other countries had multi-stage, cumulative turnover taxes (also called "cascade taxes") which were levied at each stage of the production and distribution process. The German 4% turnover tax rate was thus equivalent to an average rate of 12% on the value of the final product. The French system illustrates the complexities of basic rates followed by innumerable special rates and exemptions characteristic of all European taxes. In addition to the 25% value-added tax (TVA) on manufacturers, wholesalers, and some retailers of goods, there was also a retail sales tax covering other retailers and handicrafts at 2.83%, and a sales tax on services at 13.66%—along with a whole miscellany of specific excise taxes on such items as entertainment, wines, meat, gasoline, transport. Each tax was characterized by a lengthy list of special rates, exemptions, and options.

The German turnover tax of 4% applied at each stage of the business process—producer, manufacturer, wholesaler, retailer—was discriminatory and economically inefficient. At each stage the tax was built into the price and became pyramided and swollen as each sector in 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. A similar situation prevailed in the other EEC countries under their turnover taxes.

Sales taxes that run as high as 25%, or even 10 to 15%, are not to be treated casually or lightly. They have, at such levels, a high potential for economic mischief. They are also 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 characterize 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 taking place in Europe are in response to the first step, that of a common structure for these sales taxes.

For this first step, the EEC had to answer a 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 villain in the existing picture.

A manufacturers tax has the problem of pyramiding through subsequent markups. It also has 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 can be found in 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 involves 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 create difficult political problems.

The European choice

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). The Germans this year were the first to adopt a new value-added tax to replace their turnover taxes, and it provides an understanding of the emerging European tax picture.