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Tax Reform in Industrial Countries and the Impact of the U.S. Tax Reform Act of 1986

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Abstract

This paper surveys many of the tax reforms that industrial countries have recently carried out or that have proposed to carry out. In addition to describing those reforms, the paper attempts to identify common features. A trait common to many of these reforms is the lowering of the tax rates for income taxes, accompanied by a widening of the bases. A reduction in the number of rates for individual income taxes is another. The paper emphasizes that these reforms represented a response to changes in political winds as well as to accumulating technical knowledge about the negative effects of taxes on economic efficiency.

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*This is a revised and expanded version of a paper presented at the Spring Symposium of the National Tax Association-Tax Institute of America, Washington, D.C., May 18, 1987. The earlier version is scheduled to be published in the National Tax Journal. The paper is based on information from many sources. In several cases, the sources were secondary ones so that the full reliability of the information could not be checked. The author hopes that the mistakes have been kept to an acceptable minimum and he definitely internalizes all the remaining mistakes. Assistance received from several colleagues in the Fund is highly appreciated.

Summary

Over the past couple of years the world has seen an explosion of interest in tax reform. Many industrial and developing countries have either carried out important tax reforms or have proposed to do so in the near future. This paper focuses on industrial countries. It begins with a technical survey of major findings related to the effects of taxes on economic efficiency. It also discusses taxpayers' changing perceptions about the fairness of particular taxes. Another section of the paper attempts to identify elements common to the various reforms and discusses the extent to which these were influenced by the tax reform experience of the United States.

One feature found in many of these reforms is the lowering of the highest personal income tax rate. For a group of 12 industrial countries the average of these rates fell by 10 percentage points. In none of the countries, however, did this rate fall as much as in the United States since the beginning of the Reagan administration. Another major preoccupation of the current tax reform movement has been the reduction in the number of brackets for individual income taxes. For ten countries the average number of brackets fell from 11 to 4. This reduction is normally justified on grounds that it would make the tax systems simpler. Still another feature is the reduction in the normal corporate income tax rate. Broadening the tax base for the corporate income tax through the removal of incentives to investment often meant, however, that the tax revenue collected from corporations would increase in spite of the rate reduction. This aspect of the reform has been controversial.

The paper provides concise descriptions of the reforms in ten countries before drawing some general conclusions. One important conclusion for the role of the Fund is that when large countries undertake major tax reforms, they should be aware of, and concerned about, the effects of their reform on other countries. Tax structure changes, even when they are revenue neutral, can have as powerful effects on other countries as changes in monetary and fiscal policy. Therefore, they need to be coordinated just as those other policies. The time may come one day when these reforms are jointly discussed and carried out in order to maximize their beneficial effects on the world at large.

I. Introduction

There is no question that the tax reform movement in the United States that started in 1981 and culminated in the U.S. Tax Reform Act of 1986 has sent shock waves to other countries. Because that movement represented in part the political expression of a powerful government, and, perhaps equally important, because it appeared to be built on a foundation of discontent with various aspects of existing tax systems, it provided the officials of other countries with both a challenge and an opportunity to introduce changes in their own tax systems. One does not exaggerate in stating that very rarely has the world seen so much interest in tax reform as in the past couple of years; and very rarely has there been such a convergence of views on at least some of the *aspects of the tax systems that needed to be modified.*

Some foreign experts have referred to a "fascination effect" with the U.S. tax reform (OECD, 1987, pp. 35-36; see also Wingert, 1987; and Solal, 1987). Others have worried about a possible "brain drain" toward the United States if other countries did not respond to the American challenge by reducing the marginal tax rates on the incomes of the highly skilled and presumably highly mobile professionals. Others still have worried that the lowering of the corporate income tax rates, as well as the lowering of the marginal tax rates on the returns to the savings of individuals, would increase the attractiveness of the American economy to foreign companies--especially for knowledge-intensive firms that would benefit from the lower tax rates--thus, inducing a "capital drain" from other countries (see Nakatani, 1987).

The argument of a capital drain toward the United States was often made after the 1981 U.S. tax reform. The changes in U.S. tax rules introduced in 1981 and 1982 implied a considerable reduction in the net cost of capital compared with what that cost would have been under 1980 tax laws. 1/ It was argued by some foreign officials that, by increasing the net of tax rate of return to real investment, the United States had created an artificial pull for foreign capital. However, while after 1981 this argument applied mainly to capital-intensive firms, that benefited from the sharp increase in depreciation allowances, now it applies to profitable firms that use little capital (i.e., knowledge-intensive firms).

I will anticipate some of the conclusions of this paper by stating that it would probably be an unproductive effort to attempt to identify the response of other countries to the U.S. Tax Reform Act of 1986. For one thing, very little time has passed since that Act was enacted into law. Secondly, the Tax Reform Act of 1986 represented the conclusion of

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1/ This increase was estimated differently by different observers, but it is likely to have raised, at least temporarily, the rate of return on new investments by several percentage points.

a discussion that went on for several years. Treasury I 1/ may have had as much influence on other countries as the final Act. More importantly, that Act as well as the tax reforms that have taken place or have been proposed in other countries have been political responses to accumulating evidence on the effects of tax systems on the economy. For example, the Hon. R. O. Douglas, Minister of Finance of New Zealand, in a Statement on Taxation and Benefit Reform presented to the House of Representatives of New Zealand on the 20th of August 1985 in which he announced ". . . the most far-reaching reform of taxes and benefits in New Zealand's recent history" declared that:

> The tax system . . . has failed to keep up with changes in our society. It is unfair and is seen to be unfair. Ordinary wage and salary earners on moderate incomes are paying too much of their incomes in tax. High marginal tax rates create a drag on economic growth by penalising innovation, efficiency, hard work and saving, and by diverting people's attention towards tax avoidance". (p. 1)

Similar though less concise statements can be found in all of the documents describing the tax reforms of this period. Equity (both objective and subjective), efficiency, and simplicity are the catchwords of this tax reform movement. The Minister's statement was made a full year before the U.S. Tax Reform Act was passed by Congress.

One could argue that new technical findings, as to the negative effects of existing tax systems on the economies of the industrial countries, combined with increasing doubts about the fairness of these systems, were the real forces behind the tax reform movement. If this interpretation is correct, then the role of the U.S. tax reform process must not be seen as one that initiated the process but, rather, one that accelerated it by providing the needed political support and publicity.

This interpretation, however, is based on the assumption that technical work is not itself influenced by political developments. Another possibility is that, at least in part, technical work responds to political currents. To put it bluntly, one must not dismiss the possibility that, perhaps subconsciously, economists are more likely to reach technical conclusions that are in tune with evolving political trends than conclusions that are out of step with them. In recent years, a more conservative political environment worldwide may have in part generated technical results that made politically-attractive tax reforms appear to be in tune with recent technical findings. According to this interpretation political developments may influence technical discoveries; in turn, technical discoveries may themselves influence political choices.

1/ See U.S. Department of the Treasury, Tax Reform for Fairness, Simplicity and Economic Growth, Three Volumes (November, 1984).

