



AgEcon SEARCH

RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search

<http://ageconsearch.umn.edu>

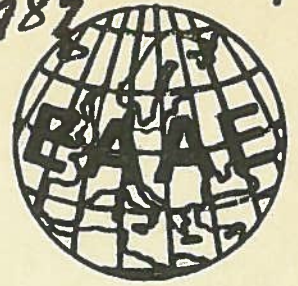
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.



Philip M. Raup
31 Aug. 1987



**WORKING GROUP A6
PAPERS**

**Vth EUROPEAN CONGRESS OF AGRICULTURAL
ECONOMISTS**

**RESOURCE ADJUSTMENT AND
EUROPEAN AGRICULTURE**

**BALATONSZÉPLAK, HUNGARY
1987.**

- 84 -

THE POSSIBILITIES OF INTRODUCING THE VALUE
ADDED TAX IN HUNGARY WITH PARTICULAR REGARD
TO AGRICULTURE

LAJOS HARZA - JÓZSEF POPP
Research Institute for Agricultural Economics
B u d a p e s t , H u n g a r y

I N T R O D U C T I O N

We have had to face increasing economic difficulties recently. For years we have been struggling hard to keep our balance of payments and to do away with liquidity problems. Under ever worsening foreign economic conditions must we procure the necessary amount of foreign currency needed for survival and stepping further. At the same time, however, we must realize - within the bounds of possibility - full employment without the decreasing of living standards. We are also to take good care of keeping the deficit rate within reasonable limits.

How can we overcome our difficulties? The answer has been clear for a long time: we should bring to date the system of our economy control by easing or even annulling certain restrictions and regulations so as to create a competitive economy.

The parts and parcels of economy are connected to each other like cog-wheels, consequently may we disturb but one of them, the mechanism will not work well. So we do need a comprehensive reform with special regard to taxing.

In our days more and more often do we raise the question if we should switch over a considerable part of the taxes from the productive sphere to the turnover sphere. According to the proposals it would be advisable to introduce in Hungary such a turnover tax system like the one used in the countries of the EEC as well as in some other countries / e.g. Austria /. This is the so-called value added tax / VAT /.

The ideas will soon be put into practice: as part of the modernizing process the VAT will be introduced in Hungary from 1-1-1988 together with the personal income tax in accordance with our present plans.

As to the theoretical and practical functioning of the VAT-system we have taken the experience of the EEC into consideration. Studying the highly developed EEC-countries' turnover tax system has provided a good deal of utilizable experience for us. First of all we have examined the VAT-system of the GFR and Denmark - and this was not a matter of chance. When switching over to VAT - or to any new type of tax-system - the character of the former system of taxation is of great importance. From the point of view of the steps to be taken it is by no means indifferent what kind of taxation preceded the newly introduced one. The fiscal system of the two countries had different antecedents:

Denmark used to have a uniphase turnover tax system while in the GFR a multiphase one was practised.

C o n c l u s i o n s

a/ Our turnover tax system is a uniphase one - the so-called wholesale tax system. As to its principles and functioning it corresponds to the turnover tax system of Denmark between 1962 - 1967. Like all wholesale tax systems the Hungarian one is inconsistent as well. Of course it is unquestionable that the taxational point is nearer to the consumption than it used to be in the system before 1968 for example. It is also true that this point cannot be placed closer to consumption - i.e. to small trade realization - as our turnover tax system connected to the given consumer's price policy is still very differentiated. Even today there are so many rates of tax ^{x/} in use that - considering the personal and objective conditions of our retail network - neither registration nor control can be realized.

x/ Before 1968 about 2000 / ! / turnover tax and price supplementary rates were in force. Even today the system uses almost 200 rates / not to speak about the rates of medicines, nutriments and therapeutical equipment /.

True as it is that the taxational point has come nearer to the consumption and so the bulk of productive minded realization is tax-exempt as a matter of course. However, even the Hungarian turnover tax system imposes cumulative taxes upon certain fields of productive realization. / This is why we can call this system a "partly gross" one. / The danger of tax accumulation appears mainly in the private sector.^{xx/}

In the case of productive minded utilization of the consumption goods - the so-called "typical ones - tax may accumulate as well. It is true that there is no tax accumulation within small trade but the costs of retail activities run up due to taxable purchase.

