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Foreign Responses to US Tax Reform

by

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FOREIGN RESPONSES TO U.S. TAX REFORM[1]

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I INTRODUCTION

This paper discusses the response of foreign countries to recent U.S. tax reforms, and specifically those contained in the 1986 Tax Reform Act. The 1980s have been a decade of worldwide tax reform, with major changes occurring in personal, corporate and other taxes in a wide range of countries. For both personal and corporate taxes, the broad directions of reform have been similar in nearly all countries; rate reductions and consolidation of brackets at personal level; elimination (or weakening) of investment incentives, and reductions in statutory rates at corporate level.

This paper asks how central U.S. reforms have been in triggering these changes. Are we dealing with a global economy which is integrated to such an extent that tax change in the largest economy inevitably triggers corresponding tax change in other countries? Or does the similarity of outcome largely reflect common intellectual influences, and despite these seemingly comparable changes, substantial diversity in tax structure across countries remains.[2]

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[2] This same issue of foreign response to the 1986 U.S. Tax Reforms is also discussed in Tanzi (1987), Bossons (1987, 1988), and Whalley (forthcoming). Tanzi, writing soon after the reforms and without having the full range of foreign response available to him, suggested that the similarity of outcome reflects common intellectual forces, more so than direct cross-country harmonization pressures. Bossons (1987), in contrast, emphasizes the importance of cross-border pressures from the U.S. onto Canada as far as corporate taxes are concerned, and emphasizes the role played by U.S. income taxes in redirecting Canadian reforms. Whalley (forthcoming) also highlights the role played by U.S. pressures at corporate level in Canadian reforms. Bossons (1988) seems to assign a larger weight to common

direct response in tax policy by smaller countries in response to reforms enacted by a larger country will occur. Where trade and/or investment flows are large, and the taxes at stake are marginal instruments which directly affect these flows, then changes in the large country will be more likely to directly trigger changes in small countries. Conversely, changes in tax policy in small countries will be conditioned by the tax structure of the large country. These generalizations, it is claimed, are reflected by the Canadian and Mexican, and to a lesser extent the Japanese, experiences in the corporate tax area.

However, direct foreign policy responses to the 1986 U.S. reforms seem somewhat limited. The common elements that one sees in the tax reform experiences of so many countries seem to reflect similar intellectual influences on tax policy as much as incentive-driven interdependence among country tax structures. This is not to deny that with continued future global integration and a further weakening or removal of barriers to factor and goods flows, this picture may change somewhat. At the same time, however, the relative importance of the U.S. in these global flows may fall further, as has been true in recent decades. More direct interconnections between country tax policies may occur, but the direct bilateral links to U.S. tax policy could eventually prove to be even weaker than at present. Whether more or less similarity will be likely in future comparisons between foreign and U.S. tax structures thus remains to be seen.

II THE CONTENT AND TIMING OF RECENT U.S. AND FOREIGN TAX REFORMS

While recent global tax reforms contain the common elements of rate reductions and bracket consolidation at personal level, and rate reductions and elimination of investment incentives at corporate level, they also contain a wide variety of other features. They have also taken place at different points in time.[2]

Tables 1 and 2 summarize the broad features of the more major tax changes in the U.S. over the period 1979-89, along with those in seven other countries. These countries have been somewhat arbitrarily chosen in light of availability of information and variety of experience, but between them they provide a reasonably broad coverage of different continental experiences. In Table 1, the main features of the reforms are summarized, while Table 2 gives a brief chronology of the more major changes involved.

In these tables, the broad common elements of reforms, namely personal and corporate rate reductions and base-broadening features in both taxes can clearly be seen in the experiences of all of these countries. But the timing, path, and content of other elements of the reforms also emerges as clearly different.

While helpful as a broad overview, to fully evaluate what lies behind these reforms in each country, more detail is needed than can be presented in summary tables such as Tables 1 and 2.

The United States

The main features of the more major U.S. reforms as enacted in the 1986 Tax Reform Act are by now well known.[3] At Personal level, the previous multi-bracket rate

Table 1

BROAD FEATURES OF TAX REFORM OUTCOMES IN THE U.S. AND 7 OTHER COUNTRIES OVER THE 1980s

	U.S.	Australia	Canada	Japan	Mexico	New Zealand	Sweden	U.K.
Personal Tax								
Bracket consolidation	14→ 2	5→ 4	10→ 3	15→ 5	28→12	5→ 2	11→ 4	13→ 6→ 2
Top Marginal rate reduction	50→28(+5)	60→49	34→29	70→50	55→40	66→33	80→50 (by 1991)	80→40
Other changes	Deductions eliminated Full taxation of capital gains	Deductions eliminated Full taxation of capital gains	Deductions converted to credits. Inclusion rate for capital gains	New tax on interest income. Increased exemptions	Some limited base broadening	Deductions eliminated	Planned removal of 90% of taxpayers from national income tax by 1991	Personal deductions eliminated
Corporate Tax								
Rate reduction/Increase	46→34	46→49→39	36→28 (Fed.only)	42→37.5	40→35	45→48→ 28→33	58→30 (by 1991)	52→35
Investment Incentives	ITC eliminated. Accelerated depreciation withdrawn	Accelerated depreciation withdrawn	ITC eliminated. Accelerated depreciation withdrawn	Accelerated depreciation withdrawn	Lump sum deductions for some fixed assets	Accelerated depreciation withdrawn	Limits on write-offs	Accelerated depreciation withdrawn
System Change	None	Classical→ Imputation	None	Split rate→ Classical	Planned cash flow for 1991	Classical→ Imputation	None	None

Table 1 (continued)

	U.S.	Australia	Canada	Japan	Mexico	New Zealand	Sweden	U.K.
<u>Sales Tax</u>								
VAT introduced/ increased	None	RST proposed but not implemented	VAT introduced	VAT introduced	VAT introduced	VAT introduced	VAT rate increased	VAT rate increased
Tax abolished	None	None	Manufacturers' Sales Tax	Commodity Tax	Selective Excises	Wholesale Sales Tax	None	None
<u>Property/ Wealth/ Inheritance</u>	None	None	None	Inheritance tax rates reduced	2% net worth tax on corporate equity (creditable against income tax)	None	New real estate tax. Reduced wealth tax.	Inheritance tax rates and brackets reduced.
<u>Balance of Taxation</u>	CIT ↑ PIT ↓	None intended in proposals enacted; but RST proposal was to ↑ indirect taxes	None intended	Direct ↓ Indirect ↑	Direct ↓ Indirect ↑	Direct ↓ Indirect ↑	Direct ↓ Indirect ↑	Direct ↓ Indirect ↑

