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QUESTION, *Professor King*: One issue that was raised by Hans Smit was the value added tax. He spoke about it in terms of what the situation was in Europe and how that had been affected there. Did you want to comment on that?

ANSWER, *Mr. Ture*: There are ideas often offered by advocates of value added taxes to the effect that, in contrast with income taxes, they exert less of a bias against saving and are less prejudicial for capital formation. That, of course, is true, but only in the context of replacing the existing income taxes and perhaps payroll taxes. There is substantial merit in the argument under those circumstances. When one adds a value added tax, however, notice what one gets. In the base of a value added tax, capital outlays and purchases of all goods and services from other businesses are effectively excluded from the value added tax base. What essentially remains, the largest single component of it, is the payments made for the use of labor services and the net return on capital. If, in fact, the income tax remains, notice that one gets a very substantial reduction in the incremental burden of the tax on capital and a huge increase in the incremental tax burden on the rewards for labor services.

If you consider the fact that even in an economy as capital intensive as this one, roughly two-thirds to three-quarters of Gross Domestic Product represents payment for the use of labor services. This enormous increase of the tax burden on the provision of labor services is grossly out of place and grossly counterproductive.

There is another consideration which is seldom articulated, but I did hear it earlier today, which is that the value added tax, by virtue of the fact that it is so submerged a tax that it is almost the ultimate of the hidden tax, defeats what I perceive to be the essential function of taxation, which is pricing out the activities of government. If one is not conscious of those tax burdens, then that pricing out function obviously is not going to be effectively performed, and there will be nothing that is cast up by way of resistance by the body politic to political decision makers over expansion of public sector activity with a requisite increase in taxes. My view about a value added tax is that I fervently hope its time has come and, for the United States, gone.

QUESTION, *Mr. Bowers*: I am concerned with the indebtedness of Canadian sovereign governments. I gather most of that debt, or all of it, is denominated in Canadian dollars they borrowed in foreign countries?

ANSWER, *Mr. Couzin*: Yes. Substantially.

QUESTION, *Mr. Bowers*: They have tax revenues in Canadian dollars and they are borrowing French francs and D marks?

ANSWER, *Mr. Couzin*: Yes. In fact, Ontario Hydro some years ago thought they had discovered the great windfall of borrowing Swiss francs at three percent and they found out why it was at three percent.

In fact, one of the oddities of the Canadian system, I am told by public finance economists, is that not only do we borrow a great deal abroad and in other currencies, because you appreciate the Canadian dollar is not a world currency, so it makes sense we borrow in other currencies, but most of that borrowing is by the provinces. This is very unusual, I am told, for federal states. I think in Germany, for example, the states are not allowed to borrow abroad. In our case, the provinces borrow proportionately more abroad than the Federal Government does, and it has a very odd effect on both fiscal and monetary policy. Remember, also, our provinces are very big spenders compared to U.S. states. So if, for example, Ontario decides to run a ten billion dollar deficit and issue two billion dollars U.S. pay bonds in New York, without having a Central Bank, what they are really doing is exporting their problem across the country, or at least as far as Ottawa.

QUESTION, *Mr. Bowers*: Totally unhedged?

ANSWER, *Mr. Couzin*: The governments certainly do some hedging, recently more than the past. They cannot, of course, hedge their sources of revenue. Of course, they are hedged in another sense because remember, in the case of, say, Ontario, a large source of the money that is going to be used to pay off the debt somewhere is in natural resources. I guess resources are hedged in the sense that they are not denominated in Canadian dollars particularly.

QUESTION, *Mr. Bower*: To the extent they are going to export for U.S. dollars and they borrowed U.S. dollars, they are hedging.

ANSWER, *Mr. Couzin*: That is what I am saying. I do not know what foreign lenders think when they lend U.S. dollars to the Government of Ontario, but if I were a foreign lender I would think it has got to be paid back out of a future tax base. While the future tax base is going to be denominated in Canadian dollars, it is also going to arise from the resources of the province and the exports and the like. In that sense I guess it is hedged, whether or not specific swap transactions are undertaken.

