

EEC Sales Tax Harmonization: an Alternative Scheme (*)

1. The EEC guidelines for indirect tax harmonization (1) suggest that each Common Market country should adopt a value added tax. In a first stage some difference in the average rate, in commodity discrimination, in assessment techniques and in the exemptions policy for the new tax should be allowed. Adjustments at the border, i.e., rebates for exports and compensatory taxes on imports, in this stage should remain in existence for the sales tax of each Common Market country, both inside and outside the EEC area so that national differences in value added tax burden, given that the tax is completely shifted forward, would not interfere with competitive conditions. Through the adjustments at the frontier, which under a value added tax (unlike those under a cascade sales tax) can be easily assessed, any commodity, whether domestically produced or imported from anywhere, will bear the same domestic tax burden in each Common Market country. In addition, any commodity exported, whether to other EEC countries or to third countries, will be entirely freed from domestic indirect taxes, so that it will compete in foreign markets on equal terms with the commodities of any other country. However, the existence of border tax adjustments within the Common Market area is considered by the EEC to be unsatisfactory as a final solution, on both political and psychological grounds and for economic reasons. It is felt that to retain "frontiers", even if as a mere administrative device to enforce equalization of

* When this paper was written the author was Rockefeller Foundation Visiting Research Professor in International Economics at The Brookings Institution, on leave from the University of Turin, Italy.

The opinions expressed in this paper are those of the author and do not purport to represent the views of other staff members, trustees or officers of The Brookings Institution.

(1) Ample information on these guidelines is given by several papers in *Revue de la Fiscalité du Marché Commun*, from 1959 on. See also *Tax Harmonization in the Common Market*, Commerce Clearing House, Chicago, 1963, on the initial steps.

competition (as the frontiers for rebates and for compensatory taxes related to sales taxation are meant to do) and not as a device to put economic barriers to commodity flows, is contrary to the philosophy of a truly unified European area. Furthermore, many economists and businessmen in the Common Market are not so sure that even a refined value added tax, well contrived and well assessed, would be automatically shifted forward in higher prices in a measure equivalent to the burden imposed at each stage. They therefore feel that frontier adjustments, in spite of their intended nature of [mere] devices to equalize competition, may result in actual distortions of competition: sometimes rebates measured on the formal aggregate value added tax burden, affecting each given commodity might exceed the "true" economic tax burden incorporated in them, and sometimes might even be insufficient to offset the full aggregate tax effect; by the same line of reasoning, allowing for the possibility of imperfect tax shifting or of overshifting, compensatory taxes collected at the frontier might sometimes undercompensate, thus acting as preferential tax treatments.

Finally, if different indirect tax burdens should persist in different places within the Common Market area, it is assumed that investment policies will be interfered with, since different locations may provide different opportunities because of the diversified tax factor affecting consumption.

2. Therefore, the EEC sales tax harmonization guidelines suggest for the final solution that the whole Common Market area should be covered by an entirely harmonized value added tax, to be levied by each member country on the tax basis originating in its territory at the same rates and with the same exemptions (if any) and assessment procedures. This value added tax uniformity, according to the EEC guidelines, would enable the border tax adjustments to be abolished entirely within the Common Market area, since no problem of equalization of competition connected with differentials of indirect tax factors will possibly emerge for any business located anywhere within the EEC. Border adjustments, with a fully harmonized value added tax, would, on the other hand, be kept for external trade, i.e., for imports and exports effected between any business inside the EEC area and any business outside it.

A twofold political and psychological benefit is expected to result from this scheme. First of all, barriers, as explained, will

disappear inside the EEC. Secondly, a uniform indirect tax frontier will be erected in face of third countries. In other words, unity will politically be fostered both by the internal freedom from tax barriers and by the coming into existence of a unified external tax barrier. From an economic point of view, distortion due to an imperfect shifting coupled with a complete border adjustment, if any, will be tolerated for external trade (which has to be controlled anyway, for tariff and other reasons) but will be ruled out for domestic trade. Locational investment choices will not be interfered with inside the EEC area by tax considerations related to the different impact of consumers' taxation on final demand.

To permit a minimum amount of indirect tax freedom to the various member countries, the EEC guidelines allow national governments, if they wish, to apply at the last stage, in addition to the harmonized value added tax, a mild single-stage sales tax, either in the form of a retail sales tax or of a purchase tax. Kept to a low level, this tax should not greatly diversify the consumers' aggregate indirect tax burden in the various member countries. Furthermore, because it is imposed at the final stage of distribution, the optional tax would not create any need for border adjustments.

