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Introduction and Summary

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Since the early 1950's, the rate of economic growth in Japan and in a number of Western European countries has been significantly higher than that in the United States. For example, during the decade from 1950 to 1960, the average rate of growth in real gross national product was 9.5 per cent in Japan, 7.7 per cent in West Germany, 6.0 per cent in Italy, 4.4 per cent in the Netherlands, and 4.2 per cent in France, compared with 3.3 per cent in the United States.

It is, of course, generally recognized that economic growth in democratic, largely free-enterprise societies can stem from a number of sources and that the importance of any single source—whether it be a larger labor force, more capital, more education, or a general advance in technology—may vary considerably from country to country. There has developed in this country a widespread belief that much of the current disparity in growth rates is attributable to differences in tax systems; that is, that the tax systems of these foreign countries are in many important respects less burdensome on growth-generating activities than the tax system of the United States, and that these countries have been able to accelerate their growth by adopting special tax measures, most of which were designed to encourage personal or corporate saving as well as capital-widening or capital-deepening investments.

This conference was concerned with the postwar tax policies of the five foreign countries mentioned above and of two other European countries—Sweden and Great Britain—whose growth rates were lower than that of the United States during the 1950's, but whose tax systems also contained special provisions which might be expected to have growth-generating effects. Particular attention was focused on such questions as the extent to which specific tax measures had in fact contributed to economic growth, and what

significant generalizations might be made from the experience of these countries.

This summary outlines the major points in the principal papers that were prepared for the conference and presents the highlights of the discussion which took place at the conference sessions.

JAPAN

Ryutaro Komiya attributes Japan's high rate of growth during the 1950's to the large proportion of its gross domestic product allocated to capital formation. to its rapid improvement in technology, and to its rapid absorption of disguised unemployment through shifts in its labor force from low-productivity sectors of the economy (such as agriculture, retail trade, and small business manufacturing) to high-productivity sectors. Postwar Japan was also favored by a very low incremental capital-output ratio which, Komiya points out, has meant that the productive efficiency of investment is very high.

Among the factors which have contributed to Japan's high level of capital formation, Komiya mentions: (1) the need to reconstruct facilities damaged or destroyed during the war; (2) the opportunity to exploit technological innovations which were developed in the United States and other countries during and after the war; (3) domestic land and labor reforms which brought about a more equal distribution of income and hence an expanded market for consumer goods; and (4) changes in the industrial structure which stimulated the growth of enterprising new firms and made most sectors of the economy more competitive. These factors, together with a steadily rising consumer demand fostered by rapidly rising incomes and large annual tax reductions, were the main driving forces behind the steadily rising level of capital formation in Japan during the late 1950's; but the fact that the level of government expenditures and taxes has been kept low is also regarded by Komiya as a contributing factor. Low levels of defense and social security expenditures and of interest on the public debt have made it possible to keep the level of government revenue low. Yet, in spite of this,

Japan's ratios of government net saving and of government fixed investment to gross domestic product have been very high, and these high levels of saving and investment have made a direct contribution to capital formation.

Komiya recognizes the importance of the availability of funds as a determinant of the level of private capital formation. He points out that both personal and corporate saving have been extremely high in Japan since the early 1950's, and that, in addition, corporations depend on bank loans as a source of fixed investment funds more heavily in Japan than in other countries. He attributes the high level of personal saving during this period to the high rate of growth in real per capita income, and to certain institutional factors such as the high and increasing proportion of "bonus" income in the total income of wage and salary earners. But another contributing factor has, in his opinion, been the declining ratio of direct to indirect taxes, which has meant a decline in the progressivity of the Japanese tax system as a whole. The high propensity to save of Japanese corporations is attributed in part to their greater need to accumulate internal funds and in part to the fact that management has relatively more freedom in the disposition of profits than in other countries. In the course of the discussion, it was brought out that the availability of bank credit during this period depended on the credit policies of the Bank of Japan, and that, in general, their policy was to lend freely until this gave rise to a balance-of-payments problem.

Komiya examines a number of the special tax provisions that were introduced to promote personal saving, such as (1) the exemption from personal income tax of interest from small deposits, (2) the exemption of capital gains on securities, (3) a limited deduction of life insurance premiums, and (4) the exclusion of a certain percentage of dividend income from personal income. Komiya is unable to measure econometrically the effects which these provisions have had on the disposition to save. If they have increased personal saving, he fears that this has been the case only because of their adverse redistributive effects. He concludes that it would have been better to increase government saving by increasing taxes, rather than to try to increase personal saving by special measures such as these.

Komiya's examination of the highly selective special tax provisions that were designed to promote corporate saving in specific industries and investment in particular types of machinery and equipment leaves him in some doubt about their over-all effectiveness. For example, although many special provisions for accelerated depreciation of assets have been introduced since 1951 for the "modernization of industrial facilities" or the "advancement of new technologies," most of them are said to be very selective in their application. Frequently, the particular industry or type of machinery and equipment eligible for a particular rate is left to the discretion of the Minister of Finance. Komiya points out that the selective nature of this system entails such complicated administrative procedures that only large firms can cope with them and the result is that accelerated depreciation has not necessarily raised the *aggregate* level of capital formation in Japan. In view of the strong investment demand and an excess demand for investment funds, the loss of accelerated depreciation allowances would have meant only more bank loans to industry, and more Bank of Japan advances to the commercial banks, as long as this did not create balance-of-payment difficulties.

Other special tax provisions of this type examined by Komiya include the tax exemptions granted on income from "important new products" and from exports, and the provisions permitting corporations to set up tax-free reserves for a variety of specified purposes. While he concedes that these provisions, like those on accelerated depreciation, may have had significant differential impacts, he doubts whether they have been very effective in increasing aggregate saving or investment. He also suggests that the discriminatory character of many of these provisions may have resulted in some misdirection of resources within the Japanese economy.

Komiya's conclusions on the effectiveness of Japan's postwar tax policies in promoting capital formation and economic growth are that, while some of the desired effects have been achieved, these have often been gained at the expense of tax equity. Unfortunately, there is little empirical knowledge of the contribution which specific growth-promoting policies have made; but it is Komiya's opinion that much of what has been accomplished could have been achieved more equitably in other ways.

In their comments on Komiya's paper, both Sumio Hara and Makoto Yasui express their general agreement with the analysis and with most of the conclusions. In their assessment of the effectiveness of the special tax provisions, however, both commentators are more positive in their views that Japanese tax policies had made important contributions to that country's growth rate. While admitting that some errors of designation may have been committed by the government, both strongly believe that accelerated depreciation has contributed to the modernization of Japanese industry.

In the general discussion of Komiya's paper, considerable attention was given to the question whether accelerated depreciation, by limiting the possibility of reducing taxes on consumption, did increase aggregate investment or whether, by limiting the possibility of further credit expansion, it merely redistributed what in effect was a given amount of funds available for investment.

WEST GERMANY

Karl Häuser's study discusses first of all the role which tax policies played in Germany's "miraculous" recovery from its state of economic collapse in 1945 through the first half of 1948. In the following period, from 1948 to 1962, there was no lack of over-all demand, and consequently the rate of economic growth during these years was primarily determined by the rate at which the supply of labor and capital could be increased, or its quality improved. It is, therefore, to the effects of taxation on work, investment, saving incentives, and the modernization and rationalization of production that Häuser directs his attention.

