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The State of Tax Policy in the Central Asian and Transcaucasian Newly Independent States (NIS)

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The State of Tax Policy in the Central Asian and Transcaucasian Newly Independent States (NIS)

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Abstract

Two possible tax policy strategies for the NIS are: (1) an optimal nondistortionary tax structure as a one-shot action; and (2) a structure with identifiable and clearly understood distortionary elements as a temporary phenomenon to close the fiscal gap. An assessment of NIS tax structures reveals that they conform to neither. They are rapidly acquiring complex features comprising multiple rates, exemptions, and other difficult-to-administer properties, with uncertain ramifications for efficiency, equity, and the fiscal deficit. Steady--and perhaps prolonged--effort needs to be made if simple, broad-based, and revenue-productive tax structures are to be achieved.

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Contents

I. Introduction

The objective of this paper is to assess whether a clear strategy over tax policy has developed in the Central Asian and Transcaucasian newly independent states (NIS). 1/ The paper begins by exploring the ideal form and components of such a strategy. It then describes the state of tax policy in the NIS, provides an assessment, and points to the gap from ideal tax policy norms. It concludes that the NIS have implemented neither an immediate shift to an ideal system nor a gradual approach from the present system to the ideal, where the interim steps are chosen with a view to containing the fiscal deficit. Rather, the NIS tax systems are rapidly acquiring complex, distortionary features which hinder tax administration without necessarily enhancing revenue-generating capacity.

II. A Tax Reform Strategy

Many articles have appeared in the literature proposing tax reform for economies in transition (Tanzi, 1993). They can be divided into two main groups: (1) those that recommend a one-shot transformation of a prevailing tax system with features found in a command economy to one that deals fully with the concerns of an optimal tax system in a market economy; and (2) those that recommend a step-wise approach that allows only broad approximations to an ideal tax structure to prevail during the transition to a market economy. 2/ Advice related to technical assistance to the NIS also reflects these two views over tax reform.

1/ They cover Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan. The scope of the paper is not to provide a description of individual tax systems, which are continually changing; rather, it is to identify their policy content in an attempt to point toward necessary improvements.

2/ On related "big bang versus gradualism" issues for overall economic policy, refer to Borensztein (1993). See Shome (1993) for fiscal issues in particular.

The concerns of the two groups are relatively clearly discernible. The first stream of thought focuses on the need to get the tax structure quickly on the right track in terms of efficiency of resource allocation, while bearing in mind its implications for horizontal and vertical equity. The belief is that continued inefficiency of resource allocation as well as unequal treatment of comparable taxpayers caused by the tax system would be very costly in terms of loss in output. This group also believes that the ideal tax structure would also be simple and, therefore, easy to implement.

The second line of thought reflects greater immediate concern for the macroeconomic implications of continued large fiscal deficits that could result from the first approach. The preferred alternative is to close or reduce the fiscal deficit as a first objective and then to think of tax reform in its purest form. This is based on a fundamental opinion that the trajectory to an ideal tax system would not be simple. Instead, it would be time consuming and could lead at least to transitory loss in revenue.

The important features of the respective tax structures can be spelled out as follows. The first would include: (1) a broad-based and, preferably, a single-rate value-added tax (VAT) that would be the mainstay of the tax system in terms of its revenue generation capacity founded on a wide base with as few exemptions and as low a threshold as possible, with credit allowed for VAT paid on capital goods purchases, to minimize inefficiency in resource allocation; the VAT would be based on the invoice and accruals methods, and be designed according to the destination--as opposed to the origin--principle of taxation to minimize tax competition and to facilitate tax administration; (2) a short list of traditional excises on alcoholic beverages, petroleum products, tobacco products, and a maximum of two or three other products considered luxuries in a particular society; (3) a corporate income tax with a single rate, equal to the top personal income tax rate, clear accounting rules for tax purposes as distinct from financial purposes, adequate provisions against arbitrary burdens on the taxpayer of inflation, and equal treatment of domestic and foreign investors coupled with regulations to counter transfer pricing problems that are likely to arise with increased foreign investment; (4) a personal income tax with a rate structure in the range of 10-30 percent, a high level of personal allowance in the range of 2-4 times per capita GDP, and few or no additional deductions; (5) a property tax to be instituted at the beginning in the urban areas as urban properties are privatized and to rural areas as agricultural land is privatized; (6) customs duties with a rate structure in the range of 10-40 percent, perhaps complemented with a minimum duty for purposes of revenue generation; and (7) the abolition of all export duties because they inhibit international competition as well as small nuisance taxes so that the tax administration can focus on the important taxes. 1/ In short, the first group espouses the ideal tax structure that many market economies strive toward. This is based on the belief that, since the NIS are starting afresh, it would be easier for them to aim directly at the ideal. 2/