QUESTION, *Mr. Rosen*: I was wondering if you could help us out with another debate in Washington right now, and that is on the investment tax credits; specifically, two items: temporary versus permanent and incremental versus first dollar.

ANSWER, *Mr. Ture*: Yes. Let me say several things about investment tax credits. They are typically presented as incentives and I bridle at that. I mentioned to you in the course of my remarks that I think the existing tax system is heavily biased against saving and capital formation. I view things like the investment tax credit, accelerated depreciation, and expensing provisions, as efforts to moderate the bias against capital formation. It seems to me what we ought to have is a system of expensing of all capital outlays.

But then you come to the investment tax credit that is now on the table. It is hard to see how one could have, with the greatest dedication of effort, come up with a more inept device than the one that has been presented to us. The temporary one, which is for big business, is, indeed, temporary, and almost for that very reason, ineffectual. It has a pay-back provision in it which means, particularly in view of the increase in the corporate tax rate, the present value of the net benefit provided by it, for all intents and purposes, is negligible. In none of the business tax departments that I have had any contact with have I found anyone at all interested in it. It is highly selective. That is, there are large categories of business investments that will not be covered by it. It is temporary, and by its temporary nature it means it is directed at getting businesses to buy things off the shelf, since the kind of capital additions that will require any extended period of time for order, production, delivery and installation, will not by its very nature be eligible.

The permanent credit for small business, I think, grossly mistakes what it is that a small business needs, grossly misapprehends what the incentive effect is, and grossly misapprehends the nature of the response that small businesses will make to it. I do not know of anybody other than President Clinton and his advisors who want this. Small business wants a lot of other things to which the Clinton Administration apparently is deaf.

"First dollar versus incremental" is the argument about "biggest-bang-for-the-buck." My remarks indicated I have had very little belief in "biggest-bang-for-the-buck" strategies. I think they are grossly misdirected. They presume that the policy maker has been able, by miraculous insight, to single out where investment ought to go, that he knows where the greatest opportunities for growth generating uses of our resources lie, a presumption which, if not the ultimate elitist view, is very close thereto, but in any event, really mistakes what the ballgame is all about.

Marginalism is always present. You do not create it by creating marginal or incremental tax credits. We should be as much concerned, for example, about any randomly selected business maintaining its present level of capital capacity or maintaining its present rate of addition to that capital capacity as expanding it. What is the policy dictum that says the contrary?

So it seems to me that one really says if you are going to rely on a credit device, you need to have it available for first dollar as well as the marginal dollar. As long as you go for the "biggest bang for the buck" incremental approach, you have, in addition, an enormous increase in complexity for business and for the Internal Revenue Service.

In passing, my test for whether or not changes in the tax law have simplified or made it a little more complicated is, what has happened to the payroll and the staffing of the Internal Revenue Service?

QUESTION, *Mr. Decker*: A question about pension funds. To what extent is the tax treatment of pension funds part or not part of an industrial policy?

ANSWER, *Mr. Couzin*: The tax treatment of pension savings is an interesting question which we have struggled with a bit in Canada. Some regard it as a major tax expenditure. It could be that the deduction for pension contribution is an attempt to provide an incentive, if I can use that word, for savings or maybe less disincentive against savings.

Or, you could call it a redefinition of the tax base so as not to tax savings. On that basis, it is not a tax expenditure; it is trying to convert the income tax into a consumption tax.

ANSWER, *Mr. Ture*: I think Robert and I are going to differ diametrically in response to your question. I alluded to the tax bias against saving. Let me expand on it for just a moment. In the income tax, the conventional variety, the kind that both of our nations have, the income that one earns and that one saves is not exempt from tax, it is included in the tax base currently, and the income that saving produces is subject to tax as well. Our saving is subject to tax over and over again, layer after layer of tax is piled on. What that does is to raise the cost of saving compared to the cost of current consumption uses of current income.