3. Even if politically attractive from the "free movement" point of view, the EEC sales tax harmonization scheme, in its apparent simplicity, appears to be open to criticism on economic grounds. Before starting on this analysis and suggesting an alternative scheme which retains similar political merits but appears economically less crude and less objectionable, let us briefly sketch the present sales tax situation in Western Europe.

France is presently the only Common Market country to rely chiefly on a value added tax for indirect taxation (2). This tax, broadly speaking, is of the "consumption" type, i.e., through rebates it entirely frees most investment goods purchased by value added taxpayers from the aggregate value added burden which, assuming it is fully shifted forward, would otherwise be incorporated in the price of investment goods. France currently levies, in addition, a retail local sales tax and a single-stage tax on services, to cope with the fact that both retail sales and services and miscellaneous tran-

(2) See Norr and Kerlan, *Taxation in France*, World Tax Series, Harvard Law School, Commerce Clearing House, Chicago, 1966, Chapter 14. For a compact analysis, see the (Richardson) *Report of the Committee on Turnover Taxation*, Cmnd. 2300, pp. 19-25.

sactions are not covered by her value added tax. The French value added tax rates are very high (the standard rate is 25 per cent and the top rate on luxuries is 33.3 per cent) and highly diversified (the average burden of value added tax plus the retail tax and the tax on services, as a percentage of gross national expenditure, is about 8 per cent; it is easy to note how different this effective average burden is from the above mentioned standard rate). However, according to the reform recently approved by the Parliament (but not yet carried on) rate diversification would be reduced and the local sales and services taxes abolished, the value added tax replacing them and thus acquiring a more general coverage and a lower standard rate (it should drop to 20 per cent) (3).

The EEC type of value added tax suggested for European harmonization is very close to the new French value added tax. It is also meant to be of the consumption type, to allow few rate discriminations and to have a general coverage. No figure for the standard rate has been explicitly suggested but a rate not higher than 17 per cent and not lower than 10 per cent should emerge for the final fully harmonized European tax.

The Common Market countries other than France all presently apply a cascade sales tax, that is, a tax collected at each stage (frequently with the exclusion of retail) on the full value of the transaction. No rebate for investment goods is allowed. A substantial rate discrimination exists, in each country, mostly for consumption policy and social policy reasons or with the aim of lessening, in some areas, the cumulative effects of the cascade mechanism.

4. Of these EEC countries, Germany is the only one presently having a well defined plan of change to a value added tax: the original draft presented by the Government suggested a value added tax of the income type, i.e., allowing for a deduction for depreciation charges, but not for a rebate on full value of investment goods purchased by value added taxpayers. However, in the last version, the German Government draft of sales tax reform suggests a con-

(3) See, for a description of this reform, M. E. LEXAN, "The Recent Evolution of the French Tax System", *European Taxation*, November 1965, pp. 264-269, A. MULLER, *L'Assiette réelle de la taxe sur la Valeur Ajoutée*, Paris, Dalloz, 1965, p. 265, (pages 255-263 provide a short discussion of the EEC sales tax harmonization proposals), and my paper, "On the feasibility of a general value added tax: some reflections on the French experience", *National Tax Journal*, December, 1966.

sumption value added tax. The standard rate (11 per cent) is much lower than the French (4). To establish less difference from the French level and the European harmonized final level, however, Germany might abolish its "Gewerbe Steuer", a sort of mixed type of direct-indirect tax levied by the "Länder" and local bodies, replacing its revenue by an increase in the new value added tax standard rate. Since the Gewerbe Steuer provides a revenue close to one-half of the present cascade tax, a 16-17 per cent value added standard rate would suffice to provide for its full replacement.

