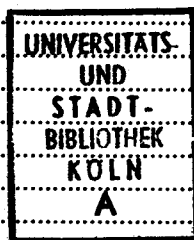


TABLE OF CONTENTS

TAXATION AND ECONOMIC PERFORMANCE	7
1. Executive summary and policy conclusions	7
1.1 Summary	7
1.1.1 Taxation, savings and investment.....	7
1.1.2 Taxation and labour	9
1.1.3 Taxation and human capital formation	10
1.1.4 Total tax effects on growth	10
1.2 Policy conclusions	11
1.2.1 Limiting or reducing the total tax burden	11
1.2.2 Responding to capital-market integration	11
1.2.3 Reducing tax distortions on employment	12
1.2.4 A need for fundamental tax reform?	12
2. Overview of past tax policies	12
2.1 Rising level of taxation	13
2.2 Shift towards higher taxation of labour	14
3. Effects of taxation on growth ("top-down" approach)	14
4. Taxation, saving and investment.....	17
4.1 How taxes affect saving.....	17
4.1.1 Tax switching and the incentive to save and invest.....	21
4.2 How taxes affect domestic investment.....	22
4.2.1 Taxation and fixed capital.....	23
4.3 How taxes affect international capital flows.....	27
4.3.1 Financial capital.....	27
4.3.2 Foreign direct investment.....	29
4.4 How taxes affect intangible capital	30
4.5 Has taxation reduced savings and investment?	32
4.6 Taxation and inflation	32
5. Taxation and labour.....	33
5.1 How taxes affect employment	35
5.1.1 Tax shifting into wages: theory and evidence.....	35
5.1.2 Tax shifting and employment.....	38
5.2 How taxes affect labour supply.....	39
5.2.1 Women's and men's labour-supply responses	40
5.2.2 Impact of tax trends and reforms.....	41
5.2.3 High effective taxation of low-income workers	43
5.3 How taxes affect labour demand.....	44
5.4. Shifting the tax burden away from labour	46
6. Results from model simulations.....	46
6.1 Simulations by the EC Commission	48
6.2 Simulations by the Canadian Department of Finance.....	48

ANNEX 1. BACKGROUND NOTES.....	81
A. Theories of economic growth and implications for policy	81
B. Past trends in tax policies.....	85
1. Income tax becomes flatter and broader-based.....	85
2. Further moves towards Value Added Tax.....	86
C. Problems of measuring tax distortions by tax/GDP ratios ("top-down" approach)	91
1. Comparability of tax/GDP ratios	91
2. The nature of tax distortions.....	91
3. Why the tax/GDP ratio may understate tax distortions.....	92
4. Why the tax/GDP ratio may overstate tax distortions.....	92
5. Effect of regulations.....	93
D. Does taxation of corporate profits matter for investment?.....	94
1. View depends on assumed source of finance	94
2. Measuring tax distortions on investment	95
E. Empirical Evidence on Tax Shifting into Wages.....	99
ANNEX 2. COUNTRY CASE STUDIES.....	106
Case Study 1: the United States.....	106
Introduction	106
The 1981 and 1986 tax reforms	106
Changes in tax rates	107
Effects on savings and investment.....	109
Private savings	109
Private investment.....	110
Effects on labour supply.....	111
Conclusions	111
Case Study 2: the United Kingdom.....	116
UK tax reforms during the 1980s	116
Introduction.....	116
Problems of the 1970s.....	116
The tax reform	117
Assessing reform.....	117
Effects on labour markets and the distribution of income	117
Effects on savings and investment	118
Conclusions	119
Case Study 3: Sweden	122
Impact of the measures.....	122
Short-run revenue losses.....	122
Changed patterns of consumption and savings	123
Effect on non-residential investment.....	123
Reduced residential investment.....	123
Uncertain labour supply effects.....	123
BIBLIOGRAPHY.....	125



Boxes

- A. Growth and income distribution
- B. Is there a negative relationship between the level of taxes and economic growth?
- C. Private saving and the “corporate veil”
- D. How mobile is capital?
- E. Capital costs and domestic investment
- F. Taxes and financial investment
- G. Taxes and foreign direct investment
- H. The labour-market tax wedge
- I. Green taxes

Tables

- 1. Average effective tax rates on capital, labour and sales
- 2. Trends in selected indicators in three major OECD areas
- 3. Empirical evidence on the relationship between savings and interest rates
- 4. Marginal effective tax rates on corporate earnings in nine countries
- 5. Marginal effective tax wedge by financing and asset at the level of the firm, 1995
- 6. Studies of the sensitivity of investment to the cost of capital
- 7. United States: Taxable income reported by foreign-controlled (FCC) and other US domestic (OUSD) companies, 1981-1990
- 8. Taxes withheld on incomes paid to non-residents, 1993
- 9. Average real pre-tax rates of return required with a 5 per cent real interest rate
- 10. The effects of inflation with a hypothetical 40 per cent capital income-tax rate
- 11. Estimates of labour-supply elasticities
- 12. Marginal tax rates of married couples with two children
- 13. Social security contributions
- 14. Marginal tax rates by income level
- 15. Marginal tax rates on gross labour costs
- 16. Incidence and causes of high marginal effective tax rates (METRs)
- 17. Economic effects of tax changes: results of model simulations

Figures

1. Tax levels and tax changes
2. Trends in general government tax revenues
3. Trends in general government total outlays
4. Tax rates and growth during the 1980s and early 1990s
5. Capital income tax wedges in 1991
6. Marginal effective tax rate on corporate income for various sources of finance
7. Taxation and foreign direct investment
8. The direct tax wedge on labour costs
9. Labour market effects of an increase in the labour tax
10. Employment and the tax wedge
11. The tax wedge and female labour participation rates
12. Trends in female and male participation rates

Annex Tables

- | | |
|------|--|
| A1.1 | Top marginal rates of personal income tax in OECD countries |
| A1.2 | Number of positive rates in personal income-tax schedule |
| A1.3 | Basic rates of corporate income tax of central government, 1986-95 |
| A1.4 | VAT in OECD countries |
| A1.5 | Some estimates of wage responsiveness to taxation |
| A2.1 | Average and marginal income tax plus combined social security and Medicare tax rates for four-person families at the same relation positions in the income distribution, 1980-1990 |
| A2.2 | Marginal effective corporate tax rates, 1980-90 |
| A2.3 | Saving and investment |
| A2.4 | Components of private saving |
| A2.5 | Average marginal effective corporate tax rates |
| A2.6 | Estimated tax revenue effect of the 1991 tax reform |
| A2.7 | Before and after-tax lending interest rates for selected years |
| A2.8 | Household savings, 1976-93 |

Annex Figure

- | | |
|----|---|
| A1 | Economic growth and initial level of income |
|----|---|