The second group finds fault with the above argument on mainly two grounds. First, the NIS are not beginning from a nonexistent tax structure.

1/ The area of international trade taxes needs much action as the NIS grapple with as yet open issues of intra-FSU trade, trade with the rest of the world, and so on. In sum, their tariff policies are yet to be developed. This area of taxation is not considered in the paper.

2/ Some, for example, McLure (1991), have also used this argument to recommend new or untried taxes such as the cash-flow tax for economies in transition.

In fact, the NIS have operated a mechanism for government revenue generation, however inefficient, for decades. Second, dismantling that structure and replacing it with the ideal one would require, at least, a medium-term effort. In the interim, in many cases, the problem of an increasing ratio of fiscal deficit to GDP--revenues falling faster even as government spending is decreasing--needs to be addressed. Therefore, there have to be transitory tax packages that would definitely have a greater revenue-generating capacity in the short run. They might include, among others: (1) wide use of tax withholding from wages, interest, and dividends, even with an underlying global concept--if not strict adherence to the concept--of personal income taxation; (2) extraordinary tax bases--for example, one that includes all or part of wages--for companies in the absence of rapid privatization while keeping the tax simple and widely based; (3) a long list of excises or production taxes; (4) a rudimentary production-type VAT up to the importer-manufacturer level; (5) relatively high rates of import duties and a temporary continuation of export duties; and (6) land taxes that would cover rural as well as urban land.

Our objective is not to select one approach over another. Rather, it is to identify whether the current tax structures of the NIS fit within these two alternatives. This is what we turn to next.

III. NIS Tax Structures 1/

This section has two objectives: (1) to present the prevailing tax systems and offer comments on their suitability; and (2) to assess whether they adhere to either of the two approaches described in the previous section.

1. Value-added tax (VAT)

A VAT was enacted in the NIS on January 1, 1992, replacing most turnover taxes. When the VAT was introduced, a high rate--28 percent--was considered necessary at least in the short term to sustain revenues at a level comparable to the old turnover taxes. 2/ The rate has been lowered recently in many republics, although it is still generally high. In Armenia, Tajikistan, and Turkmenistan the rate is still 28 percent; Uzbekistan has reduced it to 25 percent; and Azerbaijan, Kazakhstan, Kyrgyzstan, and Moldova to 20 percent. In part, the reductions have been obligated by initial moves by Russia. Most of the VATs are origin-based in the intra-NIS context (see below). It is not surprising, therefore, that a decrease in the VAT rate in one republic will prompt matching moves by trade partners.

The generally high rate of VAT has led to multiple pressures for exemptions and reduced rates. The pressures also stem from the inclination to use tax policy for the purpose of economic planning and income redistribution. As a result, the number of rates and exemptions have tended

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1/ The tax structures reflect those in existence in the early part of 1993. Subsequent changes may have taken place. The intention here is to provide a flavor of the tax complexity and rapid changes that are taking place continuously in the tax structures.

2/ They constituted a very important source of revenue--around 12 percent of GDP and 30 percent of total tax revenue--in the former Soviet Union (FSU). See Tanzi (1991).

to increase across republics, with many variations in the combination of rates and exemptions.

Fund technical assistance advises in favor of VAT structures that allow credit for the VAT paid on capital goods purchases. When the existing VAT does not possess this feature, Fund recommendations generally allow a transition phase toward full implementation of credit for capital goods purchases, keeping in mind revenue considerations. However, the prevailing VATs do not allow such credit. Also, they do not have any phasing-in plan for such credit to be allowed.

