TAXATION AND INCOME DISTRIBUTION: A THEORETICAL NOTE

by **Patom Manirojana***

Highly developed countries which have long undergone the process of economic development seem to have surpassed the problem of "how to achieve an economic growth" and are facing the question of "how to distribute the achieved wealth equally among people." The situations are different in less developed countries. Mostly limited by the scarcity of resources, the latter countries have yet to confront the dilemma of dealing with the problems of economic growth and economic equality simultaneously. As Arthur Lewis puts it:

> The less developed countries have awakened into a century where everybody wishes to ride two horses simultaneously, the horse of economic equality and the horse of economic development. The USSR has found that these two horses will not go in the same direction, and has therefore abandoned one of them. Other less developed countries will have to make their own compromise.[1]

This paper, dealing with the problem of taxation in underdeveloped countries, is confronting the same dilemma. Had underdeveloped countries aimed solely at any of these two goals--either economic growth or economic equality -- we should not have much problems to consider and discuss. But, to assume the total presence or absence of either of these two goals is to propose an unrealistic ground on which the study will be based. Consequently, we assume here the presence of both goals for underdeveloped countries. Thus, the aims of taxation in this study are both to enhance economic growth and to improve income distribution.

Based on the above assumption, this study is designed to deal with the following questions:

1. How do government tax policies affect income distribution?

2. What are appropriate policies for underdeveloped countries that wish to improve income distribution?

3. Do taxation policies that improve income distribution conflict with tax policies that encourage capital formation?

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[1] W. Arthur Lewis, *The Theory of Economic Growth* (Homewood, Ill.: Richard D. Irwin, Inc., 1955), pp. 379-80.

This paper will have five parts. After an introduction, the second part deals with the general idea of taxation in underdeveloped countries. The third part is an examination of the concept of income distribution and the conflicts of competitives goals of taxation--distribution vs. growth. The fourth part is a consideration of any possibility in which an appropriate policy compromising these conflicting goals can be formulated. And, finally, the fifth part is a summary and conclusions of the study.

TAXATION IN UNDERDEVELOPED ECONOMIES

The definitions of an 'underdeveloped country' given by many economists so far are numerous and varied. However, they tend to cover a few major common characteristics. In his examination of the current literature, Jacob Viner notes the following most common criteria of 'underdevelopment': (1) a low ratio of population to area; (2) scarcity of capital as shown by the prevalence of high interest rates; (3) the ratio of industrial output to total output or of industrial population to total population; (4) the age of a country should not be considered as a satisfactory criterion; and (5) good potential prospects for using more capital or more labor or more available natural resources to support its present population on a higher level of living.[2]

As mentioned earlier that underdeveloped countries are assumed in this study to aim at economic development, following Ursula Hicks' terms, they are then supposed to aim at "growth in real income per head while not losing sight of the fact that an increase in the gross national product is unacceptable unless it also implies some betterment of the lot of the mass of the people."[3] This is to say that economic development has a social and redistributional as well as an economic aspect. In this respect, Hla Myint even more explicitly clarifies the point. According to Myint, it is not sufficient in development policy merely to say that the level of per capita income should be raised, without facing some painful dilemmas as follows: (1) There is the problem of choice between higher income and economic security; (2) There is the problem of choice between a higher level of consumption at present and a higher rate of growth in income in the future; (3) There is the problem of choice between economic equality and economic growth; and (4) there is the problem of choice for the mass of people in the underdeveloped countries between having higher material incomes and a faster rate of growth and preserving their traditional social, cultural and religious values and ways of life.[4]

With the main theme stated above, it is quite clear that this study deals with Myint's third dilemma as far as taxation and income distribution are concerned. Since taxation is a major

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[2] See Jacob Viner, "The Economics of Development," in A.N. Agarwala and S.P. Singh (eds.), *The Economics of Underdevelopment* (London : Oxford University Press, 1968), pp. 9–13.

[3] Ursula K. Hicks, *Development Finance: Planning and Control* (Oxford: Oxford University Press, 1965), p. 1.