Between the end of the war and the currency reform of 1948, the German people were subject to very heavy tax burdens. Income and excise tax rates were particularly high, and there was also a turnover tax, a tax on net wealth, and a tax on local enterprises. Since 1948, rates have been continuously reduced, although Häuser contends that the over-all burden has remained considerably higher than that of other countries. Excluding the social security levies, he estimates that taxes take 23.4 per cent of GNP. In examining the way in which tax reduction measures have contributed to economic

growth, Häuser finds it convenient to consider separately (1) the period of rapid recovery, 1948-51, (2) the period of "normalization" and consolidation, 1952-57, and (3) the period of overemployment, 1957-62.

The first period—during which Marshall Plan aid was received, restrictions on industrial production were moderated or eliminated, and the currency reform took effect—was characterized by a very rapid rate of growth, a low marginal capital-output ratio, and increasing labor productivity. During this period, a small amount of investment could go a long way in bringing back into production plant and equipment that had been previously idle. The problem, as Häuser points out, was to supply the capital needed to sustain the recovery effort. The contribution of tax policy to the solution of this problem took a number of forms: personal income taxes were lowered somewhat; special depreciation allowances were granted to businessmen or farmers who reinvested in their own enterprises; and in the case of businesses, only half of the income left in the business (up to 10 per cent of total profits) was subject to personal income tax. With the effective rate of this tax reaching 50 per cent at the German equivalent of $6,250, Häuser points out that the last two provisions virtually compelled entrepreneurs to invest at very high rates, although he doubts whether any additional incentive to invest was needed. What these provisions did do, however, was to provide additional means for investment. Both provisions were repealed in 1951.

Growth continued during the period of "normalization" but at a slower rate. By this time, expanding output required completely new plants, a development which nearly doubled the incremental capital-output ratio. A shortage of investment funds continued to be the limiting factor on growth; and, with personal saving kept low by a high propensity to consume (and low wages), three-fourths of total saving had to come from business and government. After the repeal of the special depreciation allowances in 1951, tax encouragement for investment was given only in special cases and to encourage housing construction and shipbuilding (until 1954). Häuser points out, for example, that in certain basic goods industries where prices were still controlled, an investment incentive was provided by permitting one-half of an investment in machinery and

one-third of that in plant to be written off in three years. Moreover, for industry generally, a shift from the straight-line to the declining-balance method of depreciation at twice the straight-line rate was permitted after 1951. Exporting was encouraged by the provision of a tax-free reserve and by a special deduction of 1-10 per cent of export-derived income. The main thrust of tax policy during this period, according to Häuser, was to overcome bottlenecks and to stimulate capital goods industries. The government's success in accomplishing these ends reinforced the boom and spurred growth; but it also resulted in some overcapacity and a slowing down of growth by 1958.

Häuser also discusses a number of measures that were adopted to encourage personal saving. Although, at least up to 1958, these measures were expected to make some contribution to economic growth, they were also viewed as redressing to some extent the inherent inequity of the liberal investment allowances. Among the types of savings favored by their deductibility from taxable income in limited amounts were: savings for insurance, savings for the construction of dwellings, and direct savings accounts. In certain cases, premiums were also paid to private savers from public funds. Häuser concludes that this was a costly program but not a very effective one in raising the volume of saving.

Although Häuser thinks that high income taxes may have had some adverse effects on work incentives, especially after 1958, he finds no evidence to support the view that these high rates have limited the economic activity of entrepreneurs to any perceptible degree. He suspects that the turnover tax may have impeded specialization and so prevented the optimum allocation of resources. On the other hand, he notes certain steps that were taken by the government to improve resource allocation, such as allowances for the construction of new houses, the exemption of newly built houses from local real estate taxes, and the tax incentives given for investment in export industries and in certain basic industries, as previously noted. Finally, Häuser calls attention to the fact that, since 1953, distributed corporate profits have been taxed at a substantially lower rate than retained profits. By 1958, when the two rates were 15 and 51 per cent, respectively, this split was viewed as one of the major methods of fighting an overinvestment boom.

Häuser does not view the West German tax system as a very effec-

tive economic stabilizer. Neither the assessed income tax nor the corporation tax lend themselves to this purpose, mainly because the tax liabilities arising under both of these levies are paid in quarterly instalments on the basis of the previous year's income. Whereas taxpayers normally reduce their instalments if they anticipate a reduction in income, they seldom do the opposite when the circumstances are reversed.

In his discussion of Häuser's paper, Fritz Neumark expresses his agreement with the view that German tax policy contributed much more to growth than it did to stability during the 1950's. He also calls particular attention to the inequities in the distribution of tax burdens and to the complexities in the tax laws that resulted from Germany's growth-promoting tax policies. This, he says, was a tax system that favored the wealthy. Undistributed profits represented more than 40 per cent of total capital formation right after the war and about 30 per cent between 1953 and 1960, and this in his opinion was due in large part to the preferential tax treatment given retained earnings. Neumark goes on to point out that steps could have been taken to correct some of these inequities if the government had been willing to make the tax on net wealth somewhat progressive or had been able to reform the inheritance tax.

Paul Senf, in his comments on the Häuser paper, suggests that the main object of nearly all the tax reforms since the war has been the relief of the German economy and that there was no conscious growth policy during this period, any more than there was an effective stabilization policy. It was, however, generally agreed that, whatever their purpose, the reforms of the late 1940's and early 1950's did favor economic growth. In commenting on the extent to which the German efforts to hold down consumption and expand investment increased the concentration of wealth in business, Senf points out that the government sector as well as the business one expanded its holdings during this period. This was the result of an extraordinarily high level of government lending, which may have been as important in contributing to growth as the tax measures.

In the open discussion of the Häuser paper, questions were raised about the importance of special tax concessions, such as those made in Germany, from an incentive standpoint. It was asked whether

the liquidity effect of these concessions was not more significant, and if so why the same result could not have been obtained by shifting the emphasis from direct to indirect taxes. The German conferees were, however, of the opinion that what was done was more effective than an across-the-board reduction in income tax would have been. There was considerable doubt as to whether there was a direct connection between the inclination to produce more, on the one hand, and the fiscal treatment of the payments resulting from these activities, on the other, and consequently it was not considered absolutely necessary in the interest of economic growth to have, say, tax exemptions for overtime payments. Nevertheless, it was still believed that a policy of keeping the rates high and having special incentives was more effective than one of straight rate reduction.

ITALY

Francesco Forte's report covers both the growth-retarding and the growth-promoting features of the Italian tax system. Although Italy's rate of growth during the 1950's was the second highest among the Western European nations, Forte maintains that this impressive achievement was accomplished in spite of a fiscal system that was in many respects an obstacle to growth. On the other hand, he points out that many reforms were effected in direct taxation during this period and that they did make some contributions to the country's rate of expansion. The trouble was that these fiscal reforms were not carried far enough and were often not well enough carried out to make a great deal of difference. The government was trying to do the right thing; but it did not always succeed in getting what it wanted. Much more must be done, in his opinion, if Italy's progress of the past decade is to be continued.

The major factors accounting for Italy's high growth rate, according to Forte, have been the absorption of real and disguised unemployment in the South, a broadening of consumer markets, especially for durable goods, and high profit margins which have enabled Italian firms to finance internally a high rate of capital formation.

The country was able to tap its large reservoir of unemployed or underemployed agricultural workers in the South, both by moving some industry into that region and by inducing the workers themselves to migrate to the North. As Forte points out, this has meant higher wage payments without higher wage rates, as well as an increase in labor productivity. The increasing demand for consumer goods that was generated by this process not only necessitated the enlargement and expansion of production facilities, but also made possible economies of scale in the distribution process. It is significant that, during the 1950's, all of this was accomplished without any increase in wholesale prices. Other circumstances favoring growth at this time were an ample supply of technical personnel in the North, a fairly high propensity to save on the part of the well-to-do Italians who were benefiting most from the postwar boom, and the expansion of European and North American markets for Italian exports.

