

**COMMENTS ON SESSION II:
TAXATION AND FISCAL POLICY**

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1. On different ways to discuss one (or more) paper(s)

Let me start by thanking the Banca d'Italia for inviting me to this exciting and comprehensive conference on taxation and fiscal policy. Mr. Chairman, this is the first time I have to discuss five papers in a row, something I thought to be impossible until now that I am about to do it. Let us see how it goes.

However, I am rather used to tours de force like this. I remember participating recently in a conference in The Hague where I had to discuss a paper in the standard way. I had prepared my discussion with rather an excitement for the author was a well known European labour economist. Then, we were told by the organisers that our colleague was ill and that he would not come. In his place the organisers had included someone else at the very last minute and asked me to listen carefully to what he had to say in order to comment on that later on, for our improvised speaker had not written his paper yet. I agreed but insisted in saying also something about the paper I was supposed to discuss in the first place. Thus I saw myself, for the very first time in my academic life, discussing a paper without a speaker and discussing a speaker without a paper.

This said, trying to say something that makes justice to the effort of so many authors that is not a mere list of issues addressed by them in their respective papers in no more than fifteen minutes is just not easy at all. Moreover, as I would like to set some sort of common ground to place all of them in it then the task seems to me even more complicated. At least, I am not alone in this conference at this kind of performance.

My intention then is to share with you the reflections these five papers have inspired me at several levels.

First, when reading about taxes one immediately tends to think about governments, their expenditure policies, fine tuning, fiscal activism, moral hazard by strategic citizens or firms, tax evasion, distortions and government failures, etc. Too many aspects that surround taxes and that have to be addressed in partial equilibrium formal setups. Reading all these papers has forced me to organise my general ideas about taxes before extracting their basic contents in order to put them to my own judgement.

Second, the fact is that every author addresses different cases in different countries or world regions where policy priorities and actual economic

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circumstances vary considerably. However, looking at the mere list of issues addressed by the authors one finds either some common ground or at least a common frame where to put the pieces that each author has laid up.

Third, even if too selective a survey, some trends can be discerned from the arguments set out by the authors here discussed and that will be my concluding task in undertaking the challenge the organisers have put before me.

2. General ideas on taxation, tax reforms and tax policy

Taxes are one of the most pervasive elements in modern economies. So pervasive and yet so mysterious that few people realises that they are paying taxes several times out of every euro or dollar earned. To be sure, tax policy is responsible for this fact and also for the ultimate fact that taxpayers display distorted behaviours – as much as they can – in order to avoid the corresponding burden. Tax reform then should be viewed as an opportunity to mend this although it is not necessarily the case. Let us see what general views can be formed on taxes that lend some base for the discussion of the five papers in this session.

2.1 Taxes are levied in order to...

Rise revenues to pay for public consumption, investment, transfers and debt servicing or repayment. They are also used to change or orientate incentives for private agents. Were markets perfect or complete a good deal of government interventions and thus taxes would not be justified and people would be expending their cents in goods and services (or saving) of their primary choice. But they are not and everybody understands that taxes need to be high even if at the same time retreating their shoulders to avoid the burden or advancing their hands to get the relief.

2.2 Tax reforms are enacted so that...

The effects of tax policy can be enhanced or limited. Or to implement new visions of (more or less limited) government. Or to help other reform packages aimed at making an structurally ailing economy to take off at once again. But constantly retouching the tax code may be costly both in terms of exacerbated strategic behaviour or credibility of the tax authority. On the other hand many tax reforms are just a propaganda screen to hide more substantive inaction on certain tax figures (inflation tax).

2.3 Enhancing tax policy helps to better...

Stabilise the economy in the short-term, reach long-term fiscal sustainability

and increase economic efficiency. Of course, as long as reforms are properly designed and implemented.

2.4 *Still, some hard facts about taxes...*

In the real world should be addressed. Indeed, (i) there are lots of double taxation cases, as the fact that the sum of all tax bases amounts to several times GDP indicates, (ii) tax structures, that are historically determined, are too complex everywhere, (iii) tax base mobility implies an almost zero optimal tax rate levied on that base unless there is some form of coordination among countries that is little by little gaining ground, (iv) taxing (the purchasing power of labour) income more heavily (than capital income) implies less private consumption and less savings. To quote just few cases.

3. **Five papers with different backgrounds and objectives**

Bearing the previous discussion in mind let me now just describe briefly what are the contents of the papers. Latter I will focus on the major issues addressed by their authors.

