Declassified E.O. 12356 Section 3.3/NND No. 785015

ACC

10000/100/514

Declassified E.O. 12356 Section 3.3/NND No. 785015

10000/100/514

FINANCE & BUDGET
MAY 1943

No.	REF.	DATE	FROM OR TO
1A	———	12 MAY 43	MEMO TO HORRIFIED

Declassified E.O. 12356 Section 3.3/NND No. 785015

Declassified E.O. 12356 Section 3.3/NND No. 785015

3847

BB

Draft McFADDEN

2nd Draft MOST SECRET

HORKIFIED

HUSKYLAND.

PUBLIC FINANCE.

1. It is assumed that the policy will be to make the civil administration self-supporting either by increased taxation, which will take the form of a contribution as permitted under the Hague Rules, and/or by internal borrowing, in order to avoid wherever possible any charge falling on the public funds of this country of the U.S.A.

2. As far as can be ascertained the Zone under normal conditions shows a fairly heavy deficit. Its proportion of total revenue from taxes on income and property, including death duties and taxes on business transactions was rather less than 4% of the national total before the war, and in the absence of detailed figures for other taxes, we are assuming that this proportion will hold for the revenue as a whole. Population on the other hand is approximately 10% and is for the most part very poor compared with that of the northern and central region. We should therefore expect that HUSKYLAND would show a deficit even if the budget of Italy as a whole were balanced.

3. Some indications of the size of this deficit under war conditions may be gathered from the following considerations which though largely based on conjecture should give some indication of the order of magnitude of the sums involved.

The latest Italian Budget Estimates available (1943/4)

Declassified E.O. 12356 Section 3.3/NND No. 785015

Thanks to Dr. Lee Cross alp 10/7

conditions shows a fairly heavy deficit. Its proportion of total revenue from taxes on income and property, including death duties and taxes on business transactions was rather less than 4% of the national total before the war, and in the absence of detailed figures for other taxes, we are assuming that this proportion will hold for the revenue as a whole. Population on the other hand is approximately 10% and is for the most part very poor compared with that of the northern and central region. We should therefore expect that HUSKYLAND would show a deficit even if the budget of Italy as a whole were balanced.

3. Some indications of the size of this deficit under war conditions may be gathered from the following considerations which though largely based on conjecture should give some indication of the order of magnitude of the sums involved.

The latest Italian Budget Estimates available (1943/4) show "normal" expenditure of 48 milliards and revenue of just over 40 milliards. If we reckon HUSKYLAND'S proportion of the total revenue at 4%, and of expenditure as 10% we should calculate revenue and expenditure, (after eliminating expenditure on the Armed Forces, foreign affairs and the now non-existent colonies) at 1.6 milliards and 3.4 milliards respectively, leaving a deficit of 1.8 milliards.

4. This figure, however, needs correction as it would be considerably reduced by our occupation so far as we should not make ourselves responsible for paying interest on the National Debt. The total vote for the Ministry of Finance in the 1943/4 estimates amounts to 23 milliards. No analysis of this figure

Declassified E.O. 12356 Section 3.3/NND No. 785015

is available but it contains the debt service, the cost of general financial administration, revenue coll tion etc and various subsidies and grants. We may guess at the figure of the debt service as somewhere in the neighbourhood of 10 - 12 milliards. HUSKYLAND'S proportion of this on a 4% basis would be 40 to 48 milliards. In 1936/37 total salaries of the Ministry of Finance alone amounted to rather over 600 million. We may therefore estimate the cost of financial administration at a maximum figure of 1.5 milliards though it may be considerably less. Of this HUSKYLAND'S proportion on a 10% basis would be .15 milliards. We have at present no information as to the remainder. Presumably it represents for the most part various subsidies (? food etc.) which must be considerable, say 8 to 9 milliards, of which HUSKYLAND'S proportion on a 10% basis would be about .85 milliards, giving a total proportion on Ministry of Finance votes of about .45 to 1 milliard. This figure too may be over-estimated, and a 5% basis for subsidues may be nearer the actual facts in which case the total proportion would work out at just over 1 milliard. Add to this 10% of the Budget Estimates of the Ministries of Public Works, Education, Interior, etc., etc., we get a total expenditure for the zone of about 1.9 milliards which is only 300 millions in excess of 1.60 milliards of estimated revenue.

