TAXATION AND HOUSEHOLD SAVING

In recent years, there has been increasing concern in OECD countries about a possible savings shortage, and hence lack of capital for investment. Countries’ tax systems are often put forward as a policy tool to affect the level and allocation of saving -- but are tax breaks effective? Do they actually stimulate new saving, or simply provide windfall gains for existing savers at the expense of lost government revenue?

The OECD has just published a study which provides a detailed and critical look at the links between tax policy and saving by households. It finds no clear evidence that cutting taxes on investment income does in fact lead to increased saving, either by the household sector in isolation or at the level of the national economy, after taking into account the effect of the revenue cost of tax breaks. However tax policy clearly does affect the allocation of saving, with a strong preference being shown by households for forms which enjoy privileged treatment -- particularly pensions.

The report examines the tax treatment of five common types of saving -- bank deposits, government bonds, direct holdings of company shares, pension funds and owner-occupied housing -- in OECD countries. There are very wide variations, both within and between countries, and many special schemes to encourage saving in particular instruments or by particular groups. As a result, effective tax rates -- taking into account all the different taxes on individuals and the consequences of inflation -- vary between minus 77 per cent (that is, a government subsidy of 77 cents for every dollar earned) to well over 100 per cent (the government takes more than the real rate of return). This wide dispersion gives cause for concern, since the report stresses the importance of tax neutrality, i.e. the principle that, as far as possible, the tax system should not affect households’ choice of assets, at least whenever there are no overriding public policy reasons.

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In the international context, barriers (such as exchange controls) have been removed in the globalisation of financial markets, but interest income may be evading tax, e.g. where an individual holds a bank deposit in another country which has neither a withholding tax on interest nor effective arrangements for exchange of information. This is a cause for concern among many OECD countries and further work is being done to look at ways to protect the tax base.

The report recognises that national circumstances and political priorities vary, so that there can never be a single "right" policy towards taxation of saving. But it offers guidelines on good and bad design of tax policies, emphasising that special reliefs to stimulate saving must be very carefully targeted if they are to be effective.

Journalists may obtain a copy of the report from the OECD Press Division, 2 rue André Pascal, 75775 Paris Cedex 16 (tel 45 24 80 88 or 80 89 - fax 45 24 80 03).

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