TAXATION, PRODUCTION AND PROSPERITY

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THE Bell Report makes a good diagnosis of Philippine economic ills — despite some of its recommendations with which we do not agree — and anyone who has studied or read it has come to realize that taxation and production are two of the basic elements which, together with minimum wages, require progressive treatment in order to bring greater public welfare and prosperity to this nation.

There has been a great deal of discussion about taxation and production in their respective spheres; to my knowledge though this may be one of the few times that the constructive relationship between the two has been made the subject of an address. Our Chairman, Dr. Dalupan, deems it oportune for businessmen to explore ways in which taxation can be an incentive to production, and he is to be congratulated for his shrewdness.

Before proceeding further do I need to make it clear that I am not not proposing more new taxes. This is an academic discussion which, forming part of the collective material for this morning's general theme, "The Government and Business," may possibly serve as a reference in case those whose concern it is to frame legislation desire to modify existing taxes to provide greater incentive to production.

If we are to understand the effect of taxes on production we have to regard the mas a burden, however, necessary and justifiable they may be. How then can burden bring about or increase production? The obvious answer is, by placing the burden on non-productive investment and initially removing it from productive new investment, with a gradual leveling to normal rates as the enterprise becomes economically stable. It may be said, in consequence, that to produce the desired results there must be taxation and non-taxation preceding normal taxation. The application must vary depending on the nature of the production and the stage same has attained. We will only concern ourselves today with two classes of production: agricultural and industrial. And as taxes are necessary, non-taxation must be limited, in either case, to the incipient stage of production. Our discussion then narrows down to six premises:

a. Taxation of non-productive agricultural investment
b. Non-taxation of new agricultural enterprises
c. Adjustment of agricultural taxation to normal level
d. Taxation of non-productive industrial investment
e. Non-taxation of new industrial enterprise
f. Adjustment of industrial taxation to normal level

We will discuss each of these premises separately. I have headed the list with Taxation of Non-productive Agricultural Investment for two reasons: First, because the proposition "Taxation as an Incentive to Production" is stated in the positive sense, that is to say, the most literal interpretation of the subject is that the incentive shall be created by applying taxation. Second, because agricultural is the principal pillar of economy in the Philippines. I quote the following from the Bell Report: "In 1949, the gross national product, including disbursements of the United States, was over 5 billion pesos. Of the total amount, agriculture contributed 56%." If we exclude the United States disbursements from the total, the relative contribution of agriculture to the gross national product is appreciably greater than 56%. We further concur with the Bell Report when it further states: "Agriculture is certain to remain for a long time the dominant source of income and employment. For this reason, improved production in agriculture and the solution of long-standing land problems are essential to the improvement of the economy. Agricultural production has been restored considerably since 1946 but in 1950 it is still below the prewar average. The production of the principal food crops is now about equal to prewar levels but with an expansion of population of about 25%, food production per capital is still considerably below prewar and the nation is dependent upon imports for a sizable proportion of its food supply." Now then, to increase agricultural production it is necessary to stimulate greater interest among those who actually work the land. It has been recognized for a long time that there is no better incentive than to give them an opportunity to own the land. Part of the government's Social Justice program is, in facts, devoted to the attainment of that goal. Yet, despite these efforts, we read on the Bell Report the following excerpts: "Large profits enjoyed at various times by the landowner class have gone into the acquisition of more land. The result has been that land ownership by farmers who work the land has steadily declined." In other words, there is more and more land under ownership of people who are wealthy enough not to have to worry whether their land produces or not.

Under these circumstances, in what way can taxation be an incentive to production? To provide you with an answer I will refer to a letter, made public at the time, which under date of December 7, 1950, Mr. Daniel Aguinaldo addressed to the ECA Administrator, Mr. Vicente Checci. The letter proposed a tax system — I may venture, inspired by the theory of the internationally known tax authority Henry George — designed to accomplish, among other important social objectives, increased productivity. In this connection Mr. Aguinaldo proposed that a higher rate of real estate tax be levied on uncultivated agricultcral land, with a gradual reduction in the rate as cultivation increases, the rate finally being lowered to the normal level when the land is fully cultivated. To use Mr. Aguinaldo's own words, such form of taxation would result in either of the following:

"a. Additional investments for cultivation, or

b. Liberal arrangement between landowner and worker in which it may well be that the landowner who is unwilling or unable to undertake the cultivation himself may urge the landless to cultivate the land without charge in order to save on taxes."

But such a program would not be complete unless a great precentage of the revenues thereby received by the government are budgeted to improve present methods of cultivation. Again I quote from the Bell Report: "The national budget makes little provision for this basic occupation of the Philippine people. For the fiscal year 1951, there was appropriated to the Department of Agriculture and Natural Resources for investigations in plant industry, animal industry, fisheries, and forestry the sum of ₱1.2 million, about one-fourth of one percent of the budget. When it is considered that Philippine agriculture is regarded by its most sincere friends as very backward and susceptible to quick improvement, the neglect (through insufficient appropriation) of even elementary experimental work on which its advancement depends is difficult to understand. The Philippine budget should make adequate provision for experimental work, extension service and technical and vocational education in agriculture. The College of Agriculture at Los Baños should be rehabilitated, a central experiment station located at the college and equipped with facilities to carry on the necessary research for agricultural development. Specialized experiment stations should be established in suitable places throughout the country."

A logical conclusion to be drawn from Mr. Aguinaldo's suggestion and the findings of the Bell Report, is that idle agricultural lands should be taxed more heavily and a large percentage of the revenues thus derived utilized for the improvement of agricultural methods.