Table 2

A CHRONOLOGY OF MAJOR TAX CHANGES IN THE U.S. AND 7 OTHER COUNTRIES, 1979-89

	United States	United Kingdom	Sweden	Canada
1979		-PIT rates & brackets ↓ -VAT rate ↑		
1980				
1981	-PIT rates & brackets ↓ -ACRS depreciation system introduced			
1982				
1983			VAT rate ↑	
1984		-CIT rate ↓ -PIT & CIT allowances & deductions eliminated	-CIT rate ↓ -CIT base broadened	
1985				
1986	-PIT & CIT rates & brackets ↓ -investment incentives weakened -PIT & CIT bases broadened		-PIT rates & brackets ↓	-CIT rate ↓ -ITC eliminated -mininum personal tax introduced
1987				
1988		-PIT rates & brackets ↓ -separate taxation of husband & wife introduced	-PIT & CIT rates ↓ * -VAT base expanded -deductions eliminated	-PIT rates & brackets ↓ -CIT rate ↓ -PIT & CIT base broadened
1989		-VAT base expanded * -NISS rates & brackets ↓	-net wealth tax rates & brackets ↓ *	-9% GST (VAT) announced

* Proposed

Table 2 (continued)

	Japan	Australia	New Zealand	Mexico
1979				
1980				-10% VAT introduced
1981				
1982				
1983				-VAT rate ↑
1984				-1980-84 PIT & CIT base broadening measures introduced
1985		-PIT rates & brackets ↓ -CIT rate ↑	-PIT rates & brackets ↓ CIT rate ↑ -10% GST introduced	
1986		-PIT & CIT bases broadened		-CIT rate ↓ -new tax assess- ment scheme introduced
1987	-PIT rates & brackets ↓			
1988	-PIT rates & brackets ↓ -CIT rate ↓ -3% VAT introduced	-CIT rate ↓ * -withdrawal of concessions	-PIT rates & brackets ↓ -CIT rate ↓ -elimination of deduc- tions	-PIT rates & brackets ↓
1989			-CIT rate ↑ * -GST rate ↑	-2% net worth tax on companies introduced

* Proposed

structure, with marginal rates ranging from 11 to 50 percent, has been replaced by a two-rate structure of 15 and 28 percent with a 5 percent surcharge for some higher income individuals. There are increased personal and dependents exemptions, along with an expanded tax base through the elimination of several deductions, including sales taxes, the dividend deduction, and with an increased inclusion rate for capital gains.

At Corporate level, the top 46 percent rate has been reduced to 34 percent. In addition, there has been a substantial reduction in investment incentives, with an elimination of the investment tax credit and a weakening of acceleration in depreciation allowances. In addition, a number of industry-specific tax preferences have been restricted, including those for oil and gas producers, and for financial institutions. A previous 15 percent add-on minimum tax has been replaced with a 20 percent alternative minimum tax for corporations and a 21 percent alternative minimum tax for individuals.

These tax reforms followed a fairly clear chronology. Major changes were first introduced in June 1981 in the early years of the Reagan Administration under the Economic Recovery Tax Act. This reduced individual tax rates, which previously ranged from 14 to 70 percent, to 11 to 50 percent by 1983, with a reduction in the capital gains tax rate from 28 to 20 percent, and importantly, introduced a new accelerated depreciation system, termed the Accelerated Cost Recovery System (ACRS).

Substantial debate followed these reforms, reflecting the ongoing debate in the United States on tax issues originating in the 1970s. This was to lead to the 1984 U.S. Treasury Tax Reform proposals, and the Tax Reform Act of 1986 which finalized the changes outlined above.

Australia[4]

In the Australian case, recent tax reforms have their origins in the 1975 Asprey Taxation Review Committee and a 1981 Government Committee of Inquiry into the Australian Financial System. A subsequent June 1985 government draft White Paper proposed three alternative approaches to tax reform. The first was to reduce direct taxes, with an increased dependence on indirect taxes, a proposed change in the tax mix not present in the U.S. debate. A second was to change the tax mix further, by supplementing the reduction in direct taxes with a 5 percent broadly based consumption tax. The third was to go beyond both of these approaches with larger reductions in direct taxes and a 12.5 percent consumption tax. Major attention also focused on how to achieve better integration between the tax and social welfare systems.

These proposals generated substantial debate, which also occurred during a period which immediately preceded a national election. A nationally televised taxation summit was called to discuss these alternative approaches, which only served to undermine the political support for much of this tax reform.[5] The changes that were eventually announced in September 1985 effectively dropped both the consumption tax proposals, instead consolidating personal tax brackets from 5 to 4, with top marginal rates falling from 60 to 49 percent, an elimination of deductions and rebates, and an increase in corporate tax rates from 46 to 49 percent. The latter, opposite from the direction of change in the U.S., reflected plans to introduce a European-style imputation system (dividend tax credit system) at a higher rate.

In June 1986, a capital gains tax at full-income rates was introduced and the corporate tax base broadened to include tax shelters, capital gains and other items, with the introduction of the imputation system scheduled for July 1987. Subsequently, however, the 1988-89 Economic Statement proposed a reduction in corporate tax rates from 49 to 39 percent with a withdrawal of accelerated depreciation and other deductions. Interestingly, the driving force behind this policy reversal and lowering of corporate tax rates seems to have been a tax competition effect stemming, in large part, from the substantial reduction in New Zealand rates in February 1988, not the 1986 reduction in U.S. rates.[6]

This reform episode, therefore, finished up with a result not dissimilar to the U.S., but reflected concerns and followed a path which were quite different. The initial thrust of reform was to change the balance between direct and indirect taxes, quite opposite to the U.S. approach to reform, and initially involved increases in corporate tax rates as the imputation system was introduced. Only subsequently, two years after the initial reform was enacted, did corporate tax rates fall, and seemingly largely sparked by New Zealand rather than U.S. rate reductions.