[4] See Hla Myint, *The Economics of the Developing Countries* (New York: Praeger Publishers 1966), pp. 167–69.

element of public finance, it seems useful to look into some concepts in this area as a broader context to which taxation belongs. Tripathy, in his study, notes four important dimensions of public finance as follows:

> (a) to promote and accelerate the growth of productive investment in the economy both in the public and the private sectors, (b) to mobilize the maximum volume of real and financial resources for the investment plan of the public sectors, keeping in view the expanding demand for real and financial resources of the private sector, and in this way, to promote the growth of marginal and average rate of savings in the economy, (c) to promote the maintenance of a reasonable measure of economic stability in keeping with the maximum rate of growth of the operations economy, and (d) to redistribute the growing national output. Thus the fiscal of the government for promoting economic development of the underdeveloped countries are as an investor, as a saver, as a stabilizer and as an income redistributor.[5]

Taxation: Definitions and Concepts

In a very broad sense, taxation is "a general concept for devices used by governments to extract money or other valuable things from people and organization by the use of law."[6] What should be taken into consideration about taxation, first of all, is its major elements. A tax formula contains at least three elements: the definition of the base, the rate structure, and the identification of the legal taxpayer.[7] As a result of a tax formula, taxpayers find themselves with less money to spend and governments, on the other hand, find themselves with more money. Broadly speaking, taxation has three major functions: revenue function (the transfer of money from people to government); resource allocation and income distribution.[8]

Taxes may be classified in various ways. Usually, a common characteristic of any of the three elements of a tax formula is employed in the classification scheme. However, the single most widely used distinction is between 'direct' and 'indirect' taxation. A direct tax is the one in which the legal taxpayer cannot shift any of the tax liability to other people. Indirect taxes refer to those that are thought to be shifted from legal taxpayers to others.[9]

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[5] Ram N. Tripathy, *Public Finance in Underdeveloped Countries* (Calcutta: The World Press Private Ltd., 1964), p. 49.

[6] Earl R. Rolph, "Taxation," *International Encyclopaedia of Social Sciences*, XV, 521.

[7] See *ibid.*, pp. 521–22.

[8] *Ibid.*, pp. 522–23.

[9] A clear illustration of a direct tax is a lump-sum charge levied on a person--sometimes called a head tax or poll tax. Income, death, net worth, expenditure, and sometimes property taxes are commonly classified as direct. Taxes on sales of commodities, import duties, and license fees are grouped together as indirect. See *ibid.*, p. 522.

With particular respect to the context of economic development, Richard Thorn presents a notable system of classification of taxation. Total revenue, in his study, is broadly divided into direct taxes, indirect taxes and non-tax revenues. Direct taxes include income taxes, capital taxes and expenditure taxes. Indirect taxes are broken down into taxes on the foreign sector, sales and turnover taxes and excise taxes. And finally, non-tax revenues include income from government enterprises, marketing boards and various types of royalties.[10]

Existing Tax Systems

In general, model tax structure has five major characteristics: equity, efficiency, consistency with economic objectives, coordination and flexibility, and elasticity.[11] Certainly, these criteria are not necessarily compatible, and indeed may be from time to time conflicting among each other. Since they are stated at a very high level of abstraction, they do not seem to serve as a meaningful guideline in operational terms. With particular regard to underdeveloped countries, more concrete objectives of taxation are given by Hicks as follows: (1) a government should have the confidence of the citizens; (2) the tax officers must be intelligent, well trained in their jobs and incorruptible; (3) the purpose is to narrow the gap between the very rich and the very poor; (4) taxes can contribute in several ways to encourage economic instincts; and (5) using tax as an instrument for controlling the pressure on consumers' goods engendered by the development process.[12]

Theoretically speaking, attempts have been made to conduct systematically the study of tax structure. Harley Hinrichs, among others, set up a conceptual scheme to study the development of tax systems from primitive to advanced society. This pattern is as follows:

> **First Stage:** Traditional societies rely primarily on nontax source... and/or "traditional direct" taxes--taxes on land, livestock, heads, agricultural output, water rights, and so forth.
>
> **Second Stage:** When the society begins to break away from old ways, indirect taxation becomes more important, especially taxes on foreign trade,....
>
> **Third Stage:** Meanwhile, traditional direct taxes are likely to decline relative to national income and government revenue.