Italy is the only other EEC country which has officially expressed a willingness to adopt a value added tax. Its present cascade sales tax, as a percentage of gross national expenditure, yields nearly as much as the German cascade tax (i.e., about 5 per cent). A 12 per cent value added standard tax rate is currently considered as needed to replace the cascade tax yield. However, unlike Germany, Italy has no official detailed draft ready in this field. Furthermore, the Italian tax administration is reluctant to venture into this new tax area and the Italian Ministry of Finance has scheduled, as a priority, an extensive income tax reform. The sales tax reform, according to these plans, should be possible only later on. Businessmen and many economists are in favour of the value added tax to replace the cascade tax. But some of them would prefer, if possible, to change to a single-stage or a two-stage sales tax levied at the manufacturer-wholesaler and the wholesale-retail levels. Even among those who are inclined to opt for a value added tax, a substantial group would advocate it together with a quite heavy single-stage tax. Nobody in the business community and few economists (and, needless to say, nobody in the tax administration) would consider possible either a value added tax rate higher than 12 per cent or the extension of a value added tax to the retail stage. The chief reason for favoring a value added tax plus a single-stage (or a two-stage) sales tax appears to be the possibility of imposing all of them at mild rates. On the other hand, the only important reasons which the supporters of the value added tax give, besides the EEC harmonization objective, against a straight single-stage or a two-stage sales tax, is that the rates would then be too high and might stimulate

(4) See Dürrwächter, *Zum Mehrwertsteuer Regierungsentwurf*, Rundschau für Umsatzsteuer, 1964, pp. 145-156; M. W. ALBERS, "Die Suche Nach der Optimalen Umsatzsteuer-Erfahrungen und Reform Vorschläge in der Bundes Republik Deutschland", *Public Finance*, 1961, No. 3-4. Bundesministerium der Finanzen, *Finanzbericht*, 1964, p. 192 ss.

substantial evasion and, due to the inequalities of enforcement, distort competition (5).

The single-stage tax seems to have a substantially stronger appeal in the Netherlands (6) and Belgium than the value added tax, in case of a reform of the present sales tax system. Belgium, in particular, has shown a definite preference for a single-stage tax: one good reason for this is that the present cascade tax in Belgium is in several instances, and more than in the other cascade tax countries, replaced by a single average rate.

As for the Western European countries outside the Common Market, there are two — Austria and Spain — who have a cascade sales tax. While the Austrian tax is as old as the German, the Spanish is very new, having been introduced in 1965 to cope with the increasing expansion of central government responsibilities, connected with the high rate of the country's economic growth. No proposal to change to a different sales tax is officially entertained or discussed in Austria; nor, obviously, in Spain, which is only at the very beginning of its cascade sales tax experience.

5. The U.K., Denmark (up to now), and Switzerland apply a wholesale-stage (i.e., "purchase") tax. As is well known, there are advocates of a value added tax in the U.K., too; but the Richardson Report on turnover taxation has advised against any proposal in this direction, and in its evidence the Federation of British Industries forcefully denied the superiority of a value added tax to the purchase tax (8). Advocates of a value added tax for the U.K. seem to have a stronger case when they suggest it should replace part of the

(5) For a discussion of the sales tax reform and the change to a value added taxation in Italy see the Cosciani Report of the National Committee on Tax Reform (published in Italian by Giuffrè, Milano, 1965). See also E. Gerelli, *Rivista di Diritto Finanziario e Scienza della Finanza*, 1965, and the Acts of the two conferences on Indirect Tax Reform and European Tax Harmonization by the Centro Italiano Studi Finanziari and the Centro Internazionale di Studi e Documentazione sulle Comunità Europee, both published in Italian by Giuffrè, Milano, 1964. On the quantitative aspects of a value added tax in Italy, see M. RBY, "Alcuni elementi quantitativi per l'applicazione in Italia di una imposta sul valore aggiunto", *Quaderni di Studi Economici*, University of Naples Department of Economics, 1965.

(6) For a critical analysis of the replacement of the Dutch cascade tax with a value added tax, see J. Rengebrink, *Omzetbelasting en EEC*, Deventer, Antwerp, 1963.

(7) QUINTANE, "L'Impuesto sobre el volumen des ventas: perspectivas de una idea fiscal Espanola", *Anales de Economia*, 1964, pp. 3-160.

(8) (Richardson) *Report of the Committee on Turnover Taxation*, Cmnd. 2300. The opinion of the FBI against the proposal of replacing the purchase tax with a value added tax is given there on p. 40.

corporation tax. However, there is strong opposition to this proposal as well (9). As for Switzerland, an unofficial suggestion to consider a value added tax to replace the wholesale-stage tax has been heard (10), but it does not seem to have aroused any enthusiasm either in Government circles or in the business community nor among economists.

Denmark's wholesale tax was introduced only in 1962. A proposal to change to a value added tax was, however, approved by the Government in 1965.

