

States and other Western European nations to increase the relative portion of total government revenues arising from a multi-level transactions tax. This development will relieve the revenue pressure for substantial corporate and individual income taxes. More than likely VAT will also make it politically easier to retain general indirect taxation as a major revenue raiser. The net effect will be that pressures for European use of direct taxation will decrease and pressures against indirect taxation, particularly of the multi-stage type will also decrease. The disharmony between the tax system prevailing in the U.S. and Europe will widen.

Balance of payments considerations

A number of undesirable results can be associated with this developing international tax situation:

- (1) It makes it more difficult for the U.S. to enjoy its economic potential;
- (2) It causes the rebirth and continuation of international economic barriers to products of nations using direct taxes;
- (3) It makes foreign investment attractive in countries using VAT because it permits them to reduce their income taxes.

Negative U.S. international payments balances set into motion by the widening tax disharmony cause the following chain of events: The lower profits taxes in the EEC Member States than in the U.S. make it attractive for American capitalists to invest in the EEC and to retain reserves outside of the U.S. The relatively high profit taxes in the U.S. cause EEC capitalists to refrain from investing in the U.S.: the net result is negative international balances on capital accounts for the U.S. The Foreign Investors Tax Act of 1966 somewhat mitigates this impact by giving favors to foreign income receivers and asset holders that are not available to U.S. citizens.

The tax refund available to exporters from EEC Member States, but not available to exporters from the U.S., and the border taxes assessed by EEC, but not by the U.S. reduces international balances on trade accounts.⁷ The U.S. surplus (balance on goods and services) has deteriorated steadily from \$6.9 billion in 1965 to \$5.1 billion in 1966 and to \$4.8 billion in 1967.⁸

Possible approaches

The U.S. by shifting its national tax system toward the existing and evolving tax system of EEC Member States, can escape the "national tax disharmony syndrome." But this is not the only possible escape route. The U.S. could devalue the dollar. It could withdraw from GATT and freely change its tariffs to compensate for border taxes and tax refunds. It could severely restrict foreign investment of American savings. The alternatives to moving toward tax harmonization are not attractive.

The Europeans, and particularly the EEC Member States, also have alternatives. They could revalue their monetary units upward relative to the American dollar. They could abandon the trade advantages possessed by indirect taxes. They could collect profit and income taxes equal to the U.S. level. They could prohibit foreign investments in their country. Some of the alternatives possess the same basic unattractiveness of a reduction of freedom in international transactions as the U.S. alternatives. Others run counter to the basic competitive nature of international transactions between national groupings.

The alternatives to a basic harmonization of the U.S. tax system with the system existing and evolving among the EEC Member States show few characteristics required for acceptability. At the same time the Europeans in VAT have developed a technique for making much more effective use of their concept that the transaction should be an important tax base. The last six years have not been a period in which European taxes have been moving toward the American model (with the possible exception of the U. K.) of high profit and income tax rates. On the other hand there has been some tendency for the U.S. to move toward the European model.

It is quite possible that international economic freedom and free world economic growth would be well served by a basic change—the word reform does not seem to be the correct one, although reform is involved—of the American tax system toward the existing and evolving EEC model.⁹ This would require

⁷ Richard W. Lindholm, "National Tax System and International Balance of Payments," *National Tax Journal*, June 1966, pp. 163-172.

⁸ *Federal Reserve Bulletin*, May 1968, p. A-68.

⁹ See pp. 247-258 of *The Role of Direct and Indirect Taxes in the Federal Revenue System*, (Washington, D.C.: The Brookings Institution, 1964) for an excellent summary statement of the economic strengths of VAT.