Tax Policy and National Savings in the United States: A Survey

1. Introduction

The national saving rate in the United States has declined to low levels during the 1980s. This development is of serious concern for two major reasons. First, the low saving rate will make it difficult to sustain the rise in U.S. living standards in the future, especially when the large baby boom generation starts to retire early in the next century. Second, the recent years of sizable external current account deficits. If the recent improvement in the U.S. external account is to be sustained in the context of noninflationary growth, the national saving rates need to be raised substantially. Otherwise, the external current account can be brought into better balance only by slowing down domestic capital accumulation, which would endanger long-run growth of output and employment.

This paper analyzes how tax policy affects savings and explores which policy instruments are most effective in raising the level and improving the quality of national savings. Section 2 examines the effects of distortions in the tax system. A major theme of this section is that, while the effect of tax policy is generally small and uncertain, it nevertheless has a powerful effect on the composition of private savings and investment. In particular, the U.S. income tax system, which discriminates between personal and corporate saving and investment, has led to significant distortions in the allocation of savings among owner-occupied and rental housing, other durable consumer goods, intangible corporate assets, and various types of nonfinancial business assets. By affecting the share of foreign and domestic saving that is invested domestically, taxes have also influenced the balance of payments. High inflation rates at the end of the 1970s exacerbated most of the distortions resulting from differential tax treatments. Whereas the Tax Reform Act of 1986 and lower inflation rates have reduced some of these distortions, the growing internationalization of world financial markets has tended to raise them.

Section 4 contains some policy conclusions. It argues that raising public saving by reducing the fiscal deficit is the most direct and efficient way to raise national saving in the United States. In this context, tax policy can help to increase saving by raising government revenue. Because high saving in the United States and shows that it discriminates among various types of savings. Subsection 4b explores the way in which differential tax treatment results in inefficient resource allocation by distorting the allocation of investment. Finally, Subsection 4c investigates the effects of taxation on the levels of corporate and personal saving.

a. The current tax system

The income tax system in the United States differs from a comprehensive income tax system, in that many forms of savings largely escape income taxation and are treated essentially on a consumption basis. This subsection first discusses the main types of savings and capital income that are not fully taxed under the income tax system in the United States. It then mentions two elements in the system that may raise the tax burden on savings above that implied by a comprehensive income tax.

Although the 1986 Tax Reform Act raised the tax rate on realized capital gains to that on ordinary income, capital gains still receive preferential tax treatment for a number of reasons. First, whereas a comprehensive income tax would include all accrued capital gains in the tax base, the United States levies tax only on realized capital gains. Second, capital gains on inherited assets are exempt from income taxation because the tax code defines a new basis for capital gains on such assets as their value at the time of the death of the previous owner. Third, the effective tax rate on capital gains from owner-occupied housing is close to zero; a homeowner provision allows the tax on the capital gains from the sale of a principal residence to be deferred, while the tax code grants a one-time exemption of $125,000 in capital gains to taxpayers who are older than 55 years.

Owner-occupied housing not only receives preferential treatment of capital gains but also enjoys tax benefits that stem from the income tax exemption of the imputed rental on household durable goods. In contrast to cash income from rental housing, in-kind income from owner-occupied housing goes untaxed. Furthermore, the tax system allows owners to deduct mortgage interest (up to the original cost of the dwelling) and real estate taxes, even though it does not tax imputed income from owner-occupied housing.

As in the form of employer-financed health and pension plans, the Individual Retirement Accounts (IRAs) and Keogh plans, cash-value life insurance policies, as well as state and municipal bonds, receive preferential tax treatment, although the recent tax reform tightened some of these tax benefits. In particular, a large fraction of interest income earned through life insurance and employer-financed pension funds, as well as through state and municipal bonds, escapes capital gains tax.