Not all sectors of the economy or all sections of the country have shared in these gains to the same extent, according to Forte. Increases in the level of investment and of economic activity have been greatest in the heavily industrialized sections of northern Italy. Agriculture has lagged; and, although employment has increased in trade and services, it is doubtful whether labor productivity has increased very much in either sector. On the other hand, there have been big increases in manufacturing employment and output, especially in steel, automobiles, engineering, and chemicals.

Forte points out, however, that the Italian economy has encountered some problems during the last few years which have tended to slow down its rate of expansion. Wage rates have begun to rise faster than labor productivity, reducing retained earnings and forcing the rapidly growing consumer durable goods firms into the capital market where they have to compete with public enterprises and with the housing industry for investment funds. Finally, rising domestic costs, which have adversely affected exports, and increased consumption of agricultural and other imported products cut down quite sharply, in 1962, Italy's favorable balance-of-payments position.

Turning to the Italian fiscal system, Forte notes the steady rise in national tax revenue, both in absolute terms and as a percentage of national income. Excluding social security levies, the yield of taxes imposed by the national government rose from 15 per cent of national income in 1949 to 21 per cent in 1961. Local taxes, the yield from which represented 2.8 per cent of national income in 1961, lifted the aggregate tax burden to 23.8 per cent of national income in that year. He also points out that, at the national level, nearly 75 per cent of the tax revenue comes from indirect taxes including the general sales tax (IGE), which yields more than all of the direct taxes combined. As a result, the Italian tax system tends to be quite regressive, with the relatively slight dependence on income and wealth taxes favoring accumulation of savings by the upper income classes and stimulating investment by low marginal rates. On the other hand, the relatively heavy reliance on consumption taxes has, as Forte points out, tended to check the spending of the masses. Furthermore, although the over-all burden of taxation was quite high in Italy during the 1950's, public expenditures also rose sharply as the government increased its investment in public enterprises, highways, and education. Not only did these expenditures favor growth, but the fact that they could be financed without recourse to public borrowing during this period meant that the government was not competing with private investors in the capital markets, nor contributing to inflationary pressures by expanding the money supply.

Entering into more detailed descriptions of the Italian tax structure, Forte observes that the major part of the direct tax revenue comes not from the direct personal tax on incomes but from the so-called "real" taxes on movable wealth (including income from work) and on land and buildings. Although the "movable wealth" tax is imposed at varying rates on the different categories of income, it affects wages and profits more than it does interest and rents. In other words, it tends to be more of a burden on the working and entrepreneurial classes than on the *rentiers,* a characteristic which cannot be said to favor growth. In 1961, the revenue from "real" taxes on land and buildings was only about one-fifth of that from movable

wealth. Forte contends that the low yield of the land tax reflects the inadequacies of the present assessment system and the fact that the bulk of this tax is assessed and collected by local governments. It tends to be heaviest in the poorest communes and provinces, and lightest in those areas where the farmers are most prosperous. As for the tax on buildings, Forte points out that receipts are kept down because most old houses are still subject to rent controls and most new ones have been granted tax exemption.

Forte argues that the "movable wealth" tax on incomes derived from work is neither a very efficient revenue instrument, nor does it provide a tax environment particularly favorable to economic growth. Even though this tax was personalized and its method of assessment modernized by the tax reforms introduced by Ezio Vanoni in 1951, it is still widely evaded, especially by self-employed business or professional persons. The fact that small businesses are favored, both by more moderate assessments and by lower rates, tends to penalize growth and to preserve small and inefficient business units. Firms of the latter type may or may not be taxed on the basis of their accounts, and even when they do choose to present their accounts, these frequently are quite unreliable; even among the larger firms, there have been large margins of evasion.

Perhaps the most unsatisfactory of the direct taxes, according to Forte, is the progressive personal tax on incomes which, although legally imposed at rates ranging from 2 to 70 per cent, is widely evaded. Income in the form of interest, dividends, and the distributed profits of closely held companies generally escapes tax because no satisfactory method has been found for assessing these types of income. The courageous attempt in 1956 to force stockholders to report their investments only served to drive capital out of the country. Although, as Forte points out, much of this capital subsequently came back to Italy as foreign capital, it did not generally flow back into the market for shares.

Italy's general sales tax (IGE) is a turnover tax imposed at a general rate of 3.3 per cent; but Forte points out that there are a certain number of "increased" and "reduced" rates, as well as a system of "condensed" rates which are imposed at a single stage in the production process of certain products as rough equivalents for the

multiple-stage levies that they replace. This has resulted in a tremendous variety of rates, and dissatisfaction with such a highly differentiated tax system has prompted an increasing number of persons to urge the substitution of a value-added tax and a single-stage tax on sales for the present IGE. Such a combination would, according to Forte, have the advantage of a broader coverage, and allow a more rational policy toward differentiation to be followed.

Turning to some specific features of the Italian tax system which may have made a positive contribution to that country's economic growth, Forte discusses the effects of the "corporation tax," the special allowances for accelerated depreciation, and the assortment of special tax provisions adopted to spur economic development in the South and to increase investment in the depressed areas of central northern Italy.

Unlike most levies of this name, the Italian "corporation tax," which was enacted in 1954, is not a tax on corporate profits as such. Instead, it consists of an annual tax of .75 per cent on invested capital (capital stock, surplus) and an excess profits tax of 15 per cent on taxable income after allowing a credit of 6 per cent of invested capital. In addition, a tax rate of 0.5 per cent is applied to the value of bonds and debentures outstanding at the end of the fiscal year. Forte points out that this tax on companies tends to favor new and low-earning enterprises, but that it has a disincentive effect once a firm crosses a certain threshold. After a firm is earning a rate of return on its invested capital of about 9 per cent (before taking the deduction for the "movable wealth" tax and other "real" taxes), additional profit is taxed quite heavily, and this is said to dampen interest in risky ventures. Another serious fault that Forte finds with this tax is that it does not differentiate between the *rentier* type of activity carried on by real estate and investment companies and the entrepreneur type engaged in by industrial and commercial enterprises. He contends that the law, in effect, favors the former whereas, from the standpoint of economic growth, it ought to be the other way around.

Forte points out that Italy's accelerated depreciation allowances have taken two forms: (1) a permanent provision permitting the period of depreciation to be shortened by not more than two-fifths, in

the case of new facilities or where existing facilities have been transformed, reconstructed, or improved; and (2) a temporary provision granting initial allowances for new investments, subject to an income limitation. The first of these provisions, which was introduced in 1951, was viewed as a method of liberalizing the depreciation provisions in the Italian law which, up to that time, had been quite restrictive and permitted use only of the straight-line method based on historic cost. The second provision, which was adopted for three years in 1956, granted, for the "real" taxes on profits, an allowance of 10 per cent of the cost of new installations over and above the normal and accelerated depreciation allowances; but the additional allowance could not exceed 5 per cent of reported income and it could be taken only by enterprises that were required (or willing) to be taxed on the basis of their "accounts." In this way the government hoped to encourage small enterprises to submit to the preferred assessment method.

The initial allowance, which may be taken in the year of expenditure and in each of the two succeeding years, has been continued in effect by virtue of repeated three-year extensions of the original statute. Forte contends that the clause limiting the allowance to a stated percentage of reported income discriminates against growing enterprises and favors very large ones. Furthermore, he questions whether the government's attempt to achieve both assessment reform and growth objectives by means of this particular provision was well conceived. He does not, however, undertake to assess the effectiveness of these accelerated depreciation provisions in spurring investment.