Our turnover tax system contains all those "symptoms" / the cumulative taxation of productive utilization, problems of registration, the great number of exceptions - only the composition is different / that made Denmark change over to the VAT. The proportion of

xx/ Here the principle of tax-neutrality cannot really function since the rates of tax affecting the retailers and their enterprises are different from the ones concerning the remaining units of the economic sphere. These rates are not so differentiated, nevertheless often different rates are imposed upon identical products.

exemption within the Danish turnover tax system has never reached - in fact, it has not even come near to it - the Hungarian level. On the other ^{hand} they must have imposed much greater taxes upon productive utilization than in Hungary now.

We have no data as to the proportion of the cumulatively taxed productive utilization in Hungary. In spite of this we can assert two facts with almost complete certainty. The first: it is probable that in Hungary a much lesser part of productive utilization is taxed by the state - but it is taxed! - than in Denmark before the introduction of the VAT. The second: the multiple taxation increases both the producers' and the retail price level. As a consequence our turnover tax system - ceteris paribus^{x/} - is an inflation stimulating factor!

Consequently we don't know the rate of price advance attributable to accumulated taxation. However we can render certain processes probable. Earlier we have already mentioned that accumulated taxes are mainly characteristic of the private sector, of the smaller industry. Within the production of the national income the smaller industry comes in for a share of only 2%. As to the services rendered to the inhabitants the rate

is more than 60 %; it comes in for a considerable share in other fields as well. This means that great masses of the population can obtain the basic services and products / car repair, construction industry, articles of clothing etc. / at a higher price burdened with the doubly taxed productive-utilizing quota as well. Between 1981-1985 the price of the services rendered to the population increased with 44 % thus surpassing the pace of increase of the retail prices / ^{xx}33%/. Within this the charges of car repair e.g. have run up above the average.

The cumulative taxation is not characteristic of the trade of food-products but it can influence their prices; how great a quota of multiple taxed ^{or} productive utilization burdens the food industry - as a result of previous production and trade processes.

In the present - rather difficult - economic situation we must struggle as hard as possible to curb inflation. If we had no other profit from the introduction of the VAT than the elimination of accumulated taxation, it would be useful even then.

x/ It happens even if the state does not increase the levies.
xx/ Of course other factors have also played a great part in the process of price advance /e.g. the lack of real competition/, in fact, the supplementary factors are of greater importance than the form of taxation as the tax-system is always a function of the current economic policy.

b/
The question is: how can Denmark "afford" the luxury - not conforming to the general international practice - of not supporting the turnover of food-products with preferential taxation?

In Denmark the level of productivity is very high even on a world scale / in the industry and agriculture alike/. As a result the standard of living is very high. This is why they can use such a VAT-system that is not "preferential" for food-industry. Thanks to the high living standards the population can put up with these burdens. The VAT reimbursement is only of secondary importance as compared to these two factors. / State- and FEOGA-reimbursement /

A VAT-system taxing the turnover of food products as well in accordance with the general regulations could only be introduced and operated in Hungary if the level of productivity and the standards of living increased by leaps and bounds. As this won't probably happen within reasonable time, we have but one solution: we must /should/ impose a preferential taxation on the turnover of food products within the scope of the VAT-system to be introduced.

c/
In the GFR - because of economic policy reasons - preferential taxes are imposed upon the turnover of agricultural and food economy products to ease the situation of the consumers.

In our large agricultural concerns we can easily introduce both the normal and the lump-sum taxing. As to lump-sum taxing the situation is quite simple. In the case of normal taxing we should examine the relation of input and output tax-rates and that of the net value producing capacity of agriculture. It is a question of vital importance that the rates of tax should be fixed in the light of the national economic processes and with regard to the endurance of the taxpayers. The rates of tax must be adjusted to the changing conditions as well.