Canada[7]

Tax reforms in recent years in Canada have involved actual or planned changes at all three levels of federal taxation: Corporate, personal and sales. At personal level, there has been consolidation of brackets with a previous ten-bracket federal rate structure of 6 to 34 percent being replaced by a three-bracket structure of 17 to 29 percent. Most exemptions and deductions have been converted to tax credits, and an alternative minimum tax of 17 percent has been introduced. The inclusion rate for capital gains has increased from 50 to 75 percent (with no indexing). At Corporate level, the federal rate has been reduced from 36 to 28 percent, the investment tax credit has been eliminated, accelerated depreciation slowed, and there is increased taxation of financial institutions. At sales tax level, there has been a major change proposed but not yet enacted, involving a multi-stage federal Goods and Services Tax (VAT) to be introduced at a 9 percent rate in 1991, with an elimination of the existing federal manufacturers' sales tax.

These changes in Canada, like Australia, have different origins from the United States' experience. In May 1985, a discussion paper on corporate tax reform was released[8] along with the budget of that year. It suggested a reduction in statutory rates and an elimination of investment incentives. In January 1986, a minimum personal tax was introduced, and in the February 1986 budget, the corporate tax rate was reduced from 36 to 33 percent, along with the elimination of the general investment tax credit. In late 1986, a planned release of a discussion paper on sales tax reform was shelved, ostensibly because of the passage of U.S. tax reform legislation, and the argument that Canadian tax reform should consider a wider range of reform options, including income tax reform.[9] The result was a 1987 White Paper on tax reform which proposed further changes in individual, corporate and sales taxes.[10] The legislation which resulted in December of 1987, like the U.S., consolidated personal rate brackets, and enacted the changes in personal and corporate taxes detailed above with a further lowering in the corporate tax rate to 28 percent. This latter change clearly was seen as needed, since with lower U.S. corporate rates, increased debt financing in Canada by cross-border integrated multinationals would erode the Canadian tax base. Changes in personal taxes were also seen as following the U.S. pattern, but the arguments made were individual incentive (effort) based, rather than reflecting tax competitive effects. Distinctive Canadian elements, such as the conversion of deductions and exemptions into credits, were also consciously included in the reform package.

In January 1988, changes also occurred in the then-existing federal manufacturers' sales tax which were close to shifting the tax from a manufacturing level tax to a wholesale tax for a limited range of products. The recent April 1989 budget has subsequently reiterated plans to introduce a value-added tax[11] to replace this tax, with the concrete details of how this is proposed following this summer.

The Canadian experience, therefore, is much closer to U.S. experience than the Australian case. But it, nonetheless, has a number of features different from the U.S. case. Much of it has been focused on reform of the sales tax, motivated in part by the inherent problems and difficulties of the present tax. And while a number of the key elements in the corporate tax reform were similar to those introduced in the U.S., the debate in Canada, to some degree, predates the release of the details of U.S. plans and, like the U.S. and other countries, was influenced by the 1984 U.K. changes.

Japan[12]

Tax reform in Japan, like that in the United States and other countries, has involved consolidation of rate brackets at personal level and rate reductions at corporate level. The previous fifteen-bracket national rate structure from 10.5 to 70 percent has been replaced by a five-bracket structure from 10 to 50 percent. Inhabitants' tax, a local tax applied to the personal income tax base has been reduced from a four-bracket rate structure of 4.5 to 18 percent to a three-bracket structure of 5 to 15 percent. A 20 percent flat-rate tax on interest income received by individuals has also been introduced. Along with these changes have come increased personal exemptions.

At corporate level, rates will be reduced from 42 to 37.5 percent by 1990, along with a removal of lower rates on income distributed as dividends; a move from a split rate to a classical corporate tax system. There have also been major changes involving sales and excise taxes. A broadly based 3 percent consumption-type value-added tax has been introduced, and several national and local excise taxes have been limited in their application. In addition, inheritance tax rates have been reduced from 75 to 70 percent.

As in the Australian and Canadian cases, these reforms, while following the broad U.S. pattern in terms of the final result, reflect concerns and a process quite different from U.S. experience. In 1985, the Nakasone administration declared its commitment to undertake major tax reform in Japan, and in October 1986, the Tax Council, a government tax commission, reported. They proposed consolidating personal rate brackets from 15 to 6, with a top rate reduction from 78 to 60 percent. However, dealing with the perceived unfairness in Japan in the relative tax treatment of salaried earners, small business and farmers (the so-called 9-6-4 problem (see Noguchi (1988) and discussion below)), was a key issue. A reduction in corporate tax rates, and an introduction of a broadly based indirect tax was also planned. Part of the rationale for lowering corporate taxes was clearly stated as a perceived need to lower corporate tax rates in light of pending rate reductions in the U.S. The concern was stated in terms of threatened loss of international competitiveness.

The reform outcome was largely shaped by an influential Liberal Democratic Party Tax Commission report in December 1986, which proposed consolidating personal rate brackets from 15 to 13, and then to 6, with the top rate falling from 70 to 50 percent by 1988, a corporate tax rate of 37.5 percent by 1989, and the introduction of a 5 percent value-added tax along with a review of the current sales tax. Legislation in September 1987 consolidated national rate brackets from fifteen to twelve, and local brackets from fourteen to seven, with top national and local rates falling from 70 to 60 percent, and 18 to 16 percent respectively. A 20 percent flat-rate income tax was enacted on many types of interest.

In 1988, after heated debate on the value-added tax proposal, the government announced its commitment to a continuation of tax reform and in December, reform legislation was introduced enacting all the features listed above, including the 3 percent value-added tax.

Japanese reform, therefore, also has strong similarities to U.S. reform while at the same time revealing important differences. There has been a major focus in the reform debate on changes in indirect taxes and the introduction of a value-added tax. And changes in the income tax have focused heavily on the vertical equity issues of equal taxation of interest and labour income, and within labour income, equal taxation of different types.

Mexico[13]

Mexico represents an example of a semi-industrialized country which has also undergone major tax change in recent years, but with once again different emphasis and outcomes from the U.S. case. At personal level, the previous twenty-eight-bracket rate structure running from 3 to 55 percent has been replaced by a twelve-bracket rate structure, with top marginal rates by 1989 having fallen from 55 to 40 percent. Base-broadening measures have also been adopted in the personal tax, including limited taxation of capital gains. At corporate level, the investment tax credit has been substantially limited, and rates will have been reduced from 40 percent to 35 percent by 1991.