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[10] See Richard R. Thorn, "The Evolution of Public Finances During Economic Development," *The Manchester School of Economic and Social Studies*, XXXV, 1 (January 1967), 27–33.

[11] Charles Mansfield, "Tax Structure in Developing Countries: An Introduction," *Finance and Development*, VIII, 1 (March, 1971), 41.

[12] Hicks, *op.cit.*, pp. 65–68.

Fourth Stage: As domestic production... continues to develop internal taxes (e.g. excises and sales taxes) grow rapidly and tend to replace import duties. This stage is illustrated by the process of import substitution and the introduction of sales taxes in many developing countries in the last ten years.

Fifth Stage: When the economy reaches maturity, modern direct taxes (e.g. personal income and corporate profit taxes) become predominant...[13]

More or less, this model provides a broad idea of the direction of tax structure change over time. However, since it seems to assume the development of social systems or economies through a set of definable stages or phases-- an approach of study which has been widely criticized for a number of weaknesses.[14] As a consequence, this model tends to subject to the same criticisms.

A point of some concensus is the existence of a close relationship between the tax bases in an economy and the tax structure.[15] In a sense, the tax bases available set limits on possible tax structure. In this regard, tax bases may be an economic flow (such as personal income or import), property (such as agricultural land or urban buildings) or simply a unit of population or other unit of account. Other than tax bases, tax structure also depends on the level of development reached and all the range of political, social and cultural factors.

U Tum Wai, in his empirical study, presents some interesting findings in this area. It is found that the tax system in underdeveloped countries does not provide governments with much revenue. Two reasons are given. Firstly, most governments are of the opinion that when per capita income is low, and especially when it is near starvation level it is not desirable to tax the masses. Secondly, the size of the money (or market) sector is very small in comparison with that in developed countries. The difference between high income and low income countries is even more obvious in terms of the proportion of revenue from direct taxes to total tax revenue. In the high income countries, the proportion of revenue from direct taxation ranges from 80% (the U.S.) to 20% (Germany) and the median percentage is 43. In low income countries, the proportion ranges from 33% to 7% and the median is only 20. Among the reasons given is the fact that underdeveloped countries have found that it is easier to collect indirect taxes (e.g. customs duties) than direct taxes. Also, the rate of total taxation has been lower in underdeveloped than in the developed

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[13] Harley H. Hinrichs, *A General Theory of Tax Structure Change During Economic Development* (Cambridge Mass.: Harvard Law School, 1966), as cited in Mansfield, *op. cit.*, p. 38.

[14] See, for example, "Paul Streeten, "The Frontiers of Development Studies: Some Issues of Development Policy" *The Journal of Development Studies*, IV, 1 (October, 1967), 2–5.

[15] Richard A. Musgrave, *Fiscal System* (New Haven, Conn.: Yale University Press, 1969); as cited in Mansfield, *op.cit.*, p. 38; see, also, Joergen R. Lotz and Elliot R. Morss, "A Theory of Tax Level Determinants for Developing Countries," *Economic Development and Cultural Change*, XVIII, 3 (April, 1970), 328.

countries. Another interesting finding is that the tax structure in most underdeveloped countries relied heavily on taxes on foreign trade (import duties, export duties, and exchange taxes.). In many countries this catergory accounts for a quarter to a half of the total revenues.[16]

Taxation for Development

In underdeveloped countries, as Hicks notes, "the main emphasis of general economic policy will be on growth, with sufficient stability to prevent recurrent crises which would cause development to slow up or even retrogress, and hence give rise to losses on investment already made."[17] As mentioned earlier, according to Viner, one of the common criteria of underdevelop ment is the scarcity of capital. This point has been frequently stated in relation to the idea of economic growth. Ben-Shahar, for example, observes that among many factors contributing to rapid economic growth, capital formation is one of the most crucial elements.[18] Although there have been some recent trends running against this view that some other elements -- human capital, entrepreneurship, widening market, technological progress,to mention some--should be considered and treated as being of comparable importance, many prevailing views still continue to recognize the predominant singificance of capital formation. Sayre Schatz, for instance, confidently states in his paper that "a high rate of capital accumulation is necessary and (nearly) sufficient for rapid econmic development,...."[19] Schatz's position is somewhat shared by the ECAFE secretariat whose findings maintain that "... in countries where population is increasing by 1 1/2 per cent per annum or more, an annual net investment of 5 percent or less of national income is not enough to raise the standard of living and may not even be enough to prevent the standard of living from falling...."[20]