The methods which have been adopted to encourage investment in southern Italy include a ten-year exemption from the "movable wealth" tax of the business income of eligible industrial enterprises located in that region and a 50 per cent reduction in the rate of this tax on business income earned anywhere in Italy if such income is invested in the South. Exemption from customs duties has also been granted for machinery imported from abroad for installation in southern enterprises. It is Forte's view that the results of these special tax concessions in stimulating industrial growth have been quite modest.

Siro Lombardini, in commenting on the Forte paper, is even more pessimistic about the effectiveness of tax exemption in promoting regional development. If some form of government intervention is needed to achieve a more balanced growth of the Italian economy, he would favor the use of direct subsidies which could be administered more flexibly and with more telling effect on investment decisions. In response to this argument, Forte expressed the view that it was still too early to judge the effectiveness of this legislation. He felt that investment in the South was becoming more profitable because of the shortage of manpower and the congestion in northern Italy, and that more businesses were becoming aware of the tax advantages to be enjoyed by locating in that region.

During the open discussion of the Forte paper, it was observed that the Italian experience seemed to suggest that there was very little connection between the rationality of a country's tax system and its rate of growth. The rates of growth in countries like the United States and the United Kingdom, which appear to have relatively rational tax systems, are not altogether satisfactory; while in Italy, where the tax system is admittedly quite irrational and quite inequitable, a high rate of growth is found.

THE NETHERLANDS

In his analysis of the role which tax policy has played in promoting postwar economic growth in the Netherlands, Cornelis Goedhart gives particular attention to the methods adopted to insure an adequate level of national saving, since this, rather than the stimulation of investment, has been the main problem in that country. He points out that the Netherlands has had to have a high level of investment in order to guarantee employment and to provide a rising real per capita income for a population that was increasing somewhat more rapidly than in other EEC countries. This need was increased by the unfavorable capital-output ratio.

Fortunately, the Netherlands was favored during this period by a sufficiently high rate of expansion of total effective demand to induce the necessary level of investment. But, since exports of goods

and services account for 50-55 per cent of national income, this increase in total effective demand depended to a considerable extent on the ability of the Dutch export industries to maintain their competitive position in world markets. This, in turn, depended on the willingness of Dutch wage-earners to exercise self-restraint in their wage demands and to let the government have the final say in establishing wage levels. Indeed, Goedhart asserts that this instrument of wage policy "was the most important growth-furthering tool in the hands of the government" during the 1950's.

But he goes on to point out that a high and rising level of total effective demand could not guarantee that sufficient savings would be available to finance economic growth in the Netherlands, and that it was to further this objective that fiscal policy, and particularly tax policy, had an important role to play.

According to Goedhart, a major influence on savings in the Netherlands since the war has been the policy of financing a high proportion of government outlays from tax revenue. In other words, it has been the aim of the government to maintain as high a ratio as possible of saving (and investment) to national income by a high level of "tax-forced savings" through the national budget. He recognizes that not all of this has been net gain, but he presumes that private saving is less affected by taxation than by loan finance.

Goedhart also stresses a fundamental rule of Dutch budget policy since 1959 that the rate of increase in the central government's expenditures should be smaller than the rate of increase in national income. This rule, which calls for a greater reduction of tax rates than would be necessary to eliminate the effects of progression alone, reflects the government's view that some lowering of both average and marginal rates is necessary if economic growth is not to be endangered by harmful negative incentive effects. Since the end of the war, the Netherlands tax system has drawn a high proportion of its revenues from direct taxes and has emphasized tax equity through the principle of progression. Although, as Goedhart points out, rates have been reduced considerably over the past ten to fifteen years, it has been those with low incomes who have benefited most from these reductions. For middle and upper income families, tax rate reductions have been more modest and have been substan-

tially offset by rising prices so that, for comparable real incomes, the reduction in tax burdens has been much less than it might appear. Although the current budget policy of the Netherlands implies that an increasing part of future increases in real national income will be earmarked for private rather than for government spending, Goedhart states that it is too soon to say how effectively this policy will be carried out.

Actually, he finds that tax policy has made little contribution to personal saving since the war. As noted above, effective rates in the middle and upper income classes have not been significantly reduced, and the special measures adopted to encourage small private savings have not, in Goedhart's opinion, added much to total saving, even though they have had some effect on the savings habits of many persons. For example, he mentions the tax exemption granted individuals on premiums paid for pensions and life annuities up to a maximum of f 3,600 a year, which has resulted in an enormous influx of savings to life insurance companies and pension funds; he also mentions the exemption granted on special premiums offered to encourage young people to save.

It is Goedhart's view that tax incentives to encourage private saving have been considerably more effective when they have been directed at raising the level of business saving. Investment rebates and accelerated depreciation allowances are cited as the most important devices of this type. The former originally permitted business firms to deduct from their taxable profits 4 per cent of the total cost of new durable production facilities for five successive years, without any reduction of the basis of these assets for purposes of depreciation. The terms under which these rebates are granted have been changed from time to time, and the right to take them was withdrawn altogether from November 1956 until May 1958, as an anti-inflation measure. Since 1960, two 5 per cent rebates have been allowed. Accelerated depreciation in the Netherlands has taken the form of an initial allowance which may be taken as soon as an order is placed for a depreciable asset. The percentage of total cost which could be taken as an initial allowance has been changed from time to time; originally, it was 33⅓ per cent; but since April 1960, it has ranged from 0 per cent on passenger cars to 6 per cent on new

factories and 8⅓ per cent on certain other means of production. Still another savings-stimulating device mentioned by Goedhart is the provision permitting tax-free reserves to be set up for future losses and expenses.

Although Goedhart finds that investment income has been very heavily burdened in the Netherlands, especially at the highest income levels, he does not think that the effects of this have been too serious up to the present. It is his opinion that the corporation tax has probably been shifted to a considerable extent, and he finds little evidence that there has been any substantial tax flight of well-to-do persons from the Netherlands because of high personal income tax rates. Nevertheless, he recognizes the possibility that the combination of high corporate and individual income taxes could endanger investment in the future. In this connection, he mentions the government's proposal to reduce the company tax on distributed profits by 15 per cent in order to improve the functioning of the capital market in directing savings to those firms which can use them most effectively.

In commenting further on the impact of taxation on incentives in the Netherlands, Goedhart refers to studies made by the Central Planning Bureau, particularly to the Bureau's finding that the short-run effect of a tax-induced demand expansion on investments can be attributed in large part to the resulting tightening of the labor market, which in turn stimulates labor-saving investments. He concludes from this that, in the long run, a rapid increase in total demand will probably increase incentives for both capital widening and capital deepening.

Goedhart's general conclusion is that investment in the Netherlands since the war has been increased by tax rules favoring the use of retained business earnings for reinvestment and allowing unrestricted compensation of initial losses. On the other hand, he notes the negative incentive effect of highly progressive personal income tax rates and expresses some fear that the reaction to these is becoming stronger.

J. van Hoorn, Jr., in his comments on the Goedhart paper, first questions whether the Netherlands has been altogether right in its use of tax policy to promote public saving. While recognizing that

there are certain types of activities which the government has to engage in and for which funds have to be raised, he contends that in other areas the question ought to be whether the government or private enterprise can do the job more efficiently. He wonders, therefore, whether it is necessarily true that public savings will have to be larger in volume than private savings. He also notes that most of the tax measures that have been adopted to encourage private saving and private investment have encouraged investment in existing businesses. Why, he asks, should the private investor not be free to make his own choice?