As far as sales and excise taxes are concerned, the main change has involved a 10 percent value-added tax, with pre-existing taxes on soft drinks, gasoline, alcoholic beverages and other selected excises replaced with a special new tax on Production and Services.

These reforms, however, cover a much longer period of time than is the case for Canada, Japan or Australia. The 10 percent value-added tax was introduced in January 1980, and in January 1981, taxes on soft drinks, alcoholic beverages, beer, gasoline, processed tobacco, life insurance and telephone services were replaced with the special new tax. In January 1983, the general value-added tax rate was increased from 10 to 15 percent, and over the period between 1980 and 1984, base-broadening measures were also adopted including the elimination of preferences for capital gains and dividends. Accelerated depreciation in the corporate tax was reduced and itemized deductions in the personal tax eliminated in favour of a single deduction. However, changes in tax structure which occurred over this time were driven, in part, by the need to raise revenue to both replace declining natural resource revenues and lower the deficit.

January 1986 saw a 10 percent surcharge for high-income earners introduced, and the June 1986 tax reform bill reduced corporate tax rates from 42 to 35 after 1991. Two accounting schemes will coexist during the transitional period; one will preserve the traditional corporate tax base with an unindexed graduated rate structure of 5 to 42 percent, the other will use an indexed base and a fixed rate of 35 percent.

January 1988 also saw further changes with personal brackets consolidated from twenty-eight in 1985 to twelve in 1988, with the top marginal rate falling from 55 to 50 percent in 1988, and 40 percent in 1989. In January 1989, a 2 percent net-worth tax on companies' net equity was also introduced.

The picture which emerges, therefore, is that Mexico, like many other countries, has followed rate consolidation and rate reductions at both personal and corporate levels and reductions of incentives. Different concerns from other countries, however, have been paramount in the Mexican case. Portions of the tax reforms were enacted in part to aid compliance, by simplifying taxes, broadening bases and lowering rates, and on that basis to eventually raise revenues. Serious compliance problems have been well known in both the personal and sales tax areas in Mexico for some years, and lower rates and simplification were felt to help both. Also, with high inflation rates, large structural adjustment and other difficulties, domestic macro policy has oscillated, and at times quite wildly. Stability and predictability have become central Mexican policy themes, and the mirror image in tax policy has been broadened bases and lower rates.

New Zealand[14]

In the New Zealand case, the major elements of recent tax reforms have been the replacement of the previous five-bracket personal tax rate structure of 20 to 66 percent by a two-bracket rate structure of 24 and 33 percent, and the elimination of several deductions including gifts and employment-related expenses. At corporate level, rates have been reduced from 45 to 33 percent, with a European-style imputation system (dividend tax credit) introduced.

Sales and excise taxes have also changed, with the introduction of a broadly based consumption-type goods and services tax (VAT) at a 10 percent rate. The previous wholesale tax has been eliminated with a continuation of existing selective taxes on alcoholic beverages, tobacco and motor vehicles. In addition, deductions and preferences in the tax treatment of pension schemes have been eliminated.

As in the Australian case, these tax reforms had their origins in events in the mid-1980s. In August 1985, following both the election of a new government and a wider series of liberalization measures which the government of the day introduced, a budget statement on taxation and benefit reform announced the consolidation of personal tax rate brackets from five to three, with the top marginal rate falling from 66 to 48 percent. At the same time, a 10 percent value-added tax was announced, along with the abolition of the existing sales tax and an increase in the corporate tax rate from 45 to 48 percent, and with a European-style imputation scheme planned for 1988-89.

In the fall of 1987, however, a subsequent Treasury paper proposed a sharp reduction of both personal and corporate tax rates and a simplification of the indirect tax base along with an increase in the rate for the goods and services tax. In February 1988, the corporate tax rate was reduced from 48 to 28 percent. A two-bracket personal rate structure of 24 and 35 percent was also announced, along with an abolition of all existing deductions and full taxation of pension income. In March of 1989, a consultative committee proposed corporate tax rate increases from 28 to 33 percent, and an increase in the goods and services tax rate from 10 to 12.5 percent. In March of 1989, there was also increased taxation of and elimination of deductions in revisions to the tax treatment of pensions.

New Zealand tax reform, therefore, at the end of the day also has a similar outcome to U.S. reforms, with consolidation of personal rate brackets, and personal and corporate rate reductions. The appearances of similarity is, however, deceptive. Much larger change has occurred in New Zealand, and with wider oscillations with corporate rates first up and then down. This, in part, is consistent with the turbulent pace of New Zealand policy change in other areas during this period. Also, the concerns central to New Zealand reforms were different to those in the U.S. case. A substantial shift in the balance of taxation between direct and indirect taxes has occurred, with the introduction of a value-added tax at the same time that personal tax rates were reduced. In addition, a major initial thrust of the corporate reform was to move to an imputation-style corporate tax system, hence the initial perception of a need to raise rather than lower rates.

Sweden[15]

Swedish tax reforms in the 1980s have focused primarily on changes in a previous eleven-bracket personal rate structure. By the late 1970s, this tax had basic and supplementary national rates effectively running from 4 to 50 percent, plus a 30 percent local tax. It has, for now, been replaced by a four-bracket basic and supplementary rate structure of 5 to 42 percent, which, with a 30 percent local tax, has resulted in top combined marginal tax rates falling from 80 to 72 percent. However, more major change is planned for 1991, which may lower top marginal tax rates to 50 percent, and even more dramatically, remove 90 percent of taxpayers from the rolls for the national income tax.

At corporate level, statutory rates have been reduced from 58 to 52 percent with base-broadening measures adopted such as limited write-downs on inventories. Once again, dramatic change is to follow in 1991, with the statutory tax rate falling to 30 percent.[16]

At indirect tax level, the basic value-added tax rate has increased from 17.7 to 19 percent over the 1980s, and real estate (property) taxes (on assessed values) have been introduced at rates of 1.4 and 2 percent. Other tax changes have included a 1 percent turnover tax on sales of equity, and increases in employers' social security contributions to 37.47 percent of gross of tax wages and salaries, and a one-time 7 percent net-worth tax on insurance companies.

These reforms, unlike the New Zealand, Australian and Canadian reforms, have taken place over a long period of time, and clearly predate recent U.S. changes. Reform can be dated to 1981, to the so-called "wonderful night" agreement between the Centre Party, the Liberals and the Social Democrats. This was to lead in 1983 to an increase in the basic value-added tax rate from 17.7 to 19 percent, and in 1984 to a reduction in the national corporate tax rate from 40 to 32 percent (a combined national plus municipal rate of 58 to 52 percent), along with a broadened corporate tax base.

