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REVENUE LAWS AS A STIMULANT FOR FOOD PRODUCTION AND GROWTH: THE EAST AFRICAN EXPERIENCE**

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All of us who are interested in law and development start with the assumption that law has some relevance (we are not sure how much) as an instrument in bringing about development. The scope and influence of law as an agency of social (and here I would include economic) control received its greatest boost when society became politically organized and law became identified with the political state which could effectuate its commands and its facilitative provisions (enforce contracts, etc.) through the use or threat of force. Today most authorities have serious doubts as to the value and efficacy of the compulsive aspect of law, as it sets up dissonance in those whose choices are forced on the basis of legal, rather than nonlegal preferences.[1] The need exists to strive to eliminate coercive sanctions which are used as instruments of aggression and to encourage sanctions which will enlist the cooperation of the individual in achieving social and economic objectives. We seek to devise procedures and structures (e.g. in the agricultural context, soil conservation, cooperatives, marketing systems) which encourage cooperation and noncompetition and hence greater production and conservation.

We did not need Marx to tell us of the significance of the relationship between law and economics. From the development lawyer's point of view, the growth of economic attitudes among all of the par-

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1. *See generally* W. Muir, *Under What Circumstances Can Law Bring About Attitude Change?*, in J. GROSSMAN & M. GROSSMAN, LAW AND CHANGE IN MODERN AMERICA 48 (Pacific Palisades, Calif.: Goodyear Pub. Co. 1971). For an economist's view of government's role in influencing attitudes and the use of resources *see* W. Lewis, *Government*, in Taylor *infra* note 4 at 1, 5, 7. At page 5 he distinguishes nine categories of government functions as follows: "maintaining public services, influencing attitudes, shaping economic institutions, influencing the use of resources, influencing the distribution of income, controlling the quantity of money, controlling fluctuations, ensuring full employment, and influencing the level of investment." At *Id.*, page 7 he points out that governments must influence the use of resources because the price mechanism, which mainly influences their use, often gives socially unacceptable results. *Contra*, I.G. Myrdal, *Asian Drama: An Inquiry into the Poverty of Nations* 67 (Harmondsworth: Penguin Press, 1968). "(O)ur investigation has convinced us that the success of planning for development requires a readiness to place obligations on people in all social strata. . . . It requires, in addition, rigorous enforcement of obligations, in which compulsion plays a strategic role."

ticipants in the development process is crucial. As society becomes more economically organized and aware and more choices are based on economic advantage, the law gives a less obviously compulsive reason for making the "right" choice.[2] More research is needed as to the effectiveness of economic incentives and their relationship to law. This would enable us to order conduct more effectively, to develop more effective legal-economic sanctions or inducements, to encourage behaviour which is more socially and economically desirable. This is important particularly where one is concerned with the role of law in the area of production, storage, marketing and consumption of food because such laws have their primary impact in rural, traditional areas where informal social pressures and long established patterns of life still encourage conformity to old ways which often work against new policies. As Austin pointed out in the area of criminal law:

> (legislators) forget that positive law may be superfluous or impotent, and therefore may lead to nothing but purely gratuitous vexation. They forget that the moral or the religious (and here we could include "or the traditional") sentiments of the community may already suppress the practice as completely as it can be suppressed: or that, if the practice is favoured by those moral or religious (or traditional) sentiments the strongest possible fear which legal pains can inspire may be mastered by a stronger fear of other and conflicting sanctions.[3]

Though, as I have suggested, there is much to be learned about effective instruments of social and economic engineering, we already have in tax law a tool of significant potential. The use of tax law not only allows for the adjustment or recognition of economic realities (i.e. allows tax-free return of expenditures) but also enables the state to manipulate action by the use of positive incentives rather than negative ones, and even where the incentives may be negative they often appear to the citizen less overtly coercive.

Before addressing myself to the more specific aspects of my topic I must confess my trepidations about excursions which I as a tax lawyer must necessarily take without a passport, into the land of the

2. I would not like to be misunderstood here. Law can play a role in encouraging and facilitating, in guiding and shaping social consciousness. Economics can be used as an instrument in directing action toward society's goals. However, they are not the only, and perhaps not the best instruments in the long run in that they rely to such a great extent on selfish motivation. Nonetheless, they are important instruments in the context of the subject here dealt with.

3. J. AUSTIN, THE PROVINCE OF JURISPRUDENCE DETERMINED AND THE USES OF THE STUDY OF JURISPRUDENCE 162 (New York: Humanities Press, H.L.A. Hart ed. 1965).

economists[4] and my awareness of the dangers of generalizing about developing countries on the basis of East African experience and even of generalizing about East African countries. As to the first concern, I hope that the economists will be hospitable to a foreigner in their midst speaking Berlitz economics, and as to the latter I should explain my presumption. It is difficult to generalize when talking about tax policy in countries as diverse as those in East Africa because of the variations in economic, cultural, geographical and political conditions which exist there. However, their histories, their institutions and many of their problems and most of their resources are similar, and their use of various taxing instruments—especially the income tax—has tended to follow similar lines in all three countries. Therefore there is some basis for generalization. Furthermore, I am encouraged by the example set by Ann Seidman in her book *Comparative Development Strategies*[5] which shows that one can successfully find a common approach to analysis of problems in East Africa and other developing countries as well.