II. Some Technical Background

Before discussing the recent reforms, it may be worthwhile to summarize very briefly some of the major findings that raised questions about the existing tax systems and that pointed the way toward reform. As industrial countries have relied to a large extent on income taxes, much of the recent research has inevitably focused on these taxes.

Over the years there has been a progressive disenchantment with the objective of vertical equity; on the other hand, horizontal equity, to which legislators had previously paid only lip service, has gained in importance. For decades equity had been almost synonymous with vertical equity, and vertical equity had meant highly progressive statutory tax rates. The empirical studies on the incidence of the tax system, that were so popular in the 1960s and early 1970s, concentrated on measuring the average tax burden by income classes. They did not worry about the dispersions around those averages. However, as the marginal tax rates became very high even at relatively low income levels, the differential burden between those who could escape paying those rates and those who could not became a major issue. In the United States, the marginal personal income tax rate for a four-person family with twice the median income rose from 22 percent in 1965 to 43 percent in 1980 and was still 38 percent in 1986 (Council of Economic Advisers, 1987, p. 80). 1/ McKee, Visser, and Saunders (1986) have estimated that in 1983 the total marginal tax rate on labor use for an average production worker (calculated as a percent of total compensation, including payroll taxes) approached 60 percent in Europe. This rate was above 70 percent in Denmark, the Netherlands, and Sweden and around 45 percent for non-European OECD countries. It was 42.6 percent for the United States. Feldstein has estimated that the effective rate on investment income rose from 55 percent in the mid-1960s to 67 percent in the second half of the 1970s (see Feldstein, 1987, p. 390).

The high rates themselves prompted taxpayers to search for ways (legal, quasilegal, and illegal) to avoid paying taxes. The complexity of the laws, largely a reflection of the many objectives that tax legislators had tried to achieve through the tax system, facilitated the search for loopholes, for those who had the means to hire good lawyers and accountants, and contributed to the spreading feeling that the tax systems had become unfair and arbitrary. The fast growing literature on the underground economy and on tax evasion, is a testimony to the importance of this issue at this time. Some of the estimates of the size of tax evasion and of the underground economy are worrisome indeed (see Pyle, 1987, and Cowell, 1985, for tax evasion, and Tanzi, 1982, for the underground economy). This literature was almost nonexistent two decades ago.

1/ See also (Minarik, 1985, p. 37).

This literature itself has propagandized the inequities of the tax system and may have helped to change taxpayers' attitude toward taxation. Annual surveys by the U.S. Advisory Commission on Intergovernmental Relations over the past 15 years provide some concrete evidence of this change in attitudes. For example, the percentage of the U.S. public that considered the U.S. federal income tax the "least fair" rose from 19 percent in 1972 to about 30 percent in 1973-78, and to about 37 percent in 1979-86 (see Table 1). We have thus come a long way from the time when this tax was generally seen as "the nation's fairest . . . source of revenue" (Pechman, 1971, p. 52; see also Goode, 1964, pp. 11-12). The view that lower tax rates levied on broader bases would lead to a fairer tax system has gained wide acceptance. 1/ This idea is so well accepted today that we may tend to forget how radical it would have been considered 20 or even 10 years ago. 2/ It is one of the ideas on which there is now a growing convergence of views among countries.

Although the issue of fairness may have been the prime mover behind several of the recent tax reforms, it was also assisted by progressively more convincing technical studies that called attention to the efficiency costs of existing systems. At a time when the growth rate had slowed down in many countries, leading to high and rising unemployment, and growth had become again the central objective of economic policy, the possibility that the tax system might be putting obstacles to the growth potential of these countries could no longer be ignored. The relationship between taxes and the labor supply, taxes and the rate of saving, and taxes and the allocation of capital has attracted the attention of economists and policymakers both within and outside the United States.

Take the relationship between taxes and labor supply first. For a long time studies of this relationship had found very little evidence that the labor supply was affected in any significant way by income taxes. Writing in 1971, Pechman could conclude that "the evidence suggests that income taxation does not significantly reduce the amount of labor supplied by workers and managers" (Pechman, 1971, p. 66). A similar conclusion was reached in an OECD survey of this issue (OECD, 1975, Chapter 6, pp. 122-128). Thus, according to these so-called

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1/ The covers of the recently released reports on the Canadian tax proposals show arrows with the indications: "lower rates" (for the arrow pointing south), "fairer system" (for the lower arrows, pointing east and west).

2/ In the United States this idea resulted in proposals aimed at making the income tax a proportional one imposed with one relatively low rate on the widest base possible. This rate ranged between 12 and 18 percent depending on whether a personal exemption would be allowed (see Hall and Rabushka, 1983). Various bills along these lines were submitted to Congress.

Table 1. Which Do You Think Is the Least Fair Tax?

	March 1972	May 1975	May 1979	May 1983	May 1986
Federal Income Tax	19	28	37	35	37
State Income Tax	13	11	8	11	8
State Sales Tax	13	23	15	13	17
Local Property Tax	45	29	27	26	28
Don't know	11	10	13	15	10

Source: Advisory Commission on Intergovernmental Relations, Changing Public Attitudes on Governments and Taxes (Washington, D.C.: annual).

"first generation studies," there was no ground for concern that high marginal tax rates on labor income would reduce the supply of labor.

In more recent years, however, using new econometric tools, better and different data, and, perhaps, different motivations, economists have been obtaining, with increasing consistency, results that seem to indicate that high marginal tax rates discourage work participation by significant amounts (Killingsworth, 1983). Some of these results come from studies of the behavior of the working poor. These so-called "second generation studies" find that although the whole labor force participation is reduced by high marginal tax rates, the effect on women, and particularly on married women, is particularly striking. One recent study (Hansson and Stuart, 1985) has calculated at 0.4 percent the median weighted average wage elasticity of the total labor force derived from recent studies. For female workers alone the elasticity would be much higher. Even in the United States, where the marginal tax rates on labor use are relatively low by comparison with European countries, it has been estimated that the U.S. labor supply has been reduced by as much as 5-12 percent (Burtless and Havemann, 1985). These new results are not beyond controversy, yet their impact on policy has been substantial. 1/ As a recent OECD study has put it:

> Though it is difficult to draw clear-cut conclusions from the studies . . . on the effects of taxation on labour supply, there appears to be a widespread consensus among politicians and taxpayers that high rates of income taxes are adversely affecting work effort . . . . This is probably one of the main reasons why many governments have recently implemented or announced reductions in the schedule of rates of taxes . . . . (OECD, 1986, p. 59).

The extent to which taxes on capital income reduce the rate of saving is much more controversial than the effect of taxes on the supply of labor. Here both theoretical discussions and empirical studies have led to ambiguous conclusions. Some studies (Boskin, 1978; Gylfason, 1983; Summers, 1983) have concluded that the rate of saving is positively affected by the rate of return; others have not found any relationship (Howrey and Hymans, 1978; Friend and Hasbrouch, 1983) or they have even argued in support of a negative relationship (Tanzi and Sheshinski, 1984).