In 1986, basic and supplementary personal tax brackets were consolidated from 11 to 4, with the combined top marginal rate falling from 80 to 72 percent. 1987 saw the replacement of the combined municipal and national corporate tax by a single national tax at 52 percent, and the introduction of a real estate tax at rates of 1.5 and 2 percent. 1987 also saw the one-time 7 percent net-worth tax on insurance companies announced.

The fall of 1988 saw the release of a Ministry of Finance paper detailing plans for a wide ranging tax reform for 1991. This is supposed to remove 90 percent of taxpayers from income tax rolls, with a further reduction in the top marginal rate from 72 percent to 50 percent for those remaining. Increased taxation of capital income at personal level is planned, but with a further sharp fall in the corporate tax rate from 52 to 30 percent. The corporate tax base will be broadened through the elimination of several deferral-based deductions, and a substantial widening of the value-added tax base is planned. 1989 also saw a further proposal for a reduction in the current net-wealth tax, with the present four brackets from 1.5 to 3 percent replaced by a single rate of 1 to 1.5 percent.

The striking feature of these reforms is both the length of the period over which change has been underway, and the sweeping nature of the changes now planned for 1991. Much of the reform seems largely independent of U.S. changes. The more major changes are those proposed for 1991, with a radical restructuring of the whole personal income tax system and major change at the corporate level. Earlier changes involved consolidation in rate brackets well before change was underway in the U.S. case, and lowering of corporate tax rates also well before U.S. changes occurred.

United Kingdom[17]

The U.K. has also seen major tax change over the last decade. The multi-rate personal tax structure of a decade ago (13 brackets in 1978), which had rates running from 30 to 83 percent, has been replaced by a two-bracket structure of 25 to 40 percent. The fourteen-bracket capital transfer tax, now called the inheritance tax, has been consolidated into a four-bracket rate structure running from 30 to 60 percent. Separate taxation of husbands and wives has been introduced, and capital allowances and personal deductions have been eliminated at personal level.

At corporate level, rates have been reduced from 52 to 35 percent and acceleration in depreciation allowances sharply reduced. All previous investment allowances and incentives were replaced in 1984 with 25 percent annual declining balance depreciation. Tax preferences for occupational and personal pensions have been introduced. At indirect tax level, the value-added tax base has been broadened and the basic VAT rate increased from 8 to 15 percent. The most recent 1989 budget also reduced national insurance (social security) employer contributions.

As in the Swedish case, tax reforms in the United Kingdom have taken place over a much longer period of time than is true of other countries, and noticeably longer than for the U.S. In 1979, shortly after the election of the Conservative government, a budget consolidated personal tax brackets to six, with the top marginal rate falling from 83 to 60 percent, and increased the basic value-added tax rate from 8 to 15 percent. This pace of change continued with the 1984 budget which announced a phased reduction in corporate tax rates from 52 to 35 percent and reduced both depreciation allowances at corporate level, and deductions in the personal income tax. The 1985 budget consolidated capital transfer tax brackets from fourteen to four, with marginal rates ranging from 4 to 60 percent, abolished a previous development land levy and induced graduated social security contributions.

March 1986 saw further changes to the structure of the capital transfer tax, renamed the inheritance tax, and the introduced new incentive schemes in personal and corporate taxes. March 1987 saw a further reduction in personal tax rates and made cash received and paid the basis of accounting for the value-added tax.

The March 1988 budget consolidated personal tax brackets from six to two, with the top marginal rate falling from 60 to 40 percent and the basic rate falling from 27 to 25 percent, and with separate taxation of husbands and wives; a major change for the U.K. March 1989 saw a further reduction in social security contributions and an expansion of the value-added tax base to include new construction, water, and fuel as power for business. New tax preferences for occupational pensions were also announced.

In the U.K., therefore, the period over which tax reforms took place is considerably longer than in the U.S. case and reform is hard to separate from ongoing yearly change in budget announcements. These changes also contain many different elements from the U.S. case; including changes in value-added taxes, consolidations of rate brackets in the inheritance and social security taxes, and other components. Also, the 1984 corporate rate reductions and changes in investment incentives clearly predate the subsequent U.S. changes.

Thus, while the similarity in the broad directions of change at personal and corporate levels compared to the U.S. seems clear in all those countries, the diversity of tax reform experience across these countries is also striking. Besides the clear common features of rate reductions, bracket consolidation and weakening of investment incentives at personal and corporate levels, there are the non-common features of corporate system changes, value-added tax introductions, and changes in the balance of direct and indirect taxes. Thus, while there are instances of direct foreign response to U.S. tax reforms, particularly in countries which are the most integrated with the U.S., such as Canada, pinpointing how extensive these are, and in which countries and tax areas they have occurred is more difficult.

III DISENTANGLING THE DIRECT EFFECTS OF U.S. REFORMS ON FOREIGN TAX SYSTEMS[18]

While the picture given above of recent U.S. and foreign tax reforms suggesting a similarity of broad outcome in the corporate and personal tax areas, it also highlights that there are substantial differences of both detail and timing. In addition, the added feature in a number of these countries is the prominent role played by indirect taxes and other issues, such as system change at corporate level. To what extent, therefore, have U.S. reforms helped shape these changes abroad?

On the one hand, one might argue that tax changes in the largest country will automatically tend to trigger comparable change in other countries because of pressures which arise toward erosion of tax bases, migration and relocation.[19] On the other hand, the diversity of experience summarized above seems to suggest that this view might place too much weight on direct bilateral incentive effects in determining foreign tax changes. Because many countries were already moving in the directions in which the U.S. eventually moved, the similarity of reform outcome could, instead, be taken to reflect common intellectual influences, as much as direct incentive effects to follow U.S. reforms. Also, other bilateral links between pairs of countries (Australia-New Zealand, West Germany-U.K.) might have been more important in shaping reform outcomes.