Isofar as it deals with the agricultural sector, most of the literature on developing countries concerns itself with how the agricultural sector can be exploited as a source of revenue for development rather than how taxation can be used as an instrument to encourage agricultural output, marketing, etc. This is not a wrong-minded approach even from the point of view of those of us concerned with the optimum production and distribution of food.[6]

Any development program in order to succeed must be a balanced one. A developing economy naturally experiences pressures in some sectors more than in others. If agricultural productivity is lagging behind development in the other sectors, there will be pressures on food supplies. And a failure of balance in growth agriculture and manufacturing industry is likely to result in a shortage of foreign exchange. The interdependence of the agricultural and manufacturing sectors is

4. For sources of economic theory in the area under consideration I have relied heavily on the following materials familiar to all development tax lawyers: R. Bird & O. Oldman (eds.), *Readings on Taxation in Developing Countries* (Baltimore, Md.: Johns Hopkins Press, Rev. ed. 1967), [hereinafter "Bird & Oldman"]; M. Taylor (ed.), *Taxation for African Economic Development* (London: Hutchinson Educational, 1970), [hereinafter "Taylor"]; H. Wald, *Taxation of Agricultural Land in Under-developed Economics* (Cambridge, Mass.: Harvard University Press, 1959) and H. Wald & J. Froomkin (eds.), *Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development* (Cambridge, Mass.: Harvard Law School International Program in Taxation, 1954). *See also* M. Williams, *Development Co-operation* (Paris: Organization for Economic Co-operation and Development, 1975). *See* Bird & Oldman at pages 537-547 for additional bibliography.

5. A. Seidman, *Comparative Development Strategies* (Nairobi: East African Publishing House, 1972).

6. For an overview of world food problems *see* D. JOHNSON, WORLD FOOD PROBLEMS AND PROSPECTS (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1975).

reported by W. Arthur Lewis:

> The shortage of foreign exchange often merely reflects failure to maintain a proper balance between the growth of manufacturing industry and of agriculture. If either of these sectors expands its output, the effect is to increase the demand for the products of the other sector, and any deficiency throws its strain on the balance of payments. A rapid growth of industry calls for a rapid growth of agriculture. The industrial workers will want more food; the factories will want labour from the countryside; the expanding market of the farmers will be needed to take up the output of consumer goods; or alternately the savings or taxes of the farmers will be needed to finance industrial construction. Similarly, if agriculture is expanding, it will need a growing industry to absorb its product and its labour, and to provide the farmers with more consumer and capital goods. Stagnant agricultural productivity per man holds up the expansion of industry, and puts a strain on the balance of payments, since the growing industry will require more imports and may have to dispose of its surplus as exports. Or alternatively, if agricultural productivity is rising, industrial production must grow even faster, since the demand for food rises less rapidly and the demand for manufactures more rapidly than income per head. Balanced growth means not equal growth, but growth in the proportions dictated by the different rates of growth of demand. If the balance between industry and agriculture is neglected, as in Australia or Argentina, or bungled, as in the U.S.S.R., further progress is held up; the superiority of the development planning of Japan over that of the other countries mentioned stands out clearly in this respect.[7]

Most developing countries are in the "chronic condition of having very little capital to spare"[8] and a principle purpose of taxation in these countries is the extraction of savings to aid all development. Since no sector in these economies has an abundance of savings, all sectors must bear the burden. Haskell Wald has pointed out that "the very size of the agricultural sector in most developing countries creates a strong presumption that a substantial portion of the required revenue should be raised in that sector."[9] For example, the 1972 Report of the International Labour Office shows in Kenya

7. W. Lewis, *supra* note 1, in Taylor, *supra* note 4, at 1, 19. *See also* S. Lewis, Jr., *Taxation of Agriculture and Economic Development*, in Bird & Oldman, *supra* note 4, at 465 *et seq.*

8. W. Lewis, *supra* note 1, in Taylor, *supra* note 4, at 15.

9. H. Wald, *Basic Design for More Effective Land Taxation*, in Taylor, *supra* note 4, at 298, 300.

ninety percent of the population still lives in rural areas and earns its livelihood predominantly from agriculture.[10] Probably the percentage so located and occupied in Tanzania and in Uganda is even larger.

In addition to its role in contributing to capital formation, the responsibilities of Kenya's agricultural sector are described in the *ILO Report* as follows:

> Kenyan agriculture needs to meet (a rapidly rising) domestic demand for food, and at the same time make a big and rising contribution to keeping industry supplied with materials and to satisfying Kenya's foreign exchange needs, both by exports and by keeping Kenya as self-sufficient in as many products as possible.[11]

It has the further responsibility of raising rural incomes and employment. A lot more could be said than has been[12] about the need for the domestic production of a food surplus for development. Indeed, the existence of surplus food was a prerequisite for civilization itself.[13] Without it towns and cities could not have risen and the builders and artisans of civilization could not have set upon their work.

NONTAX INCENTIVES

The government's role in capital formation is outside the scope of this paper, though it is necessary to observe that it may take many forms or use a variety of techniques such as direct government involvement in farming (state farms), the stimulation of farming by providing low import duties on agricultural inputs (of which more will be said below), extension of credit to food producers,[14] facilitation of marketing, provision of scientific and technological know-how and so forth. Some feel a higher rate of domestic saving can be achieved only by force, by taxing farmers and landlords or by inflation.[15] Whether such force should be exercised is a political problem which every country must solve for itself upon calculation of the pos-

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10. "Employment, Incomes and Equality: A Strategy for Increasing Productive Employment in Kenya" (Geneva, International Labour Office, 1972), [hereinafter "ILO Report."]

11. ILO Report, *supra* note 10, at 151-152. Regarding the export of foodstuffs as a source of foreign exchange see note 17, *infra*.

12. *See*, for example, N. Kaldor, *Taxation for Economic Development*, in Taylor, *supra* note 4, at 158, 167, 173.

13. *See* K. BOULDING, THE MEANING OF THE 20TH CENTURY 1-12 (New York: Harper & Row, 1964).

14. Without adequate credit farmers cannot acquire necessary inputs or adopt new techniques and farming practices. ILO Report, *supra* note 4, at 156.