At the corporate level, the tax law allows corporations to depreciate their assets faster than estimated economic depreciation would suggest to, although the recent tax reform made the depreciation schedules for fixed assets somewhat less liberal while at the same time abolishing the investment tax credit. Corporate tax provisions may also benefit investments in a number of intangible assets, such as marketing, advertising, and some forms of research and development. Like physical assets, these intangible assets may provide benefits over a number of years. Whereas firms can amortize tangible investments only gradually over time, they can deduct the costs of these intangible investments as a whole in the year in which they are made. Thus, income from these intangible assets may be subject to lower effective tax rates than is income from tangible assets.

It can be argued that most assets used for research and development, advertising, or marketing have short and uncertain economic lives and, therefore, should be permitted immediate expensing. Moreover, expenditures on other intangible assets (such as patents, copyrights, franchises) can only be depressed over the legal life of such assets while goodwill, for example, cannot be amortized at all for tax purposes inasmuch as its useful life is unlimited.

Whereas most of the aforementioned elements tend to reduce the tax rate on capital income relative to a comprehensive income tax, two major elements in the tax system may raise the tax burden beyond that implied by a comprehensive income tax. The first is the double taxation of dividend income. Corporate income paid out as dividends is taxed twice, once at the corporate level and again at the shareholder level. The second element involves the interaction of inflation with the nominal character of the income tax system. Realized capital gains are taxed on a nominal basis instead of on a real basis. Moreover, the tax system adopts historical cost rather than replacement cost as the basis for depreciation allowances and inventory valuation. If inflation is positive, this procedure overstates real income, thereby increasing the tax burden beyond that imposed by a properly indexed tax system. However, lack of indexation of interest income and expense lowers the tax burden on net borrowing below the rate that would be obtained under an indexed system. This element may reduce the overall tax burden on capital income by allowing borrowers to deduct nominal interest expenses at higher tax rates than those at which lenders are taxed.

b. The tax system and the allocation of savings

The differential tax treatment of various forms of savings, which was documented in the previous subsection, typically leads to differential treatment of investment in various assets, implying an inefficient allocation of capital over various activities. Profit-maximizing investors make different investments to the point where they receive the same after-tax rate of return (adjusted for risk factors) on all these investments. If the tax system treats investments differently, the before-tax rates of return on capital, which in the absence of externalities correspond to the social rates of return, are not equalized. In particular, at the margin, the social rates of return on investments that are relatively heavily taxed exceed the social returns on more lightly taxed investments. Thus, the allocation of capital is inefficient: total output could be raised by increasing investments in heavily taxed activities at the expense of investments that bear a lighter tax burden.

As well as harming efficiency, the tax-favored status of many forms of savings is also likely to reduce the progressivity of the income tax system because the tax advantages are more valuable to individuals facing the highest marginal tax rates. Moreover, high-income individuals tend to be better informed about opportunities for tax avoidance that allow them to avoid taxes by simply restructuring their assets and liabilities. In fact, the share of tax-favored assets in the portfolios of higher-income groups with higher marginal income tax rates tends to be much greater than the share of these assets in the portfolios of lower-income groups. The combination of the differential tax treatment of capital income and a progressive structure of personal income tax rates may result in substantial revenue losses for the Government owing to tax arbitrage. In a typical case, an individual or a firm facing a high marginal tax rate accumulates a loss by borrowing to buy a lightly taxed asset. An individual facing a low marginal tax rate or a tax-exempt institution receives the interest income. On a net basis, the Government loses revenue from these transactions.

The rest of this subsection elaborates on two major tax distortions, which divert resources into owner-occupied housing and debt-financed assets, respectively. These distortions are typically referred to as under- and over-saving distortions, respectively.
The U.S. tax system is biased in favor of housing investment relative to corporate investment in plant and equipment. In particular, the favorable tax treatment of home ownership has led to excessive investment in housing as opposed to other capital projects. It has also tended to widen the imbalance between real estate assets and corporate investment. Moreover, it has benefited higher-income groups. In view of their higher marginal income tax rates, more investment takes advantage of the greater tax deduction of mortgage interest and the tax exemption of imputed rent.