One aspect that was emphasized in the paper by Tanzi and Sheshinski is that since there is statistical evidence that in the United States a large share of all financial assets is owned by individuals over

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1/ Against these results one must mention the fact that in the United States the percentage of adults in the labor force has been increasing over the past two decades and especially in periods when the marginal tax rate was rising fastest.

65 years of age, 1/ and since these individuals, in conformity with Modigliani's life-cycle theory of the consumption function, can be expected to have much higher marginal propensities to consume than the rest of the population, a policy change that increases the share of total income going to this group is likely to result in a fall in the saving rate. Therefore, an increase in the net-of-tax rate of interest is likely to result in a decrease in the saving rate. The behavior of the saving rate in the United States in the 1980s, when after-tax real interest rates were very high, is consistent with this expectation. Be that as it may, the prevalent view seems to be that high marginal tax rates on interest income reduce the rate of saving. Therefore, tax reform should reduce those marginal tax rates to stimulate individuals to save more. The recent reforms have reflected that view.

There has also been quite a lot of analysis and concern about the fact that various incentive schemes (such as accelerated depreciation, investment tax credits, and other similar incentives), especially when combined with significant rates of inflation, and the possibility of taking a deduction for nominal interest payments, lead to an allocation of investment that may be far from optimal and may imply significant efficiency costs (see King and Fullerton, 1984, and Fullerton and Henderson, 1986). The effective marginal tax rates on various types of assets and industries have been shown by several studies to be highly divergent.

Recent tax reform proposals have aimed at reducing the differences in these effective tax rates in order to achieve a tax system more neutral vis-à-vis the various categories of investment. 2/ This objective has come to be referred to as "levelling of the playing field." For example, a study by Melvyn King has presented estimates of the effective marginal tax rates for the United States and the United Kingdom before and after the reforms enacted in 1984 in the United Kingdom and proposed in Treasury I and II the United States. He has concluded that the reforms would indeed dramatically reduce the variation in effective tax rates (King, 1985). A similar conclusion has been reached in recent studies of the U.S. reform (see Steuerle, 1987,

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1/ Individuals over 65 years of age receive more than 50 percent of all interest income reported to the U.S. Internal Revenue System.

2/ As the Honourable Michael H. Wilson, Minister of Finance of Canada, stated in his speech to the House of Commons on June 18, 1987 "[The tax reform] will encourage investment decisions to be based far more on the imagination and creativity of research, engineering and marketing experts, and far less on the advice of tax specialists."

pp. 294-95). This "levelling of the playing field" would presumably make investment more productive. 1/

III. Major Elements of Recent Tax Reforms

It would not be possible in this paper to give full details of all the reforms now under way in industrial countries. Rather, in this section I will attempt to show the extent to which the various reforms could be assumed to reflect common principles. In Section IV, summary descriptions are provided for several recently enacted or proposed tax reforms. The essential elements of the 1986 U.S. reform are the following:

Individual income tax

The 1986 Tax Reform Act--

(a) sharply reduced the number of tax brackets from 15 to 2;

(b) reduced the highest marginal tax rate from 50 percent to 28 percent (or to 33 percent for some taxpayers);

(c) raised the lowest rate from 11 to 15 percent;

(d) increased the standard deduction and the personal exemption to reduce the number of taxpayers required to file;

(e) expanded the tax base by limiting or eliminating various deductions;

(f) retained indexing provisions for adjusting some nominal figures for the effect of inflation.

Corporate income tax

The 1986 Tax Reform Act--

(a) reduced the basic (or highest) rate from 46 percent to 34 percent;

(b) made the depreciation allowances much less generous;

1/ The empirical significance of this improvement in economic efficiency has been challenged by a few economists who have argued that the benefit to the economy from these efficiency gains will be swamped by the losses associated with the cut in investment due to the elimination of investment incentives (see, inter alia, Summer, 1987).

(c) repealed the investment tax credit and imposed severe limitations on many other deductions and exclusions.

The Act introduced also many provisions aimed at increasing compliance by individuals and enterprises. The revenue impact of the Act was expected to be neutral. However, there would be a major shift of the tax burden from the individuals to the corporations.

In both the individual and the corporate income tax, the predominant objectives were a reduction of the statutory rates and a broadening of the taxable base. These objectives are found in many but not all the recent reforms.

The countries where the most significant tax reforms have been recently enacted--say, in the past couple years--or are in the process of being carried out are Australia, Canada, Japan, Denmark, and New Zealand. Important changes have been introduced, or are being contemplated in several other countries including Belgium, France, Germany, Italy, the Netherlands, Norway, Sweden, and a few others. It should be recalled that in 1984 there was a major reform of the British corporate income tax 1/ and in 1979 there had been a major reduction in the British marginal tax rates for the personal income tax.

Table 2 provides information on the minimum and maximum personal income tax rates for 12 countries where changes have occurred or have been recently proposed. The information is given first for 1985 and then for 1986 or later years if an announcement of a change has already been made. If attention is first focused on the maximum rate, it will be noticed that it has fallen in all but one of the countries shown. The exception is the United Kingdom where the maximum rate remains at 60 percent after having been reduced in 1979 from 83 percent for earned income and 98 percent for investment income. On the average the maximum rate has fallen by about 10 percentage points--from 61 percent to 51 percent. However, the fall is much higher for some of the countries and particularly for the United States (22 points), Japan (20 points), and New Zealand (18 points). It remains above 50 percent in many of the countries shown. Of the G-7 countries two (United States and Canada) have reduced or are in the process of reducing the highest rate to less than 30 percent while the remaining five will have rates equal to or above 50 percent even after the proposed changes are carried out.

Since the beginning of the Reagan administration the U.S. maximum personal income tax rate has fallen by 42 points, clearly a record. The new level of the U.S. rate is dramatically lower than that of the other countries and especially of Japan and the United Kingdom for which the differences in 1988 will be 22 and 32 points, respectively. Whether

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1/ See House of Commons Paper 341: Fourth Report from the Treasury and Civil Service Committee - Session 1983-84. The 1984 Budget, Appendix 10. For a critical review of that reform, see (Edwards, 1984).

Table 2. Recent and Proposed Changes in Lowest and Highest Personal Income Tax Rates (National Levels)

(Percentages)

Country	Tax Rates in 1985	Tax Rates in 1986 or Later
Belgium	-72	-60 (Unspecified)
Australia	30-60	24-49 (From 1987)
Canada 1/	6-34	17-29 (From 1988)
Denmark 2/	50-73	50-68 (From 1987)
France	5-65	5-50 (From 1988)
Germany	22-56	19-53 (From 1990)
Ireland	35-65	35-58 (From 1986)
Italy	18-65	11-56 (From 1988)
Japan	10.5-70	10-50 (From 1988)
New Zealand	20-66	15-48 (From 1986)
United Kingdom 3/	30-60	27-60 (From 1987)
United States	11-50	15-28 (From 1988)
Average	22 4/-61	21 4/-51

Source: Based on information obtained from country sources.