The other Scandinavian countries, Sweden and Norway, apply a retail-stage sales tax. In Sweden a proposal to change from the retail tax to a value added tax, merging in it some direct tax burden, too, has recently been given serious consideration but has finally been dropped by the Government. Norway seems satisfied with its highly productive retail tax, with standard rate of 10 per cent, which puts her in second place, immediately after France, in respect of the share of sales taxation to gross national expenditure (11). Ireland applies a retail sales tax.

Another Western European country which has recently joined the group of those having a general retail sales tax is Portugal, where it should replace and broaden the scope of the existing selective luxury retail-stage rate.

Finally, Greece has a simplified type of value added tax plus an important wholesale-stage tax. Greek value added tax, unlike the French, allows deduction only of raw materials and other physical intermediate goods purchased by industrial enterprises. It is obviously far distant from the European harmonized type of value

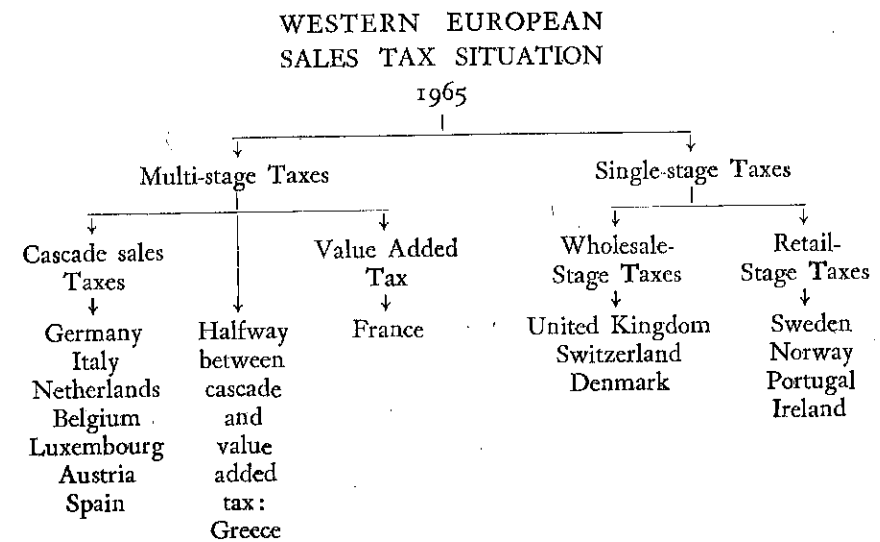
(9) See the above-mentioned Richardson Report, pp. 60-89. Against the proposal, see A. R. PREST, "A Value Added Tax Coupled with a Reduction of Taxes on Business Profits", *British Tax Review*, 1963, p. 336 ff.; for the proposal, see N. KALDOR, "A memorandum on the value added tax", *Essays on Economic Policy*, 1964, vol. I, pp. 266-293; D. K. STOUT and R. TURVEY, "Value Added Taxation, Exporting and Growth", *ibidem*, p. 314 ff.

(10) H. GERBER, *Umgestaltung der Schweizerischen Umsatzsteuer? Grossistensteuer contra Mehrwertsteuer*, *Steuer Revue*, 1965, pp. 47-84 reports that a group of scholars of the St. Gallen Business School made, in summer 1964, a case for the introduction of a value added tax in Switzerland to replace the present wholesale tax. H. Gerber himself does not appear enthusiastic about this proposal.

(11) See M. NORR, "The Retail Sales Tax in Sweden", *National Tax Journal*, 1961, pp. 174-181; L. MUTEN, "The Value Added Tax: A New Weapon in the Fiscal Armoury?", *Skandinaviska Bank*, 1963, pp. 41-46; SANDBERG, "A Value Added Tax for Sweden", *National Tax Journal*, 1964, pp. 292-296. On the new Danish value added tax, see P. GERSMANN, "La taxe sur la valeur ajoutée", *L'observateur de l'OCDE*, December, 1965, pp. 39-41.

added tax suggested by the EEC guidelines and resembles more some of the methods used by cascade tax countries to lessen the effects of the cumulative burden imposed on the full value at each stage. In fact, the present French value added tax originated through a similar scheme, but the scheme was abandoned early in the fifties after bitter criticism of its harshness and its wide distortive effects (12). Thus Greece does not seem much ahead of the true cascade sales tax countries in the process of moving to a "true" value added tax.

