Developments in Tax Systems – An International Comparison

No tendency to increase taxes on consumption

Tax competition between countries for mobile production factors is becoming evident. Many OECD countries have been reducing tax rates on corporate profits and income from capital, and the top rates on income from employment, over an extended period. As a whole, however, comparison between the countries selected here does not show any systematic undermining of direct taxation, or any reduction in its importance. The reforms which most countries have carried out were mainly intended to make taxation more neutral and so increase performance incentives and reduce steering effects. Reducing tax concessions or widening the assessment bases and lowering tax rates were the means used almost everywhere, and in some cases the reforms were accompanied by net reductions. Nor is there any fundamental indication that changes in the relation between direct and indirect taxes have any noticeable effect on economic development. There are no signs that direct taxation might be abandoned or of any consistent moves towards more consumer-oriented taxation.

This article examines the lines of development that are revealed by a comparison of the tax systems of Germany and major OECD countries, and the motives for the changes.[1]

Important trends in selected countries

In *Germany* there has not, all in all, been a shift of emphasis towards indirect taxation in the last twenty years (cf. figure 1). However, that may be expected to change in the next few years, for in 2003 there will be another increase in taxes on fuels and electricity as part of the ecological tax reform. In addition, the legislation on the tax reform 2000, which is already decided, will bring further reductions in income tax in 2004 and 2005.[2] It is also possible that the rate of value added tax will be increased, particularly as Germany is a long way down the scale of standard rates within the European Union. Hence, the weight should shift slightly from direct to indirect taxation on the whole.

The tax system in the *United States* is characterised by the predominance of direct taxes and the strictly federal nature of the US constitution. Each central, regional and local authority has complete autonomy in tax legislation, collection and administration. Unlike Germany, therefore, the taxes are levied by each territorial authority independently and the full revenue accrues to it.

The US system of income tax might appear to be very simple, as there are only five rates; these are at present lower than those in Germany. However, the system is only simple for uncomplicated cases, such as single employees on average incomes. In more complex cases a wide range of additional regulations have to be taken into account, making it much more difficult to calculate the taxable income.

Corporate taxation is also very complex. For example, there are no clear guidelines on whether a company should be taxed as incorporated or not incorporated. Both the federal administration and the individual states have their own regulations, and this can mean that a company is regarded as incorporated under federal law but not in the state where it is domiciled. The tax declarations then have to be made according to different procedures.

Great Britain carried out three far-reaching tax reforms between 1979 and 1990. The main aim was to lower the rates of income tax and shift the structure from direct to indirect taxation. In the second round of tax changes, in 1985, besides further reductions in tax rates, the concern was also to widen the assessment bases. The tax reforms in Great Britain were strongly influenced by the supply-oriented tax policy in the United States.

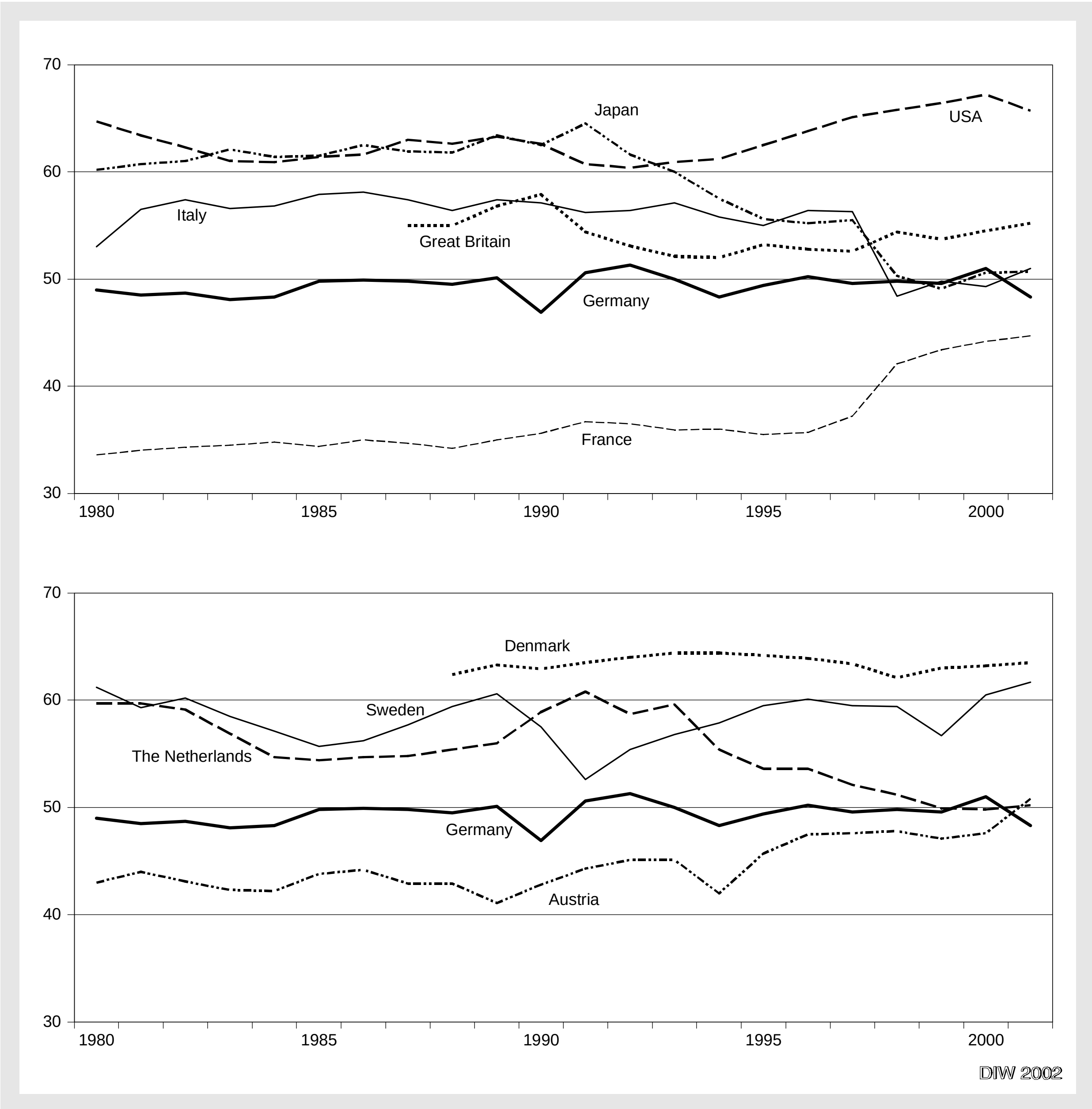
Among indirect taxes value added tax has been greatly increased. Its share in total tax revenue (including national insurance contributions) has more than doubled in the past twenty years, rising from 8% of tax revenue to 16%. On the other side, the share of excise duties has clearly fallen. It is now only 13% of total tax revenue, while at the end of the 1970s it was one-fifth.