Whatever degree of significance the capital is, it will be treated as our central concern in this paper. Our major questions, then, are that "What are the strategies necessary to achieve

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[16] See U Tun Wai, "Taxation Problems and Policies of Underdeveloped Countries," *International Monetary Fund Staff Papers*, IX, 3 (November, 1962), 429–34.

[17] Hicks, *op.cit.*, p. 62.

[18] Haim Ben-Shahar, "Capital Formation and Governmental Policy in Developing Economies, " *The Journal of Development Studies*, IV, 1 (October, 1967), 86.

[19] Sayre P. Schatz, "The Role of Capital Accumulation in Economic Development," *The Journal of Development Studies*, V, 1 (October, 1968), 39. In terms of degree, Schatz puts far more emphasis on the significance of capital than Nurkse's earlier similar view that "Capital is a necessary but not a sufficient condition for progress." Ragnar Nurkse, *Problems of Capital Formation in Underdeveloped Countries* (New York: Oxford University Press, 1966), p. 1.

[20] Quoted in Eugene Staley, *The Future of Underdeveloped Countries: Political Implications of Economic Development* (New York: Praeger Publishers, 1961), p. 260.

high rate of capital formation?" and "In what way and to what extent does taxation take part in those strageties?"

Considering the economy as a whole, capital may come from either external or domestic sources. Staley prefers to distinguish *capital formation* from the *supply of capital.* To him, capital formation is a social process. In his own words, "It must take place *internally* in much larger volume than before if a static, underdeveloped economy is to change into a progressive, developing economy. Capital from abroad can ... be a powerful catalytic agent to stimulate the process of domestic capital formation."[21] With particular regard to the domestic capital formation, it can be simply conceptualized and explained by the old popular national income framework:

$$Y = C + S$$
$$S = I$$
$$Y = C + I^{*}$$

However more sophisticated this formula has been developed up to this time, this basic idea seems to be adequate to clarify our point. According to Nurkse, the meaning of 'capital formation' is that:

> ... society does not apply the whole of its current productive activity to the needs and desires of imediate consumption, but directs a part of it to the making of capital goods: tools and instrument, machines and transport facilities, plants and equipment--all the various forms of real capital that can so greatly increase the efficacy of productive effort.[22]

Nurkse continues to point out that the marginal propensity to save is the crucial determinant of growth. As he puts it, "it is not something that takes care of itself; it does not minimize itself automatically .... A serious question that arises here concerns the degree to which reliance can be placed on voluntary saving; especially in view of the demonstration effect of advance consumption standard."[23]

Before going any further into more detailed considerations of savings problems, it is useful to examine its sources. The main sources of domestic savings are government, corporation and unincorporated businesses, and private households and individuals. The roles[24] of these

21 *Ibid.*, p. 261.

* Y = Income; C = Consumptions; S = Savings; and I = Investments.

22 Nurkse, *op.cit.*, p. 2.

23 *Ibid.*, p. 142.

24 United Nations, United Nations Conference on Trade and Development, *Trade Prospects and Capital Needs of Developing Countries* (New York: United Natiions Publications, 1968), p. 34.

sources of domestic savings are very well elaborated in the U.N. document which deserves quoting a some length:

> Government savings are motivated for the most part by the conscious desire to promote economic development, and the important role which the government sector can play in generating savings is now generally recognized. These savings consists of the surplus of current revenue over current expenditure of government and may be used either for capital expenditure by the public sector or be passed on in the form of loans for capital formation by the private sector. To increase government savings therefore means that ways must be found to raise revenue while keeping current expenditure in check.
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> Unlike individuals and governments, the savings of business enterprises are central to their main purpose, and the evidence suggests that reinvested profits not only provide a major means of expanding the productive capacity of individual firms but a major source of domestic savings as well. The size of the the corporate or modern business sector is therefore an important determinant of savings in developing countries.
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> Personal savings are of a residual nature, arising from what is left after the individual's consumption needs are satisfied. The main stumbling block to an increase in such savings is the low level of income in developing countries. Empirical evidence suggests that while at the lowest levels of income dissaving is common, as income rises both the amount and the proportion saved tend to increase.[25]

Arthur Lewis, in his *Development Planning*, points out some deficiencies of private saving and many reasons why "...so much emphasis is now placed on the importance of raising the rate of public saving .... in countries seeking to accelerate their growth."[26] This is the point where taxation tends to have a significant role.

Common to most underdeveloped countries, as we considered earlier, is the small proportion of government revenue to the gross domestic product. According to Lewis, for the revenue less than 20% of gross domestic product, government cannot provide activities to meet neither the quantity or quality now demanded. To be more precise, it should not fall below 17 per cent (excluding defense and debt charges). In U Tum Wai's findings, revenue from taxation

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[25] *Ibid,.*

[26] W. Arthur Lewis, *Development Planning: The Essentials of Economic Policy* (New York: Harper and Row Publishers, 1966), pp. 117-21.

constitutes merely a small portion of the total government revenues (so do direct taxes to total revenues). For this reason, Lewis regards taxation as the most important way to ensure an automatic increase in the ratio of government revenues to gross domestic product.[27]

As noted by Bauer and Yamey, the use of the proceeds of taxation to finance accelerated capital or investment expenditure is usually termed 'compulsory saving,' or 'taxation for development.'[28] These two authors make it clear that taxation for compulsory saving involves the transfer of funds from the private to the public sector; it is not a simple addition to total saving. Substantial compulsory saving generally involves heavy investment in public enterprises and some parts are lent to private entrepreneurs. Their idea is more or less clarified by that of Tripathy's:

> Among the various fiscal techniques of resources mobilization, taxation and inflationary financing constitute the compulsory mechanisms of forced public savings, whereas public borrowing is a voluntary technique for the mobilization of resources. In the context of the disproportionately low saving ratio and a large proportion of the savings being directed into unproductive channels in the underdeveloped countries, taxation as a compulsory technique of resource mobilization tends to acquire a predominant importance. For the financing of a large investment plan of the public sector from domestic resources, main reliance has to be placed on taxation, because public borrowing of a non-inflationary character may fail to mobilize an adequate volume of resources.[29]

However, this measure is not totally free from criticisms. For example, Bauer and Yamey remark "It is not even certain that total savings will be increased by the process. Even when savings are increased in the short run, the repercussions of the taxation may reduce the flow of savings in the long run by retarding the spread of the exchange economy and the growth of specialization..."[30] However, taxation as an instrument of resource mobilization for the public sector does not have the same danger of adversely affecting the rate of saving in the under developed countries as in the developed countries. As Tripathy observes:

> ...in the underdeveloped countries voluntary savings are very low, and a considerable proportion of it goes into hoards, holding of precious metals and investments in real estate which do not increase the productive capacity of the

[27] *Ibid.*, p. 116.

[28] Peter T. Bauer and Basil S. Yamey, *The Economics of Underdeveloped Countries* (Chicago: The University of Chicago Press,, 1957), p. 190.

[29] Tripathy, *op.cit*, p. 57.

[30] Bauer and Yamey, *op.cit.*, p. 199.

economy. Besides, taxation as a compulsory form of saving especially commends itself to the underdeveloped countries for use on an extended scale because it is used to finance socially desirable and productive projects of development in the public sector.[31]

Other than an expansion of the rate of total investment, another major goal of fiscal policy in underdeveloped countries is the direction of the flow of investment into "socially desirable channels."[32] In addition to the prevailing efforts in the private sector, the government has to take a number of measures in order to create a favorable climate in which foreign investors would be attracted to invest in the area of activities compatible with the developmental goals. The general inducement offered to foreign investors usually include:

(a) Tariff protected or import control;
(b) Duty-free entry for machinery and raw material inputs;
(c) Arrangement for the employment of expatriate personnel;
(d) Freedom to repatriate profits and capital in convertible currency.[33]

Additionally, also listed by other authors are tax holidays, income tax deferral or exemption, investment allowances, development rebates and subsidies.[34] In fact, these measures can be considered effective when they do influence the decisions of investors, who otherwise would not invest in other countries, to invest in the country. In his recent study, George Lent questions the values of fiscal concessions policy in attracting new investments. His argument is that there are so many factors, other than fiscal concessions, influencing decisions to initiate new investments in any country including the size of the market, cost and skills of the labor supply, cost and availability of materials, transportation and power, and the general level of taxation. A basic conclusion of the findings is that special incentives alone are not adequate. The country should also have a sound and equitable set of taxes to which businesses will be subject after the temporary tax benefits have expired and which apply to firms that are not eligible for the special benefits. Thus, he poses another question "whether the econmic benefits of the additional investment attracted outweigh the revenue loss from those who would have invested without the special treatment?"[35]

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[31] Tripathy, *op.cit.*, pp. 88–89.

[32] *Ibid.*, p. 52.

[33] United Nations, United Nations Conference on Trade and Development, *The Role of Private Enterprise in Investment and Promotion of Export in Developing Countries* (New York: UNCTAD, 1968), p. 47.

[34] Tripathy, *op.cit.*, p. 51.

[35] See George F. Lent, "Tax Incentives for Investment in Developing Countries," *International Monetary Fund Staff Papers*, XIV, 2 (July, 1967), 249–320.

IMPACT ON INCOME DISTRIBUTION

Underlying the idea of income distribution is the philosophy of equality. In economic terms, the most basic and obvious characteristic of inequality in a society is the fact that a greater portion of wealth belongs to a very small group of people. Inequality can be measured with respect to either the receipt of income or the ownership of property. At the macro level, inequality in terms of income distribution can be measured by the well-known method of Lorenz Curves.[36]

The gap between the income levels of the rich and the poor exists in all countries, devel-loped or underdeveloped. Such a gap tends to be wider in underdeveloped countries. To combat inequality, let alone the socialist system, the classical weapons within the framework of a capitalist system are progressive taxation of income and wealth and the provision of social services, such as medical care and education, of particular benefit to the lower income group.[37]

As far as taxation for economic equality is concerned, its original idea can be traced back to the time of John Stuart Mill. Up to this time, Mill's idea can be said to have been less popular. Viewing the situation in the United States, for example, not so many American economists are still taking Mill's position. Milton Friedman, among other economist in this group., emphasizes in his paper the limited effectiveness of the tax in redistributing income in the country and also points out the need for reform of the tax structure to reduce its uneven incidence.[38] Meanwhile, most of other economists are concerned with the effect of the income tax on incentives to work, take risks and save.[39]

TAXATION POLICY FOR DISTRIBUTION AND GROWTH

Both growth and equality have been earlier assumed to be the goals of an economy in this study. However, it is very difficult, if not impossible, to regard and treat these goals as being completely equal. For practical as well as theoretical purpose, we think that it is useful to consider the significance of one goal over another. In this paper, thus, we intend to follow Nurkse's idea which maintains that, "not a change in the interpersonal income distribution but an increase in the proportion of national income devoted to capital formation is the primary aim of public finance in the context of economic development."[40] Simply speaking, while we aim at the promotion of both equality and growth, we assign a priority to growth over income distribution. In other words, our attempt is to encourage every possible way to promote equal income distribution to the extent that it does not seriously affect the rate of growth.

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[36] See Edward C. Budd (ed.), *Equality and Poverty: An Introduction to a Current Issue of Public Policy* (New York: W. W. Norton and Company Inc., 1967), p. xii.