1/ If provincial taxes are taken into acount, the top marginal rate averaged about 53 percent before the changes proposed by the tax reform of 1987.
2/ Includes tax to primary and county authorities and church tax.
3/ Up to 1979 the top rate had been 83 percent for earned income and 98 percent on investment income.
4/ Without Belgium.

this difference will persist or will in time be eliminated; and whether it will be eliminated by cuts in the other countries' rates or by increases in the U.S. rate, remains to be seen. While these differences persist they will represent a challenge to those countries, and especially to the United Kingdom in view of its close cultural affinity with the United States. These differentials will surely provide an inducement to highly skilled and highly mobile professionals to migrate.

One could argue that the importance of the maximum rate should not be overplayed since the taxpayers who fall into that rate usually represent a small proportion of the total. Table 3 shows some readily available information with respect to this point. Unfortunately, the information is not as recent as one would like. Recent figures would undoubtedly show larger percentages. The percentage of taxpayers at the highest rate was very small except for Denmark in which it was 4.2 percent and had risen to 7 percent by 1985. However, a significant "brain drain" is not likely to require large numbers. It is sufficient that a few highly visible and productive professionals move to make a political and, perhaps, even an economic difference.

Table 2 does not show much of a trend with respect to the lowest rate. The average fell from 22 percent in 1985 to 21 percent in the later period. From a revenue point of view it is, of course, the lowest rate that is the important one. The impact on revenue of a percentage point change in the minimum rate is normally many times larger than that of a similar change in the maximum rate. The reason is obviously that there are relatively few taxpayers exposed to the highest rate. Therefore, in terms of revenue losses it is easier for governments to be generous with changes in the maximum rate. As long as income taxes remain a major source of revenue, and as long as the level of taxation of these countries needs to remain high, it is unlikely that the lowest rate can be reduced significantly unless the tax base is considerably widened or unless the rate structure is substantially modified. From an efficiency point of view there may be a lot to be gained by paying for the reduction in the highest rates through an increase in the lowest rate as the United States has done since welfare costs are positively and increasingly related to the size of the marginal tax rates.

A major preoccupation of the current tax reform movement has been a reduction in the number of brackets (and of statutory rates) for the personal income tax. This was an important aspect of the U.S. Tax Reform Act that resulted in a reduction from 15 to only two taxable brackets. Other countries have followed the U.S. lead and have also reduced, or have proposed to reduce, the number of brackets in their income tax (see Table 4).

These reductions in the number of brackets are often justified on the grounds that they will simplify the income tax. They are, in other words, a consequence of the widespread demand for "simplicity." However, it is not clear why a reduction in the number of brackets

Table 3. Taxpayers at the Highest Rates and Revenue from Highest Rates--Selected Countries 1/

Country	Percentage of Taxpayers at the Highest Rate	Percentage of of Tax Yield from Taxpayers
Australia	0.8	7.7
Belgium	0.1	1.8
Canada	0.2	4.2
Denmark	4.2	24.5
France	0.8	7.9
Germany	0.0 2/	1.8
Italy	0.0 2/	0.0
Japan	0.0 2/	n.a.
Netherlands	0.2	7.0
Sweden	0.6	4.4
United Kingdom	0.2	4.8
United States	0.1	1.8

Source: Tables 3 and 5 of OECD, Income Tax Schedules Distribution of Taxpayers and Revenues (Paris, 1981).

1/ The data refer to various years between 1975 and 1981.
2/ Less than 0.05 percent but greater than 0.0.

Table 4. Changes in Numbers of Rates and Brackets: Implemented or Proposed

Country	Before change	After change
Australia	5	4
Austria	11	5
Belgium	14	4
Canada	10	3
Japan	15	6
Italy	9	8
Netherlands	9	3-4
New Zealand	5	3
Sweden	16	3
United States	15	2
Average	11	4

Source: Based on information from various countries.

should make the preparation of tax returns simpler when taxpayers generally rely on tax tables to make their calculations. Once these tables are available, it does not matter how many brackets there are.

There may be, however, a more important economic objective that is at times achieved through the reduction in the number of rates. It is an objective that has been emphasized in the recent Japanese reform as well as in the reforms of some other countries. Specifically, the reduction in the number of brackets results in the widening of their size. If the first taxable bracket becomes very wide, and if its limits are adjusted for inflation, then the result might be that, for all practical purposes, a large number of taxpayers will be faced by what for them becomes de facto a proportional income tax with the obvious efficiency advantages that such a tax has compared with a highly progressive tax. The Japanese tax reform has gone so far as to make the size of the first taxable bracket wide enough to accommodate the income of many taxpayers over their entire career. Thus, the problems that arise because of the fact that the earnings of many individuals change with their age become much less serious. A reform proposed in the Netherlands by the Tax Reform Commission would also have a rate structure with a maximum of four brackets, the first of which would cover 88 percent of the taxpayers.

Table 5 provides some comparative information on the effect of the tax reform movement on the basic rate of the corporate income tax. 1/ Starting around 1984 there has been substantial change in these rates. This movement, however, did not start in the United States but in the United Kingdom and in the Netherlands. In the United Kingdom the rate was reduced from 50 percent in 1984 to 35 percent in 1986. In the Netherlands, it fell from 48 in 1984 to 42 percent in 1986. For the 14 countries shown in Table 4, the average is scheduled to fall from 46 percent in 1985 to 41 percent in 1988-89. If an earlier year than 1985 had been considered the reduction would appear even more significant. On present schedule, by 1988 Canada, Finland, and the United States will have the lowest rate among the countries shown in the table. 2/

The reduction in the rate is not, however, general. There are some countries (Australia and New Zealand) where the rate actually increased over the period, and some countries (Denmark, Italy, and Sweden) where it did not change. In Denmark the rate had been increased from 40 to 50 percent in 1985. In the countries where the rate was reduced, the authorities generally took steps to widen the base in order not to lose

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1/ Because the announcements on tax reforms available were not always very clear about timing, and because some of the changes applied to fiscal rather than calendar years, it was not always easy to allocate the expected changes to specific calendar years.

2/ However, especially in Canada and Finland there are substantial local taxes on corporations.

Table 5. Scheduled Changes in Corporation Income Tax Rates in Countries Undergoing Significant Reforms

Country	1985	1986	1987	1988	1989
Australia	46.0	46.0	49.0 1/	49.0	49.0
Canada	36.0	36.0	36.0	28.0	28.0
Denmark	50.0 2/	50.0	50.0	50.0	50.0
Finland 3/	43.0	33.0	33.0	33.0	33.0
France	50.0	45.0	44.0	42.0	42.0
Germany 4/	56.0	56.0	56.0	50.0	50.0
Ireland	50.0	50.0	50.0	36.0	36.0
Italy	43.37	43.37	43.37	43.37	43.37
Japan	43.3	43.3	42.0 5/	40.0 5/	37.5 5/
Luxembourg	40.0	40.0	38.0	36.0	36.0
Netherlands 6/	43.0	42.0	42.0	42.0	42.0
Sweden	52.0	52.0	52.0	52.0	52.0
New Zealand	45.0	48.0	48.0	48.0	48.0
United Kingdom 7/	45.0	35.0	35.0	35.0	35.0
United States	46.0	46.0	40.0	34.0	34.0
Average	46.0	44.0	44.0	41.0	41.0

Source: Based on information from the various countries.
1/ From July 1, 1987.
2/ Rate increased from 40 to 50 percent in March 1985.
3/ Excludes local and church taxes which average about 17 percent.
4/ A 36 percent rate applies to distributed profits.
5/ Fiscal years. These are national rates only. Including local rate the decline will be from about 53 percent to just below 50 percent.
6/ The rate was 48 percent in 1984.
7/ The rate was 50 percent in 1984.

revenue or even to gain additional revenue to pay for reductions in individual income taxes. Depreciation schedules were revised to make them less liberal and investment credits and similar other incentives were reduced or eliminated. This process may have been carried farthest in the United Kingdom and the United States. Similar changes are taking place in other countries.