The NIS have chosen the origin principle for trade among themselves. That is, exports are taxed and imports are not. The standard international convention of destination-based taxation with zero-rating of exports and regular taxation of imports, makes the VAT neutral with respect to international trade, effectively isolating domestic markets from foreign VAT changes. Origin-based taxation, on the other hand, requires strong coordination of domestic tax policies. In this case, the tax content of virtually any commodity--tradeable or not--is determined by the taxes prevailing in its origin, embodied in its inputs (and inputs of its inputs, and so on). Thus, differences in rates and exemptions among republics would tend to spread distortions in relative prices across borders. In turn, the emergence of market-oriented economies should witness increasing attempts at export competition through exempting, zero-rating, or undertaxing exportable goods. Corresponding matching moves in importing republics, undertaxing domestically produced goods, are likely to multiply, eroding the VAT base and complicating VAT administration. 1/

Armenia and Azerbaijan apply the invoice-based system for tax computation. Moldova, Turkmenistan, and Uzbekistan use a method based on the accounts of the firm. Kyrgyzstan applies different accounts-based systems to manufacturers and retailers: manufacturers are allowed credit for the tax content of inputs effectively used in production while retailers compute tax liabilities as a percentage of mark-up. This requires the maintenance of detailed separate accounts and keeping track of which inputs are used in the production of individual outputs. Finally, Kazakhstan uses the invoice method for manufacturers and the accounts-based method for retailers. 2/ The known disadvantages of accounts-based VATs are compounded by high inflation that demands frequent computation of tax returns to minimize a fall in the real value of revenue. None of the republics has developed specific accounting regulations to address inflation.

Most NIS countries apply a cash-based VAT--in contrast with common international practice, which is accruals-based. The Fund's technical assistance recommendation has been to switch to an accruals-based VAT as soon as possible. The issue is further complicated by the existence of large

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1/ Another disadvantage of origin-based taxation is that it will force a different treatment of trade among NIS countries as compared with the rest of the world. Most of the republics do not yet have significant international trade with non-FSU countries. Also, existing trade is handled by a handful of public enterprises applying ad hoc rules. This situation should change in the near future and a consistent tax treatment of imports and exports under the VAT will be needed.

2/ In the present context, accounts-based VAT refers to the method used in some NIS countries, mainly at the retail level. According to this method, VAT liability is determined as a percentage of the mark-up on sales. It necessitates detailed accounting of inventories, sales of different products, and use of inputs.

volumes of inter-enterprise tax arrears. These may significantly erode the base of a cash-based VAT. 1/

The threshold and criteria for small businesses are also varied. Armenia, Azerbaijan, and Turkmenistan apply a threshold based on sales volume although in Armenia and Azerbaijan it has not yet been legislated. Kazakhstan and Tajikistan have established a threshold based on income. 2/ Moldova and Uzbekistan do not provide a small business exemption. Thresholds are generally restricted to individuals and do not apply to companies.

Conclusion: The VAT systems currently found in the NIS have already become complicated--perhaps too complicated--for the tax administrations. They generally operate beyond the manufacturer-importer stage; some have a multiple-rate structure; they allow exemptions of various sorts; they use cash rather than the accrual method, and mixes of the invoice- and accounts-based methods of tax computation; they use the origin principle for intra-FSU trade (and, increasingly, the destination principle for trade outside the FSU). This has led to tax rate competition within the NIS with the likelihood of further problems and revenue ramifications in the future.

In the authors' view, the VATs are a *fait accompli* since they are already advanced enough not to make it a realistic consideration to return to turnover taxes in any significant way. Indeed, the VATs have become distortionary and are in need of immediate reform. They, therefore, do not really conform to either of the two--optimal or interim--approaches.

1/ For a detailed analysis of this and other characteristics of VAT implementation in NIS countries, see Silvani (1992).

2/ Since it is not uncommon for firms with a high sales volume to report low profits or even losses, thresholds based on sales can be expected to be more revenue productive.

2. Excises

Excise taxation, like the VAT, appears to be origin based. In particular, exempting imports from within the NIS from excise taxation is the common practice. Turkmenistan extends the exemption to all imports. With respect to other matters in the excise tax area, the list of excisable goods is being reduced with time and most excises are now set at ad valorem rates.