15. W. Lewis, *supra* note 1, in Taylor, *supra* note 4, at 11.

sible gains and political costs (hatred, violence, etc.). There are other costs too. The use of inflation may create shortages and therefore necessitate some rationing or licensing of essential resources, especially of food,[16] with a possible impact on nutrition.[17] In this calculus it must be kept in mind that it is very easy to overload the governments of developing countries; it is better for them to confine themselves to what they can manage. It is more desirable to employ techniques which invoke the greatest cooperation of all of the participants in the development processes.

As the U.S.S.R. has learned in its experiments with state farms, farmers cannot be forced to have a food surplus. The main instrument for achieving development goals is reward and, if necessary, the use of disincentives which are not overtly coercive. W. Arthur Lewis has observed:

> If the farmers are to collaborate, the framework within which they operate must make this worth their while. . . . Much the best way of ensuring the success of a production programme is to tax the activities one wishes to discourage, and to subsidize (in one way or another) the activities one wishes to encourage.[18]

This may suggest it is a mistake to take too much of the farmers' surplus to aid capital formation.

The raising of prices is another positive technique which the government can use to encourage production and increase the accumulation of capital in the agricultural sector. In Kenya this has been done recently regarding the prices of milk, maize, sugar, beef and cotton. However, there are, limitations to the extent to which this can be done with respect to commodities such as coffee, tea, sisal and pyrethrum which, being mainly export products, have their prices determined by world supply and demand. Raising domestic prices above their world levels would require vast government subsidies and would present problems of disposal of commodities subject to international commodity agreements (e.g. coffee).[19] Of course, the poor would be hardest hit by high food prices and there would be pressure

16. *Id.* at 14.

17. Where a major source of foreign exchange is the export of foodstuffs, as in Kenya for example, food production must be continuously and rapidly expanded so that the expansion of domestic demand will not cause home consumers to eat what otherwise might be exported as happened in Argentina. W. Lewis, *supra* note 1, in Taylor, *supra* note 4, at 19. If, instead of increased production, limitations or curbs are placed on home consumption to avoid this, then there will be harmful impact on the health and possibly the productivity of the population.

18. *Id.* at 22.

19. ILO Report, *supra* note 10, at 159.

for higher wages. The only way that this could be avoided would be to have the increase handled by marketing boards which could maintain (or even lower) the retail price to protect the poor but at the cost of high government subsidies that would have to be funded by other government revenue. That, too, might result in demands for higher wages for those taxed to provide the subsidies. If the marketing boards could improve the marketing system itself so as to reduce marketing costs, the amount of government subsidies might be reduced or eliminated altogether.[20] Another possible consequence of raising prices of certain products is it may cause producers of similar, though not subsidized, products to shift to the production of the favoured product with resulting shortages of the nonfavoured product. This happened two years ago when Kenya subsidized dairy products by raising prices to the producer and drove others out of production of cattle for meat.

The inadequacy of various economic incentives (especially in regard to subsistence farmers) as compared with taxation is explained by Nicholas Kaldor:

> Economic incentives do not operate in the same way in the subsistence sector as in the case of industry and commerce. A shortage of food is not likely to call forth increased production; a rise in the price of locally produced food may even lead to a *decrease* of the amounts which are offered for sale, since it may cause the agricultural families to reduce their amount of work (or increase their own consumption) if their own needs for things which can only be procured with money can now be satisfied in exchange for a smaller quantity of foodstuffs. The growth of urban industry, on the other hand, depends upon the growth of effective demand for its products. A very large part—often an increasing part—of the urban worker's income is spent on food, as a primary necessity; so it is to the increasing cash incomes of the farmers that we must look for the expansion of demand for nonagricultural products. The limiting factor is the proportion of total food production that goes to the market instead of being consumed by the farmers themselves. It is this proportion which limits the growth of the demand for labour outside agriculture and not the other way around.
>
> It follows that the taxation of agriculture, by one means or another, has a critical role to play in the acceleration of economic development since it is only the imposition of compul-

20. *Id.* For other dangers inherent in a policy of pushing up prices, *see id.* at 270.

> sory levies on the agricultural sector itself which can be relied on to increase the supply of food for sale, and thus to enlarge the supply of 'savings', in the required sense, for economic development. Countries as different in their social institutions of (sic) economic circumstances as Japan and Soviet Russia have been similar in their dependence on heavy agricultural taxation (one through a land tax, the other through a system of compulsory deliveries at low prices) for financing their economic development.[21]

TAXATION GENERALLY

Putting aside other instruments of development, let us look at taxation as an instrument for creation of capital in, and the raising of revenue from the agricultural sector and for the promotion of agricultural production and distribution. At the outset it should be noted that, generally speaking, taxation is too indirect and produces effects too slowly to be considered as a significant instrument by itself to accomplish the goals above mentioned. This does not mean, however, it is not a useful instrument.