The *Nagaosa* paper describes with detail the Japanese tax system and addresses the issue of putting fiscal policy to the task of taking the Japanese economy off after a decade long stagnation. Although the point here is that successive tax cuts have not helped much in the past, while the monetary margin is nonexistent, the government seems still inclined to keep taxes even lower in the short run and rise them progressively in the medium and longer run.

The *Smith* paper is very informative on the basic features of the Australian tax system, its major institutional determinants and the role history and politics has played in shaping it. An important aspect this one that we often forget to take into account. The complexity of tax codes is after all, also, the result of a thick superposition of specific treatments for specific groups. Anglo-Saxon countries however, have succeeded in keeping their tax codes simpler than most other countries and Australia is a good case at hand.

The *Buti and van den Noord* paper uses an ad hoc version of the standard Aggregate Demand and Supply model to which some supply features have been added to explore the stabilisation properties of tax policy in a monetary union. Indeed, under completely new rules concerning monetary policy, now run at EU level, it could be the case that fiscal policy still under national rule would display different properties as to its stabilisation capabilities.

The *Marino, Monacelli and Siviero* paper uses a educed version of the Quaterly Model of the Banca d'Italia to explore how sensitive is the Italian economy (fluctuations) to the built-in stabilisers of the Italian fiscal system, in particular the size of the income elasticities of taxes.

The *Hort and Ohlsson* paper is a conceptual and provocative one. The authors seek to bridge the gap between academics and tax policy practitioners and to devise an “empirical tax policy” that is sound and common sense based. They provide illustrations on the Swedish case.

4. Main questions addressed in each paper

That is the list part I first wanted to avoid in my discussion of the five papers when I started to think about how to handle the challenge. So it could be said that I have not succeeded in this avoidance for the list is actually down here. However, I think that rather than to avoid doing that list I needed to read those papers, actually make that list and say something on each paper and then go beyond by setting a framework where different results from the papers, however summarised, become pieces of a wider picture about the leading theme of the particular session the papers were inserted in: *Taxation and Fiscal policy*.

In a way, my discussion now turns into an (extremely) selective survey of tax related literature that I stretch a little bit in order to get that wider picture compact enough.

The major questions, according to my reading, addressed in each paper are thus listed below complementing the previous short description made in the preceding section.

- Nagaosa (on Japan): (i) how can you make tax policy or tax reform when monetary policy does not work, nominal tax bases are shrinking and you have huge deficits? and (ii) how ambitious can you be in combining short-term stabilisation with long-term sustainability?
- Smith (on Australia): (i) how country specific factors shape or constrain tax reform and policy? and, (ii) how those factors interact with the universal need for policy to maintain macroeconomic stability and enhance competition and innovation of the national economy in the global arena?
- Buti and van den Noord (on the EU): (i) has the role of national fiscal policy changed in a monetary union? and, (ii) are not high aggregate tax rates in most EU countries preventing stabilisation to happen?
- Marino, Monacelli and Siviero (on Italy): (i) have recent tax reforms altered the stabilisation properties of the budget? and, (ii) is it preferable to have large tax elasticities rather than low ones in order to run a lower risk of increasing output variability?
- Hort and Ohlsson (on Sweden): (i) how to bridge academics and practitioners? and, how to balance equity, efficiency and stabilisation objectives of fiscal policy?

The extent to which these questions have been answered and how is presented below in a compact way so that we can have a more comprehensive picture of the whole matters dealt with in this session of the conference.

5. Organising the results

Table 1 contains a “grille de lecture” of the main results out of the papers discussed. I have detected four major areas that my authors have dealt with in their papers: (i) short-term stabilisation, (ii) long-term sustainability, (iii) efficiency of the tax system and (iv) international tax competition.

Area (i), stabilisation, has been dealt with in four of the five papers. Buti and van den Noord and Marino, Monacelli and Siviero address this issue more than any other one to conclude that tax policy has still a say on stabilisation issues, the more so in a monetary union where the interest rate is set at central level. The simulations performed in these papers confirm that high tax rates tend to be destabilising (Buti and van den Noord) while high income elasticity of taxes tend to mitigate fluctuations (Marino *et al.*). Tax policy, one learns from Smith, is not used in Australia for stabilisation purposes. This is a way to deal with the issue and a bold one for few governments would acknowledge not to say commit themselves to not using taxes for this. But Australia is different, and virtuous. Nagaosa echoes in his paper the Japanese government concern with taxes as an stabilisation device, although he immediately admits the little success so far achieved by tax cuts in the last decade.