The asymmetry in the tax treatment of owner-occupied housing and business investment raises with inflation as a result of the same consideration. First, in contrast to the services from owner-occupied housing, the return on corporate capital is taxed. Inflation increases the income tax burden on corporate capital because it reduces the real value of depreciation allowances for corporate tax purposes. Second, unlike most owners of homes, owners of corporate capital pay tax on realized capital gains. Inflation increases the capital gains tax burden on corporate capital because it has raised the capital gains tax base. Third, housing is not taxed as a capital asset, whereas corporate capital gains are taxed on a nominal as well as a real basis, thereby increasing the effective tax rate on capital gains.

Several studies argue that the interaction of the tax system and the rising inflation rate in the late 1970s stimulated investment in owner-occupied housing relative to investment in corporate assets by reducing the real cost of owner-occupied housing relative to that of other assets. Although the cash flow constraint of rising monthly mortgage payments during the inflationary period likely limited the ability of households to fully realize the tax advantages, the empirical evidence suggests that, on balance, the tax-cost effect dominated. Henderson (1980) concludes, for example, that the interaction of inflation and the tax system raised the real cost of housing by 15 percent between 1984 and 1989.

The 1986 tax reform is likely to reduce somewhat the implicit subsidy to residential investment by lowering the marginal personal income tax rates at which individuals are taxed on capital gains (capital gains rates fell from 49 percent to 28 percent) and on dividend income (dividends rates fell from 50 percent to 34 percent) and to the extent that the personal income tax base is constrained, by reducing the effective tax rate on personal capital gains. The reform also reduces the general level of personal income tax rates, reduces personal income taxes, increases the effective income tax rate faced by some corporations, and reduces the corporate tax rate. Hence, the 1986 tax reform has raised the average effective tax rate on marginal fixed investment in the corporate sector by eliminating the Investment Tax Credit (ITC) and by scaling back depreciation benefits. They argue, therefore, that, while it has lowered the pro-fishing held in the corporate sector, the reform may have exacerbated the bias in the allocation of the national capital stock toward owner-occupied housing and away from fixed corporate investment.

However, tax reform may have improved the international allocation of capital. In open international capital markets, most resources released by the corporate sector in the United States as a result of the tax changes are likely to flow abroad rather than into the domestic housing market. However, the lower subsidy to residential investment likely reduced portfolio savings in favor of foreign assets, thereby raising the real interest rate of return on domestic capital. From a world-wide point of view, the incentive for international investment that were introduced at the beginning of the 1980s most likely contributed to an increase in the demand for investment in the United States, which provided more generous investment incentives than most other industrial countries. The partial reversal of these incentives, together with the lower incentives to invest in housing in the United States, may have contributed to a more efficient allocation of the world capital stock.

Although the recent decline in the inflation rate and the reduction in personal income tax rates have reduced the distortion in favor of owner-occupied housing, tax policy still favors investment in household durables and in housing in particular. This distortion in favor of investment in consumer durables and housing becomes more serious as more integrated in international financial markets. If supplies of foreign funds become more elastic, implicit subsidies for housing investment cause larger amounts of inefficient investment to flow into owner-occupied housing.

(2) Debt versus equity financing

The tax system favors debt over equity financing. On the borrower’s side, it allows borrowers to deduct interest expenses. On the lender’s side, in contrast, it appears to discriminate against debt instruments because it taxes interest income at a higher effective tax rate than that on accrued capital gains. On a net basis, however, the tax system favors debt: the average tax rate at which interest can be deducted exceeds the average rate at which interest is taxed at the personal level.

The differential tax treatment in favor of debt stimulates debt-financed investments. Therefore, the tax system may distort too many resources into readily marketable assets, against which corporations and households generally find it easier to borrow than against more difficult-to-seal assets. According to Summers (1985) and Gordon, Hines, and Summers (1985), the percentage of commercial structures have a major tax shelter. The tax advantages of debt relative to equity also favor low-risk over high-risk investments and large over small companies because high-risk and small firms tend to be mainly financed through equity.

