, in the case of advance of the price index, an extremely large cost for these borrowed funds in comparison with the cost of other borrowing; (5) it is unfair to select one particular group of persons for preferential treatment and to penalize the public in general by levying added taxes in order to redeem the purchasing power bonds at higher price levels; (6) the purchasing power bond causes people to move out of life insurance and other forms of savings and thus creates very difficult problems for the insurance companies and the banks; (7) unless it is provided that, if the price level declines, the bond would be paid off at maturity at not less

than the purchase price, the investors, getting back less currency units during a period of decreasing prices, would feel that they are cheated by the government and would exert pressure for some form of repayment in which no actual dollars are lost in the transaction; (8) speculation in the purchasing power bonds cannot be avoided, as their holder will guess the highest price level to make profit on the bonds and will rush to liquidate them during the downturn of prices before the prices decline further; (9) there are also the technical difficulties in choosing a proper index to measure the price at which the bonds would be repaid.

An extensive survey of authoritative opinion on this subject was recently conducted by the Sub-Committee on General Credit Control and Debt Management of the United States Congress. The opinion of the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, and the majority of economists replying to the Sub-Committee questionnaire did not believe that it would be wise to experiment with the issuance of purchasing power securities.^{1/}

1/ Monetary Policy and the Management of the Public Debt--Replies to Questions and Other Material for the Use of the Sub-Committee on General Credit Control and Debt Management, Joint Committee on the Economic Report, U.S. Congress, 1952, pp. 142-145 and 1097-1098; and Monetary Policy and the Management of the Public Debt--Report of the Sub-Committee on General Credit Control and Debt Management, Joint Committee on the Economic Report, U.S. Congress, 1952, p. 39.

VI. Special Assessments, Fees, and Tolls

When a government development project confers special benefits on private properties particularly when the benefits are localized and are identifiable, a direct levy can be made on those properties to defray the whole or a part of the expenditures incurred. This method of financing by special assessments is well adapted to certain kinds of public works, like drainage, irrigation, and highways.

Drainage and irrigation are particularly suitable for this method of raising funds, since the properties benefited are clearly identifiable and the benefits are amenable to measurement, such as by the size of the area benefited and the frontage or the value of the adjacent properties. The benefits conferred by the highways, however, are more diffused. The abutting properties are benefited, but so also is the transit traffic. The usual financial arrangement, therefore, is to assess the abutting properties and to tax the vehicles and the gasoline at the same time.

In fact, special assessment is often used together with taxation and borrowing. Many projects, although conferring localized benefits, contribute to the general welfare of the whole country. A part of their cost should be met by taxation. For projects which require a large sum of money and a long time to complete, stop-gap bonds may be issued which may be repaid by future receipts from assessments or fees.^{1/}

Fees (such as water rates) and tolls (such as road tolls) are levied also on the benefit principle, just as special assessments are. Fees and tolls are often used to meet the expenditures for current maintenance. The initial large outlay for the public works has still to be met from taxation or borrowing.

In view of the need for mobilizing all the available financial resources to meet development financing, the possibilities of applying the methods of special assessments, fees, and tolls to appropriate projects should be fully exploited.

^{1/} See also The Use of Special Assessments to Finance Development Projects by E.R. Schlesinger, ECAFE/I & T/FED/12, July 1953.

VII. Government Reinvestment

In the private economic sector, plowing back of profits plays a very important role in private capital formation. With the increasing trend of government operation of self-liquidating projects in the Far East, earnings from this may become a source of funds for new government investments.

Besides Mainland China and North Korea, which have a different political setup, only Japan and South Korea, among the Far East countries, had a high percentage of revenue coming from net earnings of public undertakings. The percentage for Japan in 1952 was 17.8 per cent and that for South Korea in 1951/52, 14.8 per cent. (See Table III in Appendix.)