5. This figure of estimated expenditure may be analysed by,ministries as follows:-

	Millions
Ministry of Finance Services, say	1,000
Justice	70
Education	340
Interior	160

Declassified E.O. 12356 Section 3.3/NND No. 785015

considerable, say 8 to 9 milliards, of which HUSKYLAND'S proportion on a 10% basis would be about .85 milliards, giving a total proportion on Ministry of Finance votes of about .45 to 1 milliard. This figure too may be over-estimated, and a 5% basis for subsidues may be nearer the actual facts in which case the total proportion would work out at just over 1 milliard. Add to this 10% of the Budget Estimates of the Ministries of Public Works, Education, Interior, etc., etc., we get a total expenditure for the zone of about 1.9 milliards which is only 300 millions in excess of 1.60 milliards of estimated revenue.

5. This figure of estimated expenditure may be analysed by,ministries as follows:-

	Millions
Ministry of Finance Services, say	1,000
Justice	70
Education	340
Interior	160
Public works	120
Communications	70
Agriculture	100
Corporations	30
Total.	1,890

6. The collection of revenue however, would obviously be very seriously affected as the result of military operations and scorched earth policy, etc., the general dislocation of business the bank moratorium, etc., etc., It is, therefore, impossible to predict how much revenue it will be possible to collect during the first year at any rate, under existing schedules of taxation.

Declassified E.O. 12356 Section 3.3/NND No. 78505

11. The figure may be anything between zero and 1.6. milliards.

7. Expenditure on the other hand may show some increases owing to the necessity of repairing war damage to essential installations though it is probable that most of this will be undertaken directly either by the Forces or by the C.C.A.C. on behalf of the Military Commander. We are faced then with the prospect of meeting a deficit of anything up to about 2 milliards.

How is this deficit to be met? Two methods may be envisaged, namely increased taxation and/or borrowing:-

8. Taxation. Under the Italian fiscal system revenue is derived from the following sources:-

(i) Direct taxes on income from land, buildings and personal property.

(ii) Special taxes on certain profits.

(iii) Indirect taxes on business transactions, including death duties, turnover, tax, stamp duties, etc.,

(iv) Customs and Excise.

(V) Taxes on monopoly commidities, i.e., salt, tobacco,, matches etc.

With regard to (i) above, Italian income taxes are graduated on a sliding scale and consist of two portions namely (i) ordinary income tax as a flat rate and (ii) a graduated surtax. Income tax is levied at different rates according to the source of income. According to the latest available information the following rates are now in force.

Declassified E.O. 12356 Section 3.3/NND No. 785015

from the following sources:-

(i) Direct taxes on income from land, buildings and personal property.

(ii) Special taxes on certain profits.

(iii) Indirect taxes on business transactions, including death duties, turnover, tax, stamp duties, etc.,

(iv) Customs and Excise.

(V) Taxes on monopoly commidities, i.e., salt, tobacco, matches etc.

With regard to (i) above, Italian income taxes are graduated on a sliding scale and consist of two portions namely (i) ordinary income tax as a flat rate and (ii) a graduated surtax. Income tax is levied at different rates according to the source of income. According to the latest available information the following rates are now in force.

Income from Capital only	20%	(Category A)
Profits from Industry and Commerce	14%	" B
Income from Professional work	12½%	" C^1
Salaries including state salaries and pensions	8%	" C^2 & D
Wages	4%	

Surtax is on a sliding scale, namely,

On incomes between 10,000 & 39,000 lire		25%
" " " 30,000 &175,000	"	50%
" " " 175,000 &485,000	"	75%
" " " 485,000 Lire	"	100%

Some increase in these rates will no doubt be possible but

Declassified E.O. 12356 Section 3.3/NND No. 785015

the amount to be found in this way is limited as the number of large incomes is small. It would be possible however to do, what we are proposing to do in Eritrea, namely, to fix a uniform rate for ordinary income tax whatever the source of income by scaling up the lower rates to the level of Category A. . . . .

(ii) above consists of (a) a special tax on war profits and (b) a special tax of 60% on profits arising from the sale of real estate and securities. (a) above is a graduated tax varying from 20 to 60% on all incomes which exceed the 1938 assessments by more than 8,000 lire. As those incomes willl probably have disappeared as the result of the occupation, no revenue is likely to accrue from this source.

9. As regards (ii) and (iv) increase in succession, stamp duties, bachelors tax, etc., turnover tax, tobacco and salt taxes, etc. would be much easier to collect and therefore prove a much more fruitful source of income. The only objection to this method is that many of these taxes would be passed on to t the consumer and would therefore be paid in part by the personnel of the occupying forces. On the other hand the increase in indirect taxes would only affect optional expenditure and in many cases expenditure which is heavily taxed at home. Income from certain indirect taxes, e.g., customs duties and tobacco, will necessarily be limited by restriction of imports.