Inflation worsens not only by taxing favor owner-occupied housing but also by distorting the financing-debt—equity bias. First, inflation raises the interest rate to debt to subsidies to debt financing. For two reasons. First, inflation raises the rate to debt to subsidies to debt financing. First, inflation raises the rate to debt to subsidies to debt financing. Second, inflation raises the tax rate to demand for housing, income, and wealth effects on the intergenerational distribution of resources. Even if the economic literature suggests, however, that tax policy affects the level of private saving primarily through income and wealth effects on the intergenerational distribution of resources, the empirical and theoretical literature does not resolve whether replacing the current income tax by a pure consumption tax would increase private saving. As a rule, consumption tax are much more powerful in raising saving. Although replacing income by wage taxes will raise the after-tax interest rate, the average tax rate at which interest can be deducted exceeds the average rate at which interest is taxed at the personal level. Second, inflation increases the tax burden on equity income by taxing capital gains on a nominal rather than a real basis. During the initial phase of high inflation, the negative effect of inflation on equity financing causes capital gains to be measured at an inflation rate. Because the marginal personal income tax rates fell so sharply during the 1980s and the corporate tax rate benefited debt-financing relative to saving, they were raised in 1984 from the 15 percent withholding tax on interest income for foreign raisins these benefits.

The Tax Reform Act of 1986 decreased the incentives for debt financing by reducing the statutory corporate tax rate at which income would be taxed and by reducing the statutory personal tax rate at which income would be taxed. Some have argued, however, that a flat personal income tax rate, has actually increased the incentive for debt financing in the United States. In view of the low effective personal income tax rate before the tax reform, the tax reform was large enough to offset the reduction in borrowing costs. Nevertheless, the tax reform increases the after-tax interest rate for U.S. savers may favor borrowing incentives in the United States only partially because more integrated international financial markets may largely separate domestic lending and financing decisions; domestic savings have only a limited impact on the cost of financing, which is largely determined by underlying demand and supply conditions worldwide rather than by conditions in the U.S. financial market alone.

The tax system continues to favor debt financing. Although the recent reduction in inflation and income tax rate reduced the tax advantage of savings in debt financing, the efficiency losses resulting from this distortion are likely to grow as international capital markets become more integrated.

c. The tax system and the level of saving

The subsection examines how the tax system affects the level of private saving. It first analyzes the effect of personal taxation on household saving. It then investigates how taxes at the corporate and personal levels influence corporate and private saving.

(1) Personal saving

Whether or not personal income taxation in the United States reduces the level of personal saving is a controversial issue. It is closely related to the question of whether replacing the current income tax system by a pure consumption tax, which exempts all capital income, would raise saving. savers bear part of the income tax burden on interest income, they receive a lower after-tax return from consumption. The empirical and theoretical-literature on the savings effect of personal taxation has therefore focused on the elasticity of saving with respect to the rate of return.

The theoretical literature demonstrates that the interest elasticity of saving can take on any sign. It is well known that the sign of the uncompensated interest elasticity is ambiguous because of offsetting income and substitution effects. However, even the sign of the compensated elasticity, which is more relevant for balanced budget exercises that are not to be determined a priori for two reasons. First, the factor costs, and cannot be determined a priori, although a compensated increase in interest rates unambiguously raises future consumption, such an increase may reduce saving because a higher after-tax interest rate implies that one does not have to save as much as before to ensure some future consumption level. Second, using pure-life-cycle models, Show, for example, that rising real interest rates may reduce saving because the tax reforms have made it easier to delay saving.