All in all, however, the relation between direct and indirect taxes has changed only slightly, on balance, in Great Britain over the past twenty years, despite the large increase in the share of VAT. The increase in the shares of VAT and corporation tax has been largely compensated by the loss of shares for income tax and

[1] For more details see Stefan Bach, Wolfgang Scheremet, Bernhard Seidel and Dieter Teichmann: 'Internationale Entwicklungstendenzen nationaler Steuersysteme – von der direkten zur indirekten Besteuerung?' DIW Berlin, Sonderheft 172, Duncker & Humblot, Berlin 2001; see also Isabelle Joumardi: 'Tax Systems in European Countries', in: *OECD Economic Studies,* no. 34, 2002/1, pp. 91ff.

[2] The second stage of the tax reform has been postponed from 2003 to 2004 to finance the flood damage in eastern Germany.

Figure 1
Direct Taxes from 1980 to 2001 by International Comparison
In % of tax revenues



Sources: OECD 2002; DIW Berlin calculations.

specific consumer taxes. Thus, the aim of the Conservative Government, namely to shift the weight from direct to indirect taxes, has been achieved only to a very small degree.

In *France* the changes in the tax system since the 1980s have been gradual rather than fundamental. Reaction to a changing international environment is evident, but the traditionally complex structure of the tax system has been retained, and a clear trend to shift the burden from direct to indirect taxation is not evident – on the contrary, indirect taxes, which have traditionally been of great importance in France, are now less significant, while the share of direct taxes has risen markedly.

Companies not only pay very high rates of corporation tax, but also have to bear a number of supplementary charges, and as employers pay considerable social insurance contributions. The redistribution of incomes still plays a large part in the French tax system, but the changes have not simplified the system; on the contrary, it has become more complex.

The tax system in *Italy* has altered markedly with the gradual changes introduced since the 1980s, while the more recent reform of 1997 caused fundamental restructuring after the major reforms in the first half of the 1970s. The weight of indirect taxes rose considerably at the end of the 1990s, while that of direct taxes and social insurance contributions fell noticeably. So far, environmental taxation has played little part in the Italian system.

The public budgets in Italy are still in a difficult financial position, so that there is not likely to be scope for substantial tax reductions unless the policy of combating tax evasion continues to be pursued vigorously, which might enable the assessment bases to be widened much further.

The developments in the system of taxation and charges in *the Netherlands* have been of interest for the discussion in Germany during the last two decades, for a variety of reasons. The basic patterns of the structure and development are very similar in the two countries, but in the Netherlands the economic trend and the tax reform process have both been more dynamic. Altogether the tax reform policy had succeeded in making direct taxation more neutral and reducing the negative incentive effects by the end of the 1990s.

The Netherlands began to ecologise its tax system relatively early, but as the rates of VAT and the excise duties had already been raised to a high level in the 1980s they could not be raised much further in view of the European single market. For value added and petroleum taxes particularly, the lower rates in Germany had to be taken into account, and at the start of the 1990s the Netherlands value added tax rate was actually reduced. However, in recent years, the process of building up indirect taxation has been stepped up – with rises in value added tax and environment-related taxes.

In *Sweden* the burden of taxation and social insurance contributions on incomes from employment, which is very heavy by international comparison, is still a problem. The top rates of tax have been greatly reduced and the average rates have been lowered as well – taking into account the widening of the assessment basis. But the marginal levels that are relevant for decision-making are still very high. Even the bottom rate of proportional municipal income tax is considerable, at over 30% on average, while the next bands of national income tax follow very quickly; the top tax rate of about 56% is reached at an annual income of only euro 41 400.

In view of the favourable revenue situation and the high budget surpluses, reductions in direct taxes and social insurance contributions are to be expected in the next few years. Above all, the Swedish Government wants to reduce the tax burden on lower and medium incomes. On the other hand it is planning initially to increase some taxes, particularly carbon dioxide tax and the taxes on diesel fuels and electricity.

In *Denmark* it is evident that despite the considerable burden of charges by international comparison – both in direct and indirect taxation – the macroeconomic development has been very positive in recent decades.

Criticism is directed particularly at the very high marginal tax rates in Denmark, especially their negative incentives on employment and capital formation. The tax reforms since 1987 have all followed the model of lowering tax rates and widening the assessment bases, but the burden on income from employment is still high.

On international comparison Denmark is in the lead in ecologising its tax system. The spread of part of the load of energy taxes – high for households, low for export-oriented or energy-intensive companies – has been introduced with regard to the strong international integration of this small but open economy.

The reforms in the 1990s have made the tax system in *Austria* much more even and neutral on the whole. The basic structures of the system of taxation and charges are very similar to those in Germany, but Austria started to reform the problematic charges earlier and has been more consistent.

In addition to the potential that still exists for reforms of corporate taxation to make this economically more neutral, the heavy burden of taxation and social insurance contributions on income from employment is seen as a problem in Austria. This is similar to the situation in Germany or the Scandinavian countries. The extension of tax payments on demand to income from capital will tend to create a dual income tax; capital yield tax will be extended to include equity capital as well.

Austria certainly has scope for increases in energy and environmental taxation, not least in view of the steps taken in Germany. But value added tax is rather high at a standard rate of 20%; as the rate is very much lower in Germany an increase here would pose problems.

The development in revenue from taxation and charges in *Japan* has been determined in recent decades by economic weakness on the one hand and tax policy on the other, which was intended to help overcome this weakness. At the end of the 1980s the tax reforms were still directed to improving the efficiency of the tax system, achieving a more just distribution by making taxation more even and increasing incentives, while stability policy considerations predominated in the reforms of the second half of the 1990s. This meant that there were large falls in revenue, particularly from direct taxes. Over the medium term the Japanese Government will not be able to avoid increasing the ratio of taxes and charges. It could start by widening the assessment basis for income tax. That includes the many tax credits and free allowances and the low taxation of pensions.