The possibility of net receipts from public undertakings depends on their efficiency of operation, on the one hand, and on their pricing policy, on the other. Public services may be priced at cost or below cost as a method of subsidizing consumption, or above cost as a method of taxation. Generally speaking, the pressure on the government to provide hidden subsidy is very great. It is also a universal phenomenon that in the time of inflation the fees and charges levied by the Government are the slowest to rise. The Far East countries which adopted the system of food purchase and allocation, such as Ceylon, often ran into heavy deficit in the trading account.

In view of the need for control of consumption in order to step up development financing, the policy of pricing of public services in the Far East countries should be reconsidered. At any rate, the price to be charged should at least be sufficient to cover cost and maintenance. Insofar as possible without creating hardship on the people living below the subsistence level, a profit element should be included in the price. Unless this is done, it does not appear that fiscal experience in the Far East would lend much support to the enthusiasm about the possibilities of government reinvestments.

Original program, excluding coal; revised program, including coal.

2/ Public Health and Social Services.

2/ Public Health and Social Services.
3/ Rural development aims at employing the unemployed and under-employed labour in rural Ceylon on the construction of houses, roads and bridges, improvement of methods of agriculture and general works of rural reconstruction.

Alternative Economic Development in South and South-East Asia, November 28, 1950, P. 7.

Source:

- (1) The Colombo Plan for Co-operative Economic Development in South and South-East Asia, Karachi, March 1952, November 20, 1950, p. 1.
- (2) The Colombo Plan: The First Annual Report of the Consultative Committee on Economic Development in South and South-East Asia, Karachi, March 1952, p. 1.
- (3) First Five-Year Plan, People's Edition, Planning Commission, Government of India, P. 35, January 1953.

Table II. Composition of Government Investments
of Burma, India, and Pakistan

Kind of Investment	Burma	India	Pakistan	Burma	India	Pakistan
	(1949/50 Revised Estimate) (In Millions of Rupees)	(1950/51 Closed Account) (In Millions of Rupees)	(1950/51 Closed Account) (In Millions of Rupees)	(1949/50 Revised Estimate) (In Percentage)	(1950/51 Closed Account) (In Percentage)	(1950/51 Closed Account) (In Percentage)
Railways	31.9	254.1	33.7	45.8	37.1	40.3
Electricity	1.6	...	...	2.3	...	...
Aviation	4.0	18.2	2.6	5.7	2.7	3.1
Civil Works	16.9	181.0	30.9	24.3	26.4	36.9
Ports	...	7.0	...	...	1.2	...
Industrial Development	11.8	89.0	5.1	16.9	12.9	6.1
Posts and Telegraphs	...	70.7	8.2	...	10.3	9.8
Multi-purpose river schemes	...	25.0	...	...	3.6	...
Grants to state governments for development	...	14.2	...	...	2.1	...
Others	3.4	26.1	3.2	4.9	3.8	3.8
Total	69.6	685.3	83.7	100.0	100.0	100.0

Source: Economic Survey of Asia and the Far East, 1951, United Nations, pp. 243, 246, and 247.