Empirical studies on the interest elasticity of saving generally suggest that interest rates have only a small direct impact on saving in the United States. The significant positive effect but others have found it difficult to reproduce his results. However, because all empirical studies in this area suffer from a number of serious methodological problems, it is not clear whether the empirical findings reflect the lack of significance of interest rate effects or the unreliability of the empirical techniques. The actual experience in the 1980s suggests that the interest elasticity of saving is quite small. Even with high nominal interest rates, households may have lowered saving because the tax changes were not expected to affect their after-tax income. Moreover, the lower subsidy to residential investment likely reduced portfolio savings in favor of foreign assets, thereby raising the real interest rate of return in the United States. Savings should not be found to have a significant direct impact on saving, however, because all empirical studies in this area suffer from a number of serious methodological problems. It is not clear whether the empirical findings reflect the lack of significance of interest rate effects or the unreliability of the empirical techniques.

The empirical and theoretical literature does not resolve whether replacing the current income tax by a pure consumption tax would increase private saving. The literature suggests, however, that tax policy affects the level of saving by raising income and wealth effects on the intergenerational distribution of resources rather than through intertemporal substitution effects on the timing of consumption. The 1986 Tax Reform Act contains provisions stimulating personal saving as well as elements reducing personal saving incentives. Tax policy may have discouraged saving by more sharply limiting the use of IRAs and other tax-deferred savings vehicles. Whether these incentives in fact succeeded in raising the overall rate of saving is not clear. The value of tax-deferred retirement accounts has probably been underestimated, for example, because the tax accounts did not substantially affect saving because the tight limits on these accounts caused most savers to do their marginal saving in fully taxed assets. An empirical study by Sheshinski (1984) shows that, although a more generous set of tax rules that would make IRA contributions represent negative saving.

The Tax Reform Act contains several provisions favorable to saving. Lower marginal tax rates on personal income may increase saving slightly by reducing the tax rate on income, although the increase in the income tax base for capital gains may partly offset this effect. More important, lower rates decrease the incentive to borrow at both the corporate and personal levels. The limitations on the deductibility of consumer interest payments may also reduce borrowing incentives somewhat. However, homeowner savers and real estate savers because the tax reform reduces the deductibility of mortgage interest it reduces the value of owner-occupied housing, which are secured by mortgage and are actually overdrafts, suggests that many home owners engage in this type of tax arbitrage. After the reform, interest payments are deducted from personal income tax only if they are secured by home mortgages. This provision negatively affects equity because it implies that only home owners, who generally belong to the higher-income groups, can deduct their interest payments.

(2) Corporate saving

Taxation affects corporate saving through two main channels. First, unless it is fully shifted, the corporate tax reduces after-tax profits. Corporate saving is, in turn, reduced unless corporate income tax rates exceed the capital gains tax rate. Second, corporate income tax rates are reduced through intertemporal substitution effects on the timing of consumption. The 1986 Tax Reform Act reduced corporate saving through both of these channels. First, it increased total corporate tax payments; several provisions that raised corporate tax payments, such as the elimination of the ITC and the tightening of minimum tax and depreciation allowances, more than offset the revenue effect of the reduction in the 1986 tax act. In contrast to owner-occupied housing, the corporate tax favors debt financing over equity financing to the extent that interest payments are deductible from personal income tax only if loans are secured by homes. This provision negatively affects equity because it implies that only home owners, who generally belong to the higher-income groups, can deduct their interest payments.
Table 1. Effects of 1986 Tax Reform Act on Corporate Savings, 1987-89 (in billions of 1986 dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Predicted Change in Corporate Taxes</th>
<th>Combined Effect on Corporate Savings</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Corporate tax</td>
<td>Payout incentives</td>
</tr>
<tr>
<td>1987</td>
<td>31.7</td>
<td>1.9</td>
</tr>
<tr>
<td>1988</td>
<td>23.6</td>
<td>4.8</td>
</tr>
<tr>
<td>1989</td>
<td>24.6</td>
<td>8.4</td>
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Whether corporate saving affects private saving depends on the relationship between corporate and personal saving. Some have argued that households perceive the “corporate welfare” effect. However, a variety of imperfect offsets in corporate saving and personal saving to offset corporate saving partially or entirely in the short run. Some empirical studies suggest that shareholders save more from accrued capital gains than from discounted capital gains. However, a recent study by Forsythe (1987) could not reject the hypothesis that households save in response to a corporate tax cut. Moreover, a country, marginal tax rate on labor income implies that a comprehensive income tax.