As suggested above, some attributes of taxation may make it preferable to other instruments; its very indirectness may be an asset. One of the most difficult aspects of effectively carrying out a development programme is getting the private sector to do what is required of it. People will not often act against their own apparent interest no matter how much politicians tell them it is in the public interest to do so or that their private interests are bound up with the public interest. The incentive and disincentive effects of taxation can at times be used to good effect. Kaldor writes:

> It is possible on the other hand that there is scope for additional taxation at the (low) end of the income scale. For example, the amount of food produced in a country may be limited, not by the availability or fertility of land, nor by knowledge or ability, but by the immediate needs of the agricultural population, who prefer to have maximum leisure and a minimum of material income, and therefore work just hard enough to cover their essential needs. In such circumstances additional taxes levied on them would tend to make them work harder and produce more—i.e. reduce their leisure, rather than their standards of material consumption. Taxation would then act as an incentive to produce more, rather

21. N. Kaldor, *supra* note 12, in Taylor, *supra* note 4, at 167.

> than force the people to consume less, and this may not encounter the same kind of resistance, particularly if the increase in taxation is a gradual one. From this point of view, the countries of Africa—where, in general, shortage of land is not a critical factor in agricultural production—are more favourably placed than those of Asia.[22]

More will be said of incentives and disincentives when we discuss income and land taxes below. It may be useful at this point to examine briefly some of the wide variety of revenue measures, which might be available to government and point out that sound fiscal policy suggests the selection of the best combination of those rather than relying on one measure alone. Haskell Wald provides an extensive list:

> (1) various types of land and produce taxes; (2) separate income taxes on agriculture or inclusion of agricultural income under a global income tax; (3) export taxes and multiple exchange rates affecting agriculture; (4) property transfer taxes; (5) general or selective sales taxes which burden the agriculturalist as consumer or producer; (6) mandatory deliveries of agricultural commodities to the government at low fixed prices; (7) fiscal monopolies, including government marketing boards; and (8) betterment levies, which might be imposed whenever the benefits of development projects are localised. While most of the measures in this list have wide applicability, not all of them would be appropriate in all countries.[23]

Import Duties

In developing countries (especially when talking about the agricultural sector) as contrasted with the developed countries, the revenue function of import duties is more important than their protective function. However, a developing nation's industrial sector may benefit from import duties on agricultural sector inputs. Assuming that government sees a need for development of the agricultural sector even at an economic cost to the other sectors, one logical solution—followed by many countries including those in East Africa—is to reduce or eliminate import duties on agricultural inputs such as tractors, combines and other machinery, breeding stock, fertilizers, insecticides, irrigation equipment and so on so to allow increased pro-

22. *Id.* at 163.
23. H. Wald, *supra* note 8, in Taylor, *supra* note 4, at 301.

duction and capital formation in that sector. How far a given country may go in this direction is a matter of judgment for the economists. Specifically relating to Kenya the ILO made a number of recommendations in 1972 regarding subsidies and reduced taxes on purchased agricultural inputs on grounds of income generation, better income distribution and employment creation.[24]

Export Tax

Export taxes in developing countries are, as Stephen Lewis has pointed out, "often more overtly 'agricultural' taxes than most other indirect taxes,"[25] and often serve as a substitute for income taxes where the latter are ineffective. Since they are largely used for their "stabilization effect" to manipulate and protect the domestic economy from external fluctuations,[26] little will be said of them here except to observe that they do discriminate in favour of crops sold domestically and therefore have a potential to make more food available locally at better prices but then also have a negative effect on foreign exchange earnings through discrimination against crops produced for sale in foreign markets and sooner or later are likely to discourage production altogether. Further, the export tax may be used as a means of influencing the terms of trade between the domestic agricultural and industrial sectors and to avoid the problem of overspecialization which might make it desirable to curtail some activities, e.g. to tax export crops which are in danger of becoming monocultures.[27]

Sales and Excise Taxes[28]

Sales and excise taxation is an area of complex implications in the world of taxation generally and, of course, cannot be fully explored

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24. *See* ILO Report, *supra* note 10, at 158, 429-434.
25. S. Lewis, *supra* note 7, in Bird & Oldman, *supra* note 4, at 470.
26. *Id.* He says,

> The major arguments of the proponents of export taxation are that it can (1) absorb windfall gains that accrue to the exporters during periods of rising prices, dampening fluctuations and reducing the primary and secondary effects of increased export earnings on the economy; (2) be administered with ease; (3) be made flexible by providing sliding scale rates to vary with international prices; (4) generate revenue from a low-saving sector and be used to diversify the economy and avoid future fluctuations; and (5) for a country in a monopoly position, serve to restrict supply and increase short-run exchange earnings.

27. W. Lewis, *supra* note 1, in Taylor, *supra* note 4, at 7-8.
28. *See generally* articles reproduced in Bird & Oldman *supra* note 4, at 297-336. With

here. Such taxes fall less overtly on the agricultural sector in developing countries but are worthy of our attention if only because of their ease of collection and the fact that they (especially sales taxes) apply to a larger percentage of the population than any other taxes and hence produce a considerable amount of revenue from a wide tax base. In developing countries, as in developed ones, the tendency is to exclude from operation of the tax basic food products particularly from sales taxes so as to encourage (or at least not to discourage) their consumption with the obvious consequential benefit to general health and labour productivity. In Kenya, for example, most unprocessed foods are exempt from the tax while most prepared foods and beverages are subject to it.[29] Such exemption of basic foods is also necessary because sales taxes tend to be regressive and therefore hit hardest those who can least afford to bear them.

It is important to keep in mind, however, that reduced sales and other taxes on agricultural products may mean not only lower prices to consumers but also (where there is an upper limit for prices of domestic products and therefore indirect taxes are normally passed on to the producer) higher prices received by producers and therefore enhanced production. It must be remembered that reduced sales and excise taxes on the agricultural sector must be "paid for" by the non-agricultural sector if government fiscal needs are to be met.

Also sales and excise taxes may be used to discourage local consumption of particular goods or, where demand is relatively inflexible as with liquor, salt, sugar and tobacco, to provide a stable source of revenue, taxation at even high rates of imported luxury foods, as in the case of East Africa, is not a reliable source of revenue. Kenya recently placed a high excise tax on sugar which tended to cut back on local consumption even though the demand on such commodity is normally rather inflexible. Excise and sales taxes on such items have

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regard to East Africa, see Patrick Heininger's excellent article: *An Early Look at the Kenya Sales Tax*, 9 E. AFRICAN L. J. 99 (1973).