Van Hoorne also finds fault with the Netherlands government's heavy reliance on progressive income and wealth taxes while striving for a high savings-investment ratio. Pointing out that resources used in both private and public investment must be at the expense of consumption, he asks whether more weight should not be given to taxes on consumption, such as the turnover tax. Finally, on incentive taxation, he expresses some skepticism about the effects which the various special provisions have had on the level of investment and wonders whether a generally lower level of taxation might not accomplish about as much.

A. J. van den Tempel, the second commentator on the Goedhart paper, questions whether tax policy was, or should have been, directed exclusively at insuring an adequate level of national saving. While he admits that investment presented no problem from 1953 through the late 1950's, he argues that this was not the situation earlier when many of the special provisions which Goedhart discusses were as important as investment stimulants as they were in promoting a high savings ratio.

Van den Tempel is also unable to agree fully with the emphasis Goedhart attaches to the 1959 rule of Dutch budget policy. Although the principle of not allowing public expenditures to rise as fast as national income is expressed in economic terms, van den Tempel argues that it was politically inspired. As an economic argument, it would hold up only if it could be demonstrated that high income taxes had significant disincentive effects, and he questions whether such a demonstration has been or can be made. Although he too is skeptical about the value of tax incentives, van

den Tempel calls attention to the powerful effect that such measures can have under the right circumstances. At times when businessmen are uncertain about the course they should follow, the implied advice they get from the government in the form of a tax concession can, he suggests, have a positive impact on spending and investment decisions.

As for the role that wage policy has played in promoting economic growth in the Netherlands, van den Tempel points out that this policy did have one serious disadvantage in that it provided no incentive for labor-saving investments and tended to overstimulate capital-widening ones. This produced a very tight labor market, which in turn brought about wage increases.

In reply to van Hoorn's question about his apparent preference for public over private savings, Goedhart stated what he believed to be the philosophy of the Dutch government on this issue, which was simply to choose a level of taxation that was in harmony with the facts. Given the assumed percentage increases in population and labor productivity, the planned level of current and capital expenditures in the public sector, and the propensity to save in the private sector, the level of taxes has to be high enough to enable public and private investment to be covered by the sum of public and private saving. To the extent that private savings can be stimulated by tax incentive measures, tax-forced saving can be reduced.

While sharing to some extent the skepticism expressed by his discussants about the effectiveness of tax policy in promoting economic growth, Goedhart was still inclined to believe that there was at least one important thing which tax policy could do, namely, to prevent bottlenecks, and especially those arising from insufficient savings, notably from profits. Adequate internal financing was, he felt, a prerequisite for economic growth.

FRANCE

In his study Pierre Tabatoni undertakes to describe the significant part which France's tax system has played in the pursuit of its growth objectives since 1950. These objectives first came into sharp

focus in 1952, when France embarked on a program to curb inflationary tendencies and spur economic growth by freeing trade, encouraging the repatriation of capital that had taken refuge abroad, stimulating the growth of voluntary saving, and integrating more effectively investment efforts in both the public and private sectors. Efforts to increase productivity were aimed primarily at increasing the capital coefficient, although it was recognized that the investment effort would have to be supported by changes in organization and management techniques, which included greater research and development efforts, improved distribution techniques, and better education and professional training. The program itself was the expression of a "master idea," that of voluntary, flexible national economic planning.

Although experimentation with new tax techniques could not be allowed to endanger tax yields at a time when inflationary pressures could not be ignored, there were a number of important reforms made in the French tax system during this period. These reforms, according to Tabatoni, were aimed at three main objectives: simplification, neutrality, and increasing the effectiveness of the system as an instrument of economic policy. It was recognized that complexity in taxation encourages fraud; that, in the absence of tax neutrality, decisions are distorted; and that limited use might still be made of tax incentive measures, even though they might make the system less simple and less neutral. The major changes involved the conversion of the schedular income tax into a progressive global tax on the net income of individuals and a proportional tax on corporations; the transformation of a complex turnover tax system into a tax on value added (T.V.A.) and a tax on services; and the introduction of a number of provisions into the tax law to encourage business saving and investment. Among the latter, Tabatoni mentions supplemental depreciation allowances and the recognition of the declining-balance method, tax deferral on gains reinvested in depreciable facilities, tax-free revaluation of fixed assets, and loss carryovers.

Although France's average real rate of growth during the 1950's was 4.2 per cent, Tabatoni points out that there was some unevenness in the annual growth rates and identifies four periods of "rapid

growth." He attributes the more rapid rate of growth attained in some of these periods to increases in consumer demand, that in others to private capital formation, and that in still others to increases in export demand. In some years, combinations of two or more of these demands are found. He then considers the part that tax policy may have played in stimulating or contributing to these major components of total effective demand.

As for private consumption, Tabatoni observes that, paradoxically, the level of consumption appears to have increased with the tax burden. Although he assumes that both direct and indirect taxation must have influenced personal savings, he has not been able to measure the impact of these taxes in this respect. Tabatoni recognizes that there is a "tradition of tax evasion" in France, but he concludes that the actual tax burden must be smaller than the theoretical one, even without taking evasion into account. The fact that capital gains are not taxed is also seen as a contributing factor. Finally, individual income tax exemptions on certain types of interest income and the exemption of life insurance premiums (up to 10 per cent of income) may also have contributed in a small way.

As for the impact of taxation on investment demand, Tabatoni cites a number of special provisions, some of which were mentioned above, which could have increased total investment or could have directed capital formation into specific areas. Among these provisions, he calls particular attention to the treatment of investment expenditures under the value-added tax. Whereas under the previous system of production taxes capital goods were taxed both when they were purchased and when they were depreciated, under the value-added tax system producers may deduct from their monthly value-added tax payments the value-added tax already paid on all acquisitions of industrial plant, machinery, and equipment. Evidence to support the view that this change promoted capital formation is found by Tabatoni in the sharp upturn in investment which followed the enactment of the T.V.A. in 1954.

Export demand is also stimulated by the exemption of export firms from the T.V.A. According to Tabatoni, this gives French products a tax advantage amounting to about 25 per cent of total cost, an advantage which they did not enjoy under the previous sys-

tem of indirect taxes. Exporters have also benefited from special accelerated depreciation privileges given them in 1957 and from their ability to accumulate special tax-free reserves to cover the risks incurred in extending medium-term export credits.

In addition to its effects on the demand for final output, Tabatoni finds that tax policy has also affected the ability of French firms to finance their investment outlays. Although public investment accounted for about one-fourth of total investment during the period under consideration, this was concentrated mainly in the construction, transportation and communication, and power sectors. In private manufacturing, trade, and tourism, less than 12 per cent of the funds used were found to have come from the major government lending agency. Hence, in these sectors the effects of taxation on private financing of investment is still considered significant. Nothing very precise can, however, be said about the general effects of taxation in this connection. According to Tabatoni, the prevalence of tax fraud among small- and medium-sized businesses and the lack of knowledge about the ability of business firms to shift their taxes prevent him from judging the real impact of these taxes. He does point out that the French capital market is so narrow that only a few powerful firms have access to it and that a high percentage of all the financing done by French businesses has to be done internally. He thinks that the tax system may be one reason for this because it reinforces the individual saver's inclination to keep his saving in liquid or semiliquid forms; but this is about as far as he goes in linking the general structure of taxation to the financing of investment.