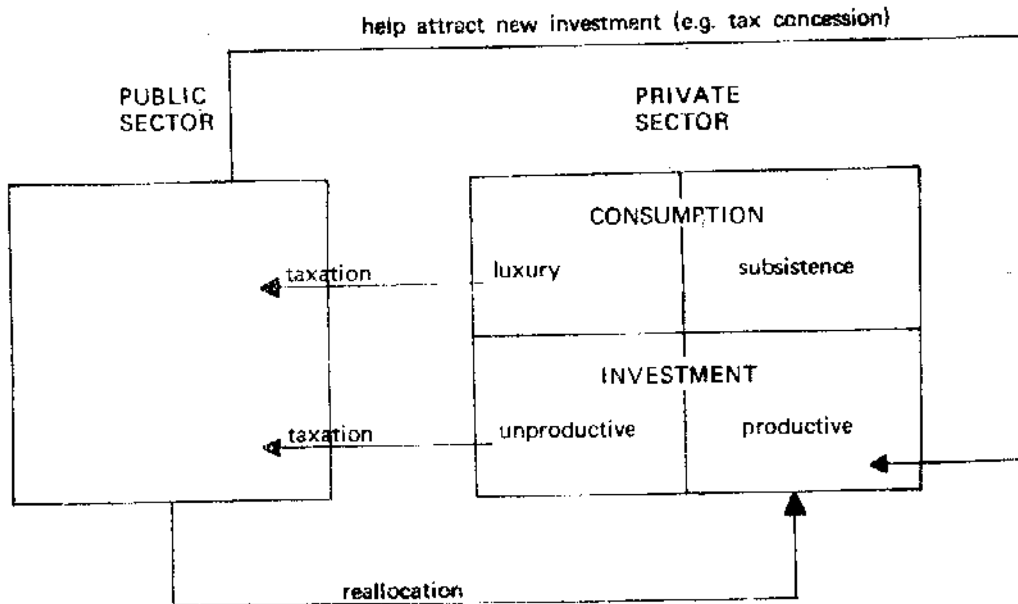
[37] *Ibid.*, p. xxix.

[38] Milton Friedman, "Government Measures to Alter the Distribution of Income," in *ibid.*, pp. 123–27.

[39] For example, Henry C. Wallich, "Inequality and Growth," in *ibid.* pp. 14–26.

[40] Nurkse, *op. cit.*, p. 147.

For the sake of simplicity, our broad idea of taxation policy for development and distribution can be outlined as follows:



In this figure, an economy is considered in terms of public/private sectors. [The intervention of governments is assumed to be desirable in order to expand investment, direct capital into the socially desirable activities, and distribute income more equally to the extent that it will not effect growth. In this regard, a private sector is conceptualized in terms of two major functions: consumption and investment. Along this line, in terms of a consistency with the developmental goals, consumptions can be broadly conceived of as subsistence and luxury; so does investment--as productive and unproductive. Numerous questions can be raised regarding the use of this conceptual model--difficulties to give operational definitions, failure to deal with detailed matters, risks of oversimplification, to mention some. In full awareness of these limitations, we propose to employ this model just for only a limited purpose to express our idea about the taxation policy for distribution and development at a very general level. Our proposed general policy is that the goal of taxation for income distribution is likely to be seriously approached in the areas of luxury consumption and unproductive investment. But in the areas of subsistence consumption and productive investment this goal will be limitedly achieved and sometimes temporarily give up in order to achieve the overriding concern of economic growth.

CONCLUSIONS

Both economic growth and economic equality are the goals of underdeveloped economies in this study. However, economic growth is assigned a priority over equality for both theoretical and practical reasons. After the considerations of the concept of taxation, historical development, and general ideas about taxation for development in underdeveloped countries, an effort is made to examine the taxation system which aimes at improving income distribution so far as it does not have an adverse effects on the process of growth.The general idea developed as a basis of the policy considerations is that the goal of taxation for income distribution is likely to be seriously approached in the areas of luxury consumption and unproductive investment. Nothing much can be done in two other areas, subsistence consumption and economically productive investment. The reasons are simply that in the former area we cannot tax and in the latter we should not, at least for the time being. The dilemma between these two competing goals will be much less serious than it may appear if the immediate priority is assigned to economic growth and economic equality is then conceived of as a long-range objective of the same economy. In the most part, it is still advisable not to cut the pie until it is big enough for all.