6. Let us summarize the existing situation.



From this summary it is easy to infer that the more prevalent sales tax in Western Europe is still the cascade sales tax: seven countries with more than half of Western Europe's population still use it; and an additional country (Greece) lives with a tax halfway from it. Single-stage taxes are, at present, by no means less important in Western Europe than the value added tax. In terms both of number of countries and of number of inhabitants, single-stage taxes override the value added tax, which is actually applied only by France, and soon will be by Denmark. To be accurate, France has not yet completely shifted to a system where the value added tax

(12) See M. LAURÉ, *La Taxe sur la Valeur Ajoutée*, Paris, Recueil Sirey, 1953.

stands alone, since, as noted, she still levies two important single-stage taxes (the Local Tax and the Tax on Services) to implement it.

That cascade taxes are unsatisfactory both from the point of view of their capricious domestic tax discriminations and because of the inherent difficulty of offsetting them at the borders, through satisfactory rebates and compensatory taxes, is widely recognized. Sooner or later an increasing number of Western European countries is bound to abandon them, in spite of their administrative workability and of their well-known high revenue. But it cannot be claimed that single-stage taxes are inferior, from an international point of view, to value added taxes, since they do not interfere at all with imports and exports. As for the domestic front, obviously investments under a single-stage tax may be completely freed or partly taxed as under the French type of value added tax, which favors "productive" industrial investments as against the others. Unintentional discriminations can hardly be greater under single-stage taxes than under value added taxes. The only troublesome point with single-stage taxes, besides the danger of evasion when high rates are applied, may be in the administrative definitional problems of taxable transactions and in the identification of their "true" price. On the other hand, the value added tax is, administratively, also a difficult tax and can hardly be made general with accurate assessment unless a high standard of bookkeeping is universal. Its definitional problems — for example, the definition of the taxable capital gains and of the deductions which identify the true value added — are by no means trivial.

Feasible value added taxes even of the most refined type must end by including in their taxable basis some values which are true capital gains but not true value added in the economic sense, or are purely apparent capital gains arising from changes in money values. Otherwise they may exclude broad classes of capital gain, thus arbitrarily discriminating in another respect. Besides this, the imperfections of tax-shifting may alter the results of the value added tax from the idealized type of a tax that burdens the final purchaser with the aggregate rates collected at each previous stage. The fact that the tax is levied at each stage may also entail a pyramiding distortive effect, and the fact that exports are rebated but are not free from charge from the beginning, except for imported commodities on which the tax is often suspended, may generate other discrimi-

nations. To sum up, the value added tax is only a second-best sales tax, the best being those of the single-stage (13).

There is ample evidence that single-stage sales taxes work satisfactorily within a federal state as member states' taxes: the fact that in the United States the member states currently and increasingly rely on single-stage sales taxes for a major source of revenue cannot be easily dismissed.

7. It should be admitted that a multi-stage cascade sales tax country may find it easier and natural to change to a value added tax which is still a multi-stage tax than to a single-stage tax, since it is already familiar with a general coverage experience and this type of change may minimize the interference with prices and tax shifting at each stage. There is no reason, however, to deny the likelihood that, after having changed to the value added tax, the country might like to make the next step and change further to a single-stage tax, i.e., to the "best" sales tax. The French value-added-tax specialist, Maurice Lauré, actually supports a similar change for the French TVA. According to his suggestions, at each stage the value added tax might be "suspended" and the full amount then collected when the good is sold at the last stage. Through the "suspension" technique, the transition from a value added to a single-stage tax may be as natural as has been the French step-by-step transition from a cascade to a value added multi-stage tax through allowing an increasing amount of deductions for the previously taxed goods. Under the EEC scheme not only should single-stage tax countries be obliged to deteriorate their indirect tax system to join the Common Market; EEC countries' movements toward a better sales tax system should also be frozen. It is difficult to under-