On the other hand, more is known about the effects of special provisions in the French tax law on the ability of business firms to finance their investments internally. Tabatoni points out that many types of tax-free reserves are available, of which depreciation reserves account for nearly three-fourths. He also notes that large corporations appear to be better able to take advantage of these reserve provisions than the smaller firms. Since 1960, all taxpayers have been able to use the declining-balance method for new assets other than residential and office buildings. He finds, however, that a large number of business firms have not elected to take advantage

of this option. A similar situation is noted with respect to the provision which permits the revaluation of depreciable assets; revaluation profits are exempt from profits taxes but a tax of 3 per cent is imposed on the reserve. Tabatoni reports that a relatively limited use has been made of this privilege by businesses in general, although one-third of the corporations have done so. Among small businesses, failure to take advantage of this provision may be due to ignorance, to the complexity of the system and the expense it entails, or to the fact that the 3 per cent tax on revaluation reserves may constitute a financial burden. Finally, attention is called to the provision in the French tax code which exempts capital gains realized upon the sale of business assets if the firm undertakes to reinvest the sales proceeds within three years. Since the gains must be earmarked for use as reserves against the depreciation of fixed investments, Tabatoni observes that this exemption is, in effect, a form of accelerated depreciation.

Recognizing that productivity may be increased by the discovery of new products and methods of production and by the adoption of better management techniques, the French government has adopted a number of special tax measures designed to encourage scientific research and a greater degree of business concentration. Tabatoni mentions in this connection the special depreciation allowances granted to stimulate investment in research facilities, the favorable treatment of patents, and the use of special measures to promote mergers and the participation by small firms in cooperative ventures in such fields as market research and accounting.

Tabatoni concludes that the new tax techniques adopted during the 1950's have encouraged business firms in France to draw on internal sources for the financing of investemnt, that they have contributed to improved management techniques by encouraging mergers and other forms of business consolidation, and that they have strengthened the position of French firms in foreign markets. Under the present tax system, business enterprises enjoy increased autonomy and a greater competitive potential.

In their comments on the Tabatoni paper, Robert Liebaut and D. de la Martinière stress the contribution which the T.V.A. has made to economic growth in France. This levy, which de la

Martinière regards as a general tax on income measured by expenditure, is said to promote growth not only by the encouragement it gives to savings but also because it lends itself less readily to fraudulent practices than the income tax, and so avoids the distortions which result from such practices. Furthermore, given the proneness of the French taxpayer to tax evasion, the fact that the opportunities for tax fraud are fewer in the value-added tax than they are in the income tax makes the former a fairer tax on the whole. And, since the tax burden increases progressively as expenditure covers a lesser proportion of foodstuffs (taxed at low rates) and a larger proportion of luxuries (taxed at higher ones), this tax is said to be based on the principle of ability to pay.

SWEDEN

In the introduction to their report, Leif Mutén and Karl Faxén take exception to the tendency found among some tax experts to overstate the effects of tax measures upon the economic actions of firms and individuals. Pointing out that economic growth presupposes the interaction of a number of factors including research, education, capital formation, and rationalization, they contend that there is still much to be learned about the growth process itself and the extent to which it can be influenced by tax policy. Even in the case of those tax policies which are presumed to have a significant impact on the economic growth, they note that there is some uncertainty about the actual impact of these policies. Special depreciation allowances may stimulate not only productive investments but also investments which contribute little to growth; and laws which permit business concerns to build up large "hidden" reserves through generous inventory valuation methods may release funds for growth-promoting investments, although the practice of tying up capital in stocks will not necessarily promote growth.

Mutén and Faxén also find in current discussions of economic growth some differences of opinion on the specific kinds of tax actions that are called for if growth is to be stimulated. They note, for example, that some writers view savings, and others investment,

as the crucial factor requiring a tax stimulus. They do not consider it their task to analyze these problems. Instead, they undertake to summarize Sweden's experience with a number of specific measures which are usually regarded as growth-stimulating. But they warn the reader in advance that, since a major portion of capital formation in Sweden takes place in the public sector, the question of the effect of the tax system on the propensity to save is not a matter of much interest in that country, except insofar as it applies to saving in special sectors such as small businesses. They also ask the reader to bear in mind that Sweden's rate of growth during the 1950's, although higher than that of the United Kingdom, was well below that of any other country represented at the Conference. This suggests to them that Swedish applications of growth-promoting tax measures could not have had any very remarkable consequences.

Among the special features of the Swedish tax system which might have been expected to have some effect on that country's rate of growth, the two which have aroused the most interest abroad have probably been the "free" depreciation system, which was in effect from 1938 to 1951, and the "investment reserve" system, which has been in effect since 1955. Mutén and Faxén point out that neither of these systems, at the time it was adopted, was regarded as a growth-stimulating measure. By adopting free depreciation, the Swedish government hoped to eliminate conflicts between taxpayers and tax administrators over correct depreciation rates, while the investment reserve device was intended to serve as a means of leveling out cyclical fluctuations by changing the timing of capital outlays. Both of these systems did, however, come to have some significance for growth.

Although the statute permitting corporations and economic associations to write off their investments in machinery and equipment as rapidly as they desired could mean a significant saving of interest through tax deferral and could, therefore, have given these enterprises added incentives to invest in such assets, Mutén and Faxén contend that the more important effect of this provision was its contribution to corporate liquidity. On the other hand, they criticize the free depreciation rule for having favored long-term investments over short-term ones, investment in machinery over invest-

ment in buildings, and firms making profits over firms losing money or new firms. Finally, the fact that free depreciation was available only to corporations and could not be used by unincorporated enterprises suggests to them that, in its bias against new and small businesses, this rule may have promoted industrial concentration.

Mutén and Faxén are unable to say much about the extent to which free depreciation did actually stimulate economic growth in Sweden during the period when it was in effect. They report that, at least until after the war, the provision was rarely used to its full extent. During the postwar investment boom it was used more extensively although, even then, it is believed to have given corporations little more than what they would have been allowed under a replacement value depreciation formula. Mutén and Faxén note that Sweden had a system of rather rigorous investment controls in operation during this period. Since these controls applied mainly to buildings, the government was in effect curbing this type of investment while stimulating it in machinery and equipment (especially in shipbuilding). It is suggested that this policy may not have led to the most efficient allocation of resources. Ultimately, the expansionary effects of free depreciation became too strong and, as a countercyclical measure, severe restrictions upon its use had to be introduced in 1951. These restrictions became permanent in 1955, at which time a new set of depreciation rules was adopted.

Under the new system of depreciation all business firms have the option of taking a straight-line depreciation at a 20 per cent rate or of using a declining-balance formula, which makes it possible for them to write off slightly more than half of the cost of a machine during the first two years of its life. In assessing the effects of these new rules on investment, Mutén and Faxén note that the reduction of the first-year allowance from 100 per cent under the free depreciation rule to either 30 or 20 per cent under the new ones means that the taxpayer has to raise more money under the latter than he was required to under the former. On the other hand, they find no great difference between the old system and the new from the standpoint of long-term investment. They point out that, like the old rules, the new ones reduce the

effective corporate rate computed as a percentage of corporate "real" income with depreciation taken according to accepted standards of cost accounting. The more rapid the expansion, the greater the reduction tends to be, a feature of the tax system which provides a strong incentive for Swedish corporations to make capital accumulation a major policy objective.

Mutén and Faxén observe that the usefulness of the investment reesrve system in evening out cyclical movements was not tested until the recession of 1958-59, at which time it proved to be an effective instrument for encouraging investment, especially after the rules governing its use had been relaxed to cover firms planning major projects running over more than two years. They cite its effective use again in 1962-63 and note the addition of a 10 per cent investment deduction in the latter year, as well as the introduction of another new provision permitting investment reserves to be used to finance the production of goods to be kept in stock.