Germany is not a high tax country

Tax policy cannot be considered separately from the obligations upon the government and the resultant expenditure. The legal framework also plays an important part. This applies particularly to the European countries, which had to meet fiscal requirements on budget deficits and the level of borrowing to join European economic and monetary union. In many European countries the obligation to consolidate the budget has affected the scope for tax policy measures.

Taxes and social charges as a whole

In Germany taxes and social insurance contributions accounted for just under 38% of (nominal) GDP at the end of the 1990s, according to the figures in the tax statistics.[3] This puts Germany in the lower half of the ten countries considered here. Only the United States and Japan are markedly lower, while Great Britain is almost on the same level as Germany (cf. figure 2). In all the other countries the ratio is higher, in some cases noticeably so, especially in Denmark and Sweden, where taxes and social insurance contributions together account for a good half of GDP.

Over a longer period, from 1965 to 1999, the ratios of charges to GDP have changed, in some cases considerably. In Germany an increase of just under 6 percentage points was noted, a good 4 percentage points being due largely to German unification. With the exception of the United States (just under 4 percentage points) and Great Britain (just under 6 percentage points), the increase was higher in every other country. In Denmark, Italy and Sweden it was 17 to 20 percentage points; while the figures in France, Austria and Japan were still about twice that in Germany, at around 10 percentage points.

[3] The figures are based on the OECD's tax statistics: Revenue Statistics 1965 to 2000, Paris 2001. Unlike the national accounts the social insurance contributions are entered here according to the actual receipts, and the projected contributions are not included. On the deviations from the national accounts see also footnote 5.

The overall tax ratio in the economy

The increase in social insurance contributions has played a considerable part in the dynamic rise in the ratio of charges. At the end of the 1990s the tax ratio in Denmark and Sweden was the highest by a large margin (cf. figure 3). In Denmark total tax revenue accounted for nearly half of the nominal GDP. However, it must be remembered here that the social benefits in Denmark are mainly financed not out of specific contributions but from general taxation. In Sweden a considerable part of the basic pension is financed from tax revenue, as are material benefits in the health system.[4]

After Denmark and Sweden comes a group of countries (Italy, Great Britain, France, Austria and the Netherlands) whose national tax ratio lay within a range from 25% (Netherlands) to a good 30% (Italy) at the end of the 1990s. The remaining countries had a very much lower national tax ratio. With just under 23% Germany was slightly above the United States (22%). Japan had by far the lowest ratio at just under 17%.

Germany is the only country examined here where the tax ratio was no higher in 1999 than in 1965. During that period the tax ratios in some other countries rose markedly, particularly in Denmark by more than 20 percentage points, in Italy by about 14 and in Sweden by a good 8. In most of the other countries the ratio rose by about 2 to nearly 7 percentage points. In the United States in 1999 it was only slightly above the figure for 1965.

The revenue structure in selected countries

The national accounts published by the OECD give a rather more up to date insight into the structure and development of revenues; however, there are differences between these and the tax statistics on which the above comments are based.[5] Marked differences are apparent

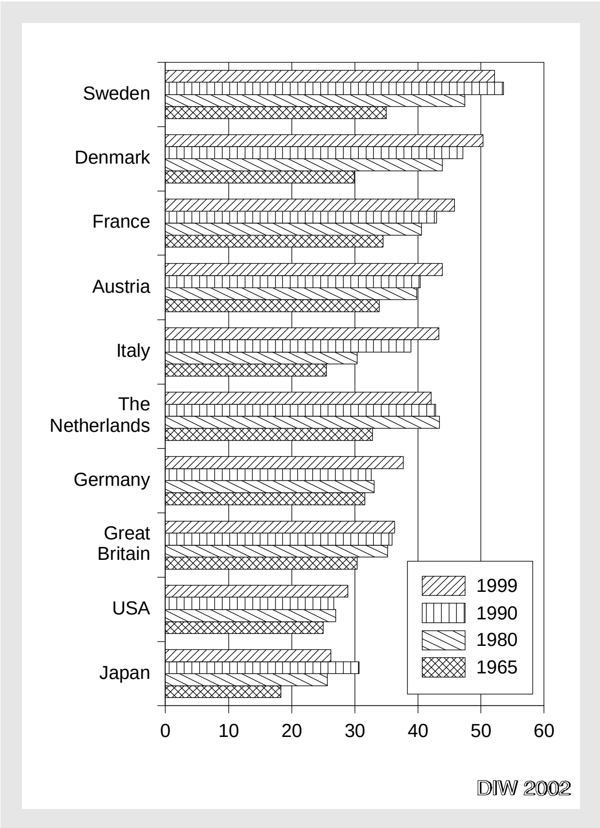
[4] In Great Britain the national health system – and the connected expenditures – are financed out of general taxation, not through a state insurance system.

[5] The tax statistics and the national accounts to date. differ not only in how recent their figures are but also in their delimitation of periods. While the tax statistics are based on the actual cash receipts, independent of the point in time when the claims or liabilities were incurred, the transactions are entered in the national accounts according to the concept of the period. Generally the deviations are not serious. One exception is social insurance contributions. While the OECD's tax statistics only include the contributions actually paid the national accounts also include the projected contributions which in theory are balanced by the pension obligations of the public authorities.

Figure 2

Taxes[1] and Social Insurance Contributions in Selected Countries in 1965, 1980, 1990 and 1999

In % of nominal GDP

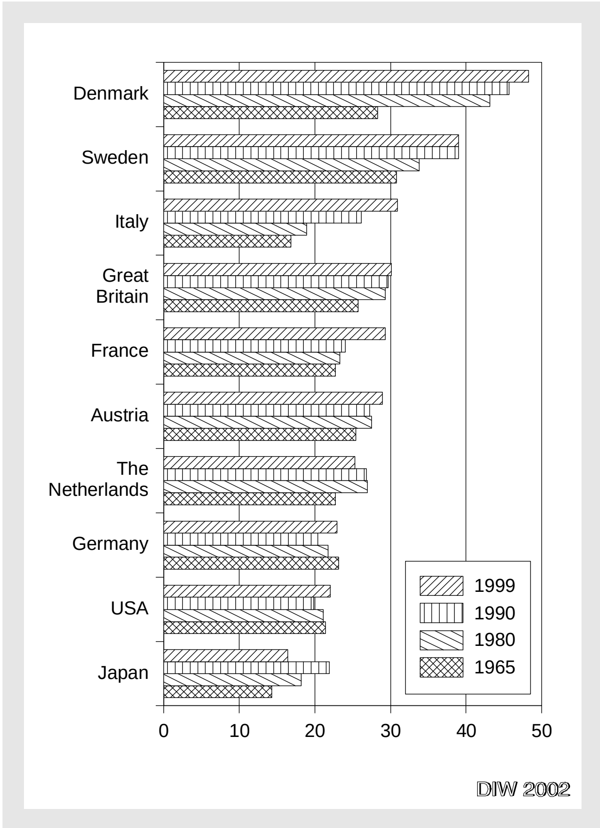


1 As defined in the tax statistics.
Sources: OECD 2001; DIW Berlin calculations.

Figure 3

The Overall Tax Ratio in the Economy[1] in Selected Countries in 1965, 1980, 1990 and 1999