Let us turn now to a brief description of some of the ongoing or proposed reforms in other industrial countries. There is also a lot of activity in many developing countries but a discussion of reforms in those countries will be left for another paper.

IV. Brief Synopses of Tax Reforms Enacted or Proposed in Industrial Countries Other than the United States

Australia

In October 1984 the Prime Minister called for a complete review of the tax system. The review was to be based on nine principles and should lead to a fairer, simpler, and more efficient tax system. The new system should (a) generate the same revenue, (b) reduce personal income tax rates, (c) reduce evasion and avoidance, and (d) have widespread community support. The Prime Minister's call resulted in June 1985 in a Draft White Paper which provided a working document for a July 1985 summit involving representatives from cross-sections of the Australian community. The Government's tax reform package was announced on September 19, 1985. Even though the reform had been intended to be revenue neutral, the final package involved some revenue loss. It also did not contain a major change in the sales tax that the Draft White Paper had contemplated: this was the replacement of the wholesale sales tax by a broad-based retail sales tax levied at a uniform rate of 12.5 percent.

The major elements of the tax reform are the following:

1. Cuts in the marginal tax rates of the personal income tax. These cuts were particularly significant for taxpayers with higher incomes. The top rate was reduced from 60 to 49 percent. The two lower rates of 46 and 48 were both reduced to 40 percent. The two lowest rates were only reduced by one percentage point--30 to 29 percent and 25 to 24 percent.

2. A comprehensive capital gains tax, which would apply to gains realized after September 19, 1985 was introduced. For assets held more than 12 months only inflation-adjusted gains are taxed. The taxable capital gain is included in the taxpayer's income in the year when the gain is realized but a five-year averaging is allowed.

3. Deductions for entertainment were disallowed.

4. A fringe benefits tax was introduced from July 1, 1986. This tax is imposed on employers on the value of noncash fringe benefits provided to employees. The tax rate is equal to the company rate which, in turn, is equal to the highest personal marginal tax rate (49 percent). The tax paid is not a deductible expense for companies.

5. A foreign tax credit system to go into effect on July 1, 1987. This will allow a credit for taxes paid abroad on income taxable in Australia.

6. As of July 1, 1987 the "classical system" for taxing companies will be replaced by a system of full imputation. 1/ The new system will credit to the resident individual shareholders the tax paid by the company so as to avoid the double taxation of dividends. If the shareholder's own income is subject to a lower rate than the top tax rate, he can apply the credit to other income.

7. The corporate income tax rate will be increased from 46 to 49 percent on July 1, 1987 to bring it in line with the maximum rate on the income of individuals.

8. Most tax shelters were abolished.

Austria

The new Austrian government has announced that it intends to introduce a major tax reform to take effect on January 1, 1989 and on January 1, 1991. For the personal income tax the reform would (a) reduce the rates by about 6 percent; (b) cut the number of tax brackets from 11 to 5; (c) simplify the tax by abolishing many exemptions and deductions. The corporate income tax would also be reformed.

Belgium

Early this year the Royal Commission for the standardization and simplification of the Belgian tax system made various proposals to the Minister of Finance. These proposals are expected to be discussed by the government in October 1987 and to be submitted to Parliament sometime in 1988. If approved, they would come into effect in 1990. The main elements of this reform would be: (a) a reduction in the number of tax rates from 14 to 4; the new rates would be 30, 40, 50, and 60 percent, respectively; (b) a reduction in the overall average rate on taxpayers from 66.7 percent to 50 percent; (c) an increase in the size of the personal exemption; (d) abolishment of the aggregation of the income of spouses to reduce the burden on married women; (e) replacement

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1/ The "classical system" taxes corporate income when it is produced and then it taxes dividends when they are received by shareholders without any credit for the taxes paid by the corporations.

of the progressive rates on corporate income by one rate; (f) introduction of a full imputation system; (g) restructuring the indirect taxes--higher taxes on alcohol, tobacco and fuel, elimination of other excises, and changes in the rates of the value-added tax.

Canada

On June 18, 1987, the Honorable Michael H. Wilson, Minister of Finance, announced a major tax reform for Canada. The factors that led to the reform were similar to those mentioned in other countries. Quoting from the Minister's speech to the House of Commons, they include the fact that the tax system (a) "allows many profitable corporations to avoid paying a fair share of tax, year after year"; (b) "allows some people with very high incomes to pay less than the average Canadian wage-earner, year after year"; and (c) "allows those who are able to usespecial tax breaks to shift the burden to others less able to carry it." The Minister went on to state that:

> Canada needs a tax system that raises revenue in a fair reliable way; a system that supports our national effort to promote economic growth and create more and better jobs. Over the years, our tax system has become a crazy quilt of special incentives, special deductions and special write-offs. Each incentive gives a break to someone. But each special tax break means that taxes have to be higher for everyone else. Special breaks have made the income tax more and more complicated, and less and less fair.

Major changes have been proposed for the personal income tax, for the corporate income tax, and for the sales tax. As in other countries, the changes in the personal income tax include rate reduction and base broadening. As a consequence of the reform, individuals will pay less income taxes while corporations will pay more. The reduction in federal personal income taxes will be $2 billion in 1988, the first year of the reform, and more than $11 billion over the next five years. Eighty percent of Canadian households would pay less personal income tax. The tax will replace the current 10 rates of federal income tax with three rates: 17 percent on the first $27,500 of taxable income, 26 percent on the next $27,500, and 29 percent on taxable income over $55,000. The highest federal rate is thus reduced from 34 percent to 29 percent. It thus falls in line with the highest federal rate in the United States where it is 28 percent. The reform restricts and removes many tax deductions and exemptions and converts the remaining ones to tax credits. Capital gains taxes are increased.

The major declared objectives of the corporate income tax reform are the following: (a) to improve the overall competitive position of Canadian business and industry, particularly vis-à-vis the United States; (b) to return the profit motive to investment by rewarding success; and (c) to ensure that profitable corporations carry a bigger

share of the total tax burden. Overall, corporations will pay more taxes in spite of a reduction in the corporate tax rates (from 36 percent to 28 percent for general business and from 30 percent to, eventually, 23 percent, for manufacturing business). This result will be achieved through an expansion of the base due to reductions in capital cost allowances and in the investment tax credit rates, and through other provisions aimed at restricting deductions.

