COMMENTS ON

"Some Ideas for Taxation During Cuba's Transition" by Gallagher

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The paper by Mark Gallagher reviews major issues already reported in prior ASCE conferences and elsewhere providing a backdrop to a very useful set of policy guidelines distilled from recent experiences, particularly in former Soviet bloc countries. Of equal importance to the policy considerations are tax administration issues. Administrative simplicity and corruption avoidance are essential factors influencing policy. Moreover, of paramount importance in a transition are organization, staffing and direction issues since the process of institution building requires a sound initial start. Simultaneously, to nurture the seeds for long-run tax compliance will enhance the process of creating a new national political culture to be reborn from the ashes of communism.

The transition in Cuba is already taking place in several dimensions including taxation, both overtly and characteristically of the regime, covertly. Not only legal measures have been enacted which both regulate and even stifle the initiative of self-employed "cuenta propistas," but also a system of sophisticated negotiations relating to "tax/retention/remittances" of Cuban professionals working overseas (doctors, sports trainers, engineers, professors, etc.) has been established. These professionals (who are prohibited from being "cuenta propistas" in Cuba) agree to pay around half of the salary they earn in other countries, mostly Latin America and Africa, to obtain exit and return visas to visit their families. Some eventually become exiles. No information in their numbers is published but estimates in the order of 10,000 appear plausible. Hence their "tax/remittance" bill can also be estimated at some 100 million dollars per year, and their significance has been recognized by the Cuban press. It is noted that the "tax" administration apparatus involved in such collection/compliance is significant and requires supervision by Cuban embassies. Less sophisticated is the huge "tax" effectively paid by Cubans employed by foreign ventures in Cuba who collect in pesos what their employers pay the Cuban government agency in dollars (a 20 to 1 ratio or "effective tax" of 95%!).

Before commenting about the specific tax measures recommended for future transition scenarios, a restatement of the mutually reinforcing guiding principles for taxation is offered for emphasis:

- **Simplicity** — ease of understanding and administration, enhanced compliance and equity perception.
- **Single rates** — transparent revenue, avoidance of distortions such as shifting individual/corporate income.
- **Minimum economic efficiency losses** — full application and compliance, enhance dynamic private sector.
- **Transparency** — channel transition to modern collective citizen discipline.

Hence, I concur with the tax reform measures recommended by Gallagher. I would also add a retention tax on earned interest both to broaden the tax base and to capture the taxes that would be paid anyway by Cuban overseas who would invest in high interest-bearing accounts in hopefully sound banking institutions during the expected transition boom. Note is also made of the need to negotiate a Cuba-United States Tax Treaty which would favor investment and repatriation.

Of keen importance is the value added tax (VAT). Value added is the value that a producer—either a manufacturer, farmer, etc.—adds to the raw materials he or she purchases. The easiest way to calculate a VAT is output minus input and then to apply the tax rate to the figure. The advantages of the VAT it that has an inherent control mechanism. Each trader's sale is someone's else's purchase; the invoices required for a credit allow the authorities to cross check the accuracy of the purchase by adding up the suppliers' sales. The data on purchases and sales in the VAT returns provides a valuable input to the calculation of profits for the purpose of income taxation.

Just as the VAT will enhance social cohesion, it should be simultaneously reinforced by a simple, low single-rate, single-exemption individual income tax. Particular care should be exercised in all minimum income amounts, whether they be for individual, corporate or VAT purposes, since they will be widely analyzed and appreciated as social policy conducive to national entrepreneurship.

The only contrarian view, which I offer for future debate, is the possibility to create non-transferable tax credit certificates as compensation for property confiscated by the Cuban government. Such certificates could also create an incentive for investment and repatriation.

A final word of caution relates to the need for strong analysis of tax implications. This is critical, whether it means maintaining reasonable tax revenue from tourism, which is competitive in the region; or recognizing that customs collection is secondary to the efficient and timely supply of imported inputs during an expansive transition which will saturate port capacities.

Hence, the future revenue requirements for a Cuban government must be met by a modern, simple, thoughtful system that can be appreciated by all, that can be seen as a just and participatory endeavor by all, and that can finance necessary government services for all.