In % of nominal GDP



1 As defined in the tax statistics.
Sources: OECD 2001; DIW Berlin calculations.

in the shares of the individual groups of charges in GDP from 1980 to 2001 for the countries analysed here. With only a few exceptions (Germany, the Netherlands) the revenue ratios were above the 1980 level in 2001 as well (cf. table 1 and figure 4). The efforts of several countries to reduce the public sector share have so far had little effect on the revenue side owing to the constraint to consolidate public finances. And the tight financial situation in the social insurance systems has also helped to ensure that the revenue shares have fallen only slightly despite some tax reductions.

At under 9% the weight of indirect taxes is noticeably less in Japan and the United States than in the European countries, where it ranges from just under 12% to 18% (cf. figure 5). The ratio has risen particularly strongly in Italy, while there have been only slight changes in the other countries.

There have been greater changes in the weight of direct than indirect taxes in the countries examined. In Japan, for example, there was a considerable reduction in the second half of the 1990s (cf. figures 1 and 6). The main reason for this is the protracted recession and the reductions in income and corporation tax. The ratio of direct taxes was also markedly lower at the end of the 1990s in the Netherlands, not least owing to targeted tax reduction programmes in that decade. The ratio was also noticeably reduced in Germany, where it is now just under 11%, putting Germany at the lower end of the scale of the countries on our list – if the special situation in Japan is not taken into account. In Denmark the ratio has persisted at a high level in recent years at around 30% of GDP; in Great Britain it fluctuated in the 1990s and most recently has been falling again markedly. In the United States, France, Austria and Italy it was higher at the end of the period than in 1980.

Altogether, during the period under review only in Italy, the Netherlands and Sweden has there been a marked shift in weight towards indirect taxes. In the

Table 1
Government Revenue in Selected Countries by Major Categories

	As % of nominal GDP[1]			As % of total government revenue		
	1980	1990	2001	1980	1990	2001
Germany						
Total revenue	43.7	41.8	43.1	100.0	100.0	100.0
of which: direct taxes	12.3	10.7	11.2	28.1	25.6	25.9
indirect taxes	12.8	12.1	11.9	29.2	28.9	27.7
social insurance contributions	16.4	16.3	18.6	37.4	39.1	43.1
USA						
Total revenue	28.7	29.3	30.9	100.0	100.0	100.0
of which: direct taxes	13.9	12.9	14.9	48.4	44.1	48.3
indirect taxes	7.6	7.7	7.8	26.4	26.3	25.2
social insurance contributions	5.9	7.1	7.2	20.7	24.1	23.2
Great Britain[2]						
Total revenue	–	37.5	39.3	–	100.0	100.0
of which: direct taxes	–	16.7	16.8	–	44.6	42.7
indirect taxes	–	12.2	13.6	–	32.4	34.7
social insurance contributions	–	7.5	7.7	–	20.0	19.5
France						
Total revenue	43.5	45.4	47.2	100.0	100.0	100.0
of which: direct taxes	7.6	8.2	12.5	17.4	18.1	26.4
indirect taxes	15.0	14.8	15.4	34.5	32.7	32.7
social insurance contributions	19.3	20.5	17.9	44.5	45.1	38.0
Italy						
Total revenue	33.5	41.2	44.3	100.0	100.0	100.0
of which: direct taxes	9.5	14.2	15.1	28.3	34.4	34.1
indirect taxes	8.4	10.7	14.5	25.1	25.9	32.8
social insurance contributions	14.1	14.4	12.7	42.0	35.1	28.7
The Netherlands						
Total revenue	46.2	43.7	42.0	100.0	100.0	100.0
of which: direct taxes	15.0	14.8	12.2	32.5	33.8	29.0
indirect taxes	10.1	10.3	12.1	21.9	23.7	28.8
social insurance contributions	15.3	14.4	14.5	33.2	33.0	34.5
Sweden						
Total revenue	53.5	59.7	57.3	100.0	100.0	100.0
of which: direct taxes	20.7	22.3	23.4	38.6	37.4	40.9
indirect taxes	13.1	16.5	14.5	24.5	27.7	25.4
social insurance contributions	14.7	14.9	15.9	27.5	25.0	27.7
Denmark[2]						
Total revenue	–	52.5	53.5	–	100.0	100.0
of which: direct taxes	–	28.3	29.4	–	53.9	54.8
indirect taxes	–	16.7	16.9	–	31.8	31.5
social insurance contributions	–	2.3	3.3	–	4.3	6.2
Austria						
Total revenue	45.2	46.4	49.5	100.0	100.0	100.0
of which: direct taxes	11.9	11.7	15.2	26.3	25.1	30.7
indirect taxes	15.7	15.6	14.8	34.8	33.5	29.8
social insurance contributions	14.7	15.6	17.1	32.5	33.6	34.5
Japan						
Total revenue	26.0	32.4	29.8	100.0	100.0	100.0
of which: direct taxes	10.6	13.2	8.7	40.8	40.7	29.1
indirect taxes	7.0	7.9	8.4	26.9	24.5	28.3
social insurance contributions	6.9	8.8	10.7	26.7	27.1	35.8

1 As defined in the national accounts. — 2 Data for 1980 not available from the national accounts.
Source: OECD, Economic Outlook no. 71, July 2002.

other countries the share of indirect taxes in total revenue from taxation and charges has changed only slightly or, as in Austria and the United States, it has actually declined.

Taxation and growth

In general, indirect taxes are mostly regarded as the more growth-friendly type. It is assumed that indirect taxation is felt very much less and is therefore economically more neutral than income tax, which can be read off directly from the salary slip or the income tax demand. If the individual feels he is being overtaxed he has an incentive to cut down on the amount he works or embark on other tax evasion strategies.