(13) See the sharp criticism of the value added tax by R. ROLPH, "The Economic Effects of a Federal Value Added Tax", *Excise Tax Compendium*, U.S. Government Printing Office, 1964, pp. 99-107. See also the list of administrative problems analyzed by G. S. WHEATCROFT, "Some Administrative Problems of an Added Value Tax", *British Tax Review*; in spite of his contention that this tax "appears to be reasonably simple to administer", Mr. Wheatcroft's analysis does not suggest that, through his proposal, one might end up either in a simple or in a nondiscriminatory tax. The superiority of single-stage over value added taxes is stressed by the *Richardson Report*, which concludes its comparison of the two types of taxes stating that "the purchase tax system is thus not only more economical as a means of collecting a tax on consumer goods but also more efficient". I have reached similar conclusions in a monograph on the various types of sales taxation published (in Italian) in the *Rivista Italiana di Scienze Economiche e Commerciali*. See also my paper mentioned in note (3).

stand in what sense this kind of harmonization accords with the basic aim of fostering progress, which is set forth at the beginning of the Rome Treaty.

8. The EEC indirect tax harmonization guidelines are open to criticism in several other economic respects.

Insofar as the different EEC countries have a different income per capita and a different income distribution, their direct taxes, if fixed at the same rates, will give different proportions of yield to GNP and therefore will entail the necessity either of different rates of indirect taxes or of a different rate of public expenditure to GNP or a different public debt policy. If, on the other hand, direct tax rates are allowed to be different, the uniformity of rates of indirect taxes will not equalize the domestic tax burden on business in each country. Given a high mobility of resources, a differential direct tax burden is likely to be more discriminatory than a differential consumption tax burden in its effect on the distribution of investments in the various countries, because while distant attractive consumption markets may always be reached through some additional transportation cost, income tax differentials must be absorbed unless one moves elsewhere, owing to the mobility of products created by the very existence of a "common market area" (14). Furthermore, insofar as indirect taxes inside and outside the EEC will not be harmonized, differential effects of the different consumers' tax burdens on demand in the local markets will still arise, because of the different distances of the various areas outside the EEC from those outside that have diversified indirect tax burdens.

9. But why, after all, is it thought that a uniform consumers' tax burden, given different levels of income per capita, affects different local consumer demands in a way which minimizes welfare losses? One may be able to judge of the welfare superiority of one tax in comparison with another when both exact the same amount of money income from the same taxpayers; but one cannot pass the same judgment on taxes with important distributional differences: this point is far from being academic, since a chief reason to retain a particular degree of discrimination in consumers' taxation rests, in

(14) D. DOSSER, "Welfare Effects of Tax Unions", *The Review of Economic Studies*, Vol. XXXI, No. 3.

each country, on political (value) judgments related to distributional grounds which each national parliament weighs in a different way.

There is a second disturbing distributional factor in having each country collect a uniform value added tax on taxable matters originating in it, i.e., that countries with a surplus of exports over imports from the other Common Market countries will be able to collect more, as a share of EEC aggregate expenditure, than countries having a deficit. Deficits to other Common Market countries may be paid through capital inflows, this being a permanent feature. Member countries running surpluses and investing their balances in other member countries or elsewhere will thus be able to tax indefinitely consumers of the other member countries more than the other member countries can tax their consumers. It is hard to see how this result would meet the requisites of distributive fairness among countries, not to speak of the responsibility of a supranational or federal government to redistribute income from the stronger to the less strong regions.

10. The most important reason for criticizing the EEC sales tax scheme, however, is related to fiscal policy considerations.

If an identical sales tax is adopted in each EEC country, most of the indirect taxes will be lost as tools of national fiscal policy both from the internal and from the international stabilization point of view (15). Furthermore, unless an exceptionally powerful EEC central government exists, they will be lost as tools of Common Market-wide fiscal policies, because of the difficulty of convincing every national government and parliament to adopt the same tax change when needed. At present, no Federal Government has any experience of managing fiscal policy through simultaneous action by every member state to pass in each parliament the same tax bill making the same tax change. Only if the EEC instituted the new value added tax as its own tax could it be used as a tool of fiscal policy. But this would imply a unified policy expenditure in the EEC covering something like 7 per cent of GNP. In turn, this, because of the broad economic and social effects of such public spending, under the democratic government principles to which Western European

(15) There is evidence that indirect taxes, as tools of fiscal policy to alter the general level of demand, are able to work better than direct taxes. See W. A. B. HOPKIN, W. A. H. GODLEY and D. A. ROWE, "An Analysis of Tax Changes", *National Institute Economic Review*, May 1965, pp. 33-42.

countries are committed, would make sense only if the EEC had its own parliament and government responding to all the citizens of the entire Common Market area. Furthermore, a unified EEC monetary authority capable of deciding monetary policy over all the EEC area would be needed, because a situation where monetary policy is kept at the member states level while fiscal policy is centralized at the EEC level is inconsistent with the obvious links between the two sets of policies as tools of stabilization.