3. Policy conclusions

This section addresses normative issues facing U.S. economic policy on the basis of the positive analysis contained in the previous section. In light of the size of the external imbalances and the objectives of increased capital formation and economic growth (particularly given the prospective demographic trends), fiscal policy in the United States should aim at raising the level of national saving while shifting the allocation of national savings away from the accumulation of certain real assets with low social rates of return.

Subsection 3.b outlines several specific tax measures aimed at improving the efficiency of savings and investment, most of which would also increase public saving by raising net government revenue.

a. How to raise national saving

According to the theory of economic policy, each policy objective should be assigned to a policy instrument that substantially contributes to achieving that objective without imposing significant costs. Thus, the objective of raising national saving should be assigned to fiscal policy as a whole, geared toward reducing the current (account) budget deficit, because an increase in public saving can most reliably and directly enhance national saving. Although some studies, including Bordo (1974), have argued that private saving is affected by the tax environment, the recent evidence suggests that public saving is more important. Nevertheless, some empirical studies find that the offset is incomplete and that public saving can systematically and fairly predictably influence the level of national saving.

The costs associated with raising public saving appear to be relatively minor. One important exception: the Government may find it politically difficult to run budget surpluses aimed at increasing public saving if these surpluses may generate private saving. However, some studies have argued that the growing social security trust fund is an important test case in this regard. However, alternative policy instruments aimed at raising national saving are likely to impose higher costs. For example, if quantitative constraints were introduced on borrowing or if insurance schemes were abolished in an effort to reverse some of the effects of the tax changes that have contributed to the past decade’s decline in private saving rates. Moreover, some of the causes behind the declining private saving rates, such as the changing age structure of population, are difficult to affect by policy.

Reducing the fiscal deficit may have other benefits apart from raising public saving. First, credible deficit reduction, especially if it is accompanied by a fundamental change in behavior of government, will increase public saving by raising net government revenue.

b. Specific tax measures

This subsection outlines some specific tax measures that are aimed at improving the efficiency of national savings by allocating a greater proportion of overall private savings to financial saving. If the efficient treatment of various types of savings is to be improved, the differential tax treatment of various types of savings must be mitigated. This can be accomplished by moving either to a more comprehensive income tax or to a pure consumption tax. Whereas a comprehensive income tax eliminates all tax preferences, a consumption tax introduces a number of distortions, which can have negative implications for economic growth.

Second, because it exempts saving, a consumption tax would require a higher tax rate on labor income than would a comprehensive income tax. A higher tax rate on labor income implies that a consumption tax distorts labor supply decisions more than does an income tax. Therefore, adjusting public saving, the Government could afford the golden rule, which maximizes steady-state consumption, an optimal tax system would contain both income taxes and consumption taxes. The optimal rates of consumption and income tax depend on the relative magnitudes of the compensated labor supply elasticity and the intertemporal substitution elasticity of consumption.

The U.S. tax system currently relies on income taxation; the share of consumption taxes in total tax revenue is quite low by international standards. The introduction of a broad-based value-added tax (VAT), which many other industrial countries have implemented, would help to increase the share of the consumption tax.

Although several authors have favored the complete elimination of the income tax by moving toward a direct consumption tax (or expenditure tax), a number of considerations favor broadening the base of the existing income tax while at the same time raising the level of taxed income. One reason is that a consumption tax would reduce the tax incentives for saving in the form of capital formation.

References:

Brooke (1987) argues that corporate saving typically flow into high productivity investment.