It is hard for me to understand what social policy objective is served by a tax system that exerts that very vigorous bias against saving. There is a growing awareness of the fact that bias is there, it is counterproductive, and that we ought to do something about reducing it.

There are a couple areas in the tax law in which that bias is very substantially moderated, and the pension provisions are a good example of such. The tax provisions with respect to retirement income conform much more closely than otherwise to the basic neutrality principles. They are mistakenly identified in our budget as tax expenditures, and if there were nothing else to raise your hackles about the concept of tax expenditure that should do it.

I authored a small volume, issued by our organization, called *Tax Expenditures: A Critical Examination*, and I would be happy to receive your order for copies of it, but I would invite your attention to it because it is a very critical and careful examination of the concept of tax expenditures and its inappropriate application in the case of such things as pension funds and so forth.

I should note in passing, that I hope you are all aware of the fact that a nominee for an important position in the Treasury Department, Assistant Secretary for Economic Policy, recently authored an article that appeared in the Boston Federal Reserve Bulletin advocating, as she put it, the scooping up of fifteen percent, roughly $450 billion, of the accumulated assets of private pension funds. Think what a great job this would do of reducing federal deficits and financing all sorts of good works. She did acknowledge there might be a Constitutional problem, but we ought to be able to find a way of getting around it. I am stunned that anybody with a recommendation of that sort would wind up, even in this administration, as a nominee for so elevated a position, but there you have it.

QUESTION, *Mr. Erdilek*: Mr. Ture, you said that society has a natural way of saving, whatever saving rate the markets bring about is the one that should be the prevailing one.

What would happen if eventually the rest of the world thinks they have accumulated enough of our portfolio in denominating U.S. dollars and they insist that the game is over for us, and that we should be just like everybody else and start borrowing in yen and deutsche marks? Would you continue to say this is how other markets work, so we will just borrow as much as we can borrow in foreign currency the way we borrowed in domestic currency in U.S. dollars? Would there be a roll for public policy on economic or other grounds to say enough is enough before the markets call the shots?

ANSWER, *Mr. Ture*: You have asked so many questions that I am not sure in what order I ought to try to answer them. One, let me correct a premise that you said I advanced, which I did not, which is there is some natural rate of saving. I do not know about that. COMMENT, *Mr. Erdilek*: I meant market determined. Let me put it that way.

ANSWER, *Mr. Ture*: Now, you are talking to the question of is there some limitation that public policy ought to seek to impose on the additional growth of our debt, and what adverse economic consequences there would be of the implementation of such a limit. You ought to bear in mind if all foreign purchasers and holders of our debt were to decide that they hold enough or too much of our obligations and seek to dispose of those obligations, there would be certain balance of payments and exchange rate consequences which would impose on them the necessity for being big importers of American products. There are some in the international economic community that think that is an ideal outcome. I profess to be neutral on that issue. I would rather the market determine whether we were big exporters or big importers of capital or of goods and services.

I do not want to finesse the question about whether there is a public policy device for limiting the further growth of the federal debt.

Actually there is.

Congressman Robert Walker, of Pennsylvania, and Senator Robert Smith, of New Hampshire, have, in their respective chambers, authored a bill called the Debt Buydown Bill, of which you may or may not have heard. It is a bill under which every individual U.S. taxpayer would be allowed to designate on his or her 1040 up to ten percent of the tax liability reported thereon to be allocated to a special trust fund, the resource of which were to be used exclusively for purchasing outstanding federal debt in the hands of the public. And with respect to each dime of such purchase of outstanding debt there would have to be a matching dime reduction in that fiscal year's federal outlays.

I do not want to say anything more about it, but I do invite your attention to the essence of that proposal. I think it is absolutely superb.