Table III. Percentage Distribution of Government Revenue Of Far East Countries

Country	Year	Total Revenue	Total Tax Revenue	Direct Tax			Indirect Tax					Net Receipt from Public Undertaking
				Tax on Income and Wealth	Land Tax	Total	Custom Duties	Trans- portation & Consump- tion Tax	Licenses Stamps Duties	Other Tax Revenue	Total	
British Borneo												
(1) Brunei	1950	(E) 100.0	93.1	...	...	...	13.9	1.7	0.6	76.3	93.1	...
(2) N. Borneo	1952	(E) 100.0	78.3	7.5	...	7.5	42.5	23.6	3.3	...	70.8	...
(3) Sarawak	1950	(E) 100.0	83.0	0.3	...	0.3	26.9	50.0	...	...	82.7	...
Burma	1951/52	(E) 100.0	88.5	34.1	4.0	38.0	25.4	2.2	1.9	9.6	50.5	...
Cambodia	1951	(DE) 100.0	88.0	...	...	11.0	...	...	3.8	...	77.0	...
Ceylon	1951/52	(DE) 100.0	93.1	24.7	...	24.7	22.7	39.7	0.8	...	68.4	2.7
China (Taiwan)	1952	(E) 100.0	71.4	15.9	4.4	20.3	...	...	2.3	...	51.0	...
Hongkong	1949/50	(A) 100.0	60.8	22.0	...	22.0	...	...	...	...	38.8	...
India												
(1) Central Gov't	1952/53	(DE) 100.0	80.9	23.5	0.2	23.6	28.1	9.0	0.3	...	57.3	2.0
(2) States	1951/52	(DE) 100.0	72.0	13.0	14.0	26.9	...	...	19.9	...	45.1	1.3
Indonesia	1951	(E) 100.0	59.8	12.4	...	12.4	7.7	6.9	0.6	41.4	72.3	2.7
Japan	1952	(A) 100.0	73.5	49.5	...	49.5	1.8	1.1	1.5	...	24.0	17.8
Korea (South)	1951/52	(DE) 100.0	66.1	21.0	...	21.0	6.7	...	1.0	9.2	45.1	14.8
Laos	1951	(E) 100.0	79.2	...	...	13.4	...	...	2.6	...	65.8	5.5
Malaya	1952	(DE) 100.0	90.7	16.0	...	16.0	32.6	36.7	3.7	...	74.7	...
Pakistan												
(1) Central Gov't	1952/53	(DE) 100.0	86.2	10.4	0.2	10.6	41.1	...	1.9	...	76.3	0.8
(2) States	1950/51	(A) 100.0	49.2	2.2	12.3	14.5	...	...	7.0	...	34.7	7.4
Philippines	1950/51	(RE) 100.0	84.7	18.3	...	18.3	4.9	...	28.0	...	66.4	...
Singapore	1952	(DE) 100.0	78.2	33.8	...	33.8	...	...	5.5	...	44.5	...
Thailand	1952	(DE) 100.0	94.9	5.7	...	5.7	27.3	9.3	4.9	12.5	89.2	0.1

Note: A: closed accounts, RE: revised estimates, E: voted estimates, DE: draft estimates.

Figures refer to Central Government revenue only. In addition, for India and Pakistan, estimates are shown separately for the provincial and state governments. Fiscal years are as follows:

- (1) Burma and Ceylon: years beginning October 1st.
- (2) Hongkong, India (Central Government and States), Japan, South Korea and Pakistan (Central Government and States), years beginning April 1st.
- (3) Philippines: year beginning July 1st.
- (4) The rest are calendar year.

Customs: divergence between the total under this heading and the sum of the sub-items, import duties and export duties, is due mainly to the inclusion or exclusion arising from land customs, customs on postal, parcels, special taxes and refunds.

Transactions and Consumption Taxes: excise duties, turnover taxes, sales taxes, entertainment duties, etc.

Brunei: Other tax revenue: mining rent and oil royalties.

Burma: Transaction and Consumption Taxes: excise duties plus "commercial taxes"; the latter includes entertainment tax, hotel and restaurant tax, business premises tax and sales tax. Licenses, stamps duties, registration fees, etc. including belting and motor vehicle taxes. Other tax receipts: net receipts from lottery, the rehabilitation and the contribution to the National Development Fund, from the State Agricultural Marketing and State Timber Boards. Net receipts from undertakings: civil supplies and electricity.

China (Taiwan): Taxes on income and wealth: income, house, household and inheritance taxes.

Hongkong: Customs: there is no general custom tariff in Hongkong, import duties being confined to liquor, tobacco, hydrocarbon oils, toilet articles, proprietary medicines and table waters. Direct Taxes: taxes on assessed rateable values and earnings and profits tax. Net Receipts from Public Undertakings: gross receipts of water supply, postal services, Kowloon-Canton Railway.

India:

Central Government:

Taxes on income and wealth: excluding share of income taxes payable to the States amounting to Rs. 508.4 million in 1952/53 (DE).

Customs: excluding customs revenue assigned to the States.

Transaction and Consumption Taxes: including revenue from opium monopoly.

Net receipts from public undertakings: railways, posts and telegraphs and state trading schemes.

States:

A and B states, of the latter, excluding Rajasthan for 1950/51 and 1951/52.