Conclusion: Excises are a commonly used form of taxation and are moving in the right direction. However, there remains the possibility of greater revenue productivity by imposing excises on the imports of excisable products. Also, excises should be imposed on the basis of the destination principle, since the same arguments apply here as in the case of the VAT.

3. Enterprise profits tax

The NIS could still be characterized by a high degree of state ownership of enterprises commensurate with difficulties in rapid privatization. This might throw some light on the rationale behind certain common provisions found in the enterprise profits tax laws that appear to be tailored to public enterprises and to heavily regulated markets. The development of market-oriented private sectors should eventually result in the revision of many segments of the present laws.

a. Tax rate: The central rate is comparable to international standards in Kazakhstan, Tajikistan, and Turkmenistan with 35 percent, Moldova with 32 percent, Armenia with 30 percent, and Azerbaijan with 28 percent. Uzbekistan has a basic rate of 18 percent. Given the acknowledged need to generate revenue, moderately higher rates could be considered.

The rate structures usually comprise some form of progression. For instance, in Moldova extraordinary profits are taxed at 80 percent. A firm is considered to have extraordinary profits when the ratio of profits to costs is more than twice the average, which is administratively determined. In Tajikistan, extraordinary profits (above 50 percent of costs) are taxed at 90 percent. The average statutory tax rate can reach 70 percent in Azerbaijan and Kazakhstan, and 60 percent in Uzbekistan and Turkmenistan. In general, special--higher--rates apply to banking, insurance, and financial intermediation.

Despite particular motivations leading the NIS to introduce multiple enterprise profits tax rates, there are many arguments against progressivity. First, profits in some industries are intrinsically erratic, a year's high profits compensating another year's losses. This problem is further aggravated by a commonly found lack of loss carry-forward provisions. Second, the possibility of high profits could be a much needed incentive for increased investment especially in risky sectors. After the initial ground-breaker entrepreneurs have obtained significant profits, competition is likely to drive profits to normal levels. Third, the lack of financial intermediation and mature banking sectors is an important cause for minimizing discriminatory tax rates against the financial sector and profits obtained by it. Indeed, the financial system may need to be temporarily subjected to a preferential regime.

b. <u>Tax base</u>: During the last few years, due to uncertain economic prospects and weakened government control over public enterprises, there has been a tendency among upper-level employees to award themselves disproportionately high salaries. In an attempt to curb this trend, the authorities, with the exception of Armenia, Kazakhstan, and Tajikistan, have included wages (Uzbekistan) or "excess" wages (Azerbaijan, Kyrgyzstan, Moldova, and Turkmenistan) in the base of the enterprise profits tax. Excess wages are defined as that part of the wage bill that exceeds four times (or six in Kyrgyzstan) the minimum wage multiplied by the number of employees. This provision, intended to obviate a problem specific to the public sector, applies, nevertheless, to all enterprises.

Even among public enterprises, the effectiveness of the measure may be questioned. Since excess wages are calculated in comparison with the firm's average wage, the levy may encourage wasteful hiring of low paid employees. 1/ In any event, the prospect of reduced after-tax profits is unlikely to dissuade managers, who do not own the firm, from awarding themselves higher wages. The issue should be considered beyond the purview of fiscal policy and will only be solved by strengthened, competent, and independent control of public enterprises, advances in the privatization process, and development of competitive labor markets.

For private enterprises, the tax on excess wages penalizes firms that employ a work force with higher training and productivity. In the case of Uzbekistan, where the entire wage bill is part of the tax base, the profits tax is equivalent to a standard corporate income tax plus a payroll tax. The unconventionality of the tax base, when it applies to foreign companies, also

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1/ Let W1 be the wage bill such that W = w x n, where w is the average wage and n is the number of employees. Let W2 be the threshold such that W2 = 4 x minimum wage. Then excess wages may be defined as:

W1 - W2 = (average wage - 4 times minimum wage) x n.