No final decision has yet been reached in relation to the sales tax reform. The Government is considering three alternative forms of the new sales tax, including a National Sales Tax which would combine the present federal sales tax and provincial sales tax, a goods and service tax, and a value-added tax.

Denmark

Denmark has recently undergone a major tax reform. This reform was announced in early 1986 and became effective on January 1, 1987. It reflected an Agreement reached in June 1985 between the Government Parties, the Social Democratic Party, and the Radical Liberal Party. According to a Government publication the purpose of the reform was (a) to counteract tax speculation, (b) to promote private savings, (c) to lower the marginal rate of taxation, (d) to improve the conditions of families with children, and (e) to provide a fairer distribution of the tax burden.

Denmark has the heaviest taxation of income in the world: the taxation of personal income has been generating an extraordinary 24 percent of GDP in recent years. In 1985, the marginal tax rate was 0 percent for 21 percent of the taxpayers, 73 percent for 7 percent of the taxpayers, and 50-60 percent for the remaining 72 percent (Foighel, 1986, p. 5). It is, thus, no surprise that ". . . individuals as well as companies [became] very conscious of the tax effects of their actions--and they have acted accordingly" (ibid, p. 6). One major problem reported by Isi Foighel, the Minister of Taxation of Denmark, is associated with the deductibility of interest payments. Given a relatively high rate of inflation until recently, and the fact that owners of real estate could easily mortgage their real estates, there was a substantial amount of borrowing and thus a substantial erosion of the tax base. This situation was aggravated by the fact that interest received, which could have increased the tax base, was received mostly by tax-exempt pension funds.

One interesting feature of the reform is the separation of income into two schedules: personal income (wages and salaries, pensions, incomes from independent business activities, etc.) and capital income (interest, dividends, imputed rent for owner-occupied houses, etc.). All income is first taxed with a basic rate of 50 percent. Deductible expenses have a value of 50 percent. In addition, personal income over DKr. 200,000 is taxed with a surtax of 12 percent. Another surtax of 6 percent applies on the total of personal income and positive net

income from capital which exceeds DKr. 260,000 for married persons. The marginal tax rate on interest income (as well as the value of interest deductions) is thus limited to 50 or 56 percent as compared to the earlier maximum of 73 percent. This change has decreased the top marginal tax rate from 73 percent to 68 percent. In 1985 the rate of the corporate income tax had been increased from 40 to 50 percent. The net effect of these changes is essentially to remove progressivity from the taxation of capital income and to tax it at a flat rate of about 50 percent.

Still concerned by excessive consumption and, thus, as a measure to stimulate personal saving, in October 1986 the Danish Government announced a new tax measure aimed at reducing even more the attraction of borrowing by households. A 20 percent tax on net interest expenses of household was introduced. Loans raised for business and educational purposes as well as loans for the acquisition of owner-occupied dwellings granted by mortgage associations were exempt. The new measure reduces the value of an interest reduction to about 30 percent.

Germany

An agreement was reached in 1987 among the Government's coalition partners on the basic content of a reform that would go to parliament in autumn and that would become fully effective in 1990. The package would include the following changes:

1. The basic personal exemptions would be increased from DM 4,536 for single taxpayers and DM 9,072 for married couples to DM 5,666 and DM 11,232, respectively. The general children's allowance would be raised from DM 2,484 to DM 3,024.

2. The lowest marginal tax rate would be reduced from 22 percent to 19 percent. However, the size of the first bracket to which this rate applies would be considerably reduced (to less than half its present value).

3. The tax schedule will be flattened to make it linear. Unmarried individuals with taxable incomes between DM 20,000 and DM 120,000 would experience reduction in their marginal tax rates. These reductions would be particularly significant for taxable incomes between DM 40,000 and DM 80,000.

4. The highest marginal tax rate would be reduced from 56 percent to 53 percent. However, the income level at which this rate applies would be reduced by DM 10,000 for single taxpayers (to DM 120,000) and by DM 20,000 for married taxpayers (to DM 240,000).

5. The corporate tax rate on undistributed profits would be reduced from 56 percent to 50 percent.

6. Depreciation allowances for medium-sized enterprises would be increased.

There have been questions on whether these changes, though significant in terms of revenue reductions and possibly in terms of incentive effects, add up to what one could genuinely call a major reform. As a German public finance expert has recently written: "The measures which have been and shall be taken in the field of tax policy don't deserve the term "tax reform". They are in substance . . . not a reform in the sense that important taxes are fundamentally changed or that the tax system as a whole has undergone a substantial revision" (Schmidt, 1987, p.1). Professor Schmidt continues that: "A broadening of the tax base has not yet been decided upon, and my guess is that only modest success can be expected here" (ibid.). He concludes that: ". . . a tax reform in the proper sense remains to be done" (ibid., p. 15).

Japan

In September 1985 Prime Minister Nakasone entrusted a Tax Commission with the task of conducting a thorough review of the Japanese tax system and to make proposals for a tax reform. In April 1986 the Commission published an Interim Report and in October 1986 it published the Final Report on the Overall Review of the Tax System. The Final Report recommended the biggest change in the Japanese tax system in 37 years. The October report was widely discussed both within and outside the Government and in December it resulted in specific bills which were submitted to the Japanese Diet in February 1987. The following description is based on those bills. However, the reform met strong opposition on some of its aspects. The final result is still uncertain at this moment.

It was generally agreed that the tax system of Japan, established after World War II, was out of step with the present Japanese economy. The Government was hoping that the revised system would be consistent with expected economic changes through the 21st century.

The guiding principles for the reform were the following:

1. Revenue neutrality.

2. A greater reliance on consumption and wealth as tax bases.

3. The spreading of the tax burden more evenly over economic activities.

4. The need to consider international implications of taxation.

5. Finally, the reform should be guided by principles of "equity, fairness, simplicity, choice, and economic vitality."

The major changes proposed are: (a) a substantial reduction in individual income taxes; (b) an almost as substantial a reduction in corporate income taxes; (c) the introduction of a value-added tax; and (d) a major reform of the present system of saving incentives.

Individual Income Taxes: The reform would reduce the revenue from individual income taxes by about 0.8 percent of GNP. This would be achieved by a drastic reduction in the progressivity of these taxes. The number of the tax brackets would be reduced from 15 to 6 over a two-year period. The rates for the national income tax would be reduced from the current range of 10.5 percent to 70 percent to a range of 10 percent to 50 percent. For the local income tax the current 14 brackets, with rates ranging from 4.5 percent to 18 percent, would be reduced to four, with rates ranging from 5 to 15 percent. For both taxes combined the highest marginal tax rate would be cut from the current level of 88 percent to the still very high level of 65 percent.

One major objective of the reform of the individual income taxes was the reduction of their progressivity and their burden especially on middle-income workers. Another important goal was to subject a large share of employed individuals to a constant marginal tax rate over most of their careers. As a consequence, the bracket to which the "basic rate" of 15 percent would apply is very wide (from ¥ 1,200,000 to ¥ 5,000,000). The reform proposes also a new special exemption for spouses without income.