It is obvious that the main purpose is not to increase the small-scale producers' tax burdens when introducing the VAT. In the light of the experiences of the GFR there are good chances to achieve this purpose. It is also clear that we should use a system in which the small-scale producers could pay taxes in an absolutely simplified way.

X/Introducing lump-sum taxing the GFR uses a practically zero-balanced turnover tax-rate as to the turnover of agricultural products.

d/ As to the introduction of the VAT in our country there are certain questions to be answered: shall we use a system that is prevalent in the whole of the national economy or shall we omit the small trade for the being?

Those who are in favour of the omission of the small trade refer mostly to the great number and unpreparedness of our small trade units. It is true that the small shop-keepers and retailers should have to face certain problems due to the new turnover tax system in the beginning. But who could away get away from this problem? This is not a sufficient reason, however, to leave them out: they would lose more than gain. If we don't extend the VAT over the small trade, this will create a gap within the unified system. So the value tax system will be neither unified, nor general or neutral. In fact, as we change over from a uniphase wholesale tax system to value added tax, we can easily get back to the very same point where we started from.

We must oblige the small trade units to keep a register in compliance with stipulations of the new turnover tax system. Of course we need time and patience for this. Certain shops - similarly to the agricultural producers - could pay preferential taxes / e.g. lump-sum / and might turn over tax-free. /Of course, only in case if the value of the turnover doesn't come up to the taxable limit./

e/ The introduction of the VAT in Hungary would help the economic perspicacity of the country. It would probably urge the establishing of a more economic product-structure and would result in making our products more marketable. However, the VAT in itself will not /cannot/ solve our economic problems. So we do need a comprehensive reform in which the market conditions may have much freer scope / bank- and credit- policy, wealth-interest, institutions, organizations, system of investments, etc. / Though the VAT will modify the price system as well and thus its introduction can be considered a sort of price reform. It

is obvious that we must thoroughly examine our support-, deprivation-, price and wage-system. Besides the above-mentioned issues we "should have a look at" our pension regulations and the prices of flats. Not to speak about the legal, accounting and finance-technical questions. Furthermore, we shall probably face several problems in connection with the introduction of the personal income tax. Besides other things we must reconcile the VAT with the personal income tax.

f/ The effect of the VAT upon the economy also depends on the period during which it is introduced. In theory it should be introduced when prosperity prevails, when there is no inflation - as the tendencies of the price level are basically determined by the prosperity - and competition-conditions. The Hungarian economy is not prepared, in this respect either, for the introduction of the VAT. Consequently, we must be aware of the fact that our hopes will not materialize fully or just to lesser extent. We expect that the introduction of the VAT will create more reasonable price conditions and that it will ease the inflationary pressure/or it will even eliminate it/. But if we are late in introducing and spreading the marketing factors, we can incite the price increasing process from two sides at the same time: with the introduction of the VAT/a single price increase/; in a "traditional" way - if the market and the competition don't say "stop", the companies will first of all use the price increase as a solution/continuous price-increase/.

*/ The highly developed Western European countries had introduced the VAT before the first soar of the oil price.

g/ The main advantage of the VAT - over multiphase gross turnover tax and the uniphase tax - lies in its purity/neutrality/, lucidity and what is most important in its generality. But how effective can this system be?

It is obvious that the efficiency of the VAT depends on the extent to which it can be put into practice, with special regard to its basic principles. From this point of view Denmark is the only country in the world where the most efficient - as to tax paying technicalities - VAT system is functioning, in theory. It uses one rate of tax, minimal fiscal immunity. The "moment" when a system functions with many rates of tax, both the neutrality and the lucidity and generality will be impaired.

After all, we can conclude that - contrary to the crystal-clear theory - it is very difficult to create and operate a turnover tax system that is efficient both from an economic and social-political point of view.

*/ If, e.g., relatively too many products and services are exempted from the VAT, the preliminary tax-deduction chain will break. This can lead to accumulated taxes even in the case of value added taxation. Of course, the extent of the accumulated taxes will not be comparable to the extent occurring in multiphase gross turnover tax systems or in a uniphase tax system.