Taxes on income and wealth: including agricultural income taxes of Rs. 32.0 million in 1951/52.

Indonesia: Other tax revenue: royalties from mining concessions and receipts from foreign exchange certificates, Rs. 2,600 million (1951).

Korea (South): General account only.

Laos: Customs: apportionment of yield transferred from common services, mainly customs and posts and telegraphs.

Pakistan:

Central Government:

Tax Revenue: includes taxes and duties levied in the Supplementary Finance Act of 1950, as follows: 1952/53 total Rs. 20 million; Rs. 2.6 million to taxes on income and wealth, Rs. 4.2 million to custom duties, Rs. 2.5 million to transactions and consumption taxes, and the balance to licenses, stamps duties, registration fees, etc.

Net receipts of Public Undertakings: railways and posts and telegraphs.

States:

Net Receipts from Public Undertakings: electrical enterprises (all provinces), State trading schemes (North-West Frontier Province and Punjab) and railways (Bahawalpur).

Philippines: Consolidated data (General, Special and Bond Funds). Total Tax Revenue: including revenue apportionment to local governments. Transaction and Consumption Taxes: excise taxes; 1950/51 including special excise tax on sales of foreign exchange (Pesos 31.8 million collected during the last three months of the year).

Thailand: Direct Taxes: including also motor vehicle taxes. Transport and Consumption Taxes: excise duties and profits of government enterprises which are mostly monopolies like opium, liquors, tobacco, sales, etc. Other tax revenue: income from mining and fisheries concessions and profits of Rice Bureau. Net Receipts from Public Undertakings: Government Purchasing Bureau.

Source: (1) Japan: General Survey of Japanese Economy, Ministry of Finance, The Japanese Government, June 20, 1953, P. 43.
 (2) Other Countries: Economic Survey of Asia and the Far East 1951, United Nations, N.Y. (P. 372-377).

Table IV. National Debt Burden of Ceylon, Japan and the Philippines, 1951.

Country	Population (million)	National Income Mil.U.S.\$	Domestic Debts		Foreign Debts		Total Debts	
			Mil.U.S.\$	Per Capita	Mil.U.S.\$	Per Capita	Mil.U.S.\$	Per Capita
Ceylon	7.7	946.5	105.4	1/ 13.7	15.4	2.0	120.8	15.7
Japan	84.3	13,469.4	770.6	2/ 9.1	...	...	...	...
Philippines	20.2	3,793.0	217.3	3/ 10.8	100.2	5.0	317.5	15.7
								8.3

1/ Year ending September 30.

2/ End of fiscal year (April to March).

3/ End of fiscal year.

Source: (1) Population: The World Almanac and Book of Facts 1953, N.Y.(2) National Income: Statistical Yearbook 1952, United Nations.(3) Domestic and Foreign Debts: International Financial Statistics, International Monetary Fund, July 1953.

Table V. Government Domestic Debts and National Income of Some Countries in Europe, Africa, and America, 1951

Country	Unit	National Income	Government Domestic Debt	As Per Cent of National Income
Finland	Billion Markkaa	609.2	49.5	8.2
France	Billion Francs	9,082	3,032	33.4
Germany	Million Deutsche Marks	90,200	1,288	1.4
Norway	Million Kroner	15,695	10,281	65.5
Portugal ^{1/}	Million Escudos	42,700 ^{2/}	9,864	23.1
Switzerland ^{1/}	Million Swiss Francs	18,160	8,006	44.1
Union of South Africa	Million S.A. Pounds	1,125	755	67.1
United Kingdom	Million Pounds	12,537	23,723 ^{3/}	189.2
United States	Billion U.S. Dollars	277.6	214.2 ^{4/}	77.2

^{1/} 1950.

^{2/} Gross National Product.

^{3/} End of fiscal year beginning April.

^{4/} As of June 30.

Source: International Financial Statistics, International Monetary Fund, June 1953.