Given all this, the unified value added tax scheme might be delayed for a longer period than was originally foreseen by the EEC. The differentiated domestic value added taxes provided with border adjustments internally to the Common Market area might then be retained until the central powers and institution outlined above could emerge to the required extent. But then the main benefit of having each country adopt a value added tax, i.e., that of abolishing the internal tax borders, would be lost for a substantial period of time. The difficulty with the present EEC sales harmonization proposal is its intrinsic rigidity. To become an effective way of freeing movements of goods within the EEC area it requires a major advance which could hardly be accomplished in a few years: in the meantime great national efforts are required in the field of tax reform, without much immediate return.

11. Countries with an important agricultural sector based on traditional family farms, fragmented trade, and little concentrated industry will hardly be able to enforce the value added tax suggested by the EEC, for, *per se*, it is a highly refined tax suitable only for a later industrial stage. This might prevent extension of the Common Market to countries like Spain, Turkey, Portugal and so on, unless they were allowed to stay outside the tax harmonization plan: but any substantial exception of the kind would mean a debasement of the EEC harmonization plan.

12. A more flexible harmonization scheme for sales taxes is needed; and possibly a scheme that can ensure early abolition of internal border tax adjustments without the need of too drastic and precipitous changes in domestic tax policies and of any limitation on their use in fiscal policy management.

I suggest the following scheme: (a) each EEC country should normally be allowed to choose either a value added tax extended to

the wholesaler or the retailer or a single-stage sales tax, or else a combination of them; (b) each EEC country should be allowed to apply different rates and exemptions — provided that the differentials are not dramatically high — for the chosen taxes and to manipulate them for reasons of its domestic tax and fiscal policy; (c) in exceptional cases the less developed countries joining the EEC could be allowed to retain, temporarily, their cascade taxes, with a commitment to move to one of the three choices mentioned under (a) within a reasonable period of time; (d) export sales to member countries should be tax free or rebated, like those to outside countries, but copies of the exporters' invoices, when sales relate to Common Market countries, should be sent to the domestic tax authority which, in turn, should pass them to the tax administration of the importing country to provide a check against fraud — as explained below; (e) this country would not collect any compensating tax at the border on EEC imports; (f) the rule of identifying the value added taxable basis through deduction of the tax from the tax, rather than through deduction of the purchases from sales, should be adopted by any EEC country having a value added tax (16); hence, on commodities imported from the other EEC countries, wholesalers or producers of countries levying a value added tax would automatically pay this tax.

As is easy to see, this scheme both grants national differentiations of types of sales taxes and of sales tax rates and allows the abolition of tax borders between the EEC countries.

Let us now demonstrate that the scheme is easily workable and that it does not create substantial economic distortions in intra-European competition or, at least, no more than the EEC scheme does.

13. To begin with, it is worth recalling that whenever a country applies a single-stage tax, at either the wholesale or retail stage, no problem arises of a tax border. Imports are automatically covered by the tax when they reach the taxable domestic trade channels; exports are automatically excluded because they (in the retail tax case) do not enter the taxed channel or (in the wholesale tax case)

(16) The deduction of the tax from the tax method is explained in the *Richardson Report* with reference to the French value added tax (pp. 14-15) and in *Norr and Kerlan, Taxation in France*.

the side of the channel where the domestic tax is collected. So long as countries with single-stage sales taxes deal among themselves, no problem of competition-equalizing tax borders therefore arises, even if they have different rates and exemption policies.

The question to be explored, then, is whether, under our scheme, the tax border issue is overcome for trade among value added tax countries and among value added and single-stage tax countries or value added plus single-stage tax countries.

Let us first consider trade among value added countries. Here, following our scheme, a full rebate on exports should be granted, in the taxing country. To give this rebate, no border administration or control is needed: the exporter has only to provide evidence that he is really exporting and to where. As the rebated exported commodities reach the other value added country, they will automatically be included in the domestic taxable basis without any need of taxation or control at the borders: this is so because, under the rule of deducting the value added tax paid in previous stages on purchases from the tax due on next sales, purchases which were fully tax free (because of the rebate) will not be eligible for any deduction claim. Their value is thus covered, automatically, by the value added tax levied on the sales of goods incorporating them.