An alternative or additional method of increasing taxation in order to meet the deficit would be to impose a contribution for this purpose, by dividing the sum to be raised among the communes and making them responsible for raising it under our supervision. This methdd has its attractions, on account of its simplicity, but it is doubtful to what extent it would be possible to extract sufficient cash in this manner without having to use pressure which for

Declassified E.O. 12356 Section 3.3/NND No. 785015

source from this source.

9. As regards (ii) and (iv) increase in succession, stamp duties, bachelors tax, etc., turnover tax, tobacco and salt taxes, etc. would be much easier to collect and therefore prove a much more fruitful source of income. The only objection to this method is that many of these taxes would be passed on to t the consumer and would therefore be paid in part by the personnel of the occupying forces. On the other hand the increase in indirect taxes would only affect optional expenditure and in many cases expenditure which is heavily taxed at home. Income from certain indirect taxes, e.g., customs duties and tobacco, will necessarily be limited by restriction of imports.

An alternative or additional method of increasing taxation in order to meet the deficit would be to impose a contribution for this purpose, by dividing the sum to be raised among the communes and making them responsible for raising it under our supervision. This methdd has its attractions, on account of its simplicity, but it is doubtful to what extent it would be possible to extract sufficient cash in this manner without having to use pressure which for political reasons it might be advisable to avoid. There is therefore something to be said in favour of using the suaver and sometimes no less effective method of eleciting funds namely by borrowing.

11. Borrowing

The most obvious way of borrowing would be by means of advances from the reconstructed Banca di Sicilia (see paper on Banking). But the sums that could be obtained in this way would be limited and would depend almost certainly upon the volume of "new" deposits (including the deposit of Army funds) and the demands of industry and agriculture. "New" savings deposits could also be made available by compelling the savings banks to place their reserves with the Banca di Sicilia. But it does not appear probable that

Declassified E.O. 12356 Section 3.3/NND No. 785015

these resources would be sufficient to stop the gap.

Moreover as experience in the Middle East and elsewhere has shown the presence of the occupying troops combined with the inevitable shortage of consumable goods is bound to lead to inflationary developments. Every effort should therefore be made to tap superflous purchasing power, in the form of longer term investments, as well as increased taxes. How to do this presents a problem. It would obviously be impossible to issue bonds, in the name of the Italian Government. It seems doubtful whether it would be possible to persuade the inhabitants to invest money in lire bonds issued by the military administration. Moreover there would be the strongest objection to Italians holding sterling or any other securities implying any obligation on the part of H.M.G. In these circumstances it would be worth while considering whether recourse could not be had to the borrowing powers of the municipalities, i.e., the provinces and communes. It might be possible therefore to impose a contribution on the municipalities and leave them the alternative of raising this either by taxation and/or by borrowing. Moreover some relief might be given to the Budget of the central administration by the elimination of various grants in aid to Communal and Provincials services. The objection to this course would be that the efficiency of the latter would be thereby impaired. On the other handthis would be a stimulus to economy especially in services like public assistance and optional services which could be

Declassified E.O. 12356 Section 3.3/NND No. 785015

money in lire bonds issued by the military administration. Moreover there would be the strongest objection to Italians holding sterling or any other securities implying any obligation on the part of H.M.G. In these circumstances it would be worth while considering whether recourse could not be had to the borrowing powers of the municipalities, i.e., the provinces and communes.

It might be possible therefore to impose a contribution on the municipalities and leave them the alternative of raising this either by taxation and/or by borrowing. Moreover some relief might be given to the Budget of the central administration by the elimination of various grants in aid to Communal and Provincials services. The objection to this course would be that the efficiency of the latter would be thereby impaired. On the other handthis would be a stimulus to economy especially in services like public assistance and optional services which could be reduced without prejudicing the health or safety of the inhabitants. It would probably be unwise to cut out the grants in aid of public health services.

The only objection to borrowing as such would be that, taking into account the limited borrowing powers of the reconstructed banks, borrowing for purposes of meeting deficits would reduce the credit available for industry. It might however be possible to tap smaller savings municipally by getting the municipalities to issue small denomination bonds which would be subscribed by the small investors who do not normally keep banking accounts.

12. But when all these measures have been taken the possibility has still to be faced that the deficits may not be wholly

Declassified E.O. 12356 Section 3.3/NND No. 785015

covered, at any rate to beginwith, in which case advances will have to be made to the central administration and/or the municipalities to cover their expenditure. These would presumably take the form of currency notes of whatever currency it is decided to use, e.g., B.M.A., lire or special lire.