If it is true to say that over the long term a greater weight of direct taxes leads to lower economic growth, then economic growth and the share of direct taxes ought to be in negative correlation – assuming that other factors, such as the total weight of taxation, do not greatly change. This relation is shown here in simplified form using scatter diagrams for two periods, from 1980 to 1990 and from 1990 to 2001.

However, the diagrams suggest that for the countries considered here the relation is not very marked. From 1980 to 1990 average economic growth in Germany was 2.25%; during that period the share of direct taxes fell (cf. figure 7). France, Austria, Sweden and Italy registered similar growth rates although their share of direct taxes increased, in Italy by as much as 5 percentage points. The Japanese economy grew by an average of 4% a year, much more strongly, although direct taxation there was increased by nearly 3 percentage points.

In the diagram for 1990 to 2001 a relation is evident between the two variants for the group of the Netherlands, Great Britain, Denmark, Austria and France. Of these countries the Netherlands reduced the share of direct taxes most strongly (by 3 percentage points), and achieved the highest growth rate at nearly 3% a year. France increased the share of direct taxes by more than 4 percentage points and only achieved annual growth of 1.75%. However, the United States and Japan do not fit into the general picture. The United States increased direct taxation – by a good 2.5% percentage points – but still achieved the highest annual growth rate of all the countries considered here, at nearly 3.5%. Conversely, Japan reduced the share of direct taxes most – by nearly 5 percentage points – but had the lowest economic growth at about 1.3% a year. In the other countries, Sweden, Germany and Italy, the share of direct taxes hardly changed – nor did it in Denmark or Great Britain – but economic growth was low. Altogether it can be said that for the period from 1990 to 2001 as well a relation between changes in the share of direct taxes and economic growth is not strongly evident in a comparison of all these countries.

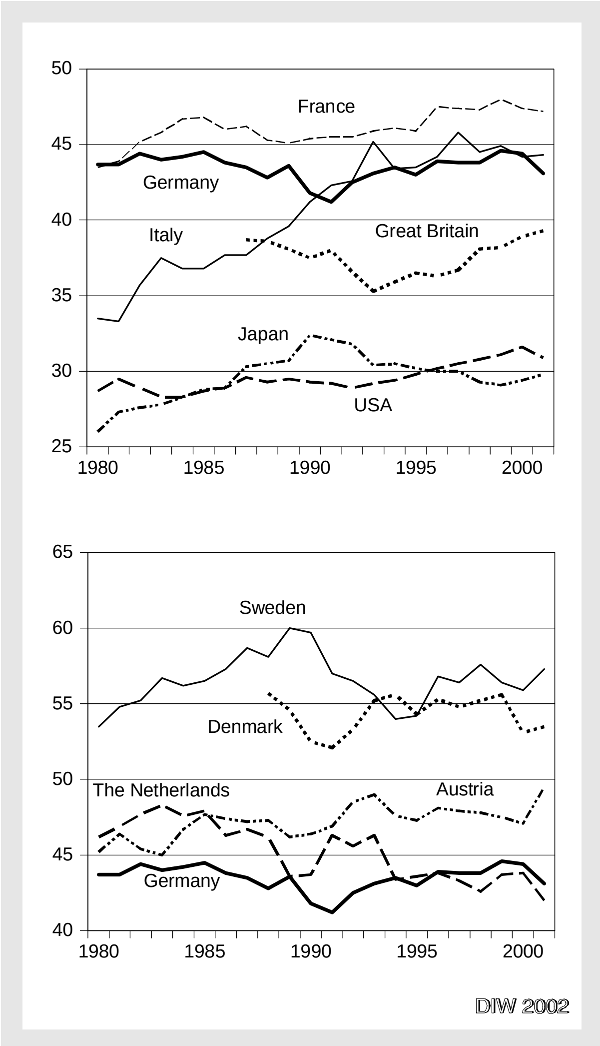
There are similarly low correlations if other figures are compared, such as the development in social insurance contributions and economic growth or the taxation of profits and capital income – measured as an implicit rate of tax[6] – and private investment activity (cf. figures 8 and 9).

The diagrams do not show a direct relation between the weight of taxation and indicators of economic devel-

Figure 4

Government Revenue 1980 to 2001 by International Comparison

In % of nominal GDP

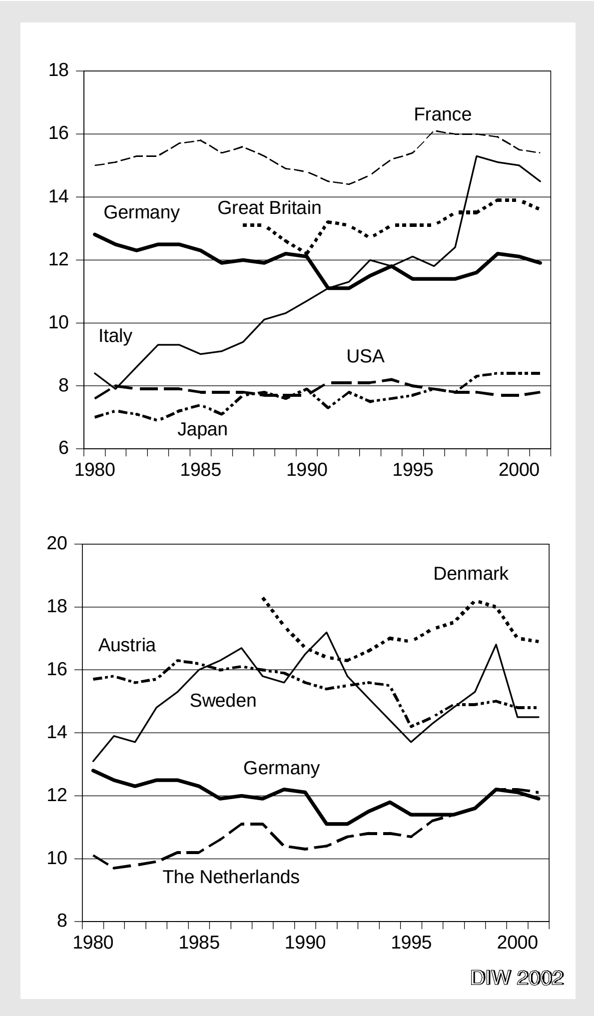


Sources: OECD 2002; DIW Berlin calculations.