Thus, there would be a tendency to maintain an average wage near 4 times minimum wage in order to reduce the possibility of incurring "excess wages."

raises the issue of whether the tax can be credited against the corporate income taxes due in their home countries.

c. <u>Depreciation</u>: A point that remains to be resolved in much of the NIS relates to depreciation deduction rules. In Kyrgyzstan, depreciation is a deductible business expense only to the extent that funds are set aside in a separate sinking fund or are used to repay debt. In Tajikistan, the law allows immediate deduction for new investment expenditure for the amount in excess of the original value of the capital goods which are being replaced and, then, normal depreciation of the full value of the new capital goods is also allowed. Turkmenistan has some deductions that amount to a double depreciation deduction and ad hoc depreciation schedules are issued every year. Uzbekistan allows deductions for repayment of some loans used to buy capital assets, which again, amounts to double depreciation deductions. Moldova allows both accelerated depreciation of full value of the asset and tax credit for part of it.

The issue is further complicated by high inflation, obsolete equipment, and the desire to give investment incentives. Some form of linear depreciation, to be applied within a shorter time frame (three to five years for capital assets and ten years for buildings), has been recommended in Fund technical assistance as a temporary measure.

d. <u>Multiple objectives</u>: A common characteristic of all enterprise profits taxes surveyed seems to be the spread of exemptions and special privileges depending on a variety of--and, on occasion conflicting--objectives. This feature tends to generate pressures to multiply further the number of different rates. There is a clear tendency to use profit taxation as an instrument of economic and social engineering. Sometimes the objectives themselves are outdated. For example, there is a general bias in favor of manufacture and against production of services ("unproductive labor"), especially financial services and entertainment (other than culture and sports) through the use of differentiated rates and exemptions. The efficiency of the market mechanism for allocation of resources requires neutrality of profits taxation. Furthermore, exemptions and multiple rates erode revenue, make tax administration difficult, and facilitate tax avoidance and evasion.

Most of the special treatment provisions that beset all the profits tax laws are intended as domestic and foreign investment incentives. Azerbaijan, Kazakhstan, Moldova, Turkmenistan, and Uzbekistan grant tax holidays (usually two years) for foreign or joint ventures. Some grant similar exemptions for investment in the production of consumer goods, nontraditional exports, etc. Temporary reduced tax rates for new firms or exemption of profits obtained by increased production are also common.

Agricultural enterprises receive favorable treatment. In Turkmenistan, collective and state farms are exempt from enterprise profits taxation and new firms producing agricultural products are given a tax holiday of two years. In Kazakhstan and Uzbekistan, farms and agricultural production are fully exempt from profits taxation. In Kyrgyzstan, they enjoy a general temporary exemption and, thereafter, a reduced rate of 10 percent. In Moldova, the enterprise profits tax rate for farming is 1.5 percent (or 10 percent of income, including wages, if it is a cooperative).

e. Payment methods: Advance payments are required once or twice a month and returns are filed, at least, once quarterly, with the objective of reducing the erosion of real revenue in an inflationary environment. There is no perfect solution to avoiding the Tanzi effect--loss in the real value of revenue due to lags in tax collection--short of attacking its cause, that is, reducing inflation. Nevertheless, the excess burden can be minimized by requiring frequent advance payments based on past returns and updated by some index of inflation, and restricting the return filing requirement to once or twice a year. This could be especially relevant for small businesses who do not usually practice sophisticated bookkeeping.

Conclusion: The enterprise profits tax conforms to neither the optimal nor the interim approach. In neither approach is a multiple-rate tax recommended as is the common practice currently. Neither approach favors the wide use of incentives, causing widespread erosion of the base, as is the case today in the NIS. 1/ The systems suffer from multiple--and conflicting--objectives, making the tax very complicated and distortionary. Technical aspects of the tax, such as depreciation rules, and (the lack) of inflation adjustment, on the other hand, lend a rudimentary aspect to the tax. These need to be quickly corrected since the problems they generate are immediate. Finally, while the interim approach would accommodate inclusion of wages in the tax base of public enterprises, in practice the systems are quite complicated inasmuch as they are based on the excess over minimum wage, leading to widespread distortions. Its application to the private sector also adds to anomalous complications of the particular construction of the

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1/ Arguably, there could be an interim role for narrowly targeted tax and nontax incentives for important, "engine-of-growth," sectors, as was the case for post-World War II Japan. See Shome (1993) on this issue. The nature of tax incentives in the NIS does not seem to be confined to very few economic activities; their objectives are more broadly defined.

tax base. Much remains to be improved, as a result of all these problems, in the area of the enterprise profits tax.