Common and Distinctive Intellectual Influences

Tracing out the intellectual influences on any tax reform is difficult and this is no more apparent than in the U.S. case. It is, for instance, somewhat simplistic to even say that the Tax Reform Act of 1986 had its origins in the 1984 U.S. Treasury document, Tax

Reform for Fairness, Simplicity and Economic Growth, because this, in turn, was a reflection of pressures which had been building for tax reform in the United States for many years.[20]

There was a feeling that the tax system had become overly complex with a proliferation of exclusions, adjustments to income, deductions, and other complexities. This, in turn, had led to substantial erosion of the tax base through loopholes which violated principles of vertical equity giving unequal treatment to equals and, in addition, distorting resource allocation. This lack of a broad comprehensive tax base was felt to further distort savings and investment through non-neutralities with respect to asset and financing decisions, adversely affect work effort, retard invention and innovation, and encourage unproductive investment in tax shelters.

There was also a view that the tax system had created unfair treatment within families, since tax burdens had increased relatively more for large families with many dependents than for other taxpayers. And in the 1980s high inflation rates and the interaction of inflation and taxes were felt to create further inequities and distortions. The tax system of the day thus did not accurately measure real income from capital in most cases.

Thus, the stated objectives of reform in the 1984 U.S. Treasury Tax Reform documents mirrored all these concerns, namely economic neutrality, lowering tax rates, equal treatment of equals, fairness for families, fairness across income classes, simplicity and perceived fairness, along with achieving an inflation-proof tax law. These were the principles upon which the tax reform was to be based and despite the machinations of the

U.S. political process which were to lead to the Tax Reform Act of 1986, these principles were never either fundamentally challenged or restated.

Intellectual influences behind tax reform in many of the other countries discussed in this paper were broadly similar, but at the same time each had its own different interpretation and slant. Thus, in the New Zealand case,[21] there was a strong view that increases in average and marginal tax rates as a result of bracket creep from inflation had redistributed taxes heavily onto middle-income individuals, and compounded problems of tax evasion and avoidance. On the other hand, there was also major emphasis in New Zealand debate on selective export and tax incentives which had been previously designed to increase investment and exports. These were felt to have resulted in a lack of uniformity and neutrality in the tax system, as well as having generated economic inefficiency.

In the Japanese case, there were again similar intellectual influences present to those shaping the U.S. reforms, but as Noguchi (1988) notes, additional issues also entered the debate. A central issue which arose early in Japanese debate was that of horizontal equity, the so-called 9-6-4 problem in Japan. It was argued at the time that the tax burden of salaried workers was heavier than those of small business owners, self-employed and farmers at similar income levels. This inequality in assessments was referred to as the 9-6-4 or 10-5-3 problem, because the portion of the income subject to taxes was alleged to be 90 to 100 percent of the actual earned income for salaried income earners, 50 to 60 percent for business income, and only 30 to 40 percent for agricultural income. This was seen as one of the central problems which needed to be addressed through tax reform; and while closely related, a different notion of horizontal equity from the U.S. case.

Another major reform issue in Japan was the preferential treatment of interest income for small savings (mainly postal savings). The claim was that the system was abused by wealthy individuals because they held numerous accounts in banks and post offices, substantially beyond the legal limit which was allowed. It was even argued that this favourable tax treatment was the main cause of high savings in Japan.

Canada, as has already been mentioned above, also represents a case of shared but different intellectual influences on its tax reform compared to the U.S. As it emerged in the middle 1980s, and as Mintz and Whalley (1989) document, the Canadian tax reform debate began with a discussion of directions for corporate reform, a little before the debate fully got underway in the United States. The influence of the 1984 U.K. reforms was clearly noticeable. In early 1985, a discussion paper released with the budget detailed corporate tax changes which were to be enacted. These reflected similar concerns to the U.S.; non-neutralities in the tax system and the need to have uniformity of treatment, but at the same time dealt with the specifically Canadian problem of an overhang of large corporate losses. The 1985 Government Corporate Tax Discussion Paper (p.17) reports that in 1981 over 60 percent of Canadian corporations were non-taxpaying, and over 46 percent of non-taxpaying corporations were making profits as indicated by their financial statements.

The reform debate then accelerated on into 1987 with a change in focus first towards sales tax reform, and eventually to personal tax reform. Debate on personal taxes reflected U.S. reform debate. Concerns over high rates were prominent, but because of the limited scope for further broadening the tax base in the Canadian case, concerns over vertical equity were less prominent.[22]

In contrast to the U.S., however, major attention began to gravitate towards the sales tax component of Canadian tax reform. The existing federal manufacturers' sales tax was seen as something of an anachronism. It had a narrow base and high rates, and a complex administrative structure with many biases which had to be removed. Thus, the thrust of the reform became the replacement of the federal sales tax by a value-added tax, with the continuing enactment of the corporate tax changes. A further corporate rate reduction announced in 1987 reflected the view that Canadian rates had to fall to match the reduction in the statutory rates introduced in the U.S. in 1986. Once again, the outcome of Canadian and U.S. reforms is similar at personal and corporate level, but reflects different origins and concerns.

Swedish tax reform represents a substantially different case from the U.S. As Andersson (1988a,b) stresses, the dominant concern in tax reform throughout the 1980s has been high marginal tax rates at personal level, which has been viewed as encouraging tax evasion, tax planning and "grey" activity, along with low savings rates within the household sector. Problems with the unevenness of existing capital income taxation have been emphasized, but with less profile than in other countries.

These problems, therefore, led the Swedes in the directions which have been documented in the previous section; concerns to deal with deductions, including interest deductions at personal level, concerns to move the tax system towards neutrality so that income from different sources were not differently treated, and concerns to remove the complexity of tax regulations, since administration and compliance had become a major concern. While producing seemingly similar results to the U.S. reform through reductions at corporate and personal level, Swedish tax reforms were so dominated by concerns to both change and lower income taxes that they took the different form compared to the U.S. reforms described above, particularly in the latest proposed changes.

Australian reforms also fit a different picture from the U.S. case, but reflect underlying similar concerns. Objectives of the reforms were dealing with concerns over vertical equity, improved economic efficiency, increased simplicity in the tax system, but the co-ordination of tax policies with social welfare programs was a distinctive Australian concern. Australia, once again, finishes with a similar outcome to that for the U.S. as far as personal and corporate tax reductions go, but the intellectual drive behind reform contains several different elements. There is an initial proposal to introduce a sales tax, reflecting an objective of moving the tax system more heavily towards indirect taxation. Moreover, with the desire to move to a new system of corporate taxes, statutory rates were initially raised.