Figure 5

Indirect Taxes 1980 to 2001 by International Comparison

In % of nominal GDP



Sources: OECD 2002; DIW Berlin calculations.

opment on a comparison of these countries. In general it can be said that the weight of taxation is only one of the factors that influence growth in an economy and its attractiveness for business investment. Nor do more extensive studies give clear empirical indications that countries that have raised the share of indirect taxes and reduced that of direct taxes have a clearly better economic performance.[7]

[6] The implicit rate of tax is calculated by relating the revenue from taxes on profits and capital income to the item 'Corporate income and income from property' in the national accounts.

Future German tax policy

While other countries embarked on extensive reforms of their direct tax systems in the 1980s, Germany has only followed suit in recent years. The steps taken so far here have mainly affected corporate taxation. The high rates have been lowered and in return the assessment bases widened.

Corporate tax reform controversial in its fine points

The main argument put forward for changing the system of corporate taxation was the need to bring the German system more into line with European legislation and the growing integration of the international capital markets. However, the more favourable treatment of retained earnings than of dividend payments infringes the neutrality of financing and legal forms; it also infringes the principle of equal treatment for all income. Smaller and medium-sized firms and small shareholders are tendentially disavantaged by the tax reform package. Over the longer term considerable incentive may well emerge to change the structures of corporate taxation. That will particularly affect the SME sector, but it will also affect shareholdings between big firms and the tendency to further internationalisation by companies. However, the former structure of corporate taxation was not neutral with regard to legal forms and financing methods either.

How serious these aspects of taxation practice are will become clear in the next few years. A number of other OECD countries with classical corporation tax systems – especially the United States and Switzerland – have even more preferential rates on retained earnings and do not regard this as a problem. In the international view, the German reform of corporate taxation in particular must be seen as a viable solution, as not only are the nominal tax rates being markedly reduced but foreign and domestic dividends are treated equally for domestic tax purposes. This will bring German corporate taxation more into line with the requirements of the international capital markets.

Reform of trading tax overdue

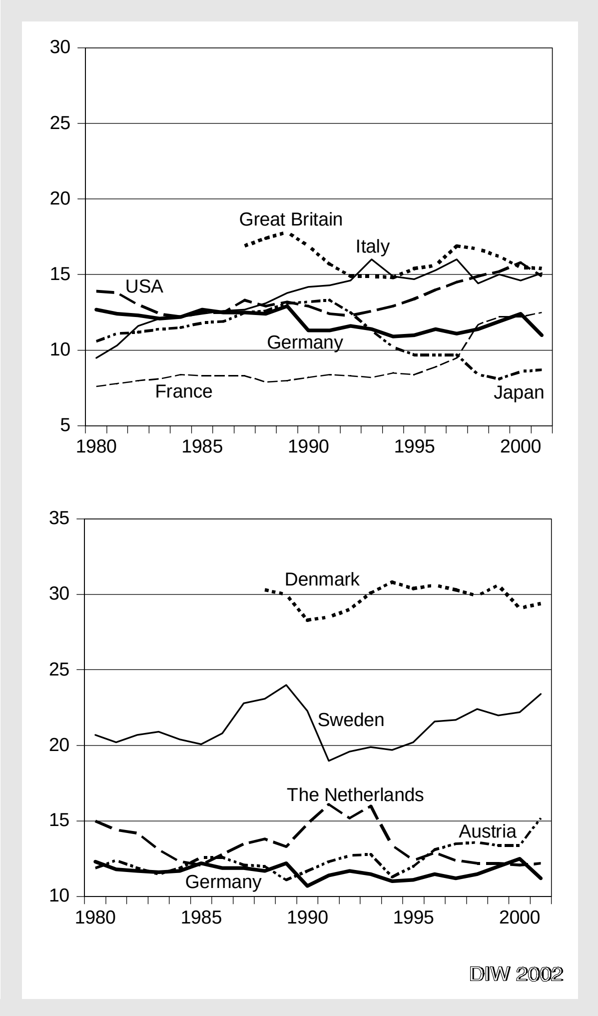
The issue of trading tax reform is still open, although it is seen as a particular disadvantage to Germany as a

[7] Cf. the survey by Willi Leibfritz, John Thornton and Alexandra Bibbee: 'Taxation and Economic Performance', Economics Department Working Papers No. 176, OECD, Paris 1997. On the effects of taxation on employment see also the survey in the article by Stefan Bach, Wolfgang Wiegard: 'Public Economics', in: Klaus F. Zimmermann (ed.): 'Frontiers in Economics', Berlin, Heidelberg: Springer 2002, p. 37-94.

Figure 6

Direct Taxes 1980 to 2001 by International Comparison

As % of nominal GDP



Sources: OECD 2002; DIW Berlin calculations.

business location in the international perspective. This tax is paid mainly by large firms, so it hardly fulfils its function now as a municipal business tax in the system a a whole.[8] For a long time the possibility of replacing trading tax with a value added tax was discussed, but now the policy is rather to allow the local governments a larger share of turnover tax or to introduce income tax supplements payable to local governments. The general offsetting of trading tax against income tax now introduced is unsystematic and should only be a transitional arrangement until a more fundamental reform of the local government tax system is possible.

The income tax rates should be lowered

When all the stages in the tax reform are in force, that is, from 2005 onwards, the progression in German income tax will no longer be in the top range by international comparison, but at the bottom. Hence, there will be no further need for direct action, at least for the top rates. Over the longer term, admittedly, it will be necessary to correct the progression in the lower and middle income ranges, for even the reformed scale moves quickly upwards here, and this will tend to reduce performance incentives.

The outlook for taxation of income on capital still open

How income from capital will be taxed in the long term depends heavily on international developments, and in particular on developments in Europe. The tendencies that are evident in taxation practice in the various European countries point at least in the medium-term view rather to final taxation at the source or taxation in the country of origin. In the corporate field it is in some cases accompanied by preferential taxation of interest on equity capital.

This must certainly be seen against the background that it is becoming increasingly difficult for the tax authorities to tax income from capital with open financial markets and the high mobility of capital in Europe, while a moderate tax at source on income from capital greatly reduces the urge to engage in creative tax accounting or tax evasion, particularly if it is final.