29. Under the language of the Act there was some question whether food served in restaurants was subject to the tax. The Sales Tax Division has taken the position that the tax does not apply to food served in restaurants. Kenya Gazette Supplement No. 10 (13 April 1973). Some of the broad categories of items excluded are:

> Live animals, most unprocessed or semi-processed meat and other animal products;
> Plants and vegetable products including most unprocessed or semi-processed foods derived from plants;
> Most raw materials including such items as minerals, chemicals, skins, raw fibres, wood in the raw, etc.;
> Medicines, medical and hospital equipment, corrective spectacles and ambulances;
> Implements used in the agricultural, forestry and dairy industries, farm machinery and fertilizers.

P. Heininger, *supra* note 28, at 107.

their political dangers as Kaldor has indicated: "To get maximum revenue it is necessary to tax articles of mass consumption—cotton cloth, sugar, flour, beer, tobacco, kerosene and so on—and this raises all the political difficulties associated with a population."[30] We are reminded of Gandhi's use of the salt tax as a political weapon and the Boston Tea Party and the Whisky Rebellion in the United States. One cannot help but think that largely political reasons motivated President Kenyatta's single-handed repeal of the Traditional Liquor Tax in 1974. Surely it was not an attempt to support a local industry or to encourage local consumption! Assuming such taxes must be employed to gather revenue or for other reasons, experience has shown they should be introduced at a low rate and if increased, increased slowly.

INCOME TAXES

A leading economist has observed:

> Western-type income taxes (and such first cousins as expenditure taxes) are not at all suited to the agricultural sectors in most developing countries. The reasons are both administrative and conceptual. . .Levels of literacy and record-keeping are generally lower in rural areas, and problems of evasion and lack of administrative personnel and procedure make it nearly impossible to apply any system directly transplanted from Washington or London. The problem of defining taxable income, difficult enough when all receipts are from marketed transactions, is even more intractable when income is largely or wholly in kind. It is probably not feasible in most places to rely on income taxes of the usual sort for any significant amount of revenue from agriculture, unless agricultural incomes are heavily skewed in favour of large landowners.[31]

He goes on to point out that personal taxes are more attractive than income taxes and are better suited to less-well-settled areas than land taxes (discussed below) because of ease of application and their tendency to cause those in the nonmonetized sector to move to the market economy. In spite of this, Kenya, which in the early 70's employed a gross personal tax (GPT), abolished it in favour of a sales tax. The Kenya Government protested loudly and long that the sales tax was not a "substitute for the GPT"—clearly an attempt to save the former from guilt by association with the latter which was ex-

30. N. Kaldor, *supra* note 12, in Taylor, *supra* note 4, at 171.

31. S. Lewis, *supra* note 7, in Bird & Oldman, *supra* note 4, at 469.

tremely regressive and very unpopular with the people.[32] It is unlikely anyone outside the government accepted this. Patrick Heininger stated "one of the aims of the sales tax is to make up the revenue and losses caused by the elimination of the GPT."[33]

Income taxes, while preferable if effective, generally are not the main tools of agricultural tax policy in developing countries because in the agricultural sector such taxes face a variety of obstacles: (1) a large number of farmers operate at a subsistence level (probably ninety-five percent of the families in Kenya are not affected by the income tax[34]), (2) farmers rarely keep accounts, (3) production expenses are difficult to verify and can easily be overstated, (4) there is no opportunity for collection at source as contrasted with P.A.Y.E. in the industrial and governmental sectors or with sales taxes and import duties, (5) as yet there are too few investigative personnel to audit farm production, and Kenya, for example, is just beginning to develop income tax administration at the district level.

While highly progressive income taxes are most equitable, it is often thought by those in the higher brackets that the higher rates are a disincentive to both income-producing activity and savings which are important for capital formation. There is an equally good argument that persons who have adjusted their lifestyles to *after-tax* income will, if the rates are increased, work *harder* to maintain their after-tax income.[35] Furthermore, it has been observed "in developing countries. . .there is some doubt as to whether individuals in higher brackets do invest in critical areas of the economy. . . ."[36] Perhaps it is better the higher rates transfer such savings into the hands of the government, which is in a better position than are individuals to

32. There was an additional, stated, reason: the government did not want anyone to feel less obliged to meet his GPT liabilities in the year when that tax was ending and the Sales Tax had begun. *See* Heininger, *supra* note 28, at 101 n.12.

33. *Id.* at 101.

34. As to the conditions of the agricultural sector in Kenya generally, see the ILO Report, *supra* note 10, *passim*, especially Chap. 10. It is safe to state that due either to lack of natural resources or location of population in relation to resources (a problem addressed by the Ujamaa Village scheme) the situation in Tanzania is worse. Given the political and economic conditions in Uganda, comparisons are difficult. Perhaps one can say only that the population survives at all is attributable largely to the that the natural resources are so good and so available to the population and therefore the people *can* survive by subsistence farming without government assistance.

35. Also, the disincentive argument assumes, quite erroneously, that persons in the higher brackets are motivated by money alone. People's goal values cover a much wider spectrum, viz: Power, wealth, skill, enlightenment, well being, respect, rectitude and affection. See any of the writings by Harold Lasswell and Myres McDougal, *e.g.* their *Jurisprudence in Policy-Oriented Perspective*, 1 U. FLA. L. REV. 486 at 506 (1966). These authors are completing a major study embracing all of their theories about law. A more complete discussion of the role of values will be found there.

36. A. Seidman, *supra* note 5, at 260.

make decisions regarding investment priorities and development strategies.