Thus, distinctive intellectual influences were present in each of these cases, along with different as well as shared concerns from the U.S. case.

Direct Triggers in the Foreign Response

A different approach to identifying the direct effects of U.S. reforms is to look for evidence of direct triggers operating between components of U.S. reforms and tax changes abroad. As far as I am able to determine, such direct trigger effects are most striking at corporate level and largely involve changes in statutory corporate tax rates.

In the Canadian case, in 1985 the government announced its commitment to corporate tax reform through a reduction in statutory tax rates, to be accompanied by a phased elimination of investment tax credits, and acceleration in depreciation allowances.

However, by the time these changes were to be enacted in 1986, the U.S. Tax Reform Act had passed resulting in a larger reduction in statutory rates in the United States. Thus, in 1987 further Canadian rate cuts were announced, rationalized by the argument that because of the large size of U.S. investment in Canada (approximately 25 percent of manufacturing industry in Canada is foreign-owned, and 95 percent of foreign-owned capital originates from the United States), it would pay integrated multinational corporations to do their debt financing in the low-tax jurisdiction, i.e. in the U.S. rather than in Canada. This, in turn, would result in a substantial erosion of the tax base, unless Canada followed the U.S. rate reduction down. The commitment in the 1987 tax reform documents was thus to produce a combined federal-provincial corporate tax rate in Canada approximately equal to the U.S. rate.

Canada provides the most dramatic of these examples, but similar arguments can be found in the debates on corporate tax reform in Japan. In the Japanese case, the argument was that high corporate tax rates undermine international competitiveness.[23] The argument was not stated is quite the same direct form as in the Canadian case, stressing the threatened erosion of the tax base, but the argument was that unless corporate tax rates were lowered in Japan to match U.S. rate reductions, there would be an outflow of business activity from Japan and eventually loss of jobs and incomes. Therefore, the U.S. rate reduction had to be followed.

As far as this author is able to determine, however, these are the only two cases where in government documents, and related debate within the country, such arguments were made at corporate level. There are undoubtedly arguments in similar vein made at personal level about the impact of tax reform on migration patterns with the threatened loss of more mobile, highly skilled workers. Such arguments were made in Japan, Canada and New Zealand, but in the latter case in reference to threatened migration to Australia more so than to the United States. In the income tax case, however, these concerns over migration effects were also clearly stated as supplementary to the basic arguments for reducing tax rates; namely, improving work incentives, aiding compliance and reducing tax evasion, dealing with problems of vertical equity, and other concerns.[24] Among the sample countries discussed in this paper, Japan and Canada, therefore, seem to represent the most significant cases of direct tax response to U.S. reforms.

These, then, are cases of direct trigger effects from changes in U.S. tax policy onto tax policy in other countries. They seem strongest in the corporate area because of the high degree of mobility involved, particularly of financial capital. They also seem strongest where there are large trade and investment linkages with the U.S., such as with Canada, Japan and Mexico.

Timing - Who Moved First?

A further issue in disentangling the direct effects of U.S. reforms on foreign tax systems is the question of timing. Who moved first, and with what effect? Dating tax reforms and determining their underlying intent is a hazardous exercise at the best of time, and comparing across countries makes it even more hazardous.

One of the complexities of trying to determine whether other countries changed their tax systems first, and if so, whether their actions predated actions in the U.S. is that what constitutes a tax reform is somewhat vague in a number of the countries considered here. In the U.S. congressional system, because of the need for eventual consensus, a date of agreement and a concrete act can be taken to date the reform. For other countries discussed in this paper which are parliamentary systems, a number of tax measures through a series of budgets cumulatively constitute reform over a much longer period of time. Thus, in the U.K. one can date reform from the 1979 budget with major cuts in personal income tax rates, but changes have continued all the way through to the recent 1989 budget, with further major tax cuts. Swedish reforms, similarly, begin in the late 1970s, but have major changes still scheduled in 1991. It is, therefore, difficult in some cases to determine the timing of reform and assess who moved first.

What seems clear, however, is that the tax area where direct linkages most forcefully come into play, namely at corporate level, did undoubtedly involve changes by other countries prior to the recent tax reforms in the United States. The 1984 budget in the United Kingdom involved a clear commitment to a reduction in the statutory corporate tax rate through phased reductions from 52 to 35 percent, and a weakening of investment incentives. In the Canadian case, the government discussion paper of February 1985 reflected thinking and discussion which had been underway within the tax policy circles in the Canadian government in previous years. Once again, this discussion partially predated the release of the 1984 U.S. Treasury documents, and if anything was more heavily influenced by the 1984 U.K. changes. The 1984 U.K. changes also had their effect on the 1984 Treasury proposals announced in the U.S. Thus, it seems clear that the tax reforms of the 1980s do not reflect a clear and unambiguous first move by the U.S. on the corporate tax front.

On the other hand, once the U.S. moved, other countries equally clearly began to modify their positions. This was either to go further in directions they were already moving, or to reverse direction. Thus, the Canadians modified their corporate tax reform in the 1987 through deeper cuts in rates in light of the U.S. actions of 1986, even though they had been moving in the same general direction from 1985 onwards. Reversals of corporate rates followed in both Australia and New Zealand.

It also seems unreasonable to claim that there was a first U.S. move at personal level. Reductions in marginal tax rates and consolidation of brackets were clearly there in the 1979 budget in the United Kingdom, and Sweden and other countries were also moving in similar directions from the early 1980s onwards. In turn, the U.S. actions of 1986 seem clearly to have not triggered the same kind of direct response that their corporate tax measures did in other countries.

Thus, despite the ambiguity of defining tax reform and detailing the content of tax reform packages, in both the corporate and personal tax areas other countries were indeed moving in the directions in which the U.S. subsequently moved in the mid-1980s prior to U.S. actions. This would seem to weaken the claim that the similarity of global reform reflects the direct effects of U.S. reforms on foreign tax systems.

Lack of Complete Replication

A final factor relevant to disentangling the direct effects of U.S. tax reforms on foreign tax systems, is the lack of complete replication of either U.S. tax changes abroad or foreign tax changes in the U.S. Thus, while the major elements of U.S. tax reforms, namely reduction in marginal tax rates and consolidation of rate brackets at personal level, and reductions in statutory rates and elimination of investment incentives, are common to the United States and the other countries whose experiences are discussed here, there are many elements which are not replicated.