Corporate Income Tax: The reform would reduce the revenue from the corporate income tax by about 0.5 percent of GNP. In 1985, taxes on corporate income as a percentage of GDP were close to 6 percent. After Norway and Luxembourg this was the highest among industrial countries. The basic national tax rate on corporate income would be reduced to 37.5 percent from the current level of 43.3 percent. For this change the transition period would be three years. Taking into account the local taxes on the corporations the effective tax rate would be reduced from about 53 percent to about 50 percent. The current lower tax rate of 33.3 percent on dividends paid will disappear over a three-year period. To compensate for some of the revenue losses associated with the lower corporate income tax rates the reform proposes reviewing the system of tax-free reserve for bonus payments and other special measures. Depreciation schedules are also expected to be brought in line with the economic life of assets.

Reform to the Tax-Exempt System: This system was introduced many years ago as an incentive to small savings but, as the country became richer, this incentive lost its main justification (see Tanzi, 1969 p 114-15). Furthermore, due to difficulties in its administration, it came to be widely abused and created inequities among different income sources. Around 70 percent of total personal savings are now in tax-exempt deposits. A consequence of this is that most interest income escapes taxation and the personal income tax has become largely a tax on labor income.

The reform proposes that (a) tax-free savings deposits be abolished except for special cases such as individuals over 65 years of age, fatherless families, handicapped, and a few others; and (b) that a final, schedular income tax be withheld at the source on interest incomes at the rate of 20 percent (15 for national tax and 5 percent for local tax). The Tax Commission recommended also that capital gains be fully taxed. However, the legislation that went to the Diet in January 1987 did not contain any major recommendation to that effect.

Sales Tax: Indirect taxes, though still very important, have been losing ground in Japan over the years. The share of indirect taxes in the total has fallen from 45 percent in 1950 to 26 percent in 1986. There is no general sales tax so that the existing indirect taxes are levied on specific items and are thus highly discriminatory. The Government proposed to introduce a broadly-based value-added tax at the rate of 5 percent. The base would exclude sales of foods, supplies of educational services, medical services, and a few other items. Small enterprises (with annual sales less than ¥ 100 million) would also be exempted. The value-added tax would replace several of the existing excises. This proposal has encountered strong political resistance and has been withdrawn for the time being.

The Netherlands

A commission for simplification of wage tax and income tax was instituted on September 20, 1985 by the Minister and State Secretary of Finance. The commission's final, unanimous report, titled A Step Towards Simplicity, was submitted to the Minister of Finance on May 28, 1986. The report provided the main outline of a reform but left the translation of the Commission's proposals in terms of specific laws, regulations, and procedures to the government. The commission "assumed the viability of the income tax;" it also assumed that, given the revenue requirements of the Netherlands, high rates were unavoidable even if deductions could be susbtantially reduced. Its proposals aimed at a neutral revenue impact.

Its main recommendations were: (a) a replacement of the existing scale for the personal income tax, which consists of nine brackets, with one that would have only three rates (40, 55, and 65), or, alternatively four rates (40, 55, 65, and 70). (b) The first rate at 40 percent would integrate the contributions for the five general social insurances. Thus, individuals would no longer pay separate social security taxes. This first rate would extend over Dfl 45,000 which would mean that about 88 percent of all taxpayers would face just this rate. The higher rates would consist only of taxes and would thus not include contributions. (c) The "exceptionally complicated and incomprehensible" system of standard exemptions and personal allowances would be abolished and replaced by a uniform standard deduction of Dfl 4,250 for everyone. (d) Other special provisions related to family circumstances.

New Zealand

New Zealand's tax reform was announced on August 20, 1985 and came into effect on October 1, 1986. In the words of the Minister of Finance, its objectives were "to introduce a greater degree of equity into the tax. . . system; to minimize the distortionary impact of the tax system on resource allocation, by reducing anomalies and concessions, widening the tax base, and lowering marginal tax rates; and to make the tax system more certain and simple" (Hon. R. O. Douglas, 1985, p. 3). A major concern about equity was that "At present people in similar economic positions often pay vastly different amounts of tax" and that ". . . the tax burden has increasingly been shouldered by the ordinary wage and salary earner." (ibid)

The basic document on the reform refers to the fact that high marginal tax rates have encouraged taxpayers to avoid and evade paying taxes; have diverted the most talented professionals into activities aimed at designing schemes to minimize tax liability; have discouraged work effort; and, have induced investors to make investment decisions based mainly on tax considerations. As the United Kingdom had done in 1979, and as Japan has intended to do in 1987, New Zealand's reform would shift the burden away from direct taxes and into indirect taxes. The main changes are the following:

1. Personal income tax

The personal income tax scale that had five taxable brackets with rates ranging from 20 to 66 was changed to one with three brackets with rates of 15, 30, and 48 percent.

2. Business taxation

The tax on companies was increased from 45 to 48 percent starting on April 1, 1986. As for Australia, the rate of the corporate income tax is thus brought into line with the maximum rate of the personal income tax. This change was made to remove tax considerations from decisions on ways of doing business. The tax on fringe benefits was also increased to 48 percent from April 1, 1986. The Government proposed to introduce a full imputation system in 1988/89 but no details were provided.

3. Indirect tax reform

The main reform here is the introduction of the "goods and services tax" on October 1, 1986. This is essentially a value-added tax levied at the single rate of 10 percent on a very wide base including imports. Exports would be zero rated and would get a rebate for taxes paid on their inputs. The "goods and services tax" would replace most of the other indirect taxes except some specific ones such as those on tobacco products, alcoholic beverages, fuels, and a few others.

4. Other measures include a proposed withholding tax on interests to be introduced in 1987 and some others to reduce tax avoidance.

Sweden

The Minister of Finance has recently published broad proposals for major tax reform but these proposals have not so far been submitted to Parliament. 1/ These proposals would replace the four current personal income tax rates (which under current legislation would be 35, 50, 64, and 75 percent) by three lower rates: 33, 45, and 60 percent. The revenue loss would be compensated by a broadening of the bases of the personal and the corporate income taxes and the net worth tax, and by higher indirect taxes. Tax rules would be simplified and a more uniform treatment of income from capital would be legislated. It should be mentioned that income taxes had already been reformed in 1983-85 when marginal tax rates had been considerably reduced from the very high levels they had reached in the early 1980s when almost half of the population faced a marginal tax rate exceeding 50 percent.

Proposals for the reform of the corporate income tax have been made in recent months by the Federation of Swedish Industries. These proposals would sharply reduce the corporate tax rate from 52 percent to 25 prcent while they would substantially broaden the base. The Government's reaction to these proposals has been reported to be favorable.

V. Concluding Remarks

In the previous pages I tried to survey as concisely as I could very recent tax reforms in a variety of countries. In the concluding remarks I would like to address several questions. First, were the tax reforms in other countries a response to the U.S. Tax Reform Act or a response to common preoccupations? Second, were the response from the other countries uniform in the sense that one finds the same changes across countries? Third, and more specifically, will the U.S. Tax Reform Act of 1986 have a specific impact on other countries? Finally, has the time come when large countries ought to coordinate major tax reforms to minimize possible negative impacts on other countries?