In their assessment of the investment reserve system, Mutén and Faxén stress its importance as an anticyclical device; but they contend that it has also had some effect on growth. It is their view that investment reserves have been used not only to accelerate already planned investment programs but also to undertake low-priority investments that were made attractive by cheap financing. On the other hand, they find no evidence that businessmen have gone so far as to let their investment reserves serve as the normal medium for financing ordinary investment programs, a development that could have had adverse consequences from the standpoint of both stability and growth. There is, however, one criticism of both the free depreciation and the investment reserve systems that does appear to them to have some validity, namely, that by making self-financing easier for some firms and for certain types of investments, they have encouraged overinvestment by those firms and in the types of assets covered by these systems.

Mutén and Faxén note that, in addition to the special provisions that have made it easier for Swedish firms to finance their investments, the general tax rules of that country have encouraged conservative dividend policies. They cite, in particular, the absence of any relief from the double taxation of corporate dividends, the fact that stock dividends are not considered as income, and the fact that

capital gains are not subject to tax after five years. They also point out that Swedish tax rules not only assist new expanding companies but also make it attractive for them to be absorbed into larger corporations. The treatment of capital gains and the liberal rules on salary deductions for managers of closely held companies encourage the build-up of small firms, while the ability of such firms later to transfer their profits to an acquiring corporation free of tax makes mergers attractive.

In the concluding section of their report, Mutén and Faxén discuss in some detail the relationship between the tax deferral opportunities available to corporations under the Swedish corporate profits tax and the rate of growth in the corporate sector. They refer to a study of these relationships which is currently being made by the Royal Commission on Taxation, and some of the preliminary results of statistical analyses are examined and compared with those derived from a theoretical model. Although the data collected and analyzed by the Royal Commission are found to give only vague indications of the relation between the rules for tax deferral and economic growth, they do suggest that the firms which fully exploit their tax deferral opportunities are more profitable than those that do not, and that—perhaps because of this—they also bear the heavier tax burdens. These data also suggest that growing corporations are more profitable and invest more than stagnant ones, but that growing corporations are more heavily burdened with taxes if they are also large corporations but not if they are small ones.

In his comments on the Mutén-Faxén paper, Claes Sandels notes that tax deferral may impair the free flow in the market of businesses as going concerns. He urges that this should be kept in mind when comparisons are made between the advantages of more liberal deferral rules and equivalent reductions in the corporate rate. Although he recognizes that investment reserves serve an important countercyclical purpose, Sandels contends that it is too generous a subsidy to be used continuously. Furthermore, he questions the desirability of continuing to use this particular device, even for purposes of stabilization, and suggests that an investment credit or a system based on depreciation allowances would be less complicated and would serve as well. In most respects, however, Sandels finds the Swedish tax system to be reasonably neutral with respect to business

transactions of various sorts. The principal exception is the corporation income tax which, in his opinion, places an extra burden on incorporated enterprises.

Lars Nabseth criticizes Mutén and Faxén for not having given more attention to the impact of budget policy on Sweden's economic development. He calls particular attention to the fact that government saving declined during the late 1950's, which made it more difficult for the industrial and housing sectors to borrow in the capital market. Then, when the country switched to the general turnover or retail sales tax, the budget was again balanced. But since this tax is imposed not only on consumption goods but also on plant, machinery, and building materials, Nabseth points out that it cannot be used as an instrument to favor investment against consumption, or vice versa.

Nabseth next calls attention to the very considerable extent to which Swedish industry financed its investments during the 1950's from internal sources. While he concedes that this may have resulted in some misallocation of investment resources, he suggests that the situation may be quite different during the 1960's. Given the likelihood of more cost inflation and modifications in the tax laws that will make internal financing less easy, Swedish firms, he argues, may well find themselves short of investment funds and may find it difficult to make up these deficiencies in the capital market. This may require changes which will make it easier for companies to go into the stock market.

Finally, he comments on the statement by Mutén and Faxén to the effect that the Swedish tax system stimulates the establishment and growth of small firms. He agrees that the present system makes it possible for the owners of small companies to save money within the firm until they are ready to sell out to another corporation. Then they can take out their profits in the form of a capital gain. But he argues that if these small dynamic enterprises are all taken up by the big corporations, this will lead to an excessive degree of concentration.

In the open discussion of the Swedish paper, one of the conferees called attention to certain important similarities between the Swedish and the German tax systems in that both involve high rates of

taxation and both provide opportunities for escaping these high tax burdens through certain kinds of saving and investment. While it was agreed that the two systems were strikingly similar in this general respect, differences in the way each applied the so-called penalty-reward system were pointed out. In the distribution of concessions, it was observed that the Swedish concentrated more on business and less on individuals, and more on investment and less on saving.

There was also some discussion of the Swedish government's willingness to facilitate corporate expansion, particularly in the form of large publicly held corporations. It was pointed out, however, that a large corporation in Sweden was not necessarily a large corporation by international standards and that in any case the large publicly held enterprise is regarded as more socialistic than the small family firm. Some doubt was expressed about the extent to which the Swedish tax system could actually stimulate economic growth by making the tax burden lower for expanding firms than for stagnant ones. It was admitted that, with a given volume of investment, it is better for growth if more of this is allocated to firms with higher profits and with better opportunities for growth; but it was recognized that there is a limit to what can be accomplished by this kind of policy. Tax considerations are not the only ones affecting investment decisions, and in a country like Sweden the lack of skilled technicians, and of manpower generally, was thought to be a more effective limit on expansion than a shortage of capital.

BRITAIN

Although Great Britain experienced the slowest rate of economic growth during the 1950's of any of the countries represented at the Conference, this does not appear to have been the result either of failure to recognize the problem or of unwillingness to try to do something about it. In his paper, Alan Williams points out that the British government did indulge in a certain amount of fiscal experimentation during this period and that this did accomplish something in the way of increased capital formation. He concedes that

the growth aspect of these policy measures has usually been incidental to their main purpose and that the over-all impact of tax policy on Britain's growth prospects has been "erratic and rather haphazard." But this does not trouble him too much, since he fears that Great Britain may be tempted to rely too much rather than too little upon tax policy to promote economic growth.

Williams directs most of his attention to those tax policies which might have been expected to have some impact on saving and investment decisions, and so indirectly on growth through capital formation. These include the differentiation (until 1958) between distributed and undistributed corporate profits, the various capital recovery allowances, and the tax measures on innovation and risk-bearing. He touches only briefly on certain other aspects of taxation such as the effect of income tax on work incentives. He finds that the lower rate at which undistributed profits were taxed before 1958 encouraged the retention, but not necessarily the reinvestment, of profits, and that the substitution of a uniform rate for a differentiated one at that time caused some reduction in corporate saving, although this appears to have been offset by the increase in personal savings that occurred at about the same time. He also reports evidence that investment decisions have been materially affected by favorable changes in investment and initial allowances, although the impact of these changes was found to have been much greater on large firms than on small ones and also much greater on growing firms than on more or less static ones. As for the impact of the tax structure on technical progress, Williams notes that the liberal provisions permitting the costs of scientific research—including 60 per cent of the cost of capital assets used in such research—to be expensed and losses to be carried forward should have provided ample encouragement for progressive firms. He thinks that Great Britain's favorable treatment of capital gains also should have favored innovation and risk-taking, but that estate duties may have cut into the capital resources of some unincorporated family businesses.

