

Contents

Introduction	1
1 The Policy Setting	7
1.1 Basic Concepts of International Taxation	7
1.2 The Harmonization Process in the EC	11
1.2.1 Value-Added Taxation with Border Controls	11
1.2.2 Value-Added Taxation in the Internal Market	15
1.3 Feasible International Tax Principles	21
2 Theoretical Aspects	29
2.1 Introduction: Domestic Taxes and Foreign Trade	29
2.2 Trade Distortions vs. Domestic Efficiency	32
2.3 Fiscal vs. Political Externalities	35
2.4 Optimal Taxation vs. Tax Reform Analysis	41
2.5 Application to EC Policy Issues	43
3 A Dual General Equilibrium Framework	47
3.1 The Trade Model and its Assumptions	47
3.2 Dual Functions and their Properties	49
3.3 Introducing General Commodity Taxes	53
3.4 General Tax Principles	56
3.4.1 General Destination Principle	56
3.4.2 General Origin Principle	57

4	Restricted Destination Principle	59
4.1	The Two-Country Model	59
4.2	Tax Reform and Terms of Trade Changes	63
4.3	Introducing Changes in the Tax Base	68
4.4	Global Welfare Effects of Tax Reform	73
5	Restricted Origin Principle	77
5.1	The Three-Country Model	77
5.2	Tax Reform in the Small-Union Case	82
5.2.1	The Basic Trade Pattern	83
5.2.2	Alternative Trade Patterns	86
5.3	Tax Reform with Endogenous World Prices	90
5.3.1	Simplifying Assumptions	91
5.3.2	Relative Price Effects	93
5.3.3	National Welfare Effects	98
5.4	Supplement: Trade Deflection	102
5.5	Summary: The Limitations of Theoretical Analysis	104
6	Alternative Tax Principles: A Numerical Comparison	107
6.1	The Empirical Model	109
6.2	The Data Base	111
6.2.1	Deriving the Benchmark Data Set	111
6.2.2	Functional Forms and Elasticity Estimates	117
6.3	Simulation Results for Homogeneous Goods	119
6.3.1	Measuring Welfare Change	119
6.3.2	Welfare Effects of a Switch in the Tax Base	121
6.3.3	Welfare Effects of a Change in Tax Rates	125
6.3.4	Overall Effects of a Change in the Tax Principle	130
6.3.5	Sensitivity Analysis	131
6.4	Extending the Model: Differentiated Goods	133
6.4.1	Changes in the Model and the Data Base	133

6.4.2	Simulation Results for Differentiated Goods	138
6.5	A Second-Best Tax Principle for the EC	144
7	Tax Rate Harmonization	147
7.1	Public Goods in the Dual Framework	148
7.2	Heterogeneous Preferences for Public Goods	151
7.3	Tax Competition and Public Good Supply	160
7.3.1	Tax Reform in One Country	160
7.3.2	Alternative Views of Government Behavior	167
7.3.3	A Brief Survey of Empirical Results	172
7.4	Optimal Tax Rate Harmonization in the EC	175
8	Summary and Outlook	179
8.1	Summary: Evaluating the Policy Choices	179
8.1.1	Results of the Study	179
8.1.2	Welfare Analysis and International Tax Policy	183
8.2	Outlook: International Capital Movements	185
	Appendix	189
Appendix A:	Derivation of Selected Equations	189
Appendix B:	MPS/GE Simulation Results	195
Appendix C:	List of Symbols Used	201
	Bibliography	203

List of Tables

1.1	Principles for International Commodity Taxation (Single-Stage Tax)	8
1.2	Comparison of International Tax Principles (Multi-Stage Tax)	11
1.3	Value-Added Tax Rates in EC Member States (1987)	15
1.4	Tax Revenues in EC Member States	17
1.5	Effects of Alternative Second-Best Tax Principles	27
2.1	Trade Distortions and Heterogeneous Preferences	35
2.2	Fiscal vs. Political Externalities	40
4.1	Restricted Destination Principle and Trade Policies	63
4.2	Welfare Effects under the Restricted Destination Principle	73
5.1	Welfare Effects under the Restricted Origin Principle (I)	90
5.2	Relative Price Effects under the Restricted Origin Principle	98
5.3	Welfare Effects under the Restricted Origin Principle (II)	101
6.1	Gross Domestic Product by Region (1987)	112
6.2	National Accounting Classification of Goods	113
6.3	International Trade Classification of Goods	113
6.4	Benchmark Data Set: Homogeneous Goods (1987)	115
6.5	Input Coefficients by Sector and Region	116
6.6	Substitution Elasticities in Single-Stage Functions	118
6.7	Homogeneous Goods (I): Switch in Tax Base (bill. US-\$)	124
6.8	Homogeneous Goods (II): Change in Tax Rates (bill. US-\$)	128
6.9	Homogeneous Goods (III): Overall Welfare Effects	130
6.10	Change in Tax Rates – Sensitivity Analysis ($\sigma^C = 0.1$)	132

6.11	Benchmark Data Set: Differentiated Goods (1987)	135
6.12	Substitution Elasticities in Nested Utility Functions	137
6.13	Differentiated Goods (I): Switch in Tax Base (bill. US-\$)	138
6.14	Differentiated Goods (II): Change in Tax Rates (bill. US-\$)	140
6.15	Differentiated Goods (III): Overall Welfare Effects	142
7.1	Global Welfare Effects and Preferences for Public Goods	157
7.2	National Welfare Effects with Public Goods	166

List of Figures

1.1	Taxation of Trade under the Restricted Destination Principle	23
1.2	Taxation of Trade under the Restricted Origin Principle	26
2.1	Externalities in Government Relations	36
4.1	Terms of Trade Effects of a Tax Change	67
4.2	Tax Base and Terms of Trade Effects of a Tax Change	72
5.1	The Basic Trade Pattern (I)	79
5.2	Symmetric Trade Pattern (II)	86
5.3	Asymmetric Trade Pattern (III)	87
5.4	Trade Flows with Deflection	103
6.1	The Basic Trade Pattern	110
6.2	Welfare Effects of a Switch in the Tax Base	122
6.3	Welfare Effects of a Change in Tax Rates	126
7.1	Costs and Benefits of Public Goods in a First-Best Setting	150
7.2	Tax Rate Harmonization with Heterogeneous Preferences	159
7.3	Fiscal vs. Political Externalities and Public Good Supply	172