As to discrimination and economic inefficiency, consider, for example, the German system: Its turnover tax of 4 percent applied at each stage of the business process—producer, manufacturer, wholesaler, retailer. (Hence the descriptive term "cascade tax" applied to these turnover taxes.) And at each stage the tax was built into the price and thus became pyramided and swollen as each sector turn applied its markup on price plus tax and then added its own tax. The consequence was acute differences in treatment between vertically integrated and non-integrated industries and concerns, between companies which performed some services for themselves and those which hired the services from others. In the other EEC countries a similar situation prevailed under their turnover taxes.

Sales taxes that run as high as 25 percent, or even 10 to 15 percent, are not to be treated casually or lightly. They have, at such levels, a high potential for economic mischief. But the exigencies of the past, the encrustations that any tax system accumulates, and the lethargy engendered by a familiarity with the status quo produced for the Europeans indirect tax structures that, at these high rates, were seriously defective.

The catalytic agent for change was the formation of the EEC. If Europe was to become a genuine common market in which goods and capital could move freely, a prerequisite was as much uniformity—harmony—as possible among the tax systems of the member countries.

The problem was clear: How to obtain uniformity out of this maze of high but disparate rates and complicated but disparate structures that characterized the sales taxes of these countries when seen as a whole. The solution chosen was a two-step approach—find a common sales tax structure that each could adopt and then move to uniformity in rates. The tax changes we are now seeing in Europe are in response to the first step, that of a common structure for these sales taxes.

*The value-added tax in Europe*

For this first step, the EEC had to answer this question: What type of sales tax structure is best suited in their economies to support a high tax rate? The choices would be among the single stage sales taxes—a manufacturers tax (Canada), a wholesale tax (Switzerland, Australia, United Kingdom), a retail tax (States in the United States, Norway), or a multi-stage tax of the value-added type (France). The multi-stage turnover type tax was not a possible choice, since it was essentially the villian in the existing picture.

A manufacturers tax has its problem of pyramiding through subsequent markups. It also has its problems of definition—what is "manufacture" and how far does it reach into assembly, packaging, bottling, etc.? The tax at this stage also discriminates against certain forms of distribution (such as manufacturers selling at retail), unless complex adjustments in prices are made for tax purposes. A wholesale tax involves many of the problems that beset a manufacturers tax, though in a different degree or form. There is the aspect of pyramiding; the problem of how to handle industries in which retailers perform certain wholesale or manufacturing functions and hence buy at cheaper prices; the problem of wholesalers who also sell at retail or manufacturers who skip the wholesale stage and sell at retail. While these considerations may point to a retail tax, the success of a retail tax can test severely the enforcement capabilities of a country, since the tax offers the largest number of taxpayers to police. In addition, these European countries already had turnover taxes under which each stratum of the economic process was presently being taxed, so that placing a tax at one stage only, say on the retailers, could well arouse difficult political problems.

The Europeans therefore turned to the value-added tax, which essentially is a multi-stage sales tax that achieves the end effect of a retail tax on personal consumption (consumption by households as contrasted with businesses). In choosing a value-added tax, they desired however to avoid the accumulated complexities of the French approach to a value-added tax—indeed the French themselves already started on their own reform. The Germans this year were the first to adopt a new value-added tax to replace their turnover taxes and we can refer to it for understanding of the emerging European picture.

The German tax is imposed at a 10 percent rate (11 percent on July 1, 1968) on almost all sales of goods and services by any business. Let us start with a manufacturer: He applies a 10 percent rate to his total sales to find the preliminary tax due. From this he subtracts the taxes he has paid on his purchases