4. Personal income tax

A common feature is the schedular character of the income tax (with the exception of Armenia). Generally, wages, dividends and interest, and entrepreneurial income are taxed differently without global assessment of overall earnings. Taxation of wages is collected at source through withholding and provides the bulk of the income tax revenues. This is adequate for it provides frequent and regular payments and simple administration.

The schedule for wage and entrepreneurial income is progressive with a minimum rate of 12 percent and a maximum of 60 percent in Azerbaijan, Tajikistan, and Uzbekistan, 50 percent in Turkmenistan, and 30 percent in Armenia (global income), Kazakhstan, and Moldova. In Armenia, Azerbaijan, Tajikistan, Turkmenistan, and Uzbekistan, most taxpayers tend to fall within the 12 or 15 percent tax rate bracket. Therefore, the high marginal tax rates do not provide significant revenue while still having negative incentive effects. The threshold is generally equal to the minimum wage. A package of reform measures that could enhance revenues would include: (1) indexing brackets and the threshold with inflation, (2) reducing marginal tax rates, (3) increasing the minimum tax rate, and (4) reducing the size of the lower brackets, in such a way that the revenue gain of the last two measures should offset the revenue loss from the first two.

Taxation of entrepreneurial income and the income of self-employed individuals is, and will be, a delicate issue during the transition to a market economy, and difficult even after the transition. Since an important part of the thrust of the transition lies in entrepreneurial activities, tax policy has to avoid discouraging them without creating possibilities for tax avoidance. The problem is compounded by the usual difficulties in identifying taxpayers and assessing their incomes. The method of choice has been to establish license fee payments in lieu of income taxes. Although license fees may be adequate during the initial stages, with the development of a larger and diversified private sector, they will have to be complemented with a more versatile and sensitive approach to income assessment. A possible intermediate method which has been recommended in selected NIS is to complement licenses with a presumptive tax based on clear and objective criteria (e.g., the size of the business premises, their location, and the number of employees). This could then constitute the forerunner of a self-assessment return filing scheme for entrepreneurs with income over a set threshold. However, an accounting- based estimate of income might have to be complemented with some form of presumptive taxation, such as the gross assets tax used by some Latin American countries.

As in enterprise profit taxation, the multiplication of exemptions, special rates, and privileges has to be singled out as the main drawback of the personal income tax laws in the NIS. Certain sectors, typically incomes from agricultural activities, receive special treatment in different forms. For example, in Moldova, farmers and farm workers are currently exempt from personal income taxation for five years.

In general, exemptions and special treatment provisions are designed to protect low-income individuals, large families, the handicapped, etc. A minimum threshold and possible fixed allowances for dependents from the immediate family are a better and more efficient way of introducing these concerns into the personal income tax. Exemption of a given proportion of income benefits higher-income households, without affecting the most needy, who would be below the existing threshold in any case. Therefore, lump-sum allowances are to be preferred to exemptions of income. Programs funded through the budget can better target and reach the sectors needing special attention. Under the present system, income tax privileges overlap with existing welfare programs in ways which are difficult to detect. Further, special rates and exemptions complicate administration of the personal income tax. In Turkmenistan, exemptions and low-rating rules have led to the requirement that bookkeepers of enterprises be trained and certified by the tax service in order to implement the withholding of taxes of employees.

Conclusion: Existing personal income tax systems tend to fall in between the optimal and interim approaches. On the one hand, final withholding of wages is common while withholding of interest and dividends may still be impractical (while financial earnings are still low and the nascent financial sector cannot be discouraged). On the other hand, top marginal tax rates are very high; there is experimentation going on regarding the taxation of entrepreneurial income; and there is a generally widespread occurrence of privileges, that is, the tax structure is encumbered by multiple objectives. Again, as in the cases of the VAT, and of the enterprise profits tax, reform and simplification of the personal income tax is already called for, even before the full development of a widely based global tax.