As indicated above, the income tax reaches very few farmers because by far the greatest percentage operate at the subsistence level. Largely for administrative reasons and perhaps because of possible disincentive effects, income tax in East Africa has been interpreted so as not to include within income subject to tax the value of such items as food produced by farmers for consumption by themselves and their families. When nationalism and public events took their toll and the three East African countries abandoned the common administration of the income tax under the structure of the East African Community, the three countries enacted separate income tax statutes.[37] Tanzania, alone, added the following provision:

> (3) For the avoidance of doubts it is hereby declared that where an individual—
>
> (a) receives benefit of domestic services from a member of his family
> (b) occupies any premises owned by him; or
> (c) utilizes any agricultural product or handicraft product produced by him for his own consumption or use or for the consumption or use by the members of his family without receiving any monetary consideration from any such member of his family for such consumption or use the value of such services, occupation or product so used shall be deemed not to be income.[38]

Possibly one of the factors motivating this articulation of preexisting practice was Tanzania's commitment to self-reliance, an encouragement for greater effort at least on the family level. Of course the effect of not taxing such amounts is to preserve a restricted base for the income tax; that is, it is a disincentive to the production of cash crops.

Some incentives to farming exist in the income tax in East Africa.[39] For example, in addition to the usual business deductions there are allowed deductions for:

> (1) any expenditure of a capital nature incurred during

37. Kenya: Act No. 16 of 1973; Tanzania: Act No. 33 of 1973; Uganda: Decree No. 1 of 1974.

38. Act No. 33 of 1973, s. 3(3).

39. Citations will be to the Kenya Income Tax Act, 1973. Similar provisions can be found in the Tanzania Act and the Uganda Decree though the section numbering may be different.

(the tax year) by the owner or occupier of farm land for the prevention of soil erosion.[40]

(2) any expenditure of a capital nature incurred in (the tax year) by the owner or tenant of any agricultural land as defined in the Second Schedule, on clearing such land, or on clearing and planting thereon permanent or semipermanent crops.[41]

Other provisions exempt altogether from the tax's application are the incomes of various listed agricultural boards[42] and agricultural cooperative societies.[43] Still other provisions provide preferential depreciation rates (20% per year for five years) for capital expenditures on the construction of farm works "incurred for the purposes of husbandry on the agricultural land in question."[44] The comparable rates in the case of industrial buildings are 2% and 4%[45] and in the case of mining activities 40% in the first year and 10% in each of the follow-

40. § 15(2)(c).

41. § 15(2)(l).

42. The First Schedule, para. 4 excludes from tax:

The income of—
The Tea Board of Kenya,
The Pyrethrum Board of Kenya,
The Sisal Board of Kenya,
The Kenya Dairy Board,
The Canning Crops Board,
The Central Agricultural Board,
The Pig Industry Board,
The Wheat Board,
The Pineapple Development Authority,
The Horticultural Crops Development Authority,
The Kenya Tea Development Authority,
The National Irrigation Board,
The Mombasa Pipeline Board.

43. The First Schedule, para. 5 excludes from tax:

The income of a co-operative society registered under the Co-operative Societies Act derived solely from selling on behalf of its members agricultural produce, dairy produce, the products of animal husbandry, handicrafts or fish of which the members of the society are the primary producers if the gross income (that is to say, the proceeds from the sale of goods by such co-operative society before deduction of any expenditure) of such co-operative society when divided by the number of its members (that is to say, the number of individuals who are members together with, where another co-operative society so registered is a member, the number of individuals who are members of that other co-operative society) on the last day of any accounting period of twelve months does not exceed three thousand shillings or, if such accounting period is more or less twelve months, such figure as bears the same relation to three thousand shillings as the number of months in such accounting period bears to twelve.

44. Second Schedule, para. 22

45. Second Schedule, para. 1 (1).

ing six years.[46] Farm machinery (along with heavy earth-moving machinery) is generally given preferred writeoff treatment: 37-½% as compared with 25% or 12-½% for other classes.[47]

Considering the nature of the agricultural sector in East Africa and in most developing countries, it can be seen that these provisions and also the granting of tax credits (as distinguished from the better technique of direct government subsidies) for the purchase of certain desirable agricultural inputs such as breeding stock, hybrid seed, fertilizer, etc. mainly assist and encourage large agro-industry enterprises, those most able to bear the burden of taxation.

Given that the income tax leaves such a large percentage, especially of the agricultural sector, out of the tax net and has a possible disincentive effect, one might ask why so much stress is being placed on it. In the twentieth century the trend has been away from other tax instruments such as the land tax (to be discussed below). In spite of its present ineffectiveness as a revenue gathering instrument, its future value is undisputed and no developing country can wait until it is "ready" for an income tax before it sets one in operation. We cannot at present expect too much from the income tax administrations in East Africa, for example. They cannot exploit the full tax potential of their countries until they learn to handle their new jobs, upgrade their personnel, adjust to the split from the community administration, bring administration to the district level and educate the public as to record keeping, etc. They have at least thus far avoided one of the serious potential perils of any tax administration, that is corruption.

Income tax systems develop certain basic principles (e.g. that the tax should be related to ability to pay including provisions for personal exemptions, investment allowances, etc.), techniques and skills which, though they cannot generally be used with maximum efficiency in taxing the agricultural sector in developing countries, are transferable to other tax instruments such as a land tax.[48] Also it might be possible to continue the larger farms under the income tax with its more precise measurement techniques and apply a land tax or other taxes to the rest.[49] Therefore, there are good reasons for es-

46. Second Schedule, para. 17 (1).

47. Second Schedule, para. 7 (2). This might be unwise from the point of labour policy because it may have a tendency to make farming more capital-intensive rather than labour-intensive.

48. *See generally* W. Heller, *The Adaptation of Income Taxation to Agriculture in Developing Countries*, in H. Wald & J. Froomkin, *supra* note 4.