Table VI. Postwar Change of Government Debts of Ceylon, Japan and Philippines, 1946-1951

Year	Ceylon 1/ (Million Rupees)				Japan 2/ (Billion Yen)				Philippines 2/ (Million Pesos)			
	National Income	Gov't Debt	Foreign Debt	Total % of Na- tional Income	National Income	Domestic Debt	% of National In- come	Domestic Debt as % of National In- come	National Income	Domestic Debt	Foreign Debt	Total % of National Income
1946	...	298.8	86.8	387.4	...	214.5	55.4	55.4	4,350	14.2	53.6	67.8
1947	2,288	309.2	86.6	395.8	1,041	306.5	29.4	29.4	5,570	14.0	167.4	181.4
1948	2,627	344.2	82.3	426.5	2,124	446.0	21.0	21.0	5,710	13.5	135.8	149.3
1949	2,873	380.0	80.1	460.1	2,884	425.7	14.8	14.8	5,650	301.0	129.7	430.7
1950	3,840	444.6	75.7	520.3	3,684	316.8	8.6	8.6	6,230	352.0	121.9	473.9
1951	4,507	501.7	73.3	575.0	4,849	277.4	5.7	5.7	7,590	434.5	200.4	634.9

1/ Year ending September 30.

2/ End of fiscal year (April to March).

3/ 1937-38 Calendar year; 1939 on, end of fiscal year, i.e. June 30.

Source: International Financial Statistics, International Monetary Fund, June 1952 and July 1953.

Table VII. Government Bond Yield of Far East Countries

(Per Cent: Average of Months)

Year	Ceylon	India	Indonesia	Japan	Pakistan
1935	...	...	...	4.117	...
1937	...	3.26	3.33	...	...
1938	...	3.20	3.05	...	...
1939	...	3.56	3.82	...	...
1940	...	3.61	4.82 ^{2/}	...	...
1945	...	3.10	...	...	...
1946	...	2.79	3.08	...	...
1947	2.93 ^{1/}	2.86	3.42	3.689	...
1948	2.94	2.97	3.52	4.501	...
1949	3.01	2.99	3.50	5.543	2.98
1950	3.04	3.02	3.50	5.500	2.98
1951	2.79	3.42	4.28	5.500	2.99
1952	2.93	3.89	4.10	5.500	2.98

^{1/} July.

^{2/} Less than 12 months.

Source: (1) Japan: Quarterly Bulletin of Financial Statistics, 4th Quarter, 1952 Fiscal Year, Ministry of Finance, Japan, p. 75.

(2) Other Countries: International Financial Statistics, International Monetary Fund, June 1953.

Table VIII. Distribution of Holders of Japanese Government Bonds, 1950 to 1952^{1/}

	In Millions of Yen			In Percentage				
	1950	1951	1952	1950-1952 Average	1950	1951	1952	1950-1952 Average
Total	241,256	261,150	302,657	268,354	100.0	100.0	100.0	100.0
Financial Institutions	43,031	43,685	45,490	44,069	17.8	16.7	15.0	16.5
Banks and Trust Companies	37,592	35,991	36,480	36,687	15.6	13.8	12.1	13.8
Insurance Companies	301	214	193	236	0.1	0.1	0.1	0.1
Others ^{2/}	5,138	7,480	8,817	7,145	2.1	2.9	2.9	2.6
Bank of Japan	143,359	93,932	105,322	114,204	59.4	36.0	34.8	43.4
Government	39,274	101,045	94,586	78,302	16.3	38.7	31.3	28.8
Deposit Bureau	37,141	...	...	12,380	15.4	...	...	5.1
Trust Fund Bureau ^{3/}	...	49,136	48,733	32,623	...	18.8	16.1	11.6
U.S. Aid Counterpart Fund	...	50,000	44,000	31,333	...	19.1	14.5	11.2
Others	2,133	1,909	1,853	1,965	0.9	0.7	0.6	0.7
Government Agencies	1,691	5,306	6	2,334	0.7	2.0	0.0	0.9
Reconversion Finance Bank	1,691	...	...	564	0.7	...	...	0.2
Japan Development Bank	...	...	...	...	...	...	...	...
Japan Export and Import Bank	...	5	5	3	...	0.0	0.0	0.0
Other ^{4/}	...	5,301	1	1,767	...	2.0	0.0	0.7
Public and Miscellaneous Institutions	13,901	17,182	57,253	29,445	5.8	6.6	18.9	10.4
Closed Institutions and Overseas	...	...	...	...	...	...	...	...
Juridical Persons	9,613	9,354	9,344	9,437	4.0	3.6	3.1	3.6
Individuals and Other Organizations ^{5/}	4,288	7,828	47,909	20,008	1.8	3.0	15.8	6.9