5. Land and assets taxes

International experience reveals that taxation of agriculture, except in the case of formal enterprises, is a difficult issue. Land taxes may play a role in bringing agricultural income into the tax net, especially since land taxes could be conveniently introduced at the moment of privatization. A cadastre would exist immediately. Also, the sale of land need not recuperate immediately the present value of land. Instead, the latter could be divided into the sale value plus the present value of the stream of tax revenue from the piece of land. This would facilitate participation by poorer farmers--who do not have access to credit--in acquiring land through the privatization process while preserving government revenues. At present, land tax legislation is being drafted or has been enacted in all the republics. However, no information is available for Tajikistan.

A tax on fixed or book assets of state enterprises has been proposed as a means to obtain a minimum return on past government investments. Such a tax exists in Armenia. Assets taxes covering public and private enterprises exist in Turkmenistan and Uzbekistan (1 percent rate).

Conclusion: If, in the interim approach, taxes such as the land tax are to be used, there is great need for them to be quickly developed and implemented. On the contrary, agricultural income seems to be favorably treated in much of the NIS; it does not seem, therefore, that much of a likelihood exists for the land tax to be utilized in a serious manner very soon. However, there is some evidence of the utilization of an assets tax to obtain a minimum return from past government investment. This tax could be transformed into a gross assets tax on all enterprises--public and private--with a credit for profits taxes paid. It would function, therefore, as a minimum profits tax. Such a form of presumptive taxation has been successfully used in Argentina and Mexico.

IV. Concluding Remarks

Even as modern tax policy is taking form in the NIS and, while recognizing that they may have come a long way from the system of transfers typical of a command economy, it would be pertinent to note that NIS tax systems are rapidly acquiring complex, distortionary features. Most of the taxes conform neither to an optimal tax structure design; nor to a simple--though distortionary--interim tax structure focused on closing the fiscal deficit. Needless to say, nascent tax administrations could hardly be expected to implement these tax structures efficiently. As a result, much remains to be improved in the tax systems.

While it is not the purpose of this paper to analyze the causes behind this situation, it may be worthwhile to list them if a correction is to be considered important. First, the NIS were operating their own complex tax/transfer mechanisms--reflecting social considerations as well as priority activities--before the period of change. Some of the current practices--even though modified--reflect old centralized operations in favor of intervention and differentiation. Effort has to be made in steadily reducing such methods. Second, many NIS are still in the phase of casting their tax policies in the model of (or as a reaction to) the Russian Federation. Third, the NIS are receiving technical assistance from diverse sources. Their tax policies reflect a mix of such advice. For example, European thinking on the VAT with the accommodation of multiple rates is different from that based on wider experience, inclusive of Latin America and Asia, which tends to indicate that multi-rated VATs are difficult to administer. Or, some experts may think that a modified cash-flow tax may be ideal in a fresh environment while others may think it to be quite complex as a starter

(Tait, 1992). Therefore, the least to hope for is that NIS tax policy might reflect the best of diverse technical assistance, rather than the worst. Fourth, experience in both West and East Europe reveals that tax reform is a complex process and may be expected to be the same in the NIS. Long preparation is needed for major tax reform even in industrial countries, such as Germany and the Netherlands, to name just two, in terms of tax administrator and taxpayer education, as well as in terms of the fruition of the process--from tax policymaking, to giving it legal form, to putting it into action. In East Europe, such as in the Czech Republic, tax packages have had to be withdrawn after their announcement and publication, to be ratified later in a modified form, through a referendum. 1/ Similarly, in the NIS, already, tax packages proposed by the executive branch of government--reflecting, for example, technical assistance recommendations of multilateral institutions--have not been accepted by the legislative branch. This simply implies that tax reform will be a slow process, as experienced in many countries in Latin America or East Asia where fundamental tax reform can be said to be taking hold after decades of experimentation.

To conclude, tax policy education in the NIS needs to be continuous, rather than in fits and starts, so that a smooth tax reform process may evolve. Complex tax policies should not be contemplated until the preparedness of the new authorities is readily apparent. However, external opinions can, at best, influence but not necessarily change overnight their existing and, often, firm convictions. A steady effort at such a modification, which could be expected to be prolonged, needs to be kept up.

1/ Also, see Gordon (1992) on Poland, and Kopits (1993) on Hungary.

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