Long-term sustainability, area (ii), is however the major concern for tax authorities in Australia and Japan. Smith concludes that the Australian tax system has its automatic stabilisers geared towards that end in what he finds more than a convenient feature. Also for Japanese tax authorities, long term sustainability is the “new approach” in their policy priorities. Nagaosa summarises the government plans concerning taxes as a compromise between further tax cuts in the short term and tax increases in the long run to balance recovery and sustainability. Looking at the effectiveness of previous tax cuts one would rather beg for tax increases as from now in order to translate expending capacity from households to the government and, if at all, tax cuts in the distant future.

Only Hort and Ohlsson deal with the efficiency issue, my area (iii) to conclude that more uniform taxation (*shrinking*), lower rates (*thinning*) and broader tax bases (*broadening*) are the ingredients of any master recipe for efficiency. Nothing against on my part and all in favour. Indeed, some of this is now being seen here and there, but not at a sufficient rate. Removing distortions is the conundrum of tax reform. Or, in other words, how to dismantle personalised treatments out of tax codes. History and accumulation of particular treatments determine the current stance of taxes (Smith) more than efficiency considerations.

Table 1
Major Results of the Papers Discussed

	Short-term stabilisation	Long-term sustainability	Efficiency	International tax competition	Overall
Nagaosa (Japan)	Some direct concern	Major concern			Lowering taxes in the short-term and increasing them in the longer-term
Smith (Australia)	The budget is not used for this	The budget is geared towards mid to long-term stability Fiscal forecasting (every 5 years)		An issue of primary importance surrounded by doubts about how to proceed best	History and local factors shape the budget Distributional aspects are important
Buti and van den Noord (UE)	Primary concern of the modelling and simulation exercise				AD-AS model shows that stabilisation properties of tax policy can change in EMU Aggregate tax rates in EU are too large and destabilising
Marino, Monacelli and Siviero (Italy)	Primary concern of the simulations				Less output fluctuations (and slowly increasing ones) if higher income elasticities of taxes. Which has been the case in Italy

(continued)

Table 1 (continued)

	Short-term stabilisation	Long-term sustainability	Efficiency	International tax competition	Overall
Hort and Ohlsson (Sweden)			Uniform taxation. Low rates. Broad bases	Should we forget about capital taxation at all?	Broadening and thinning (and shrinking) approach. Empirical tax policy (academics, practitioners)
All	When tax reforms rise the income elasticity of taxes fluctuations can diminish. Monetary and economic integration can change the nature of shocks and the stabilisation properties of tax policy	Little concern about sustainability issues in the papers with the exception of the new focus of the Japanese reform and the built-in features of the Australian budget	Although emphasising the importance of removing distortions, few practical steps have been taken by recent reforms, at most: broadening, thinning and shrinking	More and more focus on this aspect of tax policy (inc. labour mobility). Should capital be taxed at all? Game-theoretical considerations lend support to simple IS or W+T solutions that are welfare enhancing	Tax policy: Continues to be history and ad hoc determined. Geared towards output stability within above limits, and increasingly exposed to the challenges of tax bases mobility

Finally, on the issue of international tax competition, area (iv), two of the five papers give to it particular attention. It has been found that game theoretical considerations support the idea that even simple information sharing or withholding plus transfer to residence country agreements would enhance welfare well beyond the outcome of competitive solutions. This contrast with worries expressed by Smith who concedes the utmost importance to the issue amid doubts about how to proceed best in order to avoid falling into the trap of the the optimal (strategic) taxation result of not taxing capital at all. This seems to be, by the way, the preferred option of Hort and Ohlsson on this issue.

All in all, the papers discussed tell us a neat story about the fact that tax systems continue to be history and ad hoc determined rather than moving decidedly towards a much needed simplification (broadening-thinning-shrinking). Their built-in stabilisers and discretionary levers also continue to serve short run output stability more than sustainability in the long run, and this under new environments such as EMU that change the nature of shocks and the responses of economic agents. At the same time, national tax systems are increasingly exposed to the consequences of tax international base mobility without a clear international cooperative strategy to cope with the temptation of international tax competition that would drive the corresponding tax rates to near zero.