

explicitly as an important reason for making the change. The Committee for Economic Development has stated, for example, that "a major advantage of a general excise tax (over a corporate profits tax) is that it would tend to improve the ability of the United States to compete with others in world markets," and it goes on to argue that the United States must "equalize" its tax structure with that of the Common Market as tariffs between the two trading areas are reduced.²⁸

All of these policy measures have a common characteristic. Taken by one country alone, each represents a concealed devaluation of the currency, at least with respect to a selected class of transactions. But like devaluation, these measures are effective only if other countries do not respond in kind. To each country, tying foreign aid and giving preference to domestic producers in government procurement may appear to offer a means to improve the balance of payments; and indeed in the short run it may do so. But if all countries follow the same practices, the benefit to each is much reduced and some countries will have their payments positions worsened as a result. In the meantime, the total real value of foreign aid has been reduced by reliance on high cost suppliers, and inefficient production has been fostered.

The same thing is true of the other measures discussed. General adoption of export promotion schemes and government-sponsored tourist publicity will surely have a much greater effect on the total level of world exports and tourism than on the payments position of any one country, since the measures will largely cancel one another and leave only residual effects on the balance of payments. Similarly, if all countries adopt special tax incentives for domestic investment, the net improvement in competitiveness—which depends as much on incentives abroad as on those at home—will be haphazard and unpredictable. The principal effect may well be not on any one country's balance of payments position but on the total investment and the rate of growth in the world economy at large—so long as these effects are not nullified by a competitive rise in long-term interest rates! Finally, an effort to raise exports and impede imports through changes in domestic tax structure may have little overall effect on foreign trade and leave countries with tax structures which many would prefer not to have.

At any point in time there are often cogent and persuasive arguments for introducing one or more of these measures to improve the balance of payments. If other countries did not respond in kind, the desired improvement would be forthcoming. But if other countries act likewise, the measures largely cancel out. Not only is the purpose of the move nullified, but all countries may find themselves worse off in terms of their other objectives. As a rule, individual countries cannot act unilaterally without inviting reaction. If they are successful, they are quickly emulated by their neighbors, so that the initial gains are transitory at best. Countries often must act in self-defense, in response to the behavior of their trading partners. This is particularly so when measures to reduce one country's deficit do not reduce the surpluses of the surplus countries but increase the deficit of another deficit country or move countries in balance into deficit. These third countries then feel compelled to respond defensively and their actions in turn increase the deficit of the initial country. Moreover, many of the measures thus taken are difficult to reverse—countries do not readily contract export credit programs or lengthen the periods of depreciation allowable for tax purposes.²⁹

Today there is little obvious competition among policies, such as the round of tariff increases in the late twenties and the competitive depreciations of the early thirties. But more subtle and sophisticated methods can substitute, albeit imperfectly, for currency depreciation. Taken in sequence by different countries, these measures produce a kind of ratchet effect. We then have a series of competitive depreciations in disguise.

In this case it is balance of payments difficulties, actual or feared, which give rise to the undesirable competition in policies. Competition for the location of industry can also weaken economic policy in the area of regulation and taxation, due to the mobility of business. To attract new firms or to keep the firms they

²⁸ COMMITTEE FOR ECONOMIC DEVELOPMENT, REDUCING TAX RATES FOR PRODUCTION AND GROWTH 39-40 (1962).

²⁹ There are some exceptions. Measures which are subject to a time limitation can be allowed to lapse. As an anti-inflationary measure, Germany finally permitted its provisions for accelerated depreciation to lapse in 1960—after the years of large payments surpluses.