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Book Review — Digitized Version


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Suggested Citation: Boss, Alfred (1992) : [Book Review of] Taxation in the global economy, Razin, Assaf ... (eds.), Chicago, Univ. of Chicago Press, 1990, Weltwirtschaftliches Archiv, ISSN 0043-2636, Mohr, Tübingen, Vol. 128, Iss. 4, pp. 773-775

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emotive comparison of the operation of financial institutions to a gamble in a casino is partly misleading. Unlike a game in a casino, successful gambles in economic life may well be for the mutual benefit of all participants and for society as a whole. Thus, such gambles are necessary for a successful economic development. Furthermore, the stated trade-off of innovations in financial markets between increasing market efficiency and increasing the vulnerability of the financial system to shocks is dubious. Even if the structure of international banking were horizontal (i.e. no interbank transactions took place), an isolated shock to one financial institution might have far-reaching effects on other institutions via the real side of the economy, if shocks are not immediately offset by countervailing measures.

To sum up, independent of personal viewpoints, the book is — as envisioned by the authors themselves and the Southampton Series in International Economics in general — recommendable for educated laymen in the business, financial or government sector. For insiders in the economic profession, however, the explanations of fundamental economic terms such as indifference curves, expected returns, and variances are probably too long-winded.

Norbert Funke


The volume includes the papers prepared for a conference organized by the National Bureau of Economic Research. As stated in the preface, the papers examine the role of taxation in cross-border flows of capital and goods, the real and financial decisions of (multinational) corporations, and the implications of growing economic interdependence for a country's choice of a tax system.

As a point of departure, Ault and Bradford give a concise report on the rules governing the U.S. taxation of international transactions, emphasizing the changes by the Tax Reform Act of 1986. They describe the principles (if any) as well as some of the complex rules. One of the conclusions is that model building has to be modified intensively if the impact of the complex set of rules on the form and extent of international activity is to be analyzed. Reasoning on the basis of clear-cut rules such as the residence (world income) or the source (territorial) principle does not suffice if something is to be said on the effects, e.g. of the 1986 tax reform in the United States.

A brilliant article based on insights like these is Slemrod's paper on "Tax Effects on Foreign Direct Investment in the United States: Evidence from a Cross-Country Comparison". Slemrod looks at the specific rules, builds up his hypotheses and tries to test them. Slemrod investigates the influence of the U.S. (and the foreign) tax systems on foreign direct investment (FDI) into the United States. He uses effective marginal (instead of average) tax rates as explanatory variables. In addition, he breaks down FDI by the country of origin and tries to find out the influence of the very different home countries' tax systems on direct investment in the United States. His conviction is that "no single story is likely to be sufficient to explain the behavior of FDI from each of (seven) countries". In many respects (e.g. methodology, assessment of the data), Slemrod's paper is a fascinating article. It is an example for how to do applied economic research.

There are three other papers examining the ways by which the tax systems affect the decisions of multinational corporations. Jun analyzes the effect of the U.S. tax system on outward FDI. According to the aggregate time-series data used, U.S. tax policy had an important effect on direct investment abroad by influencing the relative net rate of return on investment located in the U.S. and investment located in foreign countries.
Bernard and Weiner study transfer pricing practices in the petroleum industry. They find little support for the hypothesis that multinational petroleum companies set transfer prices in such a way that taxes are evaded. The reasons might be the homogeneity of petroleum (as a good) and – as a consequence – the good chances for tax authorities to find market ("arm’s length") prices.

Hines and Hubbard investigate how the American tax rules (together with those of foreign countries) affect the dividend flows from foreign subsidiaries of U.S. multinationals to their parent companies. More precisely, the effect of deferred U.S. taxation (and of other specific rules) on the American multinationals’ policy of repatriating dividends from subsidiaries is analyzed. The study is based on micro data on about 12,000 (controlled) foreign corporations; the data are collected from tax returns for 1984. The authors find that most subsidiaries paid no dividends and that the U.S. system of taxing multinationals’ income increases the corporate tax revenue only to a small extent; however, the system distorts their decisions on financial transactions. On the whole, the data seem to be consistent with the view that multinationals effectively minimize their U.S. taxes. The cross-section data are so rich and the results are so manifold that it will be difficult in the future to analyze taxes and multinationals on the basis of aggregate time-series data.