Even if the rates in the different value added countries are different, no distortion can arise between imported and domestically produced commodities. Suppose domestically produced commodities of a given kind are taxed, at their production stages, with a halved rate. Similar commodities imported from EEC countries enter the home market tax free and commodities imported from an outside country enter, perhaps, after having paid a border tax at a full rate. Both the imported and the domestically produced commodities enter under the taxable basis either of producers employing them as intermediate goods or of wholesalers channeling them to the retailer. Here a value added tax obligation arises, measured, on the positive side, by the value of sales multiplied by the rate relevant for these sales. On the negative side, no claim for deduction can be raised on commodities imported from the EEC countries since they bear no tax; on domestically produced commodities of the same kind, the halved tax rate already paid will be deducted and on commodities imported from outside countries the full tax will be deducted. As a result, domestic commodities will entitle the seller to a lower value added tax burden exactly equal to the higher burden

previously imposed on them, as compared with commodities imported from other EEC countries. Commodities imported from countries outside the EEC will entitle the seller to a still higher deduction to an extent which exactly offsets the differential burden to which they were previously subjected.

No matter the place of origin nor how much the rate of tax on each commodity, the effective rate will be equalized when the taxation of purchases takes place.

Since to claim a tax deduction the value added taxpayer must show the invoices relating to the purchases on which he claims this deduction, in the case of imports from EEC countries there will be no risk of unwarranted tax deductions: taxpayers who bought these commodities from abroad have no tax to show on the purchase invoices to which they relate.

Tax evasion might be attempted by concealing simultaneously sales and purchases related to them. Imported commodities, being unconnected with any previous tax, might be preferred in attempting this evasion. But in order to stop such attempts, in our scheme the authorities of the country of residence of the exporter must send to the tax administration of the importer's country of residence a copy of the invoices relating to these international transactions. Thus, nobody will be able to conceal his sales through trying to conceal his purchases of imported commodities, any more than he might be able to do through trying to conceal purchases of goods domestically taxed under the value added tax.

14. It is easy to see now how our scheme meets the different needs of single-stage tax countries, value added countries and value added plus single-stage tax countries. Exporters from value added tax countries would enjoy their rebates, no matter whether they exported to EEC value added tax countries, to EEC single-stage countries, or to outside countries. This, as explained, does not require border control. Single-stage countries will automatically tax their imports from value added countries, without any danger of double taxation, because of the previous rebate. Their exports to value added tax countries will automatically be tax free and will undergo the same tax procedure as goods exported to value added countries from other EEC value added countries. The transmission of invoices here again will help to prevent any tax evasion attempted through international trade.

Countries applying simultaneously the value added and the single-stage tax will act, in respect of their value added taxes, in the way described for countries having the value added tax alone; and in respect of their single-stage taxes, like countries having this tax alone. The important point is that these countries should cover the wholesale stage with the value added tax in order to originate the automatic equalization of imported and domestically produced commodities at the wholesale level.

15. Obviously, this scheme will entail some locational investment distortion connected with the differential burden placed on consumers in the various EEC countries. But as we have seen, it is very doubtful whether this distortion has any definite welfare meaning. Our scheme will allow for some distortions through the rebate mechanism as between value added countries and countries applying the single-stage tax, if the value added tax is not completely shifted forward. On the other hand, it will allow for some distortion in the value added countries for goods coming from the single-stage countries which are free of charge from the beginning and goods domestically produced which first pay a tax and then originate the right to a recovery of the tax through the deduction mechanism. Both exports from value added to single-stage and from single-stage to value added countries would thus receive fiscal stimulus: one stimulus might offset the other in the choice of location for investments of business enterprises engaged in international trade.

In the writer's opinion, the chief merit of this proposal is that it would make the entry of the U.K. and other single-stage sales tax countries into the EEC much easier. If one thinks of this as a positive factor for the Economic Union, it is an argument that has to be listed among those in favor of our proposal. Our scheme would not prevent the possibility of subsequent steps to tighter types of sales tax harmonization: if desired, the general uniform sales tax could always be introduced later on when the European Community central body may have developed sufficiently to take upon itself autonomous tax and fiscal powers. In the meantime, an immediate mechanism of harmonization fostering free commodity movements and competition would be put into effect.

FRANCESCO FORTE

Turin