The first of these questions was addressed at some length at the beginning of this paper. To repeat the basic argument made earlier, a change in the political environment, combined with different technical findings, pointed toward reforms for certain aspects of the tax system. These reforms were promoted by concerns with equity, efficiency, and simplicity of the tax systems. The paper was emphasized

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1/ See Tax Reform in Sweden: A Proposal (April 1987). This is an English translation, with a foreword by Kjell-Olof Feldt, Minister of Finance.

that the present equity concept is somewhat different from that of earlier times. In the past vertical equity was the main preoccupation; at present it is horizontal equity. A major recent preoccupation is the differential burden of taxation on wage earners and on those who receive incomes from other sources. The concern with efficiency may have been promoted by the low growth rate of many of these countries and by the increase in the unemployment rate. This concern has been heightened by the results of various studies which appear to indicate that efficiency costs of high marginal tax rates may be significant. The objective of simplicity is perhaps not an independent one but is closely linked to the concern with equity. However, there has been concern with the size of resources allocated to the "tax industry."

Dealing with the second question, of whether the response of various countries was uniform, the answer could be noncommittal since tax reform is always country specific. Nevertheless, there are many common trends. Among these one could perhaps mention the following:

(1) The increasing dissatisfaction with the high marginal tax rates of the personal income tax. Many countries have reduced or are in the process of reducing those rates. This reduction is often facilitated by the fact that the revenue loss associated with the rate reduction is much less at the high rate than at the low rate.

(2) Many countries have tried to restructure the tax base. One finds a wide agreement on the need to increase the standard deductions and/or the personal exemptions but this increase is accompanied in many but not all cases by the elimination of many other "tax expenditures." The increase in the personal exemption and standard deduction may be a response to the demand for simplicity and may also reflect a concern for relatively poor taxpayers; the elimination of the other tax expenditures may be a reaction to the quest for horizontal equity. It may also reflect a growing dissatisfaction with excessive governmental intervention in resource allocation.

(3) There is a fairly broad concern about problems created by the deductibility of interest payments. 1/ In several countries, including Japan, Denmark, Norway, the United States, and a few others, the deductibility of tax payments has been challenged and this challenge has resulted in some countries in what is de facto a schedular personal income tax system since interest incomes are taxed separately with a flat rate. A schedular system is more acceptable when tax rates are not very progressive. As a consequence, we may see in future years less general preoccupation with the concept of a global income tax than in the past.

1/ For studies that deal with this issue, see (Steuerle, 1985; and Tanzi, 1984).

(4) Many of these reforms have tried to reduce the taxpayers' arbitrage related to (a) present and future income, (b) different types of income, and (c) different forms of business organizations. Countries have become keenly aware that when tax rates are high and progressive, taxpayers will try to shift income from periods when they would be subject to high rates to periods when they would be subject to low rates. They will try to channel income toward activities that are taxed at lower rates and they will try to carry out their business through organizational forms that provide the greatest tax benefits. A lowering of the progressivity, combined with a schedular taxation of interest income, and a top personal income that is close to the corporate income tax rate reduces these possibilities. In many countries the highest personal income tax rate and the basic corporate rate are now much closer than they used to be. This is a major change from the past when there was at times a difference of 30-40 percentage points between the two rates.

(5) There is a lot of concern about abuses connected with fringe benefits and two countries (Australia and New Zealand) have introduced specific taxes on those benefits. Other countries have introduced limitations to the fringe benefits that could be taken as deductible expenses.

(6) There is also a movement toward the elimination of the distinction between capital gains and other forms of income. Again the lowering of the marginal tax rates facilitates the integration of capital gains with other incomes. However, the problems created by gains connected with inflation have not been universally dealt with.

(7) For the corporate income tax there is a trend toward the lowering of the basic rate and a broadening of the base. However, this trend is less universal than for the personal income tax. This trend is also more controversial among tax experts, especially in the United States. Governments seem to be losing their enthusiasm toward the possibility of influencing investment decisions in ways that they consider beneficial to society. Thus, investment credits have been abolished in a variety of countries and depreciation allowances are being redefined to bring them closer in line with economic depreciation. At the same time the "classical system" of taxing corporations is being challenged and imputation has been introduced, or is in the process of being introduced, in a few countries.

(8) There is a movement toward a greater reliance on indirect taxes. This movement was perhaps started by the United Kingdom but it is spreading to other countries, including the United States, where some increases in excise taxes have already occurred.

(9) Finally, many of these reforms seem to be revenue-neutral in intentions if not in results. One important exception is Germany, where, perhaps, the major objective of the reform was revenue reduction to provide some fiscal stimulus to the economy. Governments do not seem

to have accepted the theories of some economists that rate reductions would automatically generate more revenue in the future. Perhaps the experience of the United States after the 1981 reform provided a useful lesson to others.

As to the third question, it is difficult to speculate on the direct impact of the 1986 U.S. Tax Reform Act on other countries. The Act will inevitably affect some important decisions especially with respect to foreign investment flows. Some international corporations may decide that it is more convenient, for example, to have their legal residence in the United States than, say, in Japan. There has been a lively discussion in Japan whether the United States might become a kind of tax haven for Japanese corporations. The same considerations are relevant to the movement of some highly skilled and internationally mobile individuals. For example, with the internationalization of the capital market, bond traders may be as effective in New York as they would be in Tokyo. Thus, tax consideration may play a role for some of these people.

In this connection, one must raise the question of whether these potential movements respond to what are seen as permanent or temporary levels of tax rates. Given the current size of the U.S. fiscal deficit and the fairly general agreement among policymakers that it needs to be reduced, a logical question to ask is whether foreigners will see the current income tax rates in the United States as permanent or whether they will see them as temporary. Of course, the more they think that these rates are permanent, the more likely it will be that they will respond to the U.S. Tax Reform Act.

Finally, given the fact that we now live in a world that has become highly interdependent, it would seem desirable if countries became fully aware of (and more concerned about) the effects of their tax reforms on other countries. These external effects can be substantial, especially when the countries are large. The size of these effects increases as the countries become more interdependent. These effects may relate to movements of capital and of other factors of production. It must be recognized that just as it is possible to have competitive devaluations, it is possible to have competitive tax reforms. So far there is no evidence to suggest that competitive tax reforms have been pursued. However, there is evidence to suggest that the external effects of tax reforms, whether positive or negative, were not taken into account. Tax reforms have responded mainly to domestic requirements and political concerns. The effects on other countries were given low weight.

Perhaps the time has come for policy coordination among major countries to extend to tax reforms. These reforms, even when they are revenue neutral, can be as powerful in their effects on other countries as changes in monetary or fiscal policy. Therefore, they need to be considered in policy coordination just as other policies now are. Some international organization could play a role in making countries aware of the impact on other countries of their tax reform actions (see also

on this, Tanzi, 1987). As the institution entrusted with the task of surveillance, and as the one with considerable expertise in public finance matters, the Fund would seem to be the logical institution to assume this role. The time may come one day when industrial countries could jointly discuss ways in which their tax systems could be reformed in a manner to maximize both domestic and world welfare.

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