If the various types of income are further and further separated, and so subject to unequal taxation, the ability-to-pay principle is infringed. It is undermined in any case by the various exceptions, free allowances, tax concessions and similar regulations. But strictly speaking the principle of progressive taxation of income also stands and falls with the equal taxation of all incomes. That is ultimately called in question only if income from employment is subject to the progressive scale.

However, the examples of the Nordic countries and the Netherlands and Austria show that the principle of equality has been explicitly broken in tax policy practice without essentially reducing the public's acceptance of the tax system. This appears remarkable, not least against the background of the traditional egalitarian or corporatist social and government structures of these countries.

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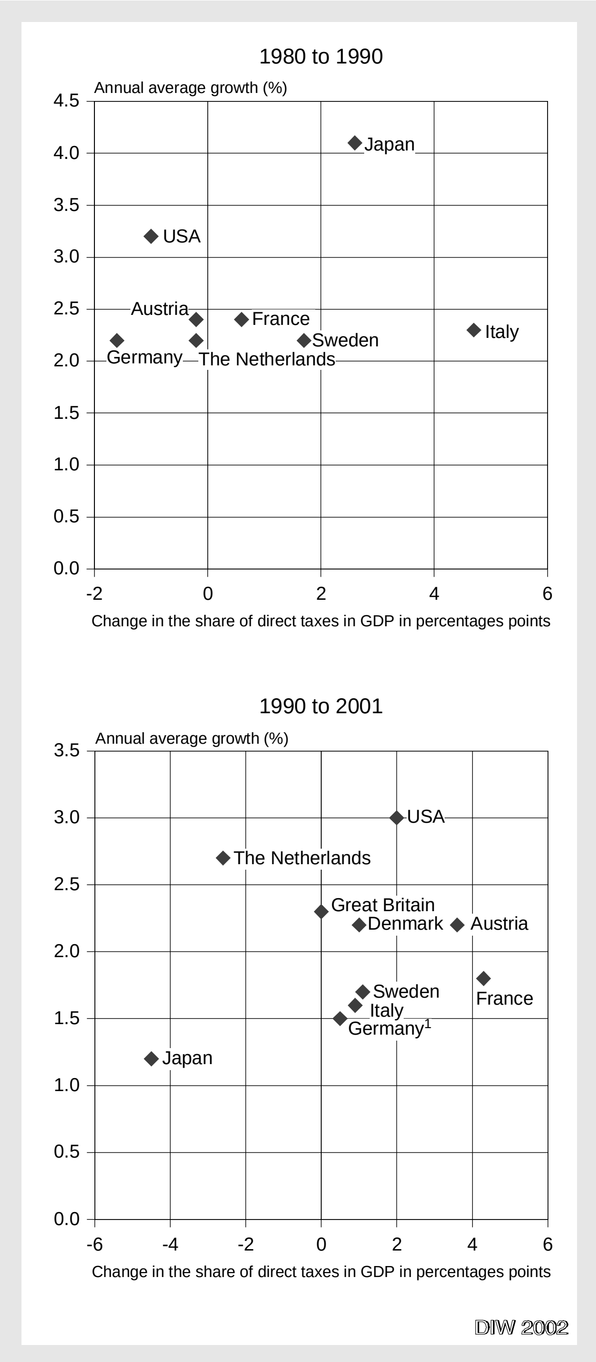
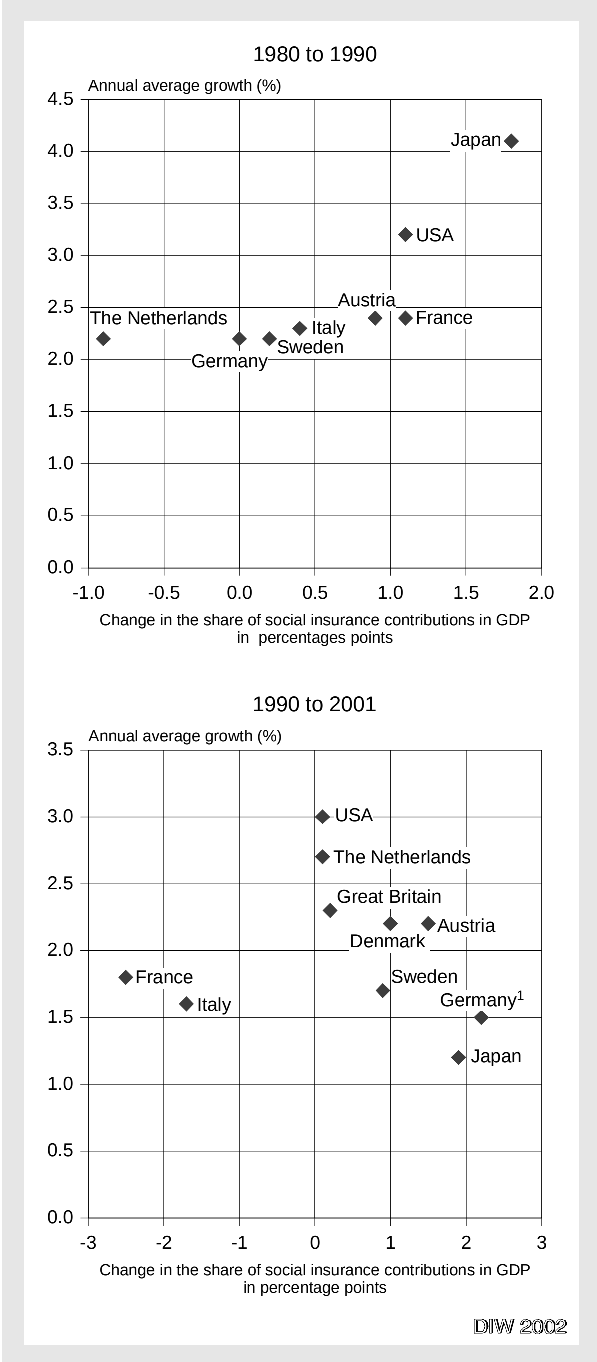
8 Cf. Stefan Bach and Dieter Vesper: 'A Crisis in Finance and Investment – Local Government Finance Needs Fundamental Reform', in: *DIW Economic Bulletin,* vol. 39, no. 9, September 2002

Figure 7
Economic Growth and Changes in the Share of Direct Taxes in GDP



1 For Germany 1991 to 2001.
Sources: OECD 2002; DIW Berlin calculations.

Figure 8
Economic Growth and Changes in the Share of Social Insurance Contributions in GDP