Three papers discuss several aspects of how tax policy in one country may influence the cross-border flow of goods and claims on assets. Frenkel, Razin and Symansky use a saving-investment balance approach to analyze the international spillovers of taxation. The model is applied to examine the international implications of domestic tax policies (Revenue-neutral shift from an income tax to a consumption tax, changes in the time profile of taxation) as well as the consequences of international tax harmonization; this is done both analytically and by means of dynamic simulations.

Feldstein and Krugman show that the popular belief that a value added tax (VAT) helps to increase net exports is wrong. They demonstrate that an idealized VAT (in the sense that it is successfully levied at a flat rate on all production for consumption) does not affect competitiveness. The effects on exports and imports that the substitution of (real world) value added taxation for income taxation might have, depend on the concrete VAT rate structure; in addition, short-run and long-term effects might be completely different.

Bovenberg, Andersson, Aramaki and Chand analyze the effects of tax incentives for investment and savings on international capital flows (and – to some extent – on global welfare). They use a tax wedge concept in the King/Fullerton tradition that is extended in order to include the relevant tax incentives for the specific saving-investment country combinations. The tax incentives for capital flows from Japan to the U.S. on one hand and from the U.S. to Japan on the other hand are measured for 1980, 1984 and 1987. The methodology, however, is applied only to portfolio investment in machinery and equipment. Nevertheless, the paper is a step forward in the process of understanding the influence of taxes on capital flows, esp. the bilateral capital flows between Japan and the United States in the 1980s.

A third set of papers explores the implications of different aspects of an open economy for the design of optimal tax policies. Razin and Sadka investigate the policy implications of the integration of capital markets; they are interested in the consequences for the optimal provision of public goods and in the implications for designing the optimal tax structure. The paper of Gordon and Levinsohn is on the optimal coordination between domestic taxation and (tariff as well as nontariff) trade policy; they try to explain why smaller and poorer countries tend to have higher levels of protection. Wilson intends to find the optimal system of taxes on (and subsidies for) capital in an economy characterized by different wages paid for similar types of workers.
The conference was to shed light on the role of tax policy in a more highly integrated world economy. Apparently, the target was hit.

Alfred Boss


Reforms of trade policies have been core topics of many structural adjustment programmes of developing countries in recent years. They comprise mostly two efforts: to replace quantitative restrictions by tariffs and to reduce the level and the spread of tariffs in order to lower effective rates of tariff protection.

This volume summarizes the experiences with early attempts of trade liberalization before stabilization and structural adjustment became topical as well as more recent liberalization episodes. Those readers who would presume overlaps between this volume and the large World Bank project on “Timing and Sequencing of a Trade Liberalization Policy” (seventeen country studies on “Liberalizing Foreign Trade” published in six volumes and an overall summary by Michaely, Papageorgiou and Choksi1) are on the right track. Except for one very short chapter on multilateral trade negotiations and Brazilian trade-policy reform (by Paulo Tarso Flecha de Lima), all other country studies are summaries of the World Bank project. Readers interested in the detailed analytical and empirical framework of the project are therefore well advised to consult the Basil Blackwell country studies.

Those who prefer “condensed” records on the performance of trade liberalization episodes in eight of the seventeen countries will find the volume useful. The studies of Donald Coes (Brazil), Domingo F. Cavallo (Argentina), Dominique Hachette (Chile), Demetris Papageorgiou (Greece), Guillerma de la Dehesa (Spain), Oli Havrylyshyn (Yugoslavia) and Richard H. Snape (Korea and Singapore) are generalized by Michaely as follows: Small resource-poor countries as well as higher-income developing countries are more likely to liberalize. Second, liberalization efforts which begin with strong measures are more likely to survive than those which start weakly. Third, reforms undertaken in a crisis situation are more likely to be sustained. Fourth, the studies do not support the view that trade reforms lead to net unemployment, not even in the manufacturing sector. Fifth, the initial level of international reserves does not appear to have been a determining factor in the survival of a liberalization attempt. Sixth, the dismantling of quantitative restrictions (rather than tariffs) was very instrumental to sustaining liberalization attempts because it turned out to be less costly (in terms of transition costs) than expected and because it was accompanied by rapidly increasing growth rates. Finally, the success of trade reforms was intimately linked to real exchange rate depreciations. The latter result calls for a package approach of tight monetary and fiscal policies, nominal exchange rate adjustments and trade policies. Recent successful experiences in Latin American economies such as Mexico and Argentina as well as failures in Brazil – both are not captured in the volume – underline the importance of a consistent policy mix with a hard budget constraint as an indispensable prerequisite.

Rolf J. Langhammer

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