= Harris ?

Declassified E.O. 12356 Section 3.3/NND No. 785015

There are represent departments views in London on the subject of a directive ever

MOST SECRET

MOST SECRET

HORRIFIED

Possible Budgetary Economies

In general the policy will be to continue public officials in their employment if they are willing to serve efficiently and follow our policy.

The question ~~thus~~ arises to what extent it will be possible to reduce the costs of administration. Para. 369 H.M.L. says that if the occupant collects taxes "he is bound to defray the expenses of the administration of the occupied territory to the same extent as the national Government was liable", and we should certainly continue the ordinary day to day costs of administration with perhaps some reduction of salaries, etc. (see separate paper on Wages). The law would, however, appear to imply an obligation to continue all public works schemes etc. in force at the time of occupation, but we have not recognised this interpretation in Eritrea, etc. and there does not appear to be any valid reason why we should do so in HORRIFIED.

Owing to the extreme secretiveness surrounding the expenditure side of the Italian Budget, it is difficult to foresee with any accuracy what items of public expenditure could be cut down. There is, however, some ground for supposing that some capital expenditure may still be continuing in the shape of land reclamation improvements to water supplies, etc. and perhaps roads. The C.F.A.C.

Declassified E.O. 12356 Section 3.3/NND No. 78505

the occupant collects taxes "he is bound to defray the expenses of the administration of the occupied territory to the same extent as the national Government was liable", and we should certainly continue the ordinary day to day costs of administration with perhaps some reduction of salaries, etc. (see separate paper on Wages). The law would, however, appear to imply an obligation to continue all public works schemes etc. in force at the time of occupation, but we have not recognised this interpretation in Eritrea, etc. and there does not appear to be any valid reason why we should do so in HORRIFIED.

Owing to the extreme secretiveness surrounding the expenditure side of the Italian Budget, it is difficult to foresee with any accuracy what items of public expenditure could be cut down. There is, however, some ground for supposing that some capital expenditure may still be continuing in the shape of land reclamation improvements to water supplies, etc. and perhaps roads. The C.F.A.C. should, therefore, make a census of all public works at the earliest opportunity with the object of determining which of them could be suspended without prejudicing the interests of military operations or creating an unmanageable problem of public relief.

In general it would appear that land reclamation schemes could be suspended without difficulty as the country is on the whole nearly self-supporting in the principal food stuffs.

New road construction, if any, could also be suspended except where military considerations dictate otherwise. Maintenance of roads could be cut down (if this has not already been done) to

a/

Declassified E.O. 12356 Section 3.3/NND No. 785015

a minimum consistent with meeting military requirements, and maintenance of public buildings may perhaps have room for some economies - though these may already have been effected to a large extent.

It is doubtful whether public health services will leave much room for economy in view of the prevalence of malaria and the generally backward state of the population.

The biggest individual item in the budget is likely to be education. It would hardly be desirable to close schools unless forced to do so by the attitude of the teachers - who are all Government servants (with the possible exception of a few religious?), though strict supervision will have to be exercised over teaching with a view to eliminating Fascist propaganda. There does not seem, therefore, to be any great room for economy in this direction.

Some economy may eventually accrue in respect of public assistance owing to the employment given by the occupying forces. Moreover, experience in Eritrea and elsewhere suggests that Italian public relief administration is inefficient and corrupt; it may, therefore, be possible to strike a substantial number of persons off the relief roll. It must, however, be anticipated that in the initial

Declassified E.O. 12356 Section 3.3/NND No. 78505

room for economy in view of the prevalence of malaria and the generally backward state of the population.

The biggest individual item in the budget is likely to be education. It would hardly be desirable to close schools unless forced to do so by the attitude of the teachers - who are all Government servants (with the possible exception of a few religious?), though strict supervision will have to be exercised over teaching with a view to eliminating Fascist propaganda. There does not seem, therefore, to be any great room for economy in this direction.

Some economy may eventually accrue in respect of public assistance owing to the employment given by the occupying forces. Moreover, experience in Eritrea and elsewhere suggests that Italian public relief administration is inefficient and corrupt; it may, therefore, be possible to strike a substantial number of persons off the relief roll. It must, however, be anticipated that in the initial stages the number of persons needing relief may be considerably increased.

Para. 17. of Section Two of the draft directive (J.S.M.912 of 1st May, 1943) provides that neither principal nor interest on National Government obligations shall be paid.

F.5.
12th May, 1943.

Declassified E.O. 12356 Section 3.3/NND No. 785015

1720