My second premise for discussion is non-taxation of new agricultural enterprise. This means the temporary lifting of the tax burden the moment a landowner puts his erstwhile idle land into production. This relief from taxation must be limited to the production of new kinds of crops or existing crops under new conditions, where a period of experimentation is necessary before economic success is achieved. This relief is afforded by Republic Act No. 35, now in effect to industry, as it exempts all new and necessary industries from the payment of all taxes for a period of four years from the date of their organization.

The third premise is the progressive adjustment of either heavy taxation or non-taxation, as the case may be, when the agricultural enterprise has attained economic stability, i.e., assured successful operation, at which time it should be made subject to the normal rates of taxation usually applicable.

The fourth premise is taxation of non-production industrial investment. This has been stated for academic reasons only, as a counter-part of the first premise, because in practical effect there is no investment in industry unless it be for production. In exceptional cases where industrial property, equipment ,or supplies are purchased by middlemen whose sole intent is to hold them for resale at higher prices — particularly in times of scarcity — such assets should be heavily taxed if they are held for more than a reasonable period.

The fifth premise is non-taxation of new industrial enterprise. In the case of industry in its incipient stage, relief from taxation is as important as imposition of taxes is in the case of idle agricultural lands. This relief from taxation is afforded by the provisions of Act No. 35 to which I have already referred.

The sixth premise is simply the application of the normal level of taxation to new industries when they have successfully emerged from the initial stage.

Apart from Act No. 35, we must credit the government for other legislation designed to encourage production by relief from taxation. The repeal by Act No. 41 passed in October, 1946 of Section 187 of the National nIternal Revenue Code which imposed a tax of 1½% on all exports was prompted by the vital need of stimulating exports of Philippine products. This resulted in lowering their cost and was, therefore, an incentive to production. Unfortunately, much of this benefit has been cancelled by the imposition of the local sales tax of 5%, 7% or higher to certain export transactions. The collecting agencies of the government, by resorting to technicalities based on court rulings which long pre-dated the repeal of the export tax, have ruled that products sold for export on an "F.O.B." or "F.A.S." basis are subject to the local sales tax because the title to the property passes in the Philippines. In other words, in order to steer clear of the local sales tax, an export sale must be made only on a "C.I.F." bass. If a mere technically can change the nature of an export sale into a local sale for the purpose of taxation, I am sure you will agree that it is imperative that something constructive should be done to correct this obvious anomaly. The Philippines, engaged as it is in a great effort to improve its dollar reserves, and very successfully, I may say, due to the ability outstandingly demonstrated by the Governor of the Central Bank, Mr. Cuaderno, and his well qualified staff — can hardly afford to have its exports impeded by mere technicalities. It is to no avail to have repealed the export of 1½% in 1946 if, on the other hand, the local sales tax of 5% or more can be imposed on export transactions when they are made on an "F.O.B." on "F.A.S." basis. Everyone knows that these terms are comon in the export trade.

Another example of stimulating industry through relief from taxes may be found in Act No. 361 which exempts the purchase of vessels from abroad from the compensating tax imposed in Section 190 of the Internal Revenue Code. This is constructive legislation because the Philippines depends so much on the availability of vessels for the carriage of its exports. In times of war vessels of foreign registry may be diverted by their owners or government from their normal routes and the Philippines could find itself in a serious plight if it had no commercial vessels of it's own. Apart from this consideration is the fact that the merchant marine is both a dollar-saving industry, and dollar producing industry. This particular Act would be more up-todate- if its provisions were extended to included commercial aviation.

The government can further encourage production, both agricultural and industrial, by incorporating into our Income Tax Law a provision found in Section 122 of the United States Internal Revenue Code which allows the carry-back and carry-over of net operating losses. It reads as follows:

> If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year."
>
> "If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the five succeeding taxable years."

This provision is in recognition of the principle that a net operating profit shall not be taxed until all the net operating losses shall have been covered by profits of prior or subsequent years. Even an established industry which has been making profits for years is subject to the influence of external factors such as war, fires, earthquakes and other catastrophes which can throw it into a subsequent period of operating losses. Under such circumstances it must be given an opportunity to recover, for unless it recovers it ceases to be a taxpayer.

Examples;

Graphs showing rise in prices of:

(a) GASOLINE
(b) DIESEL OIL
(c) CRUDE OIL

But reverting to the positive interpretation of the subject "Taxation as an Incentive to Production" and considering that under all circumstances it is first necessary to have capital before one can produce, I think it fitting to approach the end of this address by quoting the two following recommendations which, among others, were made by Dr. Francisco Dalupan in the excellent speech he delivered before the Lions Club on January 24, 1951:

> "1. Tax hoarded money not in banks in order to force the funnelling of idle capital either into the banks or directly into productive investments."
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> "2. Tax idle bank deposits over and above legal reserves to force the banks to relax their lending policies, thus stimulating lending for productive purposes."

In conclusion, may I say that of the several points I have touched upon in this address the most important, in my opinion, is the need for a larger appropriation to be given to the Department of Agriculture and Natural Resources so that it may be able to increase and intensify scientific research for the improvement of agricultural methods. This is not only just but necessary considering that the largest share of the gross national product is contributed by agriculture and that more than 70% of the people derive their livelihood from it.

From this specific statement one can expand into a general comment that the government, by evolving a scientific tax system and through productive public spending of revenues from taxation, can be a leading agency of production, along with capital, labor and management.

The power of taxation is an accepted attribute of modern forms — especially of the democratic form — of government, exercised for the purpose of financing public services. It must be admitted that business enterprise would be impossible without the security and the convenient services given by the government. However, to encourage productivity, under this general principle, there must be a judicious turning on and off of the pressure of taxation which would. on the one hand, penalize non-productive investment and, on the other, reward the introduction of new productive enterprise. If the power to tax is exercised according to sound precepts, envolved through experiences of states and peoples of the world, and if the revenues from taxation are wisely spent on productive public services, taxation can and will be an incentive to production.