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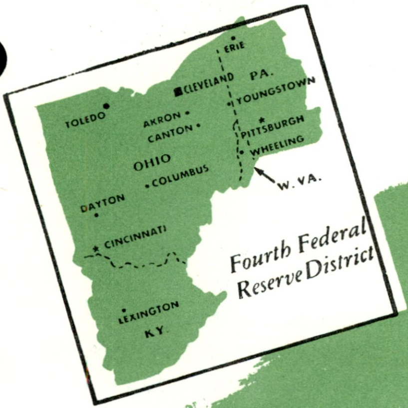

Business Trends

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THE VALUE ADDED TAX

Evaluation of the prospects for the economy's growth over the longer term has led to a reconsideration of the prevailing federal tax system. Against the background of this year's tax reduction, which represented an increase in disposable income and an accompanying stimulation of economic activity that would eventually increase tax revenues, recent discussion before the House Ways and Means Committee has involved both the feasibility of reducing or terminating excise taxes and, more broadly, the proper relationship between indirect and income taxes.

One suggestion that has been made is for the adoption of a value added tax similar to that in existence in France. This device is basically a tax on the total sales value of output at each stage of production minus the previously paid taxes imposed on goods and services purchased from prior stages. The tax liability is determined in this manner, rather than simply applying a rate to value added, because particular products are taxed at different rates. However, since a standard rate applies to most goods, the tax is in essence a levy on the value added by a producer at his particular stage. Unlike the more familiar turnover tax, the value added tax prevents the pyramiding of assessments.

The French tax is paid monthly on the value of output produced in the current month minus the taxes incorporated in goods and services purchased the previous month. For example, assume that a seller's September output is $300,000 and his goods and services purchased in August amounted to $120,000, of which $20,000 represented prior value added taxes. Applying a 20% tax rate, the seller's September tax liability would be $60,000 ($300,000 x 20%) minus $20,000, or a net liability of $40,000.

The 20% rate is standard in France although certain luxury items and designated "non-essential" goods are taxed from 23% to 25%. Specific basic goods such as timber and various fuels have a 10% rate while some widely utilized foodstuffs are taxed at only 6%. Taxes incorporated in the cost of capital equipment are deductible from the liability of the purchaser. Goods designated for export are exempt. The value added tax accounts for approximately one-third of the taxes accruing to the central government and is as important a revenue producer as corporate and personal income taxes.

Advocates of the value added tax in the United States argue that it not only would result in a reduced corporate income tax, but that in

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relation to the single stage sales tax which also has been proposed, it would spread the aggregate tax liability over a greater number of firms. Since the tax is on economic activity rather than profitability, there would be an incentive to cut costs or at least not add to them indiscriminately since they would be taxable rather than deductible.

According to its proponents, the greatest advantage of the value added tax would be the tendency to favor the efficient and profitable firm. The marginal producer just able to cover costs would not be absolved from taxation as under the present system.

Advocates also state that the value added tax could be varied either to enhance or discourage products deemed socially necessary or undesirable. They argue that it would be possible, for example, to reduce or terminate the value added tax on exports in order to increase the United States international trade surplus and thus help the balance of payments situation. This would not result necessarily in an unfair advantage in world markets since many of our competitors utilize some form of selective fiscal policy to aid exports.

However, the value added tax proposal has not been received with complete agreement by economists and industrial and labor representatives. Foremost in opposition is the contention that the tax would be regarded as an additional cost and ultimately passed on to the consumer, thereby becoming another sales tax. This tax would be regressive not only on the consumer but also on corporations as more profitable firms would have relatively less tax liability. Eventually, it is argued, the number of competitors would lessen. Whether this would be offset by increased efficiency and economies of scale is conjectural and dependent upon the individual industrial situation.

Since the previously paid taxes incorporated in capital goods are deductible, opponents state there may be a tendency either to overinvest or manipulate investment expenditures in order to reduce or even eliminate the tax liability in a particular period. In rebuttal of the efficiency claim, it is argued that the value added tax could discourage many promising young firms that are unable to achieve immediate profitability. Some of the more skeptical opponents tend to regard the French situation as rather unique, pointing to the historical difficulties in collecting income taxes in that nation.

Although the value added tax is not entirely new to the United States (Michigan has had a version of it since 1953), it would be difficult to predict its future at this time. The controversy, however, is provocative and perhaps symptomatic of an increasing willingness to discuss changes in our tax structure. Previously, there had been a tendency to regard the imposition of a tax as an irrevocable condition. The current discussion on the value added tax may lead to consideration of other changes that would be helpful in achieving a tax structure that could improve the prospects for the economy's continued growth.

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