49. "The prevailing forms of land tenure, the nature of social and family relationships, or the extent of economic inequality call for differing methods of taxation of the subsistence sector." N. Kaldor, *supra* note 13, in Taylor, *supra* note 4, at 165.

tablishing an income tax at a very early stage; indeed most income tax systems already existed under colonial regimes.

LAND TAX

Considering the present inadequacies of the income tax as an instrument for raising revenue and increasing production in the agricultural sector, where might the developing countries turn? The best answer seems to be in the direction of a land tax. Lewis, Kaldor[50] and Wald[51] among many others, affirm this choice. Stephen Lewis says:

> Despite administrative difficulties, the important advantages of most land taxes suggest that developing countries would in most cases be well advised to include an introduction or extension of land taxation in the agricultural sector in their tax plans. *No other major tax available has the potential for forcing the agricultural sector toward the rest of the market economy, inducing increased supplies of agricultural products to the nonagricultural sectors, and, perhaps, increasing the efficiency of land utilization as well.*[52]

Not only do land taxes produce effects presently unavailable from

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50. *Id.* at 169 where he says:

> The importance for economic development of an efficient system of taxation of the agricultural or subsistence sector of the community cannot be overestimated. Sooner or later the countries of Africa must develop a system whereby they can tax the produce of the land, not just the inhabitants of the land, or those agricultural products which happen to be in demand abroad and on which export duties are easy to raise. Indeed I would regard it as one of the most urgent tasks of the newly emerging independent countries of Africa to make a thorough investigation as to what is the most appropriate form of agricultural taxation suitable to their particular conditions.
>
> In the absence of a direct tax on the subsistence sector either in the form of a land tax or a poll tax, this sector can only be taxed indirectly through taxes on commodities which are bought by the agricultural sector. Such methods of indirect taxation can never, however, fulfill the same function: they do not provide the same incentives for increased production or an increase in marketable supplies, and may even tend to retard the development of the rural regions.

51. H. Wald, *supra* note 9, in Taylor, *supra* note 4, at 303 where he says:

> Generally speaking, the underdeveloped countries suffer from a poverty of acceptable alternatives as regards methods of taxing the agricultural sector. With relatively few exceptions, some form of land tax offers the only practicable and dependable means of obtaining the large amounts of revenue required from that sector. Moreover, in those fortunate countries actually having a choice among two or more methods of meeting their revenue goal for agricultural taxation, a favouring extensive reliance upon land taxes seems highly probable, even though other methods may also deserve a place.

52. S. Lewis, *supra* note 7, in Bird & Oldman, *supra* note 4, at 468-469 (emphasis added). *See also* M. Williams, *supra* note 4, at 83.

other taxes, but also they are safer in terms of their effect on development. John F. Due, an astute student of East African economics, points out:

> Of all forms of taxation, that on land offers the least danger to economic development per dollar of revenue obtained. Moreover, taxation of other forms of property is potentially less dangerous than those forms whose impact is initially on income or immediate uses of income.[53]

It should be noted that a land tax of the type here discussed (and it is usually progressive), is a tax not on the income from the land but rather on the *potential* income from the land. As Due points out, taxation of land differs from taxation of income from land in two ways:

> First, idle or underutilized land is taxed much more effectively by the former. Secondly there is no direct connection between the amount of the land tax to be paid during the year and the income earned. The lump-sum nature of the land tax, once assessed, is an incentive to greater and more efficient production, whereas income taxation or export duties may have the opposite effect.[54]

In countries where the agricultural sector is largely a subsistence economy, therefore virtually immune to revenue raising through income taxes or other indirect taxes (import and export taxes, excises, sales taxes, etc.), the land tax may be an effective source of revenue,[55] a disincentive for inefficient utilization of land or retention of idle land for speculation or for prestige purposes, and an incentive to greater production.

As the land tax increases revenue for the government, it also increases the landowner's cash need and therefore increases his production and marketing of surpluses providing a greater flow of agricultural products to the urban area and the nonagricultural sector, providing more food at lower prices with a consequently more rapid growth of the nonagricultural sector. There is an obvious similarity between this instrument for the stimulation of production and the use of the hut tax (which was far less effective) by Colonial adminis-

53. J. Due, *Tax Policy and Economic Development*, in Taylor, *supra* note 4, at 199.
54. *Id.*
55. "From an economic point of view, the basic advantage of most land taxes in developing countries is that they would strike the non-monetized sectors and/or the sectors consuming their own production, which is not true of taxes falling directly or indirectly on marketed produce." S. Lewis, *supra* note 7, in Bird & Oldman, *supra* note 4, at 465.

trations as a financial inducement to work; though, contrary to popular belief, the hut tax, at least in Kenya, was not employed in order to induce Africans to work on *European* farms, but merely to work harder on their own.[56]

Obviously, if the agricultural sector is already maximizing its output with given resources, the potential incentive effect of a land tax will do nothing more than generate unrest, frustration and hardship. Therefore, maximum benefit from the incentive effect of land taxes can result in a sustained rise in agricultural production only if it is accompanied by the infustion of inputs such as education, technology, fertilizer, insecticides, credit, equipment and so on as was done in the often referred to case of Japan. In this connection, according to the *ILO Report*[57] a majority of the farming families in Kenya (and no doubt this is true in Tanzania as well) at present lack the ability to raise the productivity of their land more than marginally and already must obtain income from sources other than their own farms by seeking work in the rural areas or in towns or must rely on remission from household members working in towns. Furthermore, most Kenyans are already highly motivated to increase their cash income to pay school fees[58] and expenses for their children.