In the U.S. case, corporate revenues were raised with a clear intent to change the tax mix between corporate and personal taxes. As far as I am able to determine, this direction of tax change is unique to the U.S. In the Canadian case, tax reforms at personal level converted existing exemptions and deductions into credits; something which was neither replicated in the U.S nor elsewhere.

In addition, at sales tax level, countries with sales taxes seemed to become embroiled in major debates on the appropriate balance of direct and indirect taxes. This occurred forcefully in New Zealand and Australia, in Sweden, the U.K., and to some extent, in Canada. Because the U.S. had no broadly based indirect tax, this was an element of the debate lacking in the U.S.

Thus, while the broad patterns of outcome from these tax reforms seem to be similar, the emphasis on various elements in some countries relative to others, and the lack of complete replication of tax change, once again weakens the claim that foreign tax policy responses were a direct reflection of the 1986 U.S. tax changes.

IV CONCLUSION

This paper discusses foreign responses to U.S. tax reforms. It tries to lay out in summary form the content of recent tax reforms in a sample of other countries (New Zealand, Australia, Japan, U.K., Canada, Sweden and Mexico), and compare them to recent U.S. changes both as far as content and timing are concerned.

These reforms are all, of course, complex in their details, but the striking feature of global tax reform in the 1980s has been the broad similarity of outcome at personal and corporate level. All the countries discussed in the paper have moved to consolidate rate brackets and reduce marginal rates at personal level. At corporate level, statutory rates have all been reduced while investment incentives have either been weakened or removed. The similarity of broad experience seems so striking that it seems natural to look for common forces at work in explaining this outcome.

Two alternative hypotheses are discussed. One is that as the largest country engaging in these reforms, other countries simply had to accommodate their tax systems to the U.S. changes and, therefore, U.S. changes drive the response abroad. The other hypothesis is that the similarity of the change largely reflects common intellectual influences which were at work in all of these countries, and direct interactions are relatively small.

The paper argues that neither hypothesis alone is able to account for the similarity of change. A number of countries outside the U.S. were making tax changes which the U.S. would subsequently follow prior to U.S. actions, and many differences in details in these reforms are not replicated in other countries. Also, the direct triggers between U.S.

tax reform and foreign tax change seem to be largely localized to the corporate tax and, in turn, to those countries with major investment links with the United States.

The conjecture offered is that the common intellectual influences may well have been the primary reason for the similarity of result, rather than the strength of direct links between countries in terms of the incentives for foreign countries to follow U.S. actions abroad. This, in no way, negates the importance of direct trigger effects, but suggests that because of many impediments between countries, such as immigration restrictions and trade barriers, that only in the corporate area would these linkages dominate. And only where the bilateral linkage to the U.S. economy was large, would policy concerns to follow U.S. actions forcefully come into play.

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ENDNOTES

1. This same issue of foreign response to the 1986 U.S. Tax Reforms is also discussed in Tanzi (1987), Bossons (1987, 1988), and Whalley (forthcoming). Tanzi, writing soon after the reforms and without having the full range of foreign response available to him, suggested that the similarity of outcome reflects common intellectual forces, more so than direct cross-country harmonization pressures. Bossons (1987), in contrast, emphasizes the importance of cross-border pressures from the U.S. onto Canada as far as corporate taxes are concerned, and emphasizes the role played by U.S. income taxes in redirecting Canadian reforms. Whalley (forthcoming) also highlights the role played by U.S. pressures at corporate level in Canadian reforms. Bossons (1988) seems to assign a larger weight to common intellectual features and influences from tax reform elsewhere (especially the U.K.) in non-Canadian cases.

2. One of the more recent compendia of country tax reforms is the volume from OECD (1987); see also OECD (1988).

3. See, for instance, Deloitte, Haskins and Sells (1986), Pechman (1987, 1988), and Herber (1988).

4. This section draws on various issues of the Tax News Service of the International Bureau of Fiscal Documentation, Amsterdam, Keating (1984), Morgan (1986) and Porter (1988).

5. See Porter (1988), p.12.

6. See the discussion of this in Porter (1988), p.18.

7. The material in this section draws on Government of Canada (1985, 1987b, 1989), Mintz and Whalley (1989), Dodge and Sargent (1988), and Whalley (forthcoming).

8. See Government of Canada (1985).

9. See the discussion in Bossons (1987).

10. See Government of Canada (1987a,b,c,d) for more details.

11. See Government of Canada (1989).

12. Material in this section draws on Shoven (1988), Keitaro (1988), Noguchi (1988), Government of Japan (1989a,b), and Ishi (1988).

13. Material in this section draws on Price Waterhouse (1988a,b), Gil Diaz (1988), and International Bureau of Fiscal Documentation, Tax News Service.

14. Material in this section draws on Stephens (1987), and the Tax News Service of the International Bureau of Fiscal Documentation (various issues).

15. The material in this section is based on Andersson (1988a,b) and the Tax News Service of the International Bureau of Fiscal Documentation (various issues).

16. These dramatic reductions in tax rates at personal and corporate levels are expected to cost approximately S.Kr.60 Billion. They will be financed by increased taxes on capital income (S.Kr.25 Billion) (the largest revenue sources are increased taxation of private dwellings, taxation of sheltered pension income, and increased capital

gains taxes), increased taxes on fringe benefits (S.Kr.15 Billion), a widened VAT base (S.Kr.10 Billion), new taxes on energy (S.Kr.10 Billion), and reduced public housing subsidies. See Andersson (1988a) for more details.

17. The material in this section draws on the discussion in Renwick (1987), Stuart Buttle and Whitehouse (1988), and the Tax News Service of the International Bureau of Fiscal Documentation (various issues).

18. A related but different issue is the extent to which countries already consciously design their tax policies in light of tax policies in the U.S. See the current Colombian government document (?? (1989)) on tax treatment of capital income in Colombia which clearly sets out the ways this is done (see pp.118-35, 219, 303-312). I am grateful to Charles McLure for bringing this to my attention.

19. See Musgrave's (1988) comments which argue this case.

20. See, for instance, the discussion in Herber (1988), and Musgrave (1987).

21. See the more detailed discussion in Stephens (1987), p.332.

22. Bossons (1987) also points this out as a key difference from U.S. experience.

23. See Shoven (1988), pp.19-20.

24. Also see the discussion of the Canadian case in Bossons (1987).

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