In reporting on the effects of the substitution of a uniform tax rate for the previously differentiated rate on corporate profits, Williams notes that profit distributions have increased since the change,

and most sharply among the unquoted private companies. Although this decline in corporate saving was more than offset by an increase in personal saving, he thinks that the latter development can be attributed only in part to increased profit distributions. He also notes a marked decline in company savings-investment ratios since 1959, as well as company savings-income ratios and the absolute level of corporate savings, and an increasing tendency for listed companies to go to the market for funds needed to purchase tangible fixed assets and to rely on short-term credit for the financing of inventories. Although Williams finds that these effects have varied according to the size and to the rate of growth of the firms involved, he concludes that the abolition of the differential profits tax would not have led to an increase in the profits distribution of firms bent on growth unless they had wanted to improve their distribution image in the market. Williams also thinks it unlikely that there have been many cases where inability to obtain financing has prevented worthwhile physical investments from being made.

In his discussion of Great Britain's capital allowances, Williams focuses his attention mainly on the effects which the initial and the capital allowances have had on investment decisions. He points out that the initial allowances—which have ranged from as much as 20 per cent on new mining works to as little as 5 per cent on fuel-saving plants—are usually viewed as interest-free loans, while the investment allowances—which have run as high as 40 per cent on ships and as low as 10 per cent on industrial buildings—are regarded as concealed subsidies. The principal difference between them is, of course, that the initial allowance does, and the investment allowance does not, reduce the basis of an asset for future depreciation. Williams reports that positive responses to these allowances have been found in a number of independent surveys, although the percentage of firms responding appears to have been surprisingly low. This may have been the result of a faulty appraisal of the situation by some businessmen or it may have been because the benefits to be gained from the allowances were not large enough to overcome the subjective or objective costs of reorganizing investment plans.

Recognizing that capital allowances "play a dual role in relation

to investment decisions," Williams gives separate consideration to their liquidity and their profitability aspects. On the alleged inadequacy of depreciation allowances as a source of replacement funds in times of rising prices, he points out that, over the period 1950-56, total tax allowances for depreciation exceeded estimated capital consumption by about 10 per cent and that the proportion appears to have risen in recent years. On the profitability aspects of the initial and the investment allowances, he notes that the latter discriminate in favor of firms that turn their capital over fastest, while the former discriminate in favor of rapidly growing firms. Consequently, in spite of the difficulties which a small minority of firms may have in financing their capital requirements, Williams doubts whether there is any justification for holding tax policy responsible for this or whether resort to further adjustments in the tax laws would be the best way of meeting this problem.

Alan Prest prefaced his comments on the Williams paper by asking whether any policies which the British government might have adopted during the past ten or fifteen years could have made very much difference in that country's rate of growth, given the constraints under which it had to operate. He thought that any conclusions about the effects of tax policy on the British economic growth during this period ought to be considered in this context. Prest also thought that Williams might have given some attention in his paper to the ways in which the British tax system has helped personal saving and to the ways in which it might conceivably have contributed to strengthening the balance of payments.

Prest was inclined to support Williams' view that the effects of the various capital allowances have been somewhat stronger than might be gathered from the statements made by businessmen on this subject. He noted that each jump in the concessions which the government has made here has been followed by large increases in capital expenditures, and he called attention to the fact that recent changes in the statutes on these allowances had made them extremely liberal. Indeed, he was inclined to doubt whether the replacement of Great Britain's profits tax by a value-added tax—as has been proposed—from which purchases of capital goods would be exempt would provide very much additional incentive to invest.

SOME CONCLUSIONS

A conference on a subject as broad as tax policy and economic growth, which involved participants from a number of different countries and from a variety of professional and business backgrounds, could hardly be expected to arrive at any very firm conclusions after two and a half days of discussion. But, despite the differences in points of view and value judgments that were reflected in the conference papers and discussions, there did appear to be substantial agreement on a number of important points.

One point that was emphasized repeatedly was the difficulty of trying to relate differences in the growth rates of various countries to differences in specific tax policies. Even though a good deal is now known about the process of growth and about the determinants of growth, it is far from easy to assign a specific weight to the contribution of any one factor in a particular country during a particular period of time. Few persons would deny that tax policies have had some influence on the postwar growth rates of all of the countries whose records were examined; but even in those countries where the influence of tax policies was believed to be greatest, there were other important contributing factors.

For example, a strong investment demand was clearly a powerful spur to growth in such countries as Japan, Germany, and Italy where, after a period of reconstruction, industry had strong incentives to exploit expanding markets at home and abroad. Furthermore, in all three of these countries, a large reserve of underemployed or immigrant workers could be tapped for the support of an expanding industrial sector. Expanding export markets were important elements in the growth of the Netherlands, France, and Germany; and Japan was particularly favored by a low capital-output ratio.

While it was recognized that tax policies can influence growth in a number of ways, it was generally assumed that the fiscal experiments in which the Conference would have the most interest were those which sought to promote growth by spurring capital formation. Attention was, therefore, directed mainly at those measures

which might have been expected to increase aggregate savings and investment in relation to gross national product. It was, of course, appreciated that one very effective way of increasing the savings ratio was to pursue a budget policy which provided for the financing of the government's own capital outlays, and in some cases also its loans to private enterprise, out of tax receipts. In both Sweden and the Netherlands, budget policies were formulated with a view to satisfying savings needs, while in France and Germany government loans to private industry in key areas were held by some to have played as important a rôle in promoting growth as the special tax measures that were adopted in those countries.

An adequate supply of savings appear not to have been a problem in Great Britain; nor was it in Italy until that country tried to tax the dividend income of its nationals. Japan's growth was also supported by a high savings ratio and by the ability of large business enterprises to draw on the resources of the Bank of Japan through the commercial banks. So it was not only through special tax policies that the governments of these countries contributed to the maintenance of high investment ratios.

Although all seven of the countries represented at the Conference experimented with various types of schemes to encourage personal savings among lower income bracket individuals, it was generally agreed that these schemes were very costly and were not as a rule very effective. The most that could be said for them was that they may have changed the form which personal savings took among these groups and that they served to counterbalance to some extent the tax advantages which liberal capital allowances and investment credits conferred on the entrepreneurial groups in these countries.

On the special tax measures intended to encourage business saving and investment, the majority view was that they had been effective not only in directing investment into certain favored sectors of industry but also in raising the general level of investment. When the representatives of each of the participating countries were asked whether, in their opinion, more general tax cuts would not have contributed as much to the growth of their country as the more selective and discriminatory measures that were adopted, the answer with one exception was in the negative. They clearly thought that

the so-called "carrot and stick" approach was justified by the circumstances prevailing in their countries during the period in question. Although it was recognized that, with perfect markets, a general tax cut could contribute as effectively, and perhaps even more effectively, to growth, it was felt that such a situation did not exist and that the firms which benefited most from the selective cuts would tend to be those with the highest propensity to invest. On the other hand, few were inclined to dispute the contention that the selective approach might be carried too far, as it perhaps was in Japan. In any case, it was agreed that the price a country might have to pay for growth promoted in this way could be very high, mainly from the standpoint of equity but also from that of an optimal allocation of resources.

One point which became more and more evident as the Conference progressed was that much too little is known about the actual effects of specific tax measures on the savings and investment decisions of individuals and corporations. Neither those who expressed confidence in the efficacy of particular measures nor those who were skeptical about the significance of any particular tax structure or measure for economic growth were able to offer much empirical support for their positions. Consequently, it would have been difficult to escape the conclusion that many more quantitative studies need to be undertaken in this area if the future tax policies of the advanced industrial nations are to be based on sound evidence of their consequences for growth.