Another aspect of a land tax is its tendency to force subdivision of underproductive land and to eliminate absentee ownership. The *ILO Report* states:

> [T]he strategy for land distribution towards more labour-intensive units is based on the premise that much land on larger farms is being under-utilized, and that output, incomes and employment would all be raised by the subdivision of farms in cases in which output per hectare is lower than might be expected from small holdings in a similar locality.[59]

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56. *See* Y. Ghai & J. McAuslan, Public Law and Political Change in Kenya. A Study of the Legal Framework of Government from Colonial Times to the Present 83 (Nairobi: Oxford University Press, 1970). The hut tax is not nearly as effective an instrument as is a land tax as Nicholas Kaldor points out when writing about a similar instrument, the poll tax:

> (A) poll tax can never fulfill the same functions as a land tax based on the potential fertility of land. A poll tax does not give the same incentives as a land tax to improve cultivation; it does not make for greater fluidity in the ownership and/or occupation by the most capable farmers. Because it can take into account economic inequality, a land tax is not only capable of yielding a much larger revenue than a poll tax, but it should also be politically more acceptable.

N. Kaldor, *supra* note 12, in Taylor, *supra* note 4, at 169.

57. ILO Report, *supra* note 10, at 37.

58. While the Government has eliminated fees for primary school children, family expenses for education, clothing, etc. are still high.

59. ILO Report, *supra* note 10, at 17.

One of the ILO's longer term recommendations for achieving this redistribution is a progressive land tax related to the size and productive potential of the holding.[60]

Insofar as it can be determined that absentee ownership is detrimental to agricultural production (or indeed to social attitudes or political ideology) the land tax might be used to attack the problem; but more direct methods could be found even within the tax sphere, e.g. a tax penalty could be imposed on such ownership,[61] or provisions could be made for under-utilized land to escheat to the state as in Tanzania which need not rely on market forces and a land tax to redistribute land.

The land tax as a *revenue source*, as distinguished from its other uses, will be less necessary where the government is able, as it is in East Africa, to obtain large or relatively large revenue through the collection and marketing of agricultural products through marketing boards. Some countries can rely to a considerable extent on export levies, as discussed above; but it seems most East African countries do not export a sufficient portion of their agricultural output to place a heavy reliance on export levies; thus they must rely on other sources.

Land taxes, naturally, have certain shortcomings or inherent dangers. One shortcoming is that their effectiveness depends upon a number of factors usually lacking in developing countries: (1) effective land surveys (including soil classification as to productive capacity and relative income potential), (2) recording of title or other interest in land such as tenancy or other rights to use (this already exists to a considerable degree in *urban*, though not rural, Tanzania and Kenya and continues to develop in all of East Africa with land reform and registration programmes) and (3) the stability of occupation and use (as contrasted with foraging, cultivation or grazing by squatters or nomadic tribes.[62] With regard to the latter, the extreme case would be the situation which President Nyrere encountered in his travels thoughout Tanzania in the late 60's importuning tribes who subsisted by foraging and gathering to give up their ways and cultivate saying, "Chaps are going to the moon and you are not even planting crops."[63] As in the case of other tax instruments, the lack of

60. *Id.* at 17, 173 and 435-436.

61. The number of absentee landowners in the agricultural sector or at least farmowners who are not personally engaged in farm labour in Kenya is reflected in a survey of nonagricultural rural enterprises, which showed that nearly seventy-five percent of the 51,000 businesses were owned by farmers either individually or in partnership. ILO Report, *supra* note 10, at 37.

62. *See* J. Due, *supra* note 53, in Taylor, *supra* note 4, at 199-200 *and* H. Wald, *supra* note 9, in Taylor, *supra* at 301-302.

63. Recounted in a speech by President Nyerere at University College, Dar es Salaam in

the factors needed for effectiveness should not be taken as a reason for not making a modest beginning and building on experience gained and techniques and skills developed in the application of other types of taxes.

While land taxes have a special appeal in that they are useful implements for the satisfaction of fiscal needs for *local* government,[64] therein also lies one of their dangers. If local governmental units (cities, towns, villages) control and come to depend on land taxes for a significant part of their revenue, there is a great temptation for the unit to expand its political boundaries to increase its tax base. Thus, as we have seen in the United States, without adequate safeguards, farms are swallowed up by the local political boundaries, higher tax rates are imposed and the owner can no longer afford to use the land for agricultural purposes. Having no alternative skills, the owner or user must sell or otherwise yield the land to others who will change its use to one which will be able to absorb the higher tax. If speculation in land is allowed, this process will be encouraged by speculators and not only are farms lost but the temptation to corruption is increased. Good agricultural land is scarce, especially in Kenya and Tanzania. For example, the *ILO Report* indicates that of Kenya's total area of 569,000 square kilometers, only about seven percent can be described as "good" in that it has adequate and reliable rainfall and good soil and is not steeply sloping.[65] The threat of cities to the production of food is not a chimerical one. The city of Nairobi's unwillingness in recent years of drought to allow the Masai to graze their starving cattle on grasses available in unoccupied city outskirts is sufficient evidence of this.

CONCLUSION

Taxation is certainly not the most effective instrument for the promotion of food production and distribution; but it can, along with other instruments available to governments, play an important part. Also, developing economies must tap every available source of revenue including subsistence farmers. . . if development goals are to be met. Therefore all governments must experiment, invent and evaluate, employing every tax instrument or mix of instruments feasible to raise the maximum amount of revenue at the same time avoiding in-

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October 1966. On the same occasion he cautioned in the other direction. When asked where Tanzania would get the capital and equipment to develop farms, he told the audience not to expect tractors when the country had not even developed the oxplow technology.

64. *See* H. Wald, *supra* note 9, in Taylor *supra* note 4, at 300.

65. ILO Report, *supra* note 10, at 33.

terference with production and overloading of the administrative capacity of the government.