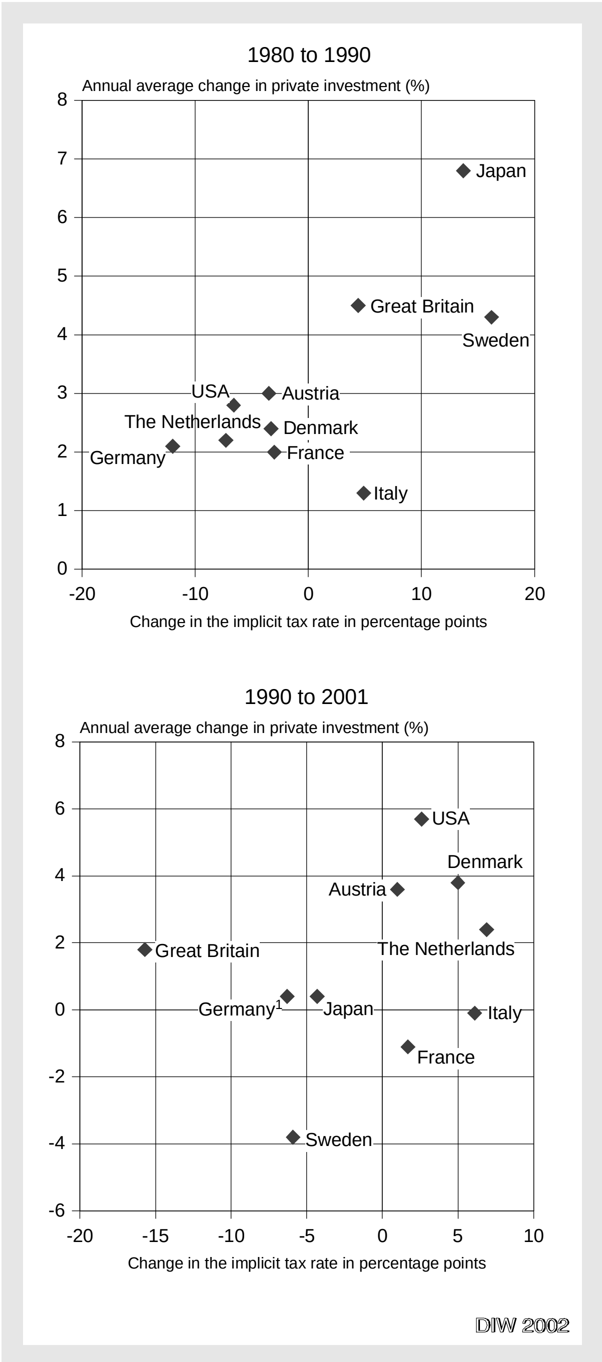
1 For Germany 1991 to 2001.
Sources: OECD 2002; DIW Berlin calculations.

The European Ministers of Finance have agreed that in the long term (at the earliest from 2010 onwards) information is to be exchanged across frontiers on earnings on capital. The intention is to include major financial centres in third countries in this procedure as well. There have also been moves in this direction at OECD level. This could guarantee that earnings on capital are taxed in the country of residence, while the scope for designing national tax policy would again increase. National legislatures would have greater freedom to

Figure 9

Change in Private Investment and the Implicit Tax Rate on Income from Self-Employment and Capital

Annual average change in private investment as %



1 For Germany 1991 to 2001.
Sources: OECD 2002; DIW Berlin calculations.

choose whether to tax earnings on capital in the same way as other income, in accordance with end-taxation, or to charge an appropriate proportion of income tax or even to exempt it very largely by taxing income without earnings from interest payments or on savings.

However, it is an open question how quickly the concept on which the EU Finance Ministers have agreed can actually be implemented. Considerable obstacles in regard to third countries still remain to be surmounted.

Conclusion: a balanced mix of direct and indirect taxation is still desirable

Despite the considerable reforms of income and corporation tax, no systematic undermining of direct taxes, or loss of importance for them is evident in the countries selected here. The United States, which is frequently cited as a model of tax and economic policy, has always relied much more on direct taxation. The reforms carried out in most of the countries were primarily directed at increasing incentives by making taxation more economically neutral. The removal of concessions or the widening of the assessment bases and the reduction in the progressive scale were the means chosen in almost every case, and some of the reforms were accompanied by net reductions. However, with a view to tax revenues the reforms – apart from those in Sweden in the early 1990s – were less radical in most countries than the most recent reforms in Germany. Now neighbouring countries like France and the Netherlands feel they need to consider further tax reductions.

To finance tax reductions raising value added tax is often considered. Germany in particular still has scope for increases here by EU comparison. But value added tax is not a generally convincing alternative to taxing incomes. There are considerable problems, such as the fraudulent deduction of pretax payments in the single market, the black economy or taxation of e-commerce.[9] Besides changes in value added tax, over the long term further increases in petroleum tax and a gradual extension of environmental taxation are to be expected.

Generally a certain renaissance of the equivalence principle is becoming evident in tax policy; this tends to lead away from the 'high tax state' and put more emphasis on the 'charges state'. Three major possibilities can be identified here:

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9 Thus, it is still not clear how cross-frontier online turnover can be taxed in future when the transactions move electronically via the data networks, that is, if foreigners sell electronic products to domestic consumers who download them. Cf. Stefan Bach and Georg Erber: 'Electronic Commerce – Opportunities and risks of global business transactions', in: *DIW Economic Bulletin,* vol. 36, no. 4, April 1999; Stefan Bach, Markus Hubbert and Walter Müller: 'Taxation of E-Commerce: Persistent Problems and Recent Developments', in: *Vierteljahrshefte zur Wirtschafttsforschung,* 69 (4), 2000, p. 669 ff.

- the privatisation of public sector tasks or the introduction of or increases in fees and contributions for services in the infrastructure, social, cultural and educational fields that can be charged to the individual;
- equivalence charges for services for groups at local and regional level ('fiscal federalism') for companies (for instance through trade and property taxes, infrastructure charges) and households (property tax, local taxation of persons or households, e.g. in the form of supplements on income tax);
- changing the systems of social insurance towards basic insurance.

If the equivalence principle were strengthened the need for general revenue from taxation and charges to finance general public expenditure would be reduced. That raises the question of how access to the services that are given in return for fees or charges can be assured for those groups in the population who cannot afford to pay for them. Above all, how the government will then be able to fulfil its social policy objectives will need to be clarified.

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