42/ Sturm (1983) estimates that a $1 fall in corporate saving raises personal saving only by between $0.50 and $0.75. Accordingly, households appear to offset some of the movements in corporate saving only partially, at least in the short run. In fact, tax policy has become more powerful in influencing where domestic and foreign savings are invested because the growing integration of world financial markets is increasingly breaking the link between domestic savings and domestic investment. Therefore, it becomes more important to distinguish between, on the one hand, the tax incentives for domestic financial savings, which may be largely invested abroad, and, on the other hand, tax incentives for investment in domestic assets.

43/ Moreover, the growing surplus in the social security trust fund is an important test case in this regard. However, alternative policy instruments aimed at raising national saving are likely to impose higher costs. For example, if quantitative constraints were introduced on borrowing or if insurance schemes were abolished in an effort to reverse some of the effects of the tax changes that have contributed to the past decade’s decline in private saving rates. Moreover, some of the causes behind the declining private saving rates, such as the changing age structure of population, are difficult to affect by policy.

44/ Tax policy should be able to complement higher public saving because it has a powerful effect on the composition of savings and investment. It should ensure that savings, including the additional savings released by smaller federal deficits, flow into investments that yield relatively high before-tax rates of return and therefore satisfy efficiency criteria.

45/ Tax policy affects the external accounts through the national savings-investment balance because it influences the incentives for investing foreign and domestic savings in domestic assets. In fact, tax policy has become more powerful in influencing where domestic and foreign savings are invested because the growing integration of world financial markets is increasingly breaking the link between domestic savings and domestic investment. Therefore, it becomes more important to distinguish between, on the one hand, the tax incentives for domestic financial savings, which may be largely invested abroad, and, on the other hand, tax incentives for investment in domestic assets.

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47/ Poterba (1987) estimates that tax reform may reduce corporate saving by about 1 percent of gross national product (GNP) in 1989. Source: Gordon and Slemrod (1988) suggest that moving toward more uniform tax rates on real capital income would enhance efficiency and reduce national welfare. In contrast, national saving incentives accompanied by large shifts in real exchange rates may become entrenched if policymakers fail to balance investment and saving incentives.

48/ Specific tax measures

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capital income through an indirect tax on the durable at the time of the purchase. In fact, tax policy is quite a powerful tool in this respect: several empirical studies indicate that demand for durables is quite elastic with respect to relative prices. Raising taxes on energy may also contribute to shifting the composition of savings away from consumer durables—which use much energy—toward financial assets. In fact, several studies suggested that higher energy prices raise financial saving. Raising excises on durables and energy may also improve the efficiency of the international resource allocation in view of the low level of these taxes in the United States relative to that in most other industrial countries. The relatively low revenue share of these taxes in the United States may explain why portfolio in the United States contain a higher share of consumer durables—which typically use much energy—and a lower share of financial assets than portfolios in other industrial countries.

With regard to the corporate income tax, positive externalities may justify the subsidy to investments in research and development implicit in the immediate expensing allowed for some of these investments. However, other intangible investments, and advertising expenditures in particular, fail to generate positive externalities. In fact, advertising may generate negative externalities. In particular, it would prevent the higher rate of capital gains tax, which was introduced in the 1986 tax reform, from worsening the distortion against equity financing.

In conclusion, tax policy can make an important contribution toward enhancing the quality of savings and investment, raising financial saving, and thus improving the external accounts. Moreover, several tax measures would not only benefit incentives but also raise net public revenue. Thus, tax policy can improve the external accounts not only by raising private financial saving but also by increasing public (and national) savings.

References


This publication presents the main issues and challenges relevant to tax policy in the European Union. It illustrates a "taxing" of the United States, but does not aim to provide an exhaustive catalogue of taxation measures. It also sets out a...
While recognising the competence of Member States, the modernisation of tax systems is essential for delivering on the priorities of the European Semester of economic policy coordination. Reforms should involve promoting a broadening of the tax base, shifting the tax burden away from labour, improving tax compliance and addressing the debt bias in corporate and personal income taxation. All efforts should also be made to combat tax evasion and tax fraud.