1/ For 1950 and 1951, end of fiscal year (April to March); for 1952, end of December.

2/ Includes Central Bank for Agriculture and Forestry. (The holding of the Central Bank for Agriculture and Forestry includes Fishery Right Certificates, deposited with it for safe custody, which amounted to ¥7,343 million as of end of December 1952.)

3/ Figures prior to March 1951 relate to those of the Deposit Bureau which has been recognized as the Trust Fund Bureau since April 1, 1951.

4/ Includes closed Institutions, Liquidation Commission, People's Finance Corporation, Housing Loan Corporation, etc.

5/ Other organizations include government bond held by local public bodies, shrines and temples, and other juridical persons and associations, and B class registered and unregistered bonds and others for which calculations on purchase or redemption are not yet completed; also include in addition ¥16,038 million of subscription in 1952 for International Reconstruction and Development Bank.

Source: Quarterly Bulletin of Financial Statistics, 4th quarter, 1952 Fiscal year, March 1953, Research Section, Ministry of Finance, Japan, p. 493.

Table X. U.S. Government Public Debts and Interest Payments
as Percentage of National Income, 1929-1951^{1/}

Year	Public Debts ^{2/} (US\$ million)	Interest Payments (US\$ million)	National Income (US\$ million)	As Per Cent of National Income	
				Public Debt	Interest Payment
1929	16,931	678.3	87,355	19.4	0.8
1930	16,185	659.3	75,003	21.6	0.9
1931	16,801	611.6	58,873	28.5	1.0
1932	19,487	599.3	41,690	46.7	1.4
1933	22,539	689.4	39,584	56.9	1.7
1934	27,053	756.6	48,613	55.6	1.6
1935	28,701	820.9	56,789	50.5	1.4
1936	33,779	749.4	66,941	50.5	1.1
1937	36,425	866.4	73,627	49.5	1.2
1938	37,165	926.3	67,375	55.2	1.4
1939	40,440	940.5	72,532	55.8	1.3
1940	42,968	1,040.9	81,347	52.8	1.3
1941	48,961	1,110.7	103,834	47.2	1.1
1942	72,422	1,260.1	137,119	52.8	0.9
1943	136,696	1,808.2	169,686	80.6	1.1
1944	201,003	2,609.0	183,838	109.3	1.4
1945	258,682	3,616.7	182,691	141.6	2.0
1946	269,898	4,722.0	180,286	149.7	2.6
1947	258,370	4,958.0	198,688	130.0	2.5
1948	252,366	5,211.0	223,469	112.9	2.3
1949	252,798	5,339.0	216,259	116.9	2.5
1950	257,377	5,750.0	239,170	107.6	2.4
1951	255,251	5,613.0	277,554	92.0	2.0

^{1/} Public debt and interest payments refer to June 30.

^{2/} Public debt refers to total gross direct debt. From 1946-51 includes fully guaranteed securities.

Source: Interest Payments and Public Debt:

(1) 1929-45: Historical Statistics of the United States, 1789-1945, U.S. Department of Commerce, pp. 299 and 305.

(2) 1946-51: Federal Reserve Bulletin, Vol. 34, 1948, and May 1953, pp. 502 and 506, Board of Governors of the Federal Reserve System, Washington, D.C.

National Income:

(1) 1929-48: National Income and Product of the United States, 1929-50, U.S. Government Printing Office, Washington, 1951, pp. 158-9.

(2) 1949-51: Survey of Current Business, July 1952, U